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Chapter Ins 55

LIFE AND HEALTH REINSURANCE AGREEMENTS

Ins 55.01 Scope. (1) This chapter applies only to:

(a) Domestic life and accident and health insurers;

(b) Licensed life and accident and health insurers which are not subject to a substantially similar rule or law in their state of domicile; and

(c) Licensed property and casualty insurers which are not subject to a substantially similar rule or law in their state of domicile with respect to their accident and health business.

(2) This rule does not apply to assumption reinsurance, yearly renewable term reinsurance or nonproportional reinsurance such as stop loss or catastrophe reinsurance.

History: Cr. Register, July, 1993, No. 451, eff. 8–1–93.

Ins 55.02 Accounting requirements. (1) No insurer may, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the office of the commissioner of insurance if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

(a) 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.

(b) The ceding insurer can be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer, other than 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.

(c) The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, other than offsetting experience refunds against current and prior years' losses under the agreement, or 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. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement, including, but not limited to, a provision which provides that it is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels which forces the ceding company to prematurely terminate the reinsurance agreement.

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

(e) 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 or the ceding insurer is required to pay reinsurance premiums, or other fees or charges, to a reinsurer which are greater than the direct premiums collected by the ceding company.

(f) The treaty does not transfer all of the significant risk inherent in the business being reinsured.

(g) 1. Except as provided by subd. 2., 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 legally segregates, by contract or contract provision, the underlying assets.

2. The assets supporting the reserves for classes of business which do not have a significant credit quality, reinvestment or disintermediation risk, for the following classes of business, may be held by the ceding company without segregation of the assets:

a. Health Insurance – LTC/LTD

b. Traditional Non–Par Permanent

c. Traditional Par Permanent

d. Adjustable Premium Permanent

e. Indeterminate Premium Permanent

f. Universal Life Fixed Premium (no dump–in premiums allowed)

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

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

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

(h) Settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within 90 days of the settlement date.

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

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

(k) 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.

(2) For the purpose of this chapter, the following table identifies for a representative sampling of products or type of business, the risks which are considered to be significant. If a product is not specifically included in the table, the risks for the product shall be determined to be significant in a manner consistent with this table. Risk categories are:

(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 assets will default or that there will be a decrease in earning power. 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.

TABLE + – Significant 0 – Insignificant

RISK CATEGORY

	a	b	c	d	e	f
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

(3) An insurer may, with the prior written approval of the commissioner, take reserve credit or establish an asset for ceded reinsurance which does not comply with sub. (1) or (2).

(4) An insurer which enters into a reinsurance agreement which involves the reinsurance of business issued prior to the effective date of the agreements, and any subsequent amendments to such a reinsurance agreement, shall file the agreement with the commissioner within 30 days from its date of its execution. An insurer shall include with the filing data detailing the financial impact of the transaction.

(5) A ceding insurer's actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this chapter and any applicable actuarial standards of practice when determining the proper credit in financial statements filed with the commissioner. The actuary shall maintain adequate documentation and be prepared upon request to describe the actuarial work performed for inclusion in the financial statements and to demonstrate that the work conforms to this rule.

(6) An insurer shall, in the insurer's statutory financial statement, show:

(a) Any increase in surplus net of federal income tax resulting from arrangements described in sub. (4) separately as a surplus item (aggregate write–ins for gains and losses in surplus in the capital and surplus account); and

(b) Recognition of the surplus increase as income 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.

Note: The following is an example of the application of s. Ins 55.02 (6): 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.

History: Cr. Register, July, 1993, No. 451, eff. 8–1–93.

Ins 55.03 Written agreements. An insurer may not reduce any liability or establish any asset in any financial statement filed with the office of the commissioner of insurance, based on a reinsurance agreement or amendment to any agreement unless:

(1) The agreement, amendment or a binding letter of intent has been duly executed by all parties no later than the date for which the financial statement is reporting the financial condition of the insurer;

(2) If only a letter of intent has been executed, a reinsurance agreement or an amendment to a reinsurance agreement is to be executed within a reasonable period of time, not exceeding 90 days from the execution date of the letter of intent; and

(3) The reinsurance agreement or amendment provides that:

(a) The agreement or amendment constitutes the entire agreement between the parties with respect to the business being reinsured and that there are no understandings between the parties other than as expressed in the agreement; and

(b) Any change or modification to the agreement or amendment is null and void unless made by amendment and signed by all parties.

History: Cr. Register, July, 1993, No. 451, eff. 8–1–93.

Ins 55.04 Effect of failure to comply. No insurer may reduce any liability or establish or maintain an asset for the purpose of determining whether the insurer is in financially hazardous condition, establishing or representing the financial condition of the insurer, or for the purpose of meeting compulsory surplus or security surplus requirements if the insurer may not reduce the liability or establish or maintain the asset on its financial statement under this chapter.

History: Cr. Register, July, 1993, No. 451, eff. 8–1–93.

Ins 55.05 Applicability. (1) This chapter applies to reinsurance agreements entered into prior to, on or after its effective date.

(2) An insurer shall reduce to zero by December 31, 1994, any reserve credits or assets established with respect to reinsurance agreements entered into prior to August 1, 1993 which, under the provisions of this chapter would not be entitled to recognition of the reserve credits or assets. Section Ins 6.73 and the annual statement instructions in effect prior to August 1, 1993 continue to apply to agreements entered into prior to August 1, 1993 until December 31, 1994.

Note: Ins 6.73 was repealed eff. 8–1–93.

(3) This chapter is in addition to, and does not supersede other requirements, including, but not limited to, the requirements of ch. Ins 52.

History: Cr. Register, July, 1993, No. 451, eff. 8–1–93.