# 02 DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION

031 BUREAU OF INSURANCE

Chapter 760 LIFE AND HEALTH REINSURANCE AGREEMENTS

1. Authority

This regulation is adopted and promulgated by the Superintendent pursuant to Title 24-A M.R.S.A. § 731-B(7).

2. Preamble

A. The State of Maine Bureau of Insurance recognizes that licensed insurers routinely enter into reinsurance agreements that yield legitimate relief to the ceding insurer from strain to surplus.

It is, however, improper for a licensed ceding insurer to enter into a reinsurance agreement for the principal purpose of obtaining significant surplus aid without transferring all of the significant risks inherent in the business being reinsured, as the expected potential liability of the ceding insurer under such agreement remains essentially unchanged by the reinsurance agreement, notwithstanding certain risk elements contained in the agreement, such as catastrophic mortality or extraordinary survival. If the terms of a reinsurance agreement give rise to any of the conditions enumerated in Section 4(A), the existence of such condition may constitute a violation or noncompliance with one or more of the following:

(1) 24-A M.R.S.A. § 424(2);

(2) 24-A M.R.S.A. § 731-B;

(3) 24-A M.R.S.A. § 417(2)(a);

(4) 24-A M.R.S.A. § 4356.

3. Scope

This regulation shall apply to all domestic life and accident and health insurers and to all other licensed life and accident and health insurers not subject to a substantially similar regulation in their domiciliary state. This regulation shall also similarly apply to licensed property and casualty insurers with respect to their accident and health business. This regulation does not apply to assumption reinsurance, yearly renewable term reinsurance, stop loss nonproportional reinsurance or catastrophe nonproportional reinsurance.

4. Accounting requirements

A. No insurer subject to this regulation shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the Bureau 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 renewal expenses of the ceding insurer allocable pursuant to terms of the agreement 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 costs 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 or automatically upon the occurrence of some event, which includes but is not limited to 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 provisions requiring 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. Voluntary termination does not include situations where termination occurs or may be required due to oppressive or arbitrary provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance agreement;

(4) The ceding insurer must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded;

(5) The reinsurance agreement entails the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. It shall be 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 agreement does not transfer all of the significant risk inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with this table.

Risk categories:

(a) Morbidity

(b) Mortality

(c) 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.

(d) Credit Quality (C1)

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that an asset will suffer default or that there will be a decrease in earning power of the asset. It excludes market value declines due to changes in interest rate.

(e) Reinvestment (C3)

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.

(f) Disintermediation (C3)

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.

(7) The ceding company does not (other than for the classes of business excepted below), 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 Superintendent which legally segregates, by contract or contract provision, the underlying assets when the credit quality, reinvestment, or disintermediation risk is significant for the business reinsured.

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

-- Health Insurance -- LTC/LTD

-- Traditional Non-Par Permanent

-- Traditional Par Permanent

-- Adjustable Premium Permanent

-- Indeterminate Premium Permanent

-- Universal Life Fixed Premium

(no dump-in premiums allowed)

In order for a credit to be allowed, the reinsurance agreement must provide for a reserve interest rate adjustment when funds held by the ceding insurer are not segregated. In determining the reserve interest rate adjustment, the ceding insurer must use a formula which reflects its investment earnings and incorporates all realized and unrealized gains and losses reflected in the insurer's annual statutory financial statement. Any adjustment which produces an additional cost for the reinsurance coverage shall be recognized as a liability of the insurer. The following is an acceptable formula:

\*\*\*\*\* FORMULA HERE \*\*\*\*\*

Where: I is the net investment income (Exhibit 2, Line 16, Column 7 Part 1, Line 9, Column 8 for casualty blanks) CG is capital gains less capital losses (Exhibit 4, Line 10, Column 6 Part 1A, Line 10, Column 7, for casualty blanks) X is the current year cash and invested assets (Page 2, Line 10A, Column 1) plus investment income due and accrued (Page 2, Line 16, Column 1) less borrowed money (Page 3, Line 22, Column 1) Y is the same as X but for the prior year

(8) Settlements are made less frequently than quarterly or payments due from the reinsurer are not made 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, 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.

B. Notwithstanding Subsection A, an insurer subject to this rule may, with the prior approval of the Superintendent, take such reserve credit or establish such asset as the Superintendent may deem consistent with provisions of 24-A M.R.S.A. or administrative Rules adopted by the Superintendent.

C.

(1) Agreements entered into after the effective date of this rule which produce significant surplus aid and which involve the reinsurance of business issued prior to the effective date of the agreements, along with any subsequent amendments thereto, shall be filed by the ceding company with the Superintendent within thirty (30) days from the date of execution. Each filing shall include data detailing the financial impact of the transaction. The actuary who represents the ceding insurer and signs the financial statement actuarial opinion with respect to the annual valuation of reserves, shall consider this rule and any applicable actuarial standards of practice in determining proper credit in financial statements filed with the bureau. The actuary shall maintain adequate documentation and, upon request, describe and support the actuarial work performed for inclusion in the financial statement and demonstrate that such work conforms to provisions of this rule.

(2) Any increase in surplus net of federal income tax resulting from arrangements described in Subsection C(1) shall be identified separately on the insurer's statutory financial statement as a surplus item (aggregate write-ins for gains and losses in surplus in the Capital and Surplus Account, page 4 of the Annual Statement) and recognition of the surplus increase as income shall be reflected on a net of tax basis in the "Reinsurance ceded" line, page 4 of the Annual Statement as earnings emerge from the business reinsured.

(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 percent 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 percent 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 percent 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.)

5. Written agreements

A. 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 Bureau, unless the agreement, amendment or a binding letter of intent has been duly executed by both parties no later than the date of account of the financial statement.

B. In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within ninety (90) days from the execution date of the letter of intent, in order for credit taken to continue respecting the reinsurance ceded.

C. The reinsurance agreement shall contain provisions which provide that:

(1) The agreement shall constitute the entire agreement between the parties with respect to the business being reinsured and all understandings between the parties are expressed in the agreement; and

(2) Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.

6. Existing agreements

Insurers with reserve credits or asset valuations established with respect to reinsurance agreements entered into prior to the effective date of this regulation, which agreements were in compliance with Maine laws and rules then in effect, but which give rise to any of the conditions enumerated in Section 4(A), shall have until December 31, 1994 to reduce those reserve credits or asset valuations to zero. No reserve credits or asset which did not conform to requirements then in effect may be established with respect to reinsurance agreements entered into prior to the effective date of this rule.

7. Effective date

This regulation shall become effective August 11, 1993.

History. -- Effective. 8-11-93.

History. -- Statutory Authority.--24-A M.R.S.A. § 731B(7).

EFFECTIVE DATE (ELECTRONIC CONVERSION): January 14, 1997

APAO WORD VERSION CONVERSION (IF NEEDED) AND ACCESSIBILITY CHECK: July 18, 2025