TITLE 210 - NEBRASKA DEPARTMENT OF INSURANCE

CHAPTER 57 - LIFE AND HEALTH REINSURANCE AGREEMENTS

001. Authority. This regulation is adopted and promulgated by the Director of Insurance of the State of Nebraska pursuant to Neb. Rev. Stat. §§ 44-101.01 and § 44-416.04.

002. Preamble.

002.01 The Nebraska Insurance Department recognizes that licensed insurers routinely enter into reinsurance agreements that yield legitimate relief to the ceding insurer from strain to surplus.

002.02 However, the Department has become aware that some life insurers it is improper for a licensed insurer, in the capacity of ceding insurer, to have at times entered into reinsurance agreements, for the principal purpose of producing significant surplus aid for the ceding insurer, which provide little or no indemnification of policy benefits by the reinsurer. In addition, the Department is concerned with reserve credits taken under reinsurance agreements which provide some indemnification of policy benefits where those policy benefits are not included in the gross reserves established by the ceding insurer typically on a temporary basis, while not transferring all of the significant risks inherent in the business being reinsured. 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. The terms of such agreements referred to herein and described in Section 004 would violate any one or more of the following:

002.02(a) Neb. Rev. Stat. Section § 44-322 relating to financial statements of insurers, thus, resulting in distorted financial statements which do not properly reflect the financial condition of the ceding life insurer;

002.02(b) Neb. Rev. Stat. Sections §§ 44-416.01 through 44-416.03 relating to reinsurance reserve credits, thus, resulting in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded; and

002.02(c) Neb. Rev. Stat. Sections §§ 44-4809, 44-4812, and 44-4817 relating to creating a situation that may be hazardous to policyholders and the people of this State.

003. 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 which are 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 shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.
004. Accounting requirements.

004.01 No life insurer subject to this regulation shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the Department if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

004.01(a) The primary effect of the reinsurance agreement is to transfer deficiency reserves or excess interest reserves to the books of the reinsurer for a "risk charge" and the agreement does not provide for significant participation by the reinsurer in one or more of the following risks: mortality, morbidity, investment or surrender benefit. 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;

004.01(b) The reserve credit taken by the ceding insurer is not in compliance with Nebraska insurance statutes, rules or regulations, including actuarial interpretations or standards adopted by the Department. 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, 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;

004.01(c) The reserve credit taken by the ceding insurer is greater than the underlying reserve of the ceding company supporting the policy obligations transferred under the reinsurance agreement;

004.01(d) 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. Voluntary termination does not include situations where termination occurs because of unreasonable 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 treaty:

004.01(e) The ceding insurer can be deprived of surplus at the reinsurer's option 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 shall not be considered to be such a deprivation or surplus;

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

004.01(ge) No cash payment is due from the reinsurer, throughout the lifetime of the reinsurance agreement, with all settlements prior to the termination date of the agreement made only in a "reinsurance account," and no funds in such account are available for the payment of benefits. 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; or

004.01(hf) The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income reasonably expected from the reinsured policies. 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 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 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.

+ - Significant 0 – Insignificant

RISK CATEGORY

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<th>Product Category</th>
<th>a</th>
<th>b</th>
<th>c</th>
<th>d</th>
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*LTC = Long Term Care Insurance  
LTD = Long Term Disability Insurance

004.01(g)(i) The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business excepted in Section 004.01(g)(ii)) 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 Director which legally segregates, by contract or contract provision, the underlying assets.

004.01(g)(ii) Notwithstanding the requirements of Section 004.01(g)(i), 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)

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 (Exhibit 2, Line 15, Column 7)
- \( CG \) is capital gains less capital losses (Exhibit 3, Line 11, Column 6, less Exhibit 4, Line 9, Column 4)
- \( X \) is the current year cash and invested assets (Page 2, Line 11, Column 4) plus investment income due and accrued (Page 2, Line 17, Column 4) less borrowed money (Page 3, Line 22, Column 1)
- \( Y \) is the same as \( X \) but for the prior year

004.01(h) 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.

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

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

004.01(k) 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.

004.02 Notwithstanding subsection 004.01, a life insurer subject to this regulation may, with the prior approval of the Director, take such reserve credit or establish such asset as the Director may deem consistent with Nebraska insurance statutes, rules, or regulations, including actuarial interpretations or standards adopted by the Department.

004.03(a) Agreements entered into after the effective date of this regulation 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 Director within thirty (30) days from its date of execution. Each filing shall include data detailing the financial impact of the transaction. The ceding insurer’s actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this regulation and any applicable actuarial standards of practice when determining the proper
credit in financial statements filed with this 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 such work conforms to this regulation.

004.03(b) Any increase in surplus net of federal income tax resulting from arrangements described in Section 004.03(a) 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% 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.]

005. Written agreements.

005.01 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.

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

005.03 The reinsurance agreement shall contain provisions which provide that:
005.03(a) 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; and

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

006. Existing agreements. Life insurers subject to this rule may continue to liabilities or establish assets in financial statements filed with the Department for reinsurance ceded under types of reinsurance agreements described in subsection 002.02 and Section 004, provided:

006.01 The agreements were executed and in force prior to the effective date of this rule;

006.02 No new business is ceded under the agreements after the effective date of this rule;

006.03 The reduction of liability or the asset established for the reinsurance ceded is reduced to zero (0) by December 31, 1994, or such later date approved by the Director as a result of an application made by the ceding insurer prior to December 31 of the year in which this rule becomes effective;

006.04 The reduction of liability or the establishment of the asset is otherwise permissible under all other applicable provisions of Nebraska statutes, or regulations, including actuarial interpretations or standards adopted by the Department; and

006.05 The Department is notified, within ninety (90) days following the effective date of this rule, of the existence of such reinsurance agreements and all corresponding credits taken in the ceding insurer’s 1990 Annual Statement.

007. Director's authority. This rule is in accordance with the vested powers and prior approval authority of the Director concerning life reinsurance reserve credit consistent with the provisions of the Nebraska insurance statutes, rules or regulations, including actuarial interpretations or standards adopted by the Department.

008. Effective date. This rule shall become effective as to Annual Statements for the year 1991 and Annual Statements and Quarterly Financial Statements thereafter.