

**CHAPTER 162. LIFE AND HEALTH  
REINSURANCE AGREEMENTS**

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**Authority**

The provisions of this Chapter 162 issued under sections 319, 319.1, 319.2 and 320 of The Insurance Company Law of 1921 (40 P. S. §§ 442, 442.1, 442.2 and 443); and section 514 of The Insurance Department Act of 1921 (40 P. S. § 221.14), unless otherwise noted.

**Source**

The provisions of this Chapter 162 adopted September 10, 1993, effective September 11, 1993, 23 Pa.B. 4309, unless otherwise noted.

**§ 162.1. Purpose.**

(a) This chapter sets forth the conditions whereby a ceding insurer will not be permitted to receive credit for reinsurance in financial statements filed with the Department if the reinsurance agreement does not transfer all of the significant risks inherent in the business being reinsured or, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged by the reinsurance transaction, notwithstanding certain risk elements in the reinsurance agreement, such as catastrophic mortality or extraordinary survival.

(b) In addition to specifying the conditions which would result in denial of credit, this chapter requires reinsurance agreements which fall within the scope of §§ 162.3 and 162.5 (relating to scope; and agreements to be filed with Commissioner), including data detailing the financial impact of the agreements, to be filed by the ceding insurer with the Department and specifies the accounting methodology to be followed by the ceding insurer in reporting any increase in surplus resulting from those agreements in financial statements filed with the Department.

(c) This chapter also provides safeguards to insure that agreements for which credit has been taken are actually executed and effective within a time period that reasonably corresponds to the date of the insurer's financial statements.

**§ 162.2. Definitions.**

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

*Commissioner*—The Insurance Commissioner of the Commonwealth.

*Department*—The Insurance Department of the Commonwealth.

*Domestic*—Incorporated or organized under the laws of the Commonwealth.

*Foreign*—Incorporated or organized under the laws of a jurisdiction other than the Commonwealth.

### § 162.3. Scope.

(a) This chapter applies to licensed domestic life and accident and health insurers as well as to licensed foreign life and accident and health insurers which are not subject to a substantially similar regulation in their domiciliary state.

(b) In addition, this chapter similarly applies to licensed domestic and foreign property and casualty insurers with respect to their accident and health business.

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

#### Cross References

This section cited in 31 Pa. Code § 162.1 (relating to purpose).

### § 162.4. Accounting requirements.

(a) An insurer subject to this chapter may not, for reinsurance ceded, reduce liability or establish an asset in financial statements filed with the Department if, by the terms of the reinsurance agreement, in substance or effect, one or more of the following conditions exist:

(1) The reserve credit taken by the ceding insurer is greater than the underlying reserve of the ceding insurer supporting the policy obligations transferred under the reinsurance agreement.

(2) 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. Renewal expenses include commissions, premium taxes and direct expenses including billing, valuation, claims and maintenance expected by the ceding insurer at the time the business is reinsured.

(3) 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. However, 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, will not be considered to be a deprivation of surplus or assets for purposes of this subsection.

(4) The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement. 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 will be considered a reimbursement to the reinsurer for negative experience for purposes of this subsection. In addition, voluntary termination does not include termination as a result of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of an unreasonable provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels thereby forcing the ceding insurer to prematurely terminate the reinsurance treaty.

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

(6) 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 insurer to pay reinsurance premiums, or other fees or charges, to the reinsurer which are greater than the direct premiums collected by the ceding insurer.

(7) The treaty 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 the following table:

*Risk Categories*

(A) Morbidity.

(B) Mortality.

(C) Lapse—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—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. This risk category excludes market value declines due to changes in interest rate.

(E) Reinvestment—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—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 insurer may have to sell assets at a loss to provide for these withdrawals.

*Table of Risk Significance*  
+— Significant    0 — Insignificant

|   | <i>Risk Category</i> |   |   |   |   |   |
|---|----------------------|---|---|---|---|---|
|   | A                    | B | C | D | E | F |
| Health Insurance Other than<br>Long Term Care/Long<br>Term Disability | +                    | 0 | + | 0 | 0 | 0 |
| Health Insurance—Long<br>Term Care/Long<br>Term Disability            | +                    | 0 | + | + | + | 0 |
| Immediate Annuities   | 0                    | + | 0 | + | + | 0 |
| Single Premium Deferred<br>Annuities                                  | 0                    | 0 | + | + | + | + |
| Flexible Premium Deferred<br>Annuities                                | 0                    | 0 | + | + | + | + |
| Guaranteed Interest<br>Contracts                                      | 0                    | 0 | 0 | + | + | + |
| Other Annuity Deposit<br>Business                                     | 0                    | 0 | + | + | + | + |
| Single Premium Whole Life<br>Traditional Non-Par<br>Permanent         | 0                    | + | + | + | + | + |
| Traditional Non-Par Term  | 0                    | + | + | 0 | 0 | 0 |
| Traditional Par Permanent   | 0                    | + | + | + | + | + |
| Traditional Par Term  | 0                    | + | + | 0 | 0 | 0 |
| Adjustable Premium<br>Permanent                                       | 0                    | + | + | + | + | + |
| Indeterminate Premium<br>Permanent                                    | 0                    | + | + | + | + | + |
| Universal Life Flexible<br>Premium                                    | 0                    | + | + | + | + | + |
| Universal Life Fixed<br>Premium                                       | 0                    | + | + | + | + | + |
| Universal Life Fixed<br>Premium (dump-in<br>premiums allowed)         | 0                    | + | + | + | + | + |

(8) The credit quality, reinvestment or disintermediation risk is significant for the business reinsured and the ceding insurer does not, other than for the classes of business excepted in subparagraph (i), either transfer the underlying assets to the reinsurer or legally segregate the 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.

(i) Notwithstanding the provisions of this paragraph, 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 insurer without segregation of the assets:

Health Insurance—Long Term Care/Long Term Disability  
Insurance  
Traditional Non-Par Permanent  
Traditional Par Permanent  
Adjustable Premium Permanent  
Indeterminate Premium Permanent  
Universal Life Fixed Premium (no dump-in premiums allowed)

(ii) If the ceding insurer elects to hold the assets supporting the reserves for the classes of business stated in subparagraph (i) or for classes of business which do not represent a significant risk as noted in subparagraph (i), the determination of the modified coinsurance reserve interest rate adjustment shall conform to a formula which reflects the ceding insurer's investment earnings and incorporates all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

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

Where:

- I =the net investment income
- CG =realized and unrealized capital gains less realized and unrealized capital losses
- X =the current year cash and invested assets plus investment income due and accrued less borrowed money
- Y =the same as X but for the prior year

(9) 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.

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

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

(12) 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.

(b) Notwithstanding the provisions of subsection (a), an insurer subject to this chapter may, with the prior written approval of the Commissioner, take the reserve credit or establish the asset as the Commissioner may deem consistent with statutes, regulations, orders or rulings of the Commonwealth or the Department, including actuarial interpretations or standards adopted by the Department.

### § 162.5. Agreements to be filed with Commissioner.

Agreements entered into after September 12, 1993, which involve the reinsurance of business issued prior to the effective date of the agreements, along with subsequent amendments thereto, shall be filed by the ceding insurer with the Commissioner within 30 days from the date of execution. Each filing shall include data detailing the financial impact of the transaction.

#### Cross References

This section cited in 31 Pa. Code § 162.1 (relating to purpose); and 31 Pa. Code § 162.6 (relating to statutory financial reporting requirements).

### § 162.6. Statutory financial reporting requirements.

An increase in surplus net of Federal income tax resulting from arrangements described in § 162.5 (relating to agreements to be filed with Commissioner) 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) and recognition of the surplus increase as income shall be reflected on a net of tax basis in the "reinsurance ceded" line 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% 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.

**§ 162.7. Responsibility of valuation actuary.**

The ceding insurer’s actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this chapter and applicable actuarial standards of practice when determining the proper credit in financial statements filed with the Department. The actuary should 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 chapter.

**§ 162.8. Written agreements.**

(a) A reinsurance agreement or amendment to an agreement may not be used to reduce liability or to establish an asset in a financial statement filed with the Department, unless the agreement, amendment or a binding letter of intent has been executed by both parties no later than the “as of date” of the financial statement.

(b) In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement shall be executed within a reasonable period of time, not exceeding 90 days from the execution date of the letter of intent, for credit to be granted for the reinsurance ceded.

(c) The reinsurance agreement shall contain provisions which provide the following:

(1) The agreement shall constitute 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.

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

**§ 162.9. Existing agreements.**

Insurers subject to this chapter shall reduce to zero by December 31, 1995, reserve credits or assets established with respect to reinsurance agreements entered into prior to September 12, 1993, which, under this chapter would not be entitled to recognition of the reserve credits or assets but the reinsurance agreements shall have been in compliance with laws or regulations in existence immediately preceding September 12, 1993.

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