

**State of California
Office of Administrative Law**

In re:
Department of Insurance

Regulatory Action:

Title 10, California Code of Regulations

Adopt sections: 2303.23, 2303.24, 2303.25,
2303.26, 2303.27, 2303.28

Amend sections: 2303, 2303.1, 2303.2,
2303.4, 2303.5, 2303.8,
2303.9, 2303.11, 2303.12,
2303.13, 2303.14, 2303.15,
2303.17, 2303.19, 2303.21,
existing 2303.22
renumbered as 2303.29,
existing 2303.23
renumbered as 2303.30,
and existing 2303.24
renumbered as 2303.22

Repeal sections:

**NOTICE OF APPROVAL OF REGULATORY
ACTION**

Government Code Section 11349.3

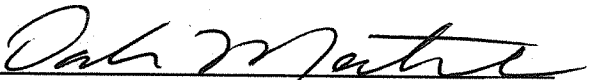
OAL Matter Number: 2017-1012-04

OAL Matter Type: Regular (S)

This rulemaking action amends regulations in Title 10 of the California Code of Regulations to comply with the Nonadmitted and Reinsurance Reform Act, 15 U.S.C. Section 8221, et seq. The action also adopts regulations concerning reinsurance for life insurance policies.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 1/1/2018.

Date: November 27, 2017


Dale P. Mentink
Senior Attorney

For: Debra M. Cornez
Director

Original: Dave Jones
Copy: Monica Macaluso

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2017-0606-05	REGULATORY ACTION NUMBER 2017-1012-04S	EMERGENCY NUMBER
For use by Office of Administrative Law (OAL) only		<p>2017 OCT 12 P 3:53</p> <p>OFFICE OF ADMINISTRATIVE LAW</p>	
<p>NOTICE</p>		<p>REGULATIONS</p>	
<p>AGENCY WITH RULEMAKING AUTHORITY Department of Insurance</p>			<p>AGENCY FILE NUMBER (if any) REG-2016-00024</p>

ENDORSED - FILED
in the office of the Secretary of State
of the State of California

NOV 27 2017
1:47 P.M.

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
OAL USE ONLY <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER 2017-24-2	PUBLICATION DATE 6/16/17

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S) Reinsurance Oversight	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)
2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)	
<p>SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)</p> <p>ADOPT 2303.23, 2303.24, 2303.25, 2303.26, 2303.27, 2303.28</p> <p>AMEND See Attachment One</p> <p>REPEAL</p>	TITLE(S) 10

3. TYPE OF FILING

<input checked="" type="checkbox"/> Regular Rulemaking (Gov. Code §11346)	<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §511346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.	<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h))	<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
<input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)	<input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)	<input type="checkbox"/> File & Print	<input type="checkbox"/> Print Only
<input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))		<input type="checkbox"/> Other (Specify) _____	

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)
First 15-day comment period 8/28/17-9/12/17. Superseded by second 15-day comment period 8/31/17-9/15/17.

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

<input checked="" type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))	<input type="checkbox"/> Effective on filing with Secretary of State	<input type="checkbox"/> \$100 Changes Without Regulatory Effect	<input type="checkbox"/> Effective other (Specify) _____
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6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660)	<input type="checkbox"/> Fair Political Practices Commission	<input type="checkbox"/> State Fire Marshal
<input type="checkbox"/> Other (Specify) _____		

7. CONTACT PERSON Monica Macaluso	TELEPHONE NUMBER 415 538-4118	FAX NUMBER (Optional) (415) 538-5729	E-MAIL ADDRESS (Optional) macalusom@insurance.ca.gov
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8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE 	DATE 10/12/17
TYPED NAME AND TITLE OF SIGNATORY Geoffrey Margolis, Deputy Commissioner & Special Counsel	

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

NOV 27 2017

Office of Administrative Law

Attachment One

STD Form 400 Submission of Regulations

Reinsurance Oversight

OAL Notice File Number: Z-2017-0606-05

CDI File Number: REG-2016-00024

B.2. Sections Affected

AMEND

2303, 2303.1, 2303.2, 2303.4, 2303.5, 2303.8, 2303.9, 2303.11, 2303.12, 2303.13, 2303.14, 2303.15, 2303.17, 2303.19, 2303.21, [existing] 2303.22 [renumbered as 2303.29], [existing] 2303.23 [renumbered as 2303.30], and [existing] 2303.24 [renumbered as 2303.22].

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, CA 94105**

FINAL TEXT OF REGULATION

Reinsurance Oversight

Title 10, Chapter 5, Subchapter 3, Article 3
Reinsurance Oversight Regulations

Amend Section 2303. Reinsurance Accounting, Agreements and Oversight.

Sections 2303 through ~~2303.25~~ 2303.30 of this article set forth the principal requirements of substance and procedure in accounting for reinsurance on insurer financial statements, the general requirements applicable to reinsurance agreements, and related sanctions and oversight. The sections are applicable to all insurers licensed, accredited, or certified in California, the approved U.S. trusts of otherwise unauthorized reinsurers, and licensed reinsurance intermediaries, and reserve financing arrangements pertaining to life insurance policies issued by domestic life insurers containing guaranteed non-level gross premiums, guaranteed non-level benefits and universal life insurance policies with secondary guarantees. The sections may be referred to as the Reinsurance Oversight Regulations.

Note: Authority cited: Sections 720, 730, 736, 739.9, 922.8, 922.85, 923, 924, 1011.5, 1215.9, 1781.12, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 739, 900, 922.1, 922.2, 922.3, 922.31, 922.4, 922.41, 922.42, 922.43, 922.5, 922.6, 922.7, 922.8, 922.85, 922.9, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Amend Section 2303.1. Purpose.

Sections 2303 through ~~2303.25~~ 2303.22 of this article set forth requirements for the proper and uniform preparation by licensed insurers of the financial statements required by the California Insurance Code and the requirements for acceptable reinsurance arrangements. The requirements are intended to elicit from insurers a true exhibit of their financial condition and to safeguard the solvency of licensees. The sections give notice as to the manner in which the Commissioner will exercise the discretion set forth in Code Sections 700, 701, 704, 717, 730, 733, 922.2 through 922.85, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10, and Section 12921 of the Code as respects accounting for reinsurance in insurer financial statements, acceptable reinsurance arrangements, and regulatory oversight. All statutory references are to the California Insurance Code ("Code") unless otherwise stated.

The duties and the discretion of the Insurance Commissioner conferred by statute to ensure proper accounting for reinsurance and oversight of reinsurance arrangements are not exhausted by these regulations.

Note: Authority cited: Sections 720, 730, 736, 922.8, 922.85, 923, 924, 1011.5, 1215.9, 1781.12 and 12921, Insurance Code; CalFarm Insurance Company v. Deukmejian , 48 Cal. 3d 805 (1989); and 20th Century Insurance Company v. Garamendi, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 900, 922.1, 922.2, 922.3, 922.31, 922.4, 922.41, 922.42, 922.43, 922.5, 922.6, 922.7, 922.8, 922.85, 922.9, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10 and 12921, Insurance Code.

Amend Section 2303.2. Definitions.

As used in this article:

(a) "Accredited reinsurer" means an insurer that has been accredited pursuant to Code Section 922.4(b) and Section 2303.4 of this article.

(b) "Actuarial Method" means the methodology used to determine the Required Level of Primary Security, as described in section 2303.26.

~~(c)~~(b) "Alien insurer" means an insurer organized under the laws of any jurisdiction other than a State of the United States.

~~(d)~~(e) "Approved U.S. trust" or "U.S. trust" means the multiple beneficiary trust established by an insurer or group of insurers to secure obligations under reinsurance agreements, ~~that has~~ which have been approved pursuant to the provisions of Code Section 922.4(d) and Section 2303.5 of this article.

~~(e)~~(d) "Assuming insurer" or "reinsurer" means the insurer to which risk is transferred under a reinsurance agreement.

~~(f)~~(e) "Ceding insurer" means the insurer that transfers risk to another insurer under a reinsurance agreement.

~~(g)~~(f) "Certified reinsurer" means an insurer that has been certified pursuant to Code Section 922.41.

~~(h)~~(g) "Commissioner" means the California Insurance Commissioner.

(i) "Covered Policies" means, subject to the exemptions described in Section 2303.25 of this article, those policies, other than Grandfathered Policies, of the following policy types:

1. Life insurance policies with guaranteed non-level gross premiums and/or guaranteed non-level benefits, except for flexible premium universal life insurance policies; or,

2. Flexible premium universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period.

~~(j)(h)~~ "Department" means the California Department of Insurance.

~~(k)(+)~~ "Domestic insurer" means a licensed insurer domiciled in this state.

~~(l)(+)~~ "Domestic ceding insurer" means a domestic insurer that is a ceding insurer.

~~(m)(k)~~ "Examine" or "examination" as used in Code Section 730 includes an examination or review of any nature, scope or frequency by the Department of a licensed insurer, regardless of the location of the review or examination.

~~(n)(+)~~ "Financial statements" mean the statements and reports of an insurer filed with the Commissioner for the purpose of exhibiting the insurer's financial condition and affairs.

~~(o)(m)~~ "Foreign ceding insurer" means a foreign insurer that is a ceding insurer.

~~(p)(n)~~ "Foreign insurer" means a licensed insurer domiciled in another state.

(q) "Grandfathered Policies" means policies of the types described in subdivision (i)1. and (i)2. above that were:

1. Issued prior to January 1, 2015; and

2. Ceded, as of December 31, 2014, as part of a reinsurance treaty that would not have met one of the exemptions set forth in Section 2303.25 of this article had that section then been in effect.

~~(r)(e)~~ "Insurer" includes "reinsurer" unless otherwise apparent from the context.

~~(s)(p)~~ "Licensed insurer" means an insurer that has been issued a Certificate of Authority permitting it to transact insurance business in this state.

~~(t)(e)~~ "NAIC" means the National Association of Insurance Commissioners.

~~(u)(+)~~ "NAIC Accounting Guidance" means the NAIC Accounting Practices and Procedures Manual and the NAIC annual statement blanks and instructions, as amended from time to time, as made applicable to licensed insurers pursuant to Code Section 923.

(v) "Non-Covered Policies" means any policy that does not meet the definition of Covered Policies, including Grandfathered Policies.

(w) "Other Security" means any security acceptable to the Commissioner other than security meeting the definition of Primary Security.

(x) “Primary Security” means the following forms of security:

1. Cash meeting the requirements of Code Section 922.5(a);
2. Securities listed by the Securities Valuation Office meeting the requirements of Code Section 922.5(a), but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and
3. For security held in connection with funds-withheld and modified coinsurance reinsurance treaties:
 - A. Commercial loans in good standing of CM3 quality and higher;
 - B. Policy Loans; and
 - C. Derivatives acquired in the normal course of business and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance treaty.

(y)(s) “RBC Report” means the Risk Based Capital report required of domestic insurers by Code Section 739.2, and of foreign insurers by their state of domicile.

(z)(t) “Regulatory oversight” means the exercise of any or all powers granted a regulator to monitor or control the operations of an insurer; oversight may be formal, informal or voluntary. As used in this article, regulatory oversight means any of those actions taken by a regulator in response to a hazardous financial condition of an insurer. Regulatory oversight may be preliminary in nature, such as a determination to include a licensee on a regulator's watch list.

(aa)(u) “Reinsurance contract” or “reinsurance agreement” or “reinsurance treaty” means a contract by which an insurer transfers to another insurer all or part of its risk on business it has directly written or assumed.

(bb)(v) “Reinsurance intermediary” or “intermediary” means a licensed reinsurance intermediary-broker or a licensed reinsurance intermediary-manager, as defined in Code Section 1781.2.

(cc) “Required Level of Primary Security” means the dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.

(dd)(w) “Unauthorized reinsurer” means a reinsurer that is not licensed, accredited, or certified in this state, and that does not maintain an approved U.S. trust.

(ee) “Valuation Manual” means the valuation manual adopted by the NAIC as described in Code Section 10489.96(b)(1), with all amendments adopted that are effective for the financial statement date on which credit for reinsurance is claimed.

(ff) "VM-20" means the "Requirements for Principle-Based Reserves for Life Products," including all relevant definitions, from the Valuation Manual.

Note: Authority cited: Sections 720, 730, 736, 739.9, 922.8, 922.85, 923, 924, 1011.5, 1215.9, 1781.12, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 739, 900, 922.1, 922.2, 922.3, 922.31, 922.4, 922.41, 922.42, 922.43, 922.5, 922.6, 922.7, 922.8, 922.85, 922.9, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Amend Section 2303.4. Credit for Reinsurance Ceded to Accredited Reinsurer.

(a) Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer that is an accredited reinsurer in California as of the date on which statutory financial statement credit for reinsurance is claimed, unless (1) the assuming insurer is the subject of a regulatory order or regulatory oversight on the grounds of hazardous financial condition by any state in which it is licensed, (2) the cession of a domestic insurer is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article, or (3) the assuming insurer was not licensed or otherwise permitted to write or assume the lines or classes of business in its state of domicile.

(b) A reinsurer seeking accreditation shall file an application with the Commissioner that must include:

1. An executed Certificate of Assuming Insurer Form AR-1, published in Section ~~2303-25(a)~~ 2303.22(a) of this article, wherein the reinsurer:

A. Submits to the authority of the Commissioner to examine its books and records, and agrees to bear the expense of such examination or examinations; and

B. Affirms it has attached to such Certificate a current list of its ceding insurers domiciled in California, and undertakes to submit to the Commissioner additions to or deletions from such list at least once per calendar quarter.

2. An executed Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2, published in Section ~~2303-25(b)~~ 2303.22(b) of this article;

3. A certified copy of a certificate of authority or other acceptable evidence of a license to transact insurance or reinsurance in at least one state;

4. A statement, verified by an officer of the reinsurer, disclosing whether the reinsurer, or any affiliated person with an interest of 10% or more in the reinsurer, is currently known to be the subject of any order or proceeding initiated by a regulator in any jurisdiction regarding (1) conservation, liquidation or receivership, (2) revocation or suspension of a license or accreditation, or (3) restricting or precluding the transaction of insurance based

upon a hazardous financial condition. Where the regulatory action is confidential, disclosure to the Commissioner is required only if permitted by the regulator issuing the order or initiating the oversight. The statement shall affirm that no actions, proceedings or orders subject to disclosure by this paragraph are outstanding, except as disclosed in the statement. The reinsurer shall attach to the statement copies of orders and other documents initiating proceedings for matters disclosed in the statement. The statement shall be in a form acceptable to the Commissioner.

5. A copy of the reinsurer's:

A. Annual financial statements for the past 3 years and all quarterly financial statements filed since the most recent annual statement, if any. The annual statements, including any amendments and NAIC required attachments, shall be signed and verified by the reinsurer's principal executive officer or manager residing within the United States;

B. Most recent examination report, with an "as of" date of not more than 5 years prior to its submission;

C. Most recent independent audit report and report of internal controls, with an "as of" date of not more than 15 months prior to its submission;

D. Most recent 8-K, 10-K and 10-Q forms, if any, filed with the SEC by the applicant or any controlling person;

E. Certificate of good standing from its state of domicile, or from the state of an alien insurer's port of entry;

F. Most recent holding company registration statement and any supplements thereto filed with its state of domicile;

G. Most recent RBC report; and

H. News releases issued by or on behalf of the reinsurer within the year prior to submission.

6. Additional information or documentation as requested by the Commissioner.

(c) To retain eligibility as an accredited reinsurer, the reinsurer shall:

1. File its quarterly and annual financial statements and its RBC report at the same time those documents are filed with its state of domicile;

2. File an updated list of domestic insurer cedents quarterly;

3. File copies of news releases as they are issued by or on behalf of the reinsurer; by prior arrangement with the Department, such filings may be made electronically; and

4. File, on or before August 15 of each year, the documents required by subdivision (b) of this section, except that it is not necessary to file duplicates of financial documents and press releases already submitted.

(d) The costs and expenses incurred by the Department to review a reinsurer's application for accreditation and subsequent filings shall be charged to and collected from the reinsurer. The application for accreditation and required filings shall be submitted in the manner set forth in Section ~~2303.22(e)~~ 2303.21(c) of this article.

(e) An accredited reinsurer, authorized under Code Section 922.4(b) for the specific purpose of permitting statement credit for a cession by a licensed insurer without the security required by Code Section 922.5, is not a licensed insurer and may not solicit or transact insurance business in this state either directly or through an agent or reinsurance intermediary acting on its behalf.

Note: Authority cited: Sections 922.8, 922.85 and 923, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.2, 922.3, 922.4, 922.42, 922.43, 922.6 and 923, Insurance Code.

Amend Section 2303.5. Credit for Reinsurance Secured by an Approved U.S. Trust.

(a) Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer that, as of any date on which statutory financial statement credit for reinsurance is claimed and thereafter for so long as credit for reinsurance is claimed, maintains an approved U.S. trust as security for the payment of the valid claims of its U.S. domiciled ceding insurers, their assigns and successors in interest, unless the cession of a domestic insurer is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article. As used in this section, "assuming insurer" includes all categories of insurers described in Code Section 922.4(d)(4).

(b) An assuming insurer seeking approval of a U.S. trust under Code Section 922.4(d) may file an application with the Commissioner in the manner set forth in Section ~~2303.22(d)~~ 2303.21(d) of this article. The application shall include:

1. A copy of the trust document, certified by the commissioner of the Oversight State. As used in this section, "Oversight State" means the state where the trust is domiciled or the state whose commissioner has accepted principal regulatory oversight of the trust pursuant to the terms of the trust agreement;

2. A certified copy of the approval of the form of the trust issued by the commissioner of the Oversight State;

3. An independent audit report;

4. An actuarial opinion;

5. Copies of all documents submitted to the Oversight State, unless the Commissioner has agreed that copies of specified documents need not be provided;

6. An executed Certificate of Assuming Insurer Form AR-1, published in Section ~~2303.25(a)~~ 2303.22(a) of this article, wherein the assuming insurer:

A. Submits to the authority of the Commissioner to examine its books and records, and agrees to bear the expense of any such examination; and

B. Affirms it has attached to the Certificate a current list of its ceding insurers domiciled in California, and undertakes to submit additions to or deletions from the list to the Commissioner at least once per calendar quarter, unless, for good cause shown, the Commissioner permits a different reporting interval for additions to or deletions from the list;

7. An executed Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2, published in Section ~~2303.25(b)~~ 2303.22(b) of this article; and

8. Any other documents requested by the Commissioner.

(c) The form of a trust reviewed under this section shall not be acceptable to the Commissioner unless it (1) meets the requirements of Code Sections 922.4(d)(3), (2) meets the requirements of subdivision (f) of this section if the assets of the trust include a letter of credit, and (3) provides that the trustee shall be liable for its negligence or willful misconduct.

(d) A trust shall not be deemed sufficient by the Commissioner unless it (1) is in the amount prescribed in Code Section 922.4(d)(4), (2) is held in a U.S. financial institution which meets the requirements of Code Section 922.7, and (3) consists of assets meeting the requirements of this section. Assets equal to liabilities shall be on deposit in the trust no later than 45 days after the end of each calendar quarter unless the Commissioner determines that, for good cause shown, a reasonable extension of time to fund the deposit should be granted. Trust assets shall consist only of cash in United States dollars, certificates of deposit issued by a United States financial institution as defined in Code Section 922.7(a), investments as permitted in subdivision (e) of this section, or letters of credit as permitted in subdivision (f) of this section.

(e) In determining the sufficiency of the trust, only the following investments may be considered, according to their fair market value:

1. Government obligations that are not in default as to principal or interest, that are valid and legally authorized and that are issued, assumed or guaranteed by:

A. The United States or by any agency or instrumentality of the United States;

B. Any state of the United States;

C. A territory, possession or other governmental unit of the United States;

D. An agency or instrumentality of a government unit referred to in subparagraphs (B) and (C) of this paragraph, if the obligations are by law (statutory or otherwise) payable, as to both principal and interest, from taxes levied or by law required to be levied or from adequate special revenues pledged or otherwise appropriated or by law required to be provided for the purpose of making these payments, but not including obligations payable solely out of special assessments on properties benefited by local improvements; or

E. The government of any other country that is a member of the Organisation for Economic Co-operation and Development and whose government obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

2. Obligations that are issued in the United States, or that are dollar-denominated and issued in a non-U.S. market, by a solvent United States institution (other than an insurance company) or that are assumed or guaranteed by a solvent United States institution (other than an insurance company) and that are not in default as to principal or interest if the obligations:

A. Are rated A or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC, or if not so rated, are similar in structure and other material respects to other obligations of the same institution that are so rated; or

B. Are insured by at least one authorized insurer (other than the investing insurer or parent, subsidiary or affiliate of the investing insurer) licensed to insure obligations in this state and, after considering the insurance, are rated AAA (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC; or

C. Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC;

3. Obligations issued, assumed or guaranteed by a solvent non-United States institution chartered in a country that is a member of the Organisation for Economic Co-operation and Development or obligations of U.S. corporations issued in a non-U.S. currency, provided that in either case the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

4. An investment made pursuant to the provisions of paragraphs (e)1., (e)2. or (e)3. of this section shall be subject to the following additional limitations:

A. An investment in or loan upon the obligations of any one institution, other than an institution that issues mortgage-related securities, shall not exceed five percent (5 %) of the assets of the trust;

B. An investment in any one mortgage-related security shall not exceed five percent (5 %) of the assets of the trust;

C. The aggregate total investment in mortgage-related securities shall not exceed twenty-five percent (25 %) of the assets of the trust; and

D. Preferred or guaranteed shares issued or guaranteed by a solvent United States institution are permissible investments if all of the institution's obligations are eligible as investments under subparagraphs (e)2.A. and (e)2.C. of this section, but shall not exceed two percent (2%) of the assets of the trust;

5. As used in this subdivision:

A. "Mortgage-related security" means an obligation that is rated AA or higher (or the equivalent thereto) by a securities rating agency recognized by the Securities Valuation Office of the NAIC and:

i. Represents ownership of one or more promissory notes or certificates of interest or participation in such notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of such notes, certificates, or participation of amounts payable under such notes, certificates or participation), which notes:

a. Are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, or on a residential manufactured home as defined in 42 U.S.C.A. ~~Section~~ § 5402(6), whether the manufactured home is considered real or personal property under the laws of the state in which it is located; and

b. Were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution that is supervised and examined by a federal or state housing authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. ~~Sections~~ §§ 1709 and 1715b, or, where such notes involve a lien on the manufactured home, by any such institution or by any financial institution approved for insurance by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. ~~section~~ § 1703; or

ii. Is secured by one or more promissory notes or certificates of deposit or participation in such notes (with or without recourse to the insurer thereof) and, by its terms, provides for payments of principal in relation to payments or reasonable projections of payments, or notes meeting the requirements of sub_items (e)5.A.i.a. and (e)5.A.i.b. of this section.

B. "Promissory note", when used in connection with a manufactured home, shall also include a loan, advance or credit sale as evidenced by a retail installment sales contract or other instrument;

6. Investments in common shares or partnership interests of a solvent United States institution are permissible if:

A. Its obligations and preferred shares, if any, are eligible as investments under subdivision (e) of this section; and

B. The equity interests of the institution (except an insurance company) are registered on a national securities exchange, as provided in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to and following, or otherwise registered pursuant to that Act, and, if otherwise registered, price quotations for them are furnished through a nationwide automated quotations system approved by the National Association of Securities Dealers, Inc. Financial Industry Regulatory Authority, or successor organization. A trust shall not invest in equity interests under paragraph (e)6. of this section in an amount exceeding one percent (1%) of the assets of the trust even though the equity interests are not so registered and are not issued by an insurance company;

7. Investments in common shares of a solvent institution organized under the laws of a country that is a member of the Organisation for Economic Co-operation and Development are permissible if:

A. All its obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; and

B. The equity interests of the institution are registered on a securities exchange regulated by the government of a country that is a member of the Organization for Economic Cooperation and Development;

8. Obligations issued, assumed or guaranteed by a multinational development bank, provided the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

9. Securities of an investment company registered pursuant to the Investment Company Act of 1940, 15 U. S.C. §§ 80a-1 and following, are permissible investments if the investment company:

A. Invests at least ninety percent (90%) of its assets in the types of securities that qualify as an investment under paragraphs (e)1., (e)2. or (e)3. of this section; or that invests in securities that are determined by the Commissioner to be substantively similar to the permitted securities; or

B. Invests at least ninety percent (90%) of its assets in the types of equity interests that qualify as an investment under paragraph (e)6. of this section;

10. An investment in or loan upon any one institution's outstanding equity interests shall not exceed one percent (1%) of the assets of the trust;

11. Investments in an investment company qualifying under subparagraph (e)9.A. of this section shall not exceed ten percent (10%) of the assets in the trust and the aggregate amount of investments in such investment companies shall not exceed twenty-five percent (25%) of the assets in the trust. Investments in an investment company qualifying under subparagraph (e)9.B. of this section shall not exceed five percent (5%) of the assets in the trust;

12. The aggregate investment in equity interests permitted under paragraphs (e)6. and (e)7. and subparagraph (e)9.B. of this section shall not exceed ten percent (10%) of the assets in the trust;

13. Investments in or issued by an entity controlling, controlled by or under common control with either the grantor or beneficiary of the trust shall not exceed five percent (5%) of total investments; and

14. No more than twenty percent (20%) of the total of the investments in the trust may be the foreign investments authorized under subparagraph (e)1.E., paragraph (e)3., subparagraph (e)6.B. or paragraph (e)7. of this section, and no more than ten percent (10%) of the total of the investments in the trust may be securities denominated in foreign currencies. For purposes of applying the preceding sentence, a depository receipt denominated in United States dollars and representing rights conferred by a foreign security shall be classified as a foreign investment denominated in a foreign currency.

(f) In the determination of whether a trust is sufficient to cover the assuming insurer's liabilities, a letter of credit issued by a United States financial institution as defined in Code Section 922.7(a) may be considered, in an amount not to exceed twenty percent (20%) of the assets in the trust. In order for a letter of credit to qualify as an asset of a trust reviewed under this section the trust agreement shall provide that:

1. The trustee shall have the right and the obligation to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced; and

2. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall constitute negligence and/or willful misconduct.

(g) In the determination of whether a trust is sufficient to cover the assuming insurer's liabilities, the term "liabilities" shall mean the assuming insurer's gross liabilities attributable to reinsurance ceded by United States domiciled insurers that are not otherwise secured by acceptable means, and shall include:

1. For business ceded by insurers authorized to write either disability, or property and casualty insurance, or both:

- A. Losses and allocated loss expenses paid by the ceding insurer recoverable from the assuming insurer;
- B. Reserves for losses reported and outstanding;
- C. Reserves for losses incurred but not reported;
- D. Reserves for allocated loss expenses; and
- E. Unearned premiums.

2. For business ceded by insurers authorized to write life, disability and annuity insurance:

- A. Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;
- B. Aggregate reserves for accident and health policies;
- C. Deposit funds and other liabilities without life or disability contingencies; and
- D. Liabilities for policy and contract claims.

As used in this subdivision, "disability" means the class of insurance defined in Code Section 106.

(h) If an assuming insurer provided security meeting the requirements of Sections 2303.7, 2303.8 or 2303.9 of this article, then exhaustion of that security is a condition precedent to presentation of a claim by the ceding insurer for payment by a trustee of a U.S. trust established by the assuming insurer. The condition precedent shall be deemed satisfied if security held under Section 2303.9 of this article has been exhausted, and a demand for payment of the security established by the assuming insurer under Section 2303.7 or 2303.8 of this article has not been met within sixty (60) days of the demand.

(i) The Commissioner shall designate a trust meeting the requirements of this section as an approved U.S. trust. To retain eligibility of the trust, the assuming insurer shall file its annual and quarterly financial statements, trust statements, and lists of ceding insurers with the

Commissioner at the same time such filings are made with the Oversight State. Not later than February 28 of each year, the assuming insurer shall file the trustees' report required by Code Section 922.3(d)(3)(E). Not later than August 15 of each year, the assuming insurer shall file the documents required in subdivision (b) of this section in the manner provided in Section ~~2303.22(d)~~ 2303.21(d), except that it is not necessary to file duplicates of financial documents already submitted. Alien insurers shall include in the annual filings all reports required by their domiciliary countries.

(j) Pursuant to Section 922.3 of the Code, the costs and expenses incurred by the Department to review the trust documents, reports, subsequent amendments, and periodic filings shall be charged to and collected from the assuming insurer.

(k) An assuming insurer, authorized under Code Section 922.4(d) for the specific purpose of permitting statement credit for a cession by a licensed insurer without the security otherwise required of the reinsurer by Code Section 922.5, is not a licensed insurer and may not solicit or transact insurance business in this state either directly or through an agent or reinsurance intermediary acting on its behalf.

Note: Authority cited: Sections 922.8, 922.85 and 923, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.2, 922.3, 922.4, 922.43, 922.6 and 923, Insurance Code.

Amend Section 2303.8. Credit for Reinsurance Secured by Letter of Credit.

(a) Credit on financial statements of a domestic insurer shall be allowed for reinsurance ceded to an assuming insurer, in an amount not exceeding the liabilities carried by the ceding insurer, to the extent that security is provided by a letter of credit satisfactory to the Commissioner, unless the cession is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article.

(b) As used in this section:

1. "Beneficiary" means the domestic insurer for whose sole benefit the letter of credit has been established by an issuing or confirming bank, and includes any successor by operation of law of the named beneficiary, including without limitation any liquidator, rehabilitator, receiver or conservator.
2. "Applicant" means the reinsurer that applies for and causes the letter of credit to be issued.

(c) A letter of credit naming a domestic insurer as beneficiary shall not be satisfactory to the Commissioner unless it meets the following requirements:

1. The letter of credit shall be issued or confirmed by a qualified United States financial institution as defined in Code Section 922.7(a).

2. The letter of credit shall state that it is irrevocable and unconditional, and shall:
 - A. Contain no extraneous language or reference to any other agreements, documents or entities.
 - B. Provide that, except where the amount of the letter of credit is increased, the letter cannot be modified without the prior written consent of the beneficiary.
 - C. Provide that the obligation of the issuing or confirming bank is not contingent upon reimbursement or its ability to perfect a lien or obtain a security interest.
3. In order to draw funds, the letter of credit shall require only the presentation of a sight draft indicating the credit number.
4. The letter of credit shall contain an issue date and an expiration date.
5. The letter of credit shall be for a term of not less than one year.
6. The letter of credit shall contain an "evergreen" clause which provides that the term of the letter shall extend automatically without amendment for the same term as the original letter, unless at least sixty (60) days prior to the expiration date, a notice of non-renewal is sent to the beneficiary by registered or certified mail, return receipt requested, or by overnight courier service, signature upon delivery required.
7. The letter of credit shall state the address of the issuing bank or confirming bank where the letter is issued or confirmed, where it is payable, and where drafts may be presented for payment. The letter may also permit the presentation of sight drafts at other designated offices.
8. If the letter of credit is made subject to the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 600), or any successor publication, then the letter of credit shall specifically provide for a period of not less than sixty (60) days after the resumption of business to draw against the letter of credit in the event that one or more of the occurrences specified in Article 36 of Publication 600, or any successor publication, occur causing interruption of the business of the bank or of the beneficiary.
9. If the letter of credit is not made subject to the publication referenced in paragraph (c)8. of this section, the letter shall provide for a period of not less than sixty (60) days after resumption of business to draw against the letter of credit in the event of an interruption of the business of the bank or of the beneficiary caused by an Act of God, riot, civil commotion, insurrection, war, terrorism or any other cause beyond control or by any strike or lockout.
10. If the letter of credit is more than one page, each page shall identify the issuing bank and the credit number.

11. The heading of the letter of credit may include a boxed section containing the name of the applicant, the beneficiary's name and state of domicile, and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that such information is for internal identification purposes only.

(d) An optional form that meets the letter of credit requirements of this section is provided in Section ~~2303.25(d)~~ 2303.22(d) of this article. A written determination that an alternate form meets the requirements of this section may be made in the manner set forth in Section ~~2303.22(e)~~ 2303.21(e) of this article.

(e) A reinsurance agreement entered in conjunction with a letter of credit naming a domestic insurer as beneficiary may contain provisions that:

1. Require the assuming insurer to provide letters of credit to the ceding insurer and specify what they are to cover.

2. Stipulate that the assuming insurer and ceding insurer agree that a letter of credit provided by the assuming insurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the agreement, and shall be utilized by the ceding insurer or its successors in interest only for one or more of the following reasons:

A. To pay or reimburse the ceding insurer for:

- i. The assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of such policies;
- ii. The assuming insurer's share, under the specific reinsurance agreement, of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurer, under the terms and provisions of the policies reinsured under the reinsurance agreement; and
- iii. Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer.

B. To secure payment of the assuming insurer's obligations where the letter of credit will expire without renewal or be reduced or replaced by a letter of credit for a reduced amount and where the assuming insurer's obligations under the reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the expiration date, by withdrawing amounts equal to the assuming insurer's share of the liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer and exceed the amount of any reduced or replacement letter of credit, and depositing those amounts in a separate account in the name of the ceding insurer in a qualified United States financial institution as defined in Code Section 922.7(b) apart from its general assets, in trust for such uses and purposes specified in subparagraph (e)2.A. of this section as may remain after withdrawal.

3. Provide for an interest payment, at a rate not in excess of the prime rate of interest, on the amounts held pursuant to paragraph (e)2. of this section; or the return of any amounts drawn down on the letters of credit in excess of any amounts that are subsequently determined not to be due.

(f) A denial of statement credit under this section shall be made in the manner prescribed in Section ~~2303.19(e)~~ 2303.18(c) of this article.

Note: Authority cited: Sections 922.8, 922.85 and 923, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.2, 922.3, 922.5 and 923, Insurance Code.

Amend Section 2303.9. Credit for Reinsurance Secured by Funds Withheld.

(a) Credit on financial statements of a domestic insurer shall be allowed for reinsurance ceded to an unauthorized reinsurer, in an amount not exceeding the liabilities carried by the ceding insurer, to the extent of unencumbered funds withheld by the ceding insurer as security for payment of the reinsurer's obligations under the reinsurance agreement, unless the cession is not in compliance with applicable requirements of Sections 2303.11 through 2303.13 of this article.

(b) As used in subdivision (a) of this section, "unencumbered funds withheld" means funds that are held in the United States solely in the name of and under the exclusive control of the ceding insurer. For purposes of this section, "exclusive control of the ceding insurer" includes (1) funds held in an escrow or trust account where the ceding insurer has the sole right to withdraw assets from the account at any time and without prior notice to the reinsurer, and (2) funds held in an escrow or trust account to secure a cession to an affiliate. The agreement establishing the escrow or trust account shall be in a form satisfactory to the Commissioner.

(c) A denial of statement credit under this section shall be made in the manner prescribed in Section ~~2303.19(e)~~ 2303.18(c) of this article.

Note: Authority cited: Sections 922.8, 922.85 and 923, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.2, 922.3, 922.5 and 923, Insurance Code.

Amend Section 2303.11. Transfer of Risk - Life & Disability.

(a) This section prescribes accounting and other requirements for domestic life and disability insurers and for domestic property and casualty insurers with respect to their disability business. Failure to comply with this section results in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded, and, pursuant to Section 922.3 of the Code, the Commissioner shall not allow credit for such reinsurance.

(b) This section shall not apply to assumption reinsurance, or non-proportional reinsurance such as stop loss or catastrophe reinsurance. Except as provided in the Statutory Accounting

Principles (“SSAP”) 61 of the NAIC Accounting Guidance, it shall also not apply to yearly renewable term reinsurance (“YRT”), as described in SSAP 61, that provides reserve credit not greater than up to one year’s valuation mortality cost.

(c) No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

1. 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 on the portion of the business reinsured, unless a liability is established for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). Those expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the company at the time the business is reinsured.
2. The ceding insurer can be deprived of surplus or assets at the reinsurer’s option, at a specified time scheduled in the reinsurance agreement, or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer, except that termination of the reinsurance agreement by the reinsurer for nonpayment of reinsurance premiums or other amounts due, such as modified coinsurance reserve adjustments, interest and adjustments on funds withheld, and tax reimbursements, shall not be considered to be such a deprivation of surplus or assets.
3. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years’ losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years’ losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience.
4. The ceding insurer must, at specific points in time scheduled in the agreement or at the reinsurer’s option, terminate or automatically recapture all or part of the reinsurance ceded.
5. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. 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.
6. The treaty does not transfer all of the significant risks inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are typically considered to be significant. For products not

specifically included, the risks determined to be significant shall be consistent with this table.

Table of Significant Risks

Risk Categories:

i. Morbidity

ii. Mortality

iii. Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

iv. Credit Quality

This is 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 rate.

v. Reinvestment

This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

vi. Disintermediation

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do 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 rates. The company may have to sell assets at a loss to provide for these withdrawals.

	+ - Significant 0 - Insignificant RISK CATEGORY					
	i.	ii.	iii.	iv.	v.	vi.
Health Insurance – other than LTC/LTD*	+	0	+	0	0	0
Health Insurance – LTC/LTD *	+	0	+	+	+	0
Immediate Annuities	0	+	0	+	+	0
Single Premium Deferred Annuities	0	0	+	+	+	+
Flexible Premium Deferred Annuities	0	0	+	+	+	+
Guaranteed Interest Contracts	0	0	0	+	+	+
Other Annuity Deposit Business	0	0	+	+	+	+
Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium (dump-in premiums allowed)	0	+	+	+	+	+

*LTC = Long Term Care Insurance

LTD = Long Term Disability Insurance

7. The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust or escrow account or otherwise establish a mechanism satisfactory to the Commissioner which segregates, by contract or contract provision, the underlying assets. Assets held to secure statement credit for a cession to an unauthorized reinsurer as permitted by Code Section 922.5(a)(1) may not be placed in a trust or escrow account unless (1) the reinsurer is an affiliate of the ceding insurer, or (2) the agreement establishing the escrow or trust account provides that the ceding insurer has the sole right to withdraw assets from the account at any time and

without prior notice to the reinsurer. The agreement establishing the escrow or trust account shall be in a form satisfactory to the Commissioner.

A. This paragraph shall not apply to the assets supporting the reserves for the following classes of business:

- (i) Health Insurance - LTC/LTD
- (ii) Traditional Non-Par Permanent
- (iii) Traditional Par Permanent
- (iv) Adjustable Premium Permanent
- (v) Indeterminate Premium Permanent
- (vi) Universal Life Fixed Premium (no dump-in premiums allowed)

B. When asset segregation is not required, the associated formula for determining the reserve interest rate adjustment shall reflect the ceding company's investment earnings and incorporate all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

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

Where:

- 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

8. Settlements are made less frequently than quarterly or amounts receivable from the reinsurer are not paid in cash within ninety (90) days of the settlement date.

9. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.

10. The ceding insurer is required to make representations or warranties about future performance of the business being reinsured.

11. 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.

(d) Notwithstanding subdivision (c) of this section, the Commissioner may allow such reserve credit or establishment of such asset as the Commissioner considers appropriate. Such allowance shall not be deemed approval of the reinsurance treaty nor shall it be considered an indication that reinsurance credit may be allowed for other similar treaties.

(e) Any agreement entered into after the Effective Date of this section which involves the reinsurance of business issued prior to the effective year of the agreement, along with any subsequent amendments thereto, shall be filed by the ceding company with the Commissioner within 30 days from its date of execution if such ceding company is domiciled in this state. Each such filing shall include data detailing the financial impact of the transaction. In the case of an agreement which was entered into prior to the Effective Date of this section but was subsequently amended on or after the Effective Date of this section, such agreement and amendment shall also be filed within 30 days from the date of execution of the amendment if such amendment added business issued prior to the effective year of the amendment and if the ceding company is domiciled in this state. The requirements of this subdivision are in addition to any other filings required by the Code or this article.

(f) Any increase in surplus net of federal income tax resulting from reinsurance agreements entered into or amended after the Effective Date of this section which involve the reinsurance of business issued prior to the effective date of the agreements shall be identified separately on the insurer's statutory financial statement as a surplus item and recognition of the surplus increase as income shall be reflected on a net of tax basis as earnings emerge from the business reinsured.

For 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 on 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.

(g) The ceding insurer's appointed actuary shall consider this section and any applicable actuarial standards of practice when determining the proper credit to take in financial statements filed with this Department. The appointed actuary ~~shall~~ shall maintain adequate documentation and be prepared upon request to justify the inclusion of credit in the financial statement.

(h) If a letter of intent precedes the execution of a reinsurance agreement or amendment to a reinsurance agreement, then the agreement or the amendment must be executed within a reasonable period of time, not exceeding ninety (90) days from the execution date of the letter of intent.

(i) No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any financial statement filed with the Department, unless the agreement, amendment or a binding letter of intent has been duly executed by both parties no later than the "as of date" of the financial statement.

(j) The reinsurance agreement shall expressly state that it constitutes the entire 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. The entire agreement clause may provide that it shall not be construed to limit the admissibility of evidence regarding the formation, interpretation, purpose or intent of the reinsurance agreement.

(k) In the review of a reinsurance agreement to determine transfer of risk, all contracts between the ceding insurer, its affiliates and the reinsurer may, in the Commissioner's discretion, be reviewed.

(l) A denial of statement credit under this section shall be made in the manner prescribed in Section ~~2303.19(e)~~ 2303.18(c) of this article.

Note: Authority cited: Section 922.8, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.3 and 923, Insurance Code.

Amend Section 2303.12. Transfer of Risk - Property & Casualty.

This section applies only to property and casualty insurance.

(a) Transfer of risk shall be determined by application of the risk transfer requirements of the NAIC Accounting Guidance. In the review of a reinsurance agreement to determine transfer of risk, all contracts between the domestic ceding insurer, the reinsurer, and their respective affiliates, may, in the Commissioner's discretion, be reviewed to evaluate contractual features that may (1) limit the amount of insurance risk to which the reinsurer is subject under the agreement, or (2) delay the timely reimbursement of claims by the reinsurer.

(b) A denial of statement credit for failure of risk transfer shall be made in the manner prescribed in Section ~~2303.19(e)~~ 2303.18(c) of this article.

Note: Authority cited: Section 922.8, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.3 and 923, Insurance Code.

Amend Section 2303.13. Contract Requirements for Statement Credit.

- (a) Credit for reinsurance may be claimed by a domestic ceding insurer only for an agreement that meets the requirements of this section.
- (b) A reinsurance agreement of a domestic insurer ceding property and casualty business shall expressly state that it constitutes the entire agreement between the parties with respect to the business covered by the agreement, except for separate contracts expressly disclosed within the agreement or in an exhibit incorporated by reference. The entire agreement clause may provide that it shall not be construed to limit the admissibility of evidence regarding the formation, interpretation, purpose or intent of the reinsurance agreement.
- (c) The agreement shall contain an acceptable insolvency clause, conforming to the requirements of Code Section 922.2(a)(2).
- (d) The agreement shall meet the credit for reinsurance requirements of the NAIC Accounting Guidance that are not inconsistent with the requirements of this article.
- (e) Reinsurance of individual risks pursuant to facultative certificates issued by the reinsurer shall not be required to comply with subdivision (b) of this section.
- (f) A denial of statement credit shall be made in the manner prescribed in Section ~~2303.19(e)~~ 2303.18(c) of this article.

Note: Authority cited: Section 922.8, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.2, 922.3 and 923, Insurance Code.

Amend Section 2303.14. Form of Agreements.

(a) This section specifies contract provisions required to be included in a reinsurance contract for which a domestic insurer ~~or a volume insurer~~ claims statement credit. The failure to follow a requirement does not result in a denial of statement credit, but rather a determination that the reinsurance contract is deficient as to form. One or more reinsurance contracts that are deficient as to form may be sufficient to support a finding that the insurer's reinsurance arrangements are materially deficient for purposes of Code Section 700(c) and 717(d).

(b) A reinsurance contract shall be determined to be deficient as to form if it does not comply with each of the following requirements:

1. If an agreement contains an "early termination" provision wherein a party may terminate the agreement upon the occurrence of specified conditions, the following requirements apply to a termination by the reinsurer:

A. The basis for termination may not include the entry of an order of rehabilitation, conservation or liquidation against the ceding insurer.

B. The provision shall require written notice to the ceding insurer of not less than sixty (60) days prior to the effective date of termination.

C. The provision shall require signature upon delivery of the notice and may specify procedures to establish proof of attempted service if signature is refused.

D. The provision may state that upon receipt of a notice sent by the reinsurer, the ceding insurer may consent to a lesser notice period.

E. The provision may state that it shall not be construed to include termination of the contract for cause.

2. If the contract provides for payments between the parties to be transmitted through an intermediary, the contract shall include the following provision:

“Payments by [the ceding insurer] to the intermediary shall be deemed to constitute payment to (the reinsurer). Payments by (the reinsurer) to the intermediary shall be deemed to constitute payment to [the ceding insurer] only to the extent that such payments are actually received by [the ceding insurer].”

Notwithstanding this requirement, the parties to the reinsurance contract may agree therein that the reinsurer may make payment directly to the ceding insurer with notice of the payment sent to the intermediary.

~~(e) A reinsurance contract of a volume insurer is not deficient as to form on the grounds of failure to comply with the requirements of subdivision (b) of this section if:~~

~~(1) On the date of execution of a new or renewal contract the insurer was not a volume insurer; or~~

~~(2) The insurer was not a volume insurer in the year preceding the execution of a new or renewal contract, and the contract was executed within one hundred twenty (120) days of the “as of” date of the insurer’s most recent annual statement.~~

~~(c) (d)~~ The reinsurance arrangements of a domestic ~~or volume ceding insurer~~ may be determined to be materially deficient for purposes of Code Section 700(c) and 717(d) if (1) the arrangements include one or more reinsurance contracts that are deficient as to form, and (2) the aggregate amount of business ceded by the deficient contracts is an amount that equals or exceeds 25% of either the total premium or total liabilities as reported on the ceding insurer’s most recent financial statement. “Total premium” and “total liabilities” include both direct and assumed business. “Total liabilities” is defined in Section 2303.15(h) of this article.

~~(d) (e)~~ Reinsurance of individual risks pursuant to facultative certificates issued by the reinsurer shall not be required to comply with subdivision (b) of this section.

~~(e) (f)~~ Section 2303.14 of this article shall not be construed as stating the only bases for a determination by the Department that a reinsurance agreement is deficient as to form or the reinsurance arrangements of a licensed insurer are materially deficient.

Note: Authority cited: Section 720, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700 and 717, Insurance Code.

Amend Section 2303.15. Oversight of Reinsurance Transactions.

(a) It is a condition to the issuance of a Certificate of Authority that the policyholder surplus of a licensed insurer shall at the time of admission and at all times subsequent be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs, as determined by applying the following factors, among others:

1. The size of the insurer, as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.
2. The extent to which the insurer's business is diversified among the several lines of insurance.
3. The number and size of risks insured in each line of business.
4. The extent of the geographical dispersion of the insurer's insured risks.
5. The nature and extent of the insurer's reinsurance program.
6. The quality, diversification, and liquidity of the insurer's investment portfolio.
7. The recent past and projected future trend in the size of the insurer's investment portfolio.
8. The recent past and projected future trend in the size of the insurer's surplus, and the policyholder surplus maintained by other comparable insurers.
9. The adequacy of the insurer's reserves.
10. The quality and liquidity of investments in subsidiaries made under Code Section 1215.1. The Commissioner may treat any such investment as a disallowed asset for purposes of determining the adequacy of the policyholder's surplus whenever, in his judgment, the investment so warrants.
11. The quality of the company's earnings and the extent to which the reported earnings include extraordinary accounting items.

(b) Except for cessions to affiliates, the failure of a domestic insurer ~~or volume insurer~~ to retain at least 10% of direct premium written per line of business may be grounds for a finding that the insurer's reinsurance arrangements are materially deficient for purposes of Code Section 717(d). The Commissioner may consent to a lesser percentage of retained risk upon demonstrated business necessity. If the consent permitted by this subdivision is not obtained during the review of a filing made pursuant to Code Section 1215.5(b)(3) or subdivisions (e) ~~or (g)~~ of this section,

an application for such consent may be made in the manner provided in Section ~~2303.22(f)~~ 2303.21(f) of this article.

(c) As used in this section:

1. "One party" includes a pool of affiliated insurers, or two or more insurers within the same group of affiliated insurers.
2. "Assumption" means assuming risk by indemnity reinsurance.
3. "Sale" or "purchase" includes the transaction commonly referred to as "assumption reinsurance."

(d) As used in Code Section 1011(c), the term "substantially its entire property or business" means an amount of business such that the sale, cession, assumption or purchase thereof has the potential to render a company insolvent or create a hazard to its policyholders or creditors. A sale, cession, assumption or purchase that equals or exceeds either 75% of an insurer's total premium or 75% of its total liabilities, calculated before the subject transaction, shall constitute "substantially its entire property or business" for purposes of Code Section 1011(c). This subdivision shall not be construed as limiting the type of transactions within the scope of Code Section 1011(c).

(e) ~~A licensed domestic insurer that enters a transaction, under one or more agreements with one party, that is within the scope of subdivision (d) of this section without obtaining the prior written consent of the Commissioner as provided in this article is subject to a proceeding initiated pursuant to Code Section 1011. All licensed insurers, including foreign insurers, entering into sale or purchase transactions, as defined in subdivision (c)3. of this section, that are within the scope of subdivision (d) must obtain the prior written consent of the Commissioner.~~ An application for the Commissioner's consent to ~~such~~ a transaction within the scope of subdivision (d) of this section may be submitted as provided in Section ~~2303.22(g)~~ 2303.21(g) of this article, and shall satisfy any filing requirement of Code Section 1215.5(b)(3) for the transaction.

~~Where the transaction is an affiliate transaction by a licensed insurer that is a member of an insurance holding company system and the insurer is exempt from registration pursuant to Code Section 1215.4(a), the application shall be in the form of a notice of the transaction submitted by the insurer to the Department as provided in Section 23022.22(g) of this article. The notice shall include: (1) the names and relationships of the parties to the transaction, (2) the identity of the domiciliary regulator responsible for review of the transaction pursuant to the applicable insurer holding company system act, (3) an estimate of total liabilities ceded under the agreement, and (4) a copy of the reinsurance agreement. Unless the Commissioner objects within 90 days of receipt of the notice, the Commissioner shall be deemed to have consented to the transaction.~~

(f) A domestic insurer that enters into an affiliated reinsurance transaction that is not within the scope of subdivision (d) of this section but still meets the statutory threshold set forth in Code

Section 1215.5(b)(3) shall remain subject to the filing requirements of the Holding Company Act.

~~(g) (f)~~ The Commissioner's consent to a cession of 100% of direct written premium on prospective business to an affiliate or an inter-company pool shall be conditioned upon ~~(1) the agreement providing a retrocession to the ceding insurer of an amount not less than 10% of its direct written premium, and (2) the ceding insurer either maintaining surplus at a level sufficient to cover its direct writings, or including within the reinsurance agreement provisions that protect the ceding insurer in a manner satisfactory to the Commissioner.~~

~~(g) Unless a reinsurance agreement is filed with the Department pursuant to Code Sections 1011.5 or 1215.5(b)(3), or is an affiliate transaction by a licensed insurer that is a member of an insurance holding company system and the insurer is exempt from registration pursuant to Code Section 1215.4(a), a licensed insurer which intends to sell, cede, assume or purchase an amount of business that equals or exceeds either 50% of its total premium or 50% of its total liabilities under one or more agreements with one party, shall submit the proposed transaction to the Commissioner for his examination and a determination that the transaction is not objectionable for purposes of Code Section 717(d). The 50% calculation shall be made before the subject transaction. The transaction shall be submitted for examination as provided in Section 2303.22(h) of this article and shall be deemed not objectionable if the Commissioner has not objected within 90 days of its receipt by the Department.~~

(h) For purposes of the calculations required by subdivision (d) ~~and subdivision (g)~~ of this section:

1. "Total premium" and "total liabilities" include both direct and assumed business.

2. "Total liabilities" shall mean:

A. In the case of property and casualty business, the aggregate of the following items:

(i) Reserves for losses reported and outstanding;

(ii) Reserves for losses incurred but not reported;

(iii) Reserves for allocated loss expenses; and

(iv) Unearned premiums.

B. In the case of life and health business, the aggregate of the following items:

(i) Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;

(ii) Aggregate reserves for accident and health policies;

(iii) Deposit funds and other liabilities without life or disability contingencies; and

(iv) Liabilities for policy and contract claims.

~~(3) "Liabilities" shall include modified coinsurance reserves for reinsurance assumed and shall exclude modified coinsurance reserves for reinsurance ceded.~~

(i) Where security for a cession is not provided because the reinsurer is a licensed insurer or an accredited reinsurer, the Commissioner may condition consent or non-objection to a transaction filed with the Department by a domestic ~~or volume~~ insurer pursuant to subdivision (e) ~~or (g)~~ of this section upon including within the reinsurance agreement provisions that protect the ceding insurer in a manner satisfactory to the Commissioner.

(j) If the ceding insurer is ~~either a domestic insurer or a volume insurer~~, and the reinsurance agreement provides for the transmission of payments between the parties through an intermediary, then the following provisions shall apply:

1. Consent, approval or non-objection to the transmission of payments through the intermediary in a transaction filed with the Department pursuant to subdivision (e) ~~or (g)~~ of this section may be conditioned upon the intermediary providing the following documents, authenticated as required by Section ~~2303.17(e)~~ 2303.16(c) of this article:

A. A copy of the intermediary's most recent financial statement provided to its client insurer;

B. A copy of the intermediary's most recent independent audit report, if any;

C. If the intermediary is not independently audited, an un-audited balance sheet, income statement, and statement of cash flow, each with an "as of" date of not more than 90 days prior to the date of filing of the reinsurance agreement under review by the Department;

D. A statement of funds the intermediary holds in fiduciary accounts; and

E. A description of any professional liability or fidelity insurance policies or bonds naming the intermediary as an insured or principal.

2. A satisfactory examination report of the intermediary issued by the Department with an "as of" date of not more than 3 years prior to the date of the filing of the reinsurance agreement under review by the Department may be submitted by the intermediary in lieu of the items listed in paragraph 1. above.

3. At his discretion, the Commissioner may initiate an examination of the intermediary and condition his consent, approval or non-objection to the transmission of payments

through the intermediary upon the subsequent receipt of a satisfactory examination report. In determining whether an examination should be initiated, the Commissioner shall consider the projected aggregate amount of payments to be transmitted quarterly through the intermediary, the relative financial strength of the parties to the agreement, the availability and adequacy of any fidelity bonds or insurance, and the length of time since the last examination of the intermediary, if any. Transmission of payments through the intermediary shall be deemed non-objectionable to the Commissioner for the subject agreement, if he has not objected to the payment arrangement on the grounds of an unsatisfactory examination report within 180 days after issuing the conditional consent, approval or non-objection.

(k) The Department may coordinate the examination of a transaction with other interested state regulatory authorities. In the case of an affiliate transaction filed with the Department pursuant to subdivision (e) of this section by a licensed insurer that is a member of an insurance holding company system and is exempt from registration pursuant to Code Section 1215.4(a), the Department shall coordinate its examination of the transaction with the domestic state regulatory authority that is principally responsible for the licensed insurer's holding company system transactions.

(l) Upon denial of an application for consent filed pursuant to subdivision (e) of this section, or disapproval or objection to a transaction filed pursuant to Code Section 1215.5(b)(3) or ~~subdivision (g) of this section~~, the Department shall issue a finding in the form of a written explanation setting forth the reasons for the determination. The determination may be appealed to the Chief of the Financial Surveillance Branch or to the successor position after a reorganization of the Department, in a manner consistent with making a request for a permitted accounting practice.

(m) If, subsequent to the Commissioner's consent, approval or non-objection to an agreement, the parties desire to amend the agreement, notice of the proposed amendment shall be filed with the Commissioner not less than 30 days prior to its execution for a determination of whether a new application or filing will be required. Notice shall be filed in the manner prescribed in Section ~~2303.22(k)~~ 2303.21(k) of this article. A copy of the notice shall also be provided to the Department's financial analyst and attorney who had been assigned review of the initial application or filing. The notice shall include a copy of the amendment and an explanation of the reason therefor, along with a copy of the Commissioner's prior written consent or non-objection, if any. "Consent" includes transactions where consent is deemed pursuant to subdivision (e) of this section. ~~"Non-objection" includes transactions deemed not objectionable pursuant to subdivision (g) of this section.~~ The amendment shall not require a new application or filing if the Commissioner has not advised of the need for such within 30 days of receipt of the notice; however, the failure to timely object shall not be construed to limit the power of the Commissioner to object to the amendment upon a subsequent renewal or amendment of the amended agreement.

(n) The reporting requirements of subdivision (m) of this section shall not apply to a special acceptance. As used in this subdivision, "special acceptance" means the extension of a reinsurance contract to embrace a specific risk not automatically included within its terms, for

example, a different class of business, an inordinate size of obligation, or an excluded risk, where, once accepted, all other contract terms apply.

(o) Any consent granted by the Commissioner is conditioned upon the truth and veracity of the documents and information submitted by or on behalf of the licensed insurer making the application or filing. If the Department determines that the documents or information submitted were materially false or misleading, or that material information was not disclosed, the consent granted shall be void ab initio. If the Department determines that a licensed insurer has violated the terms of the consent granted in any manner, the consent granted may be terminated immediately at the discretion of the Commissioner. As used in this subdivision, "consent granted" includes an approval, the issuance of a notice of non-objection, and the failure to timely respond to a notice or filing made pursuant to subdivisions (e), ~~(g)~~ or (m) of this section. Willfully providing false information to the Department for any purpose shall constitute a material deficiency under Code Section 717(e) and (h) and is grounds for revocation of a Certificate of Authority.

(p) This article shall not be construed as limiting the type of reinsurance arrangements that may be determined materially deficient for purposes of Code Section 717(d).

(q) When a licensed insurer is sold as a corporate shell, or when a sale of the insurer or other circumstance results in a significant change in the insurer's operations so that all or a majority of the documents previously submitted to the Department by the insurer concerning its operations are no longer valid:

1. The insurer shall, within 60 days after a sale or other significant change in its' operations, submit for examination by the Department all documents the Department deems necessary to determine compliance with Code Section 700(c); for good cause shown, the time to submit required documents may be extended;
2. A filing for a determination of compliance with Code Section 700(c) may be made in the manner set forth in Section ~~2303.22(i)~~ 2303.21(i) of this article;
3. The insurer may continue its operations while the examination is pending;
4. With respect to a licensed insurer not seeking an amendment to its Certificate of Authority or other approval from the Department, the burden of establishing any material deficiency under Code Section 717 shall be on the Department; and
5. Notwithstanding the provisions of this subdivision, a licensed insurer shall not transact insurance, as that term is defined in Code Section 35, without first obtaining the approvals that may be required from the Department, such as prior approvals for rates or policy forms.

(r) When the Department requests a formal commitment from a licensed insurer to undertake a future act, the commitment made on behalf of the insurer shall be in the form of a certified copy of a board resolution or, at the discretion of the Department, a writing signed by (1) the insurer's

chairman, president or any vice president and (2) the insurer's corporate secretary, any assistant secretary, chief financial officer or any assistant treasurer. The Department may require that signatures be notarized.

(s) The verified report of examination required by Code Section 734.1 to be issued after a regularly scheduled examination of all the affairs of a licensee shall not routinely be issued in conjunction with the limited examination of a licensee's reinsurance arrangements that is required or permitted by this article. Nor shall a verified report of examination routinely be issued for examinations that are limited in scope and undertaken in the routine oversight of a licensee's financial affairs. Notwithstanding the foregoing, a formal report of examination shall be issued upon the written request of the examined licensed insurer. The written request shall include an acknowledgement that further examination may be necessary in order to prepare the formal report of examination specified in Code Section 734.1.

Note: Authority cited: Sections 720, 730, 736, 923, 1011.5, 1215.89, 1781.12 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994).
Reference: Sections 700, 701, 717, 730, 733, 736, 923, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10 and 12921, Insurance Code.

Amend Section 2303.17. Reporting of Regulatory Action.

An insurer that is either licensed or accredited in this state shall provide written notice to the Department within five (5) days of receipt of notice in any form or manner that it is the subject of a regulatory order or regulatory oversight by any state in which it is licensed concerning a hazardous financial condition. Where the regulatory action is confidential, disclosure to the Department is required only if permitted by the regulator issuing the order or initiating the oversight.

Note: Authority cited: Sections 720, 730, 922.8, 1011.5 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 717, 730, 733, 922.4, 923, 925, 925.2, 925.4, 1011, 1215.5(f) and 12921, Insurance Code.

Amend Section 2303.19. Commissioner's Discretion.

The Commissioner may exercise discretion in requiring strict compliance with the requirements of Sections 2303.1 through 2303.22 of this article where the Commissioner determines that (1) the variance is reasonable and justifiable in relation to the insurer's overall financial condition, (2) the true financial condition of the insurer may be elicited from analysis of the financial statements and other public documents as may be filed, and (3) compliance would cause undue hardship to the insurer.

Note: Authority cited: Sections 720, 730, 736, 922.8, 922.85, 923, 1011.5, 1215.9 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 900, 922.1, 922.2, 922.4, 922.41, 922.5, 922.6, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f) and 12921, Insurance Code.

Amend Section 2303.21. Required Deposits, Fees and Filing Offices.

(a) All costs and expenses incurred by the Department in connection with the review of an application, request or filing made under this article by or on behalf of an insurer or reinsurance intermediary in excess of any deposit paid shall be billed to the insurer or reinsurance intermediary making the application, request or filing. The Commissioner shall maintain a schedule of the deposits required under this article on the Department's website and, after 90 days' notice provided on the website schedule, may revise the deposit amounts as necessary to substantially cover the expected costs of review.

(b) As used in Code Section 924, which assesses late fees for the failure to make timely filings, the term "statements or stipulations" shall include all filings required by this article and the filings made pursuant to Code Section 1011.5.

(c) The initial application and annual filings required by Section 2303.4 of this article for accredited reinsurers shall be submitted in duplicate, except that only one copy of the items listed in Section 2303.4(b)5.D. of this article is required, accompanied by a deposit of \$1,500.00. The application shall consist of a cover letter transmitting the items specified in Section 2303.4

(d) The initial application and annual filings required by Section 2303.5 of this article for an approved U.S. trust, and the application for approval of trust amendments, shall be submitted in duplicate, except that with respect to financial documents provided to the Oversight State, duplicate copies are required only of the audit report, actuarial opinion and CPA report. The requesting reinsurer or group of affiliated insurers shall provide the Department with a \$3,000 deposit in conjunction with the initial application for approval of a U.S. trust, a \$500 deposit for review of an amendment to the form of an approved U.S. trust, and a \$1,500 deposit with the annual filing. The application shall consist of a cover letter transmitting the items specified in Section 2303.5.

(e) A deposit of \$500 shall accompany examination requests made pursuant to Section 2303.8(d) of this article for a determination that a letter of credit form meets the requirements of Section 2303.8(c). The application shall consist of a cover letter and a copy of the proposed letter of credit.

(f) An application for the consent required by Section 2303.15(b) of this article to retain less than 10% of direct premium written per line of business shall be submitted for examination in duplicate, accompanied by a deposit of \$1,500. The application shall include a cover letter explaining the proposed reinsurance arrangements, including the business necessity for the exception.

(g) An application submitted pursuant to Section 2303.15(e) of this article concerning a reinsurance agreement, or a sale and purchase transaction as defined in Section 2303.15(c)3., subject to Code Section 1011(c) shall be submitted in duplicate, accompanied by the fee required for an application made under Code Section 1011.5. The form and instructions for applications not in the form of the notice permitted by Section 2303.15(e) may be obtained from the

Corporate Affairs Bureau at the address provided in subdivision (k) of this section or from the Department's public website at www.insurance.ca.gov.

~~(h) An application for the determination required by Section 2303.15(g) of this article concerning specified reinsurance agreements shall be submitted for examination in duplicate, accompanied by a deposit of \$1,500. The application shall include a cover letter explaining the proposed transaction, a copy of the reinsurance agreement and any other relevant documents, and pro-forma financial statements for the term of the agreement, or three years, whichever is less, with and without the reinsurance.~~

(h) The initial application or passport application, and annual filings required by Code Section 922.41 for certified reinsurers shall be submitted in duplicate, accompanied by a deposit of \$1,500. The application shall consist of a cover letter transmitting the items specified in Code Section 922.41 or the NAIC Uniform Application Checklist for Certified Reinsurers.

(i) A filing for the examination required by Section 2303.15(q) of this article for a determination of compliance with Code Section 700(c) shall include all supporting documents required for an initial application for a Certificate of Authority, shall be made in duplicate, and shall be accompanied by a deposit of \$1,500. The application forms and instructions may be obtained from the Corporate Affairs Bureau at the address provided in subdivision (k) of this section or from the Department's public website at www.insurance.ca.gov.

(j) Applications made pursuant to Section ~~2303.17~~ 2303.16 of this article for the examination of a reinsurance intermediary shall be submitted in duplicate, accompanied by a deposit of \$1,000.

(k) The applications, annual filings and requests made pursuant to subdivisions (c) through (j) of this section shall be submitted to:

CALIFORNIA DEPARTMENT OF INSURANCE
CORPORATE & ~~REGULATORY~~ AFFAIRS BRANCH BUREAU
45 FREMONT STREET, 24TH FLOOR
SAN FRANCISCO, CA 94105

All other filings or notices required or permitted by this article shall be accompanied by an explanation of the reason for the filing or notice and shall be submitted to:

CALIFORNIA DEPARTMENT OF INSURANCE
FINANCIAL ANALYSIS DIVISION
300 SOUTH SPRING STREET, SOUTH TOWER
LOS ANGELES, CA 90013

(l) The notification required by Code Section 922.31 related to reinsurance recoverables and reinsurance program diversification, including supporting documentation demonstrating that the exposure is safely managed by the domestic ceding insurer, shall be submitted using the

Department's Online Assistance System for Insurer Submittals (OASIS) in the format published on the Department's public website at www.insurance.ca.gov.

Note: Authority cited: Sections 720, 730, 736, 922.43, 922.8, 922.85, 924, 1011.5, 1215.9, 1781.12 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994).
Reference: Sections 700, 717, 717.5, 730, 733, 736, 922.31, 922.4, 922.41, 922.43, 922.5, 923, 924, 1011.5, 1215.5(b)(3) and 1781.10, Insurance Code.

Moved and Renumbered Section 2303.22 to Section 2303.29. Severability.

Moved and Renumbered Section 2303.23 to Section 2303.30. Effective Date.

Renumber Section 2303.24 to 2303.22. Approved Forms.

(a) The Certificate of Assuming Insurer Form AR-1 as published in this section is required under Section 2303.4 and 2303.5 of this article.

(b) The Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2 as published in this section is a form acceptable to the Commissioner under the requirements of Sections 2303.4 and 2303.5 of this article.

(c) The Letter of Credit for Reinsurance Form AR-3 as published in this section is a form acceptable to the commissioner for the purpose of securing ceded reinsurance under Section 2303.8 of this article.

(d) Following are Forms AR-1 through AR-3:

FORM AR-1

CERTIFICATE OF ASSUMING INSURER

The undersigned insurer, the Assuming Insurer under a reinsurance agreement with one or more insurers domiciled in California, hereby certifies that it:

1. Submits to the authority of the Insurance Commissioner of California ("Commissioner") to examine its books and records and agrees to bear the expense of any such examination.
2. Submits with this form a current list of insurers domiciled in California reinsured by Assuming Insurer and undertakes to submit additions to or deletions from the list to Commissioner at least once per calendar quarter, unless the Commissioner approves another reporting interval for additions to or deletions from the list.

Assuming Insurer: _____

NAIC # _____

By (Chairman, President or
any Vice President): _____

Title _____

Date: _____

By (Corporate Secretary, any
Assistant Secretary, Chief
Financial Officer or any
Assistant Treasurer): _____

Title _____

Date: _____

State/County:

On _____ before me, _____, personally appeared _____ and _____, known to me (or proved to me on the basis of satisfactory evidence) to be the persons whose names are subscribed to the within instrument and acknowledged to me that they executed the same in their authorized capacity, and that by their signatures on the instrument the Assuming Insurer, upon behalf of which the persons acted, executed the instrument.

Witness my hand and official seal:

Signature _____ Notary Public

Form AR-1 (09/04)

**DESIGNATION OF AGENT FOR SERVICE OF PROCESS
AND CONSENT TO JURISDICTION**

The undersigned, _____, a corporation organized under the laws of _____, hereby appoints and designates _____, having his/her place of business at _____ in the City of _____, California, as its agent for service of process, upon whom may be served any notice, summons or process in any action, suit, arbitration or proceeding instituted by or on behalf of an insurer domiciled in California or by the California Insurance Commissioner ("Commissioner"). If at any time the undersigned is without an agent for service of process, or service cannot be made upon the appointed agent, service may be made upon the Commissioner, and such service shall have the same force and effect as if made upon the undersigned. This appointment and designation shall terminate, without notice to the appointee, upon filing with the Commissioner a designation form appointing another agent.

The undersigned hereby consents to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from a reinsurance agreement with an insurer domiciled in California, or arising from its status as an accredited reinsurer or a reinsurer with an approved U.S. trust in California. The undersigned agrees to comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or appellate court in the event of an appeal. However, nothing in this paragraph constitutes a waiver of the right of the undersigned to commence an action in any court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. This paragraph is not intended to conflict with or override the obligation of the parties to arbitrate their disputes if such an obligation is created in an underlying agreement.

Name of Corporation _____
By _____ (Officer)

Printed Name and Title of Officer: _____
Date _____

ACKNOWLEDGMENT OF AGENT

I, _____, the appointee named above, hereby certify that I am a licensed attorney in California and the individual appointed herein as agent, and that I maintain an office at the address stated for me above. I agree to be reasonably available during normal business hours at such address for service on me for the appointing company of any notice, summons or process. I further agree that in the event the address of my office is changed during the existence of this appointment, I will promptly give notice thereof in writing to the appointing company and to the California Insurance Commissioner.

Signature _____

State of California Bar Number _____

Submit original to: California Department of Insurance, Corporate Affairs Bureau
45 Fremont Street, San Francisco, CA 94105

Form AR-2 (09/05)

**LETTER OF CREDIT
AS SECURITY FOR REINSURANCE CEDED**

BANK:
ADDRESS:

Letter of Credit No. _____ Issue Date: _____

To Beneficiary: [Name of Insurer Beneficiary]

We have established this irrevocable, and unconditional Letter of Credit in your favor as beneficiary for drawings up to an aggregate of U.S. \$ _____, effective immediately. This Letter of Credit is issued, presentable and payable at our office at _____ and expires with our close of business on _____. Except when the amount is increased, this Letter of Credit cannot be modified or revoked without your written consent.

We will promptly honor your sight draft(s) drawn on us, indicating our Credit Number _____, for all or any part of this Letter of Credit, upon presentation at our office at the address given above, or such other office as we may advise, on or before the expiration date hereof or any automatically extended date. Other than your sight draft, no other document need be presented.

This Letter of Credit shall automatically extend without amendment for a period of one year from the expiration date, or any future expiration date, unless at least sixty (60) days prior to any expiration date we notify you by registered or certified mail, return receipt requested, or by overnight delivery service, signature upon delivery required, that this Letter of Credit shall not be renewed.

Our obligation under this Letter of Credit is unconditional and is not dependent upon our ability to perfect a lien, or obtain a security interest or any other form of reimbursement.

The term "beneficiary" as used herein includes any successor by operation of law of the named beneficiary. If a court of law appoints a successor in interest to the named beneficiary, then the term "beneficiary" includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

This Letter of Credit is subject to and governed by the laws of the State of California (excluding the conflict of law provisions), and the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce, Publication No. 600, or any successor publication, except where that publication is in conflict with California law. Notwithstanding Article 36 of said publication, if this Letter of Credit expires during an interruption of your business or our business, caused by an Act of God, riot, civil commotion, insurrection, war, terrorism, or any other cause beyond control or by any strike or lockout, we hereby specifically agree to pay as provided herein if this Letter of Credit is drawn against within 60 days after the resumption of business.

BANK: _____

AUTHORIZED SIGNATURE: _____

AR-3 (09/05)

Note: Authority cited: Section 922.8, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 922.4 and 922.5, Insurance Code.

Adopt Section 2303.23. Term and Universal Life Insurance Reserve Financing, Purpose and Intent.

Sections 2303.23 through 2303.28 establish standards governing reserve financing arrangements pertaining to life insurance policies issued by domestic life insurers containing guaranteed non-level gross premiums, life insurance policies containing guaranteed non-level benefits, and universal life insurance policies with secondary guarantees; and are intended to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 2303.2 of this article, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance treaty or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course of business and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance treaty).

Note: Authority cited: Sections 739.9, 922.85, 923, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 739, 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Adopt Section 2303.24. Term and Universal Life Insurance Reserve Financing, Applicability.

Sections 2303.23 through 2303.28 of this article shall apply to reinsurance treaties that cede liabilities pertaining to Covered Policies, as that term is defined in Section 2303.2(i), issued by any life insurance company domiciled in this state. Sections 2303.23 through 2303.28 and Sections 2303.1 through 2303.22 of this article shall both apply to such reinsurance treaties; provided, that in the event of a direct conflict between a provision of Sections 2303.23 through 2303.28, and a provision of Sections 2303.1 through 2303.22, of this article, the provision of Sections 2303.1 through 2303.22 of this article shall be construed to be inapplicable, but only to the extent necessary in order to resolve the conflict.

Note: Authority cited: Sections 739.9, 922.85, 923, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 739, 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Adopt Section 2303.25. Term and Universal Life Insurance Reserve Financing, Exemptions.

Sections 2303.23, 2303.24, 2303.26, 2303.27 and 2303.28 of this article do not apply to:

(a) Reinsurance of:

1. Policies that satisfy the criteria for exemption set forth in Section 2542.5(f) of article 12.3 or Section 2542.5(g) of article 12.3; and which are issued before the later of:

A. The effective date of Sections 2303.23 through 2303.28 of this article, and

B. The date on which the ceding insurer begins to apply the provisions of VM-20 to establish the ceded policies' statutory reserves, but in no event later than January 1, 2020.

2. Portions of policies that satisfy the criteria for exemption set forth in Section 2542.5(e) of article 12.3 and which are issued before the later of:

A. The effective date of Sections 2303.23 through 2303.28 of this article, and

B. The date on which the ceding insurer begins to apply the provisions of VM-20 to establish the ceded policies' statutory reserves, but in no event later than January 1, 2020.

3. Any universal life policy that meets all of the following requirements:

A. Secondary guarantee period, if any, is five (5) years or less,

B. Specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the Commissioner's Standard Ordinary (CSO) valuation tables and valuation interest rate applicable to the issue year of the policy, and

C. The initial surrender charge is not less than 100 percent (100%) of the first year annualized specified premium for the secondary guarantee period.

4. Credit life insurance.

5. Any variable life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.

6. Any group life insurance certificate unless the certificate provides for a stated or implied schedule of maximum gross premiums required in order to continue coverage in force for a period in excess of one year.

(b) Reinsurance ceded to an assuming insurer that meets the applicable requirements of Code Section 922.4(d).

(c) Reinsurance ceded to an assuming insurer that meets the applicable requirements of Code Sections 922.4(a) or (b), and that, in addition:

1. Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory

accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"), and

2. Is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in Article 4.1 of Code Sections 739 et seq. when its RBC is calculated in accordance with the life risk-based capital report including overview and instructions for companies, as the same may be amended by the NAIC from time to time, without deviation.

(d) Reinsurance ceded to an assuming insurer that meets the applicable requirements of Code Sections 922.4(a) or (b), and that, in addition:

1. Is not an affiliate, as that term is defined in Code Section 1215(a), of:

A. The insurer ceding the business to the assuming insurer, or

B. Any insurer that directly or indirectly ceded the business to that ceding insurer.

2. Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual;

3. Is both:

A. Licensed or accredited in at least 10 states (including its state of domicile), and

B. Not licensed in any state as a captive, special purpose vehicle, special purpose financial captive, special purpose life reinsurance company, limited purpose subsidiary, or any other similar licensing regime, and

4. Is not, or would not be, below 500% of the Authorized Control Level RBC as that term is defined in Code Sections 739 et seq. when its Risk-Based Capital (RBC) is calculated in accordance with the life risk-based capital report including overview and instructions for companies, as the same may be amended by the NAIC from time to time, without deviation, and without recognition of any departures from NAIC statutory accounting practices and procedures pertaining to the admission or valuation of assets or liabilities that increase the assuming insurer's reported surplus.

(e) Reinsurance ceded to an assuming insurer that meets the requirements of either Code Section 922.85(b)(5)(A) pertaining to certain certified reinsurers or Code Section 922.85(b)(5)(B), pertaining to reinsurers meeting certain threshold size and licensing requirements.

(f) Reinsurance not otherwise exempt under subdivisions (a) through (e) if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply:

1. The risks are clearly outside of the intent and purpose of Sections 2303.23 through 2303.28 of this article (as described in Section 2303.23 of this article),
2. The risks are included within the scope of Sections 2303.23 through 2303.28 of this article only as a technicality, and
3. The application of Sections 2303.23 through 2303.28 of this article to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall post on the Department's public web site a notice of any decision made pursuant to this subdivision to exempt a reinsurance treaty from Sections 2303.23 through 2303.28 of this article, as well as the general basis therefor (including a summary description of the treaty).

Note: Authority cited: Sections 739.9, 922.85, 923, and 10489.94, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 739, 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Adopt Section 2303.26. Term and Universal Life Insurance Reserve Financing, Actuarial Method.

(a) The Actuarial Method that is used to establish the Required Level of Primary Security for each reinsurance treaty subject to Sections 2303.23 through 2303.28 of this article shall be VM-20, applied on a treaty-by-treaty basis, including all relevant definitions, from the Valuation Manual as then in effect, applied as follows:

1. For Covered Policies described in Section 2303.2(i)1. of this article, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR) regardless of whether the criteria for exemption testing can be met. However, if the Covered Policies do not meet the requirements of the Stochastic Reserve exclusion test in the Valuation Manual, then the Actuarial Method is the greatest of the Deterministic Reserve, the Stochastic Reserve, or the NPR. In addition, if such Covered Policies are reinsured in a reinsurance treaty that also contains Covered Policies described in Section 2303.2(i)2. of this article, the ceding insurer may elect to instead use subdivision (a)2. of this Section as the Actuarial Method for the entire reinsurance agreement. Regardless of whether subdivision (a)1. or subdivision (a)2. are used, the Actuarial Method must comply with any requirements or restrictions that the Valuation Manual imposes when aggregating these policy types for purposes of principle-based reserve calculations.
2. For Covered Policies described in Section 2303.2(i)2. of this article, the Actuarial Method is the greatest of the Deterministic Reserve, the Stochastic Reserve, or the NPR regardless of whether the criteria for exemption testing can be met.

3. Except as provided in subdivision (a)4. of this Section, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.

4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Required Level of Primary Security may be reduced as follows:

A. If a reinsurance treaty cedes only a quota share of some or all of the risks pertaining to the Covered Policies, the Required Level of Primary Security, as well as any adjustment under subdivision (a)4.C. of this Section, may be reduced to a pro rata portion in accordance with the percentage of the risk ceded;

B. If the reinsurance treaty in a non-exempt arrangement cedes only the risks pertaining to a secondary guarantee, the Required Level of Primary Security may be reduced by an amount determined by applying the Actuarial Method on a gross basis to all risks, other than risks related to the secondary guarantee, pertaining to the Covered Policies, except that for Covered Policies for which the ceding insurer did not elect to apply the provisions of VM-20 to establish statutory reserves, the Required Level of Primary Security may be reduced by the statutory reserve retained by the ceding insurer on those Covered Policies, provided that the retained reserve of those Covered Policies shall be reflective of any reduction pursuant to the cession of mortality risk on a yearly renewable term basis in an exempt arrangement;

C. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis in an exempt arrangement, the Required Level of Primary Security may be reduced by the amount resulting by applying the Actuarial Method including the reinsurance section of VM-20 to the portion of the Covered Policy risks ceded in the exempt arrangement, except that for Covered Policies issued prior to January 1, 2017, this adjustment is not to exceed $[c_x / (2 * \text{number of reinsurance premiums per year})]$ where c_x is calculated using the same mortality table used in calculating the Net Premium Reserve; and

D. For any other treaty ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance treaties, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of subdivision (a)4.A., subdivision (a)4.B., subdivision (a)4.C., and subdivision (a)4.D. of this Section to apply. Such adjustments to the Required Level of Primary Security will be done in the sequence that accurately reflects the portion of the risk ceded via the treaty. The ceding insurer shall document the rationale and steps taken to accomplish the adjustments to the Required Level of Primary Security due to the cession of less than one hundred percent (100%) of the risk.

The Adjustments for other reinsurance will be made only with respect to reinsurance treaties entered into directly by the ceding insurer. The ceding insurer will make no adjustment as a result of a retrocession treaty entered into by the assuming insurers.

5. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

6. If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance treaty subject to Sections 2303.23 through 2303.28 of this article, in no event will the aggregate Required Level of Primary Security for those reinsurance treaties be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those treaties were ceded in a single treaty subject to Sections 2303.23 through 2303.28 of this article;

7. If a reinsurance treaty subject to Sections 2303.23 through 2303.28 of this article cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:

A. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 2303.27 of this article shall be used to determine the reinsurance credit for the Covered Policy reserves; and

B. Credit for the Non-Covered Policy reserves shall be granted only to the extent that security, in addition to the security held to satisfy the requirements of subparagraph A., is held by or on behalf of the ceding insurer in accordance with Code Sections 922.4 and 922.5. Any Primary Security used to meet the requirements of this subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

(b) For the purposes of both calculating the Required Level of Primary Security pursuant to the Actuarial Method and determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply:

1. For assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and

2. For all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st on or immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and

asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

Note: Authority cited: Sections 922.8, 922.85, 923 and 10489.94, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Adopt Section 2303.27. Term and Universal Life Insurance Reserve Financing, Requirements for Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation.

(a) Subject to the exemptions described in Section 2303.25 of this article and the provisions of Section 2303.27(b) of this article, credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to Covered Policies pursuant to Code Sections 922.4 and 922.5 if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full and in accordance with the applicable requirements of Article 3a of Chapter 5 of Part 2 of Division 2 of the Insurance Code, commencing at Section 10489.1, and related regulations, in Articles 12.3 and 12.4 of Subchapter 3 of Chapter 5 of Title 10 of the California Code of Regulations, commencing at Sections 2542 and 2544, respectively, and actuarial guidelines in the NAIC Valuation Manual, and credit claimed for any reinsurance treaty subject to Sections 2303.23 through 2303.28 of this article does not exceed the proportionate share of those reserves ceded under the contract; and

2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance treaty subject to Sections 2303.23 through 2303.28 of this article and provides support for its calculation as determined to be acceptable to the commissioner; and

3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance treaty within the meaning of Code Section 922.5, on a funds withheld, trust, or modified coinsurance basis; and

4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to paragraph 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of Code Section 922.5; and

5. Any trust used to satisfy the requirements of this section 2303.27 shall comply with all of the conditions and qualifications of section 2303.7 of this article, except that:

A. Funds consisting of Primary Security or Other Security held in trust shall, for the purposes identified in section 2303.26(b) of this article, be valued according

to the valuation rules set forth in section 2303.26(b) of this article, as applicable; and

B. There are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of section 2303.27(a)(3) of this article; and

C. The reinsurance treaty must prohibit withdrawals or substitutions of trust assets that would leave the fair market value of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by section 2303.27(a)(3) of this article) below 102% of the level required by section 2303.27(a)(3) of this article at the time of the withdrawal or substitution; and

D. The determination of reserve credit under Section 2303.7(g) of this article, shall be determined according to the valuation rules set forth in section 2303.26(b) of this article, as applicable; and

6. The reinsurance treaty has been approved by the commissioner.

(b) Requirements at Inception Date and on an On-going Basis; Remediation

1. The requirements of Section 2303.27(a) of this article must be satisfied as of the date that risks under Covered Policies are ceded (if such date is on or after the January 1, 2018 effective date) and on an ongoing basis thereafter. Under no circumstances shall a ceding insurer take or consent to any action or series of actions that would result in a deficiency under Section 2303.27(a)3. or 2303.27(a)4. of this article with respect to any reinsurance treaty under which Covered Policies have been ceded, and in the event that a ceding insurer becomes aware at any time that such a deficiency exists, it shall use its best efforts to arrange for the deficiency to be eliminated as expeditiously as possible.

2. Prior to the due date of each Quarterly or Annual Statement, each life insurance company that has ceded reinsurance within the scope of Section 2303.24 of this article shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance treaty under which Covered Policies have been ceded, whether as of the end of the immediately preceding calendar quarter (the valuation date) the requirements of Section 2303.27(a)3. and 2303.27(a)4. of this article were satisfied. The ceding insurer shall establish a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held pursuant to Section 2303.27(a)3., unless either:

A. The requirements of Section 2303.27(a)3. and 2303.27(a)4. of this article were fully satisfied as of the valuation date as to such reinsurance treaty; or

B. Any deficiency has been eliminated before the due date of the Quarterly or Annual Statement to which the valuation date relates through the addition of Primary Security and/or Other Security, as the case may be, in such amount and in

such form as would have caused the requirements of Section 2303.27(a)3. and 2303.27(a)4. of this article to be fully satisfied as of the valuation date.

3. Nothing in Section 2303.27(b)2. of this article shall be construed to allow a ceding company to maintain any deficiency under Section 2303.27(a)3. or 2303.27(a)4. of this article for any period of time longer than is reasonably necessary to eliminate it.

Note: Authority cited: Sections 922.85, 923 and 10489.94, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Adopt Section 2303.28. Term and Universal Life Insurance Reserve Financing, Prohibition against Avoidance.

No insurer that has Covered Policies as to which sections 2303.23 through 2303.28 of this article apply, as set forth in Section 2303.24, shall take any action or series of actions, or enter into any transaction or arrangement or series of transactions or arrangements if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation, or to circumvent its purpose and intent, as set forth in Section 2303.23 of this article.

Note: Authority cited: Sections 739.9, 922.85, 923, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 739, 900, 922.4, 922.5, 922.85, 923, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Move, Renumber and Amend Authority and Reference Citations of Section 2303.22 to Section 2303.29. Severability.

If any provision of this article, or the application of a provision to any person or circumstance, shall be held invalid, the remainder of the article, and the application of the provision to persons or circumstances other than those to which it is held invalid, shall not be affected.

Note: Authority cited: Sections 720, 730, 736, 739.9, 922.8, 922.85, 923, 1011.5, 1215.9, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 739, 900, 922.1, 922.2, 922.3, 922.31, 922.4, 922.41, 922.42, 922.43, 922.5, 922.6, 922.85, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.

Move, Renumber and Amend Section 2303.23 to Section 2303.30. Effective Date.

(a) Section 2303 through Section 2303.25 of this article shall become effective on January 1, 2007, or the 30th day following the day those sections are filed with the Secretary of State, whichever is later (the "Effective Date").

~~(b)(a)~~ No licensee may claim reserve credit for a new or renewal reinsurance agreement executed on or after ~~the Effective Date~~ January 1, 2018, unless the agreement and any security provided therefor conform to the applicable requirements of this article.

~~(e)(b)~~ All reinsurance agreements and any security provided therefor that are executed prior to January 1, 2007 ~~the Effective Date~~ shall remain subject to the requirements of Bulletin 97-5 issued pursuant to Code Section 922.8. Bulletin 97-5 is incorporated herein by reference for that limited purpose.

~~(d)(c)~~ Licensees shall continue to conform to the requirements of the NAIC Accounting Guidance, to the extent that those requirements do not conflict with applicable requirements of the Code and Bulletin 97-5, or, after ~~the Effective Date~~ January 1, 2018, with this article.

(d) Sections 2303.23 to 2303.28 of this article shall pertain to all Covered Policies in force as of and after January 1, 2018.

Note: Authority cited: Sections 720, 730, 736, 739.9, 922.8, 922.85, 923, 924, 1011.5, 1215.9, 1781.12, 10489.94 and 12921, Insurance Code; *CalFarm Insurance Company v. Deukmejian*, 48 Cal. 3d 805 (1989); and *20th Century Insurance Company v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 717, 717.5, 730, 733, 736, 739, 900, 922.1, 922.2, 922.3, 922.4, 922.41, 922.5, 922.6, 922.7, 922.8, 922.85, 922.9, 923, 924, 925, 925.2, 925.4, 1011, 1011.5, 1215.5(b)(3), 1215.5(f), 1781.10, 10489.1, 10489.12, 10489.96 and 12921, Insurance Code.