

1 **836-012-0300**

2 **Authority; Statement of Purpose; Director's Authority**

3
4 (1) OAR 836-012-0300 to [836-012-0330] **836-012-0331** are adopted pursuant to the authority of
5 [ORS 731.244](#) and [731.508](#) for the purpose of implementing [ORS 731.508](#) (6).

6 (2) OAR 836-012-0300 to [836-012-0330] **836-012-0331** apply to each domestic insurer
7 transacting life insurance, health insurance or both, to each domestic health care service
8 contractor, and to each other authorized insurer or health care service contractor transacting life
9 insurance, health insurance or both who is not subject to substantially similar rules or regulations
10 in its domiciliary state. 836-012-0300 to [836-012-0330] **836-012-0331** do not apply with respect
11 to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional
12 reinsurance such as stop loss or catastrophic reinsurance.

13 (3) The Director recognizes that authorized insurers routinely enter into reinsurance agreements
14 that yield legitimate relief to the ceding insurer from strain to surplus. It is improper for an
15 authorized insurer, however, in the capacity of ceding insurer, to enter into reinsurance
16 agreements for the principal purpose of producing significant surplus aid for the ceding insurer,
17 typically on a temporary basis, while not transferring all of the significant risks inherent in the
18 business being reinsured. In substance and effect, the expected potential liability to the ceding
19 insurer in agreements that do not transfer all of the significant risks remains basically unchanged
20 by the reinsurance transaction, notwithstanding certain risk elements in the reinsurance
21 agreement, such as catastrophic mortality or extraordinary survival.

22
23 Stat. Auth.: ORS 731.244 & [ORS 731.508](#)

24 Stats. Implemented: [ORS 731.508](#)(6)

25 Hist.: ID 8-1993, f. & cert. ef. 9-23-93; ID 7-1995, f. & cert. ef. 11-15-95

26
27 **836-012-0310**

28 **Accounting Requirements**

29
30 (1) An insurer that is subject to OAR 836-012-0300 to [836-012-0330] **836-012-331** shall not,
31 for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed
32 with the Director if by the terms of the reinsurance agreement, in substance or effect, one or
33 more of the following conditions exist:

34 (a) Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer
35 in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the
36 ceding insurer on the portion of the business reinsured, unless a liability is established for the
37 present value of the shortfall (using assumptions equal to the applicable statutory reserve basis
38 on the business reinsured). Those expenses include commissions, premium taxes and direct
39 expenses, including but not limited to expenses for billing, valuation, claims and maintenance
40 expected by the ceding insurer at the time the business is reinsured;

41 (b) The ceding insurer is required to reimburse the reinsurer for negative experience under the
42 reinsurance agreement, except that neither offsetting experience refunds against current and prior
43 years' losses under the agreement nor payment by the ceding insurer of an amount equal to
44 current and prior years' losses under the agreement upon voluntary termination of in-force
45 reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for
46 negative experience. Voluntary termination does not include situations in which termination

1 occurs because of unreasonable provisions that allow the reinsurer to reduce its risk under the
2 agreement. An example of such a provision is the right of the reinsurer to increase reinsurance
3 premiums or risk and expense charges to excessive levels, forcing the ceding insurer to
4 prematurely terminate the reinsurance treaty;

5 (c) The ceding insurer can be deprived of surplus or assets at the reinsurer's option or
6 automatically upon the occurrence of some event, such as the insolvency of the ceding insurer,
7 except that termination of the reinsurance agreement by the reinsurer for non-payment of
8 reinsurance premiums or other amounts due, such as modified coinsurance reserve adjustments,
9 interest and adjustments on funds withheld and tax reimbursements, shall not be considered to be
10 such a deprivation of surplus or assets;

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

13 (e) The reinsurance agreement involves the possible payment by the ceding insurer to the
14 reinsurer of amounts other than from income realized from the reinsured policies. For example, it
15 is improper for a ceding insurer to pay reinsurance premiums or other fees or charges to a
16 reinsurer that are greater than the direct premiums collected by the ceding insurer;

17 (f) The treaty does not transfer all of the significant risk inherent in the business being reinsured.
18 The following table in this subsection identifies, for a representative sampling of products or
19 type of business, the risks that are considered to be significant. For products not specifically
20 included, the risks determined to be significant must be consistent with this table. The risk
21 categories are as follows:

22 (A) Morbidity;

23 (B) Mortality;

24 (C) Lapse, which is the risk that a policy will voluntarily terminate prior to the recoupment of a
25 statutory surplus strain experienced at issue of the policy;

26 (D) Credit Quality (C1), which is the risk that invested assets supporting the reinsured business
27 will decrease in value. The main hazards are that assets will default or that there will be a
28 decrease in earning power. Credit quality excludes market value declines due to changes in
29 interest rate;

30 (E) Reinvestment (C3), which is the risk that interest rates will fall and funds reinvested (coupon
31 payments or monies received upon asset maturity or call) will therefore earn less than expected.
32 If asset durations are less than liability durations, the mismatch will increase;

33 (F) Disintermediation (C3), which is the risk that interest rates rise and policy loans and
34 surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset
35 durations are greater than the liability durations, the mismatch will increase. Policyholders will
36 move their funds into new products offering higher rates. The insurer may have to sell assets at a
37 loss to provide for these withdrawals.

38
39 For purposes of the following chart: + - Significant 0 - Insignificant
40 RISK CATEGORY

41
42 A B C D E F
43

44 Health Insurance - other than long + 0 + 0 0 0
45 term care insurance and long term
46 disability insurance

1
2 Health Insurance - long term care + 0 + + + 0
3 insurance and long term disability
4 insurance
5
6 Immediate Annuities 0 + 0 + + 0
7
8 Single Premium Deferred Annuities 0 0 + + + +
9
10 Flexible Premium Deferred Annuities 0 0 + + + +
11 Guaranteed Interest Contracts 0 0 0 + + +
12
13 Other Annuity Deposit Business 0 0 + + + +
14
15 Single Premium Whole Life 0 + + + + +
16
17 Traditional Non-Par Permanent 0 + + + + +
18
19 Traditional Non-Par Term 0 + + 0 0 0
20
21 Traditional Par Permanent 0 + + + + +
22
23 Traditional Par Term 0 + + 0 0 0
24
25 Adjustable Premium Permanent 0 + + + + +
26
27 Indeterminate Premium Permanent 0 + + + + +
28
29 Universal Life Flexible Premium 0 + + + + +
30
31 Universal Life Fixed Premium 0 + + + + +
32 Universal Life Fixed Premium 0 + + + + +
33 dump-in premiums allowed
34

35 (g)(A) The credit quality, reinvestment or disintermediation risk is significant for the business
36 reinsured and the ceding insurer does not (other than for the classes of business excepted in
37 paragraph (B) of this subsection (g) either transfer the underlying assets to the reinsurer or
38 legally segregate such assets in a trust or escrow account or otherwise establish a mechanism
39 satisfactory to the Director that legally segregates, by contract or contract provision, the
40 underlying assets;

41 (B) Notwithstanding the requirements of paragraph (A) of this subsection (g), the assets
42 supporting the reserves for the following classes of business and any classes of business that do
43 not have a significant credit quality, reinvestment or disintermediation risk may be held by the
44 ceding insurer without segregation of such assets:

- 45 (i) Health Insurance - long term care insurance and long term disability insurance;
- 46 (ii) Traditional Non-Par Permanent;

- 1 (iii) Traditional Par Permanent;
 - 2 (iv) Adjustable Premium Permanent;
 - 3 (v) Indeterminate Premium Permanent; and
 - 4 (vi) Universal Life Fixed Premium, (no dump-in premiums allowed).
- 5 (C) For assets that are not legally segregated, the associated formula for determining the reserve
6 interest rate adjustment must reflect the ceding insurer's investment earnings and incorporates all
7 realized and unrealized gains and losses reflected in the statutory statement. The following is an
8 acceptable formula:

9

$$10 \text{ Rate} = 2 (I + CG)$$
$$11 X + Y - I - CG$$

12

13 When: I -- is the net investment income;

14

15 CG -- is capital gains less capital losses;

16

17 X -- is the current year cash and
18 -- invested assets plus invest-
19 -- ment income due and accrued
20 -- less borrowed money; and

21

22 Y -- is the same as X but for the
23 -- prior year.

- 24
- 25 (h) Settlements are made less frequently than quarterly or payments due from the reinsurer are
26 not made in cash within 90 days of the settlement date;
 - 27 (i) The ceding insurer is required to make representations or warranties not reasonably related to
28 the business being reinsured;
 - 29 (j) The ceding insurer is required to make representations or warranties about future performance
30 of the business being reinsured; or
 - 31 (k) The reinsurance agreement is entered into for the principal purpose of producing significant
32 surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the
33 significant risks inherent in the business reinsured and, in substance or effect, the expected
34 potential liability to the ceding insurer remains basically unchanged.

35 (2) Notwithstanding section (1) of this rule, with the prior approval of the Director, an insurer
36 that is subject to OAR 836-012-0300 to [836-012-0330] **836-012-331** may take such reserve
37 credit or establish such asset as the Director determines to be consistent with the Insurance Code
38 or rules adopted thereunder, including actuarial interpretations or standards adopted by the
39 Director.

40 (3)(a) An agreement entered into on or after November 9, 1995, that involves the reinsurance of
41 business issued prior to the effective date of the agreement, along with any subsequent
42 amendments thereto, shall be filed by the ceding insurer with the Director not later than the 30th
43 day after its date of execution. Each filing must include data detailing the financial effect of the
44 transaction. The ceding insurer's actuary who signs the financial statement actuarial opinion with
45 respect to valuation of reserves shall consider OAR 836-012-0300 to [836-012-0330] **836-012-**
46 **331** and any applicable actuarial standards of practice when determining the proper credit in

1 financial statements filed with the Director. The actuary shall maintain adequate documentation
2 and be prepared upon request to describe the actuarial work performed for inclusion in the
3 financial statements and to demonstrate that such work conforms to OAR 836-012-0300 to [836-
4 012-0330] **836-012-0331**.

5 (b) Any increase in surplus net of federal income tax resulting from arrangements described in
6 subsection (a) of this section shall be identified separately on the insurer's statutory financial
7 statement as a surplus item (aggregate write-ins for gains and losses in surplus in the Capital and
8 Surplus Account) and recognition of the surplus increase as income must be reflected on a net of
9 tax basis in the "Reinsurance ceded" line, as earnings emerge from the business reinsured. The
10 following example applies to this subsection:

11 (A) On the last day of calendar year N, company XYZ pays a \$20 million initial commission and
12 expense allowance to company ABC for reinsuring an existing block of business. Assuming a
13 34% tax rate, the net increase in surplus at inception is \$13.2 million (\$20 million - \$6.8 million)
14 that is reported on the "Aggregate write-ins for gains and losses in surplus" line in the Capital
15 and Surplus account. \$6.8 million (34% of \$20 million) is reported as income on the
16 "Commissions and expense allowances on reinsurance ceded" line of the Summary of
17 Operations;

18 (B) At the end of year N+1 the business has earned \$4 million. ABC has paid \$.5 million in
19 profit and risk charges in arrears for the year and has received a \$1 million experience refund.
20 Company ABC's annual statement would report \$1.65 million (66% of (\$4 million - \$1 million -
21 \$.5 million) up to a maximum of \$13.2 million) on the "Commissions and expense allowance on
22 reinsurance ceded" line of the Summary of Operations, and -\$1.65 million on the "Aggregate
23 write-ins for gains and losses in surplus" line of the Capital and Surplus account. The experience
24 refund would be reported separately as a miscellaneous income item in the Summary of
25 Operations.

26
27 Stat. Auth.: ORS 731.244 & [ORS 731.508](#)

28 Stats. Implemented: [ORS 731.508\(6\)](#)

29 Hist.: ID 8-1993, f. & cert. ef. 9-23-93; ID 7-1995, f. & cert. ef. 11-15-95

30
31 **836-012-0331 (NEW)**

32 **Existing Agreements**

33
34 **For purposes of an insurer's statutory financial statement filings, each insurer subject to**
35 **OAR 836-012-0300 to 836-012-331 shall reduce to zero any reserve credits or assets**
36 **established with respect to reinsurance agreements entered into prior to November 9, 1995**
37 **that, under the provisions of OAR 836-012-0300 to 836-012-331 as amended, would not be**
38 **entitled to recognition of the reserve credits or assets.**

39
40 **Stat. Auth.: ORS 731.244 & ORS 731.508**

41 **Stats. Implemented: ORS 731.508(6)**

42
43 *[836-012-0331T] Repeal Temporary Rule*

44 *[Existing Agreements]*

45

1 *[For purposes of an insurer's statutory financial statement filings, each insurer subject to OAR*
2 *836-012-0300 to 836-012-331 shall reduce to zero any reserve credits or assets established with*
3 *respect to reinsurance agreements entered into prior to November 9, 1995 that, under the*
4 *provisions of OAR 836-012-0300 to 836-012-331 as amended, would not be entitled to*
5 *recognition of the reserve credits or assets.]*

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7 Stat. Auth.: ORS 731.244 & ORS 731.508

8 Stats. Implemented: ORS 731.508(6)

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