

**WEST VIRGINIA**  
**SECRETARY OF STATE**  
**KEN HECHLER**  
**ADMINISTRATIVE LAW DIVISION**

Form #3

Do Not Mark In this Box

**FILED**

AUG 20 2 38 PM '96

OFFICE OF WEST VIRGINIA  
SECRETARY OF STATE

**NOTICE OF AGENCY APPROVAL OF A PROPOSED RULE  
AND  
FILING WITH THE LEGISLATIVE RULE-MAKING REVIEW COMMITTEE**

AGENCY: Insurance Commissioner TITLE NUMBER: 114

CITE AUTHORITY W. Va. Code §§ 33-4-15b(h) and 33-2-10

AMENDMENT TO AN EXISTING RULE: YES  NO

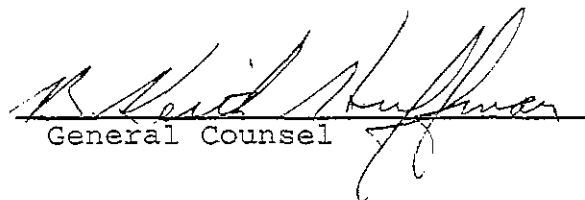
IF YES, SERIES NUMBER OF RULE BEING AMENDED: \_\_\_\_\_

TITLE OF RULE BEING AMENDED: \_\_\_\_\_

IF NO, SERIES NUMBER OF NEW RULE BEING PROPOSED: Series 48

TITLE OF RULE BEING PROPOSED: Life and Health Reinsurance Agreements

THE ABOVE PROPOSED LEGISLATIVE RULE HAVING GONE TO A PUBLIC HEARING OR A PUBLIC COMMENT PERIOD IS HEREBY APPROVED BY THE PROMULGATING AGENCY FOR FILING WITH THE SECRETARY OF STATE AND THE LEGISLATIVE RULE MAKING REVIEW COMMITTEE FOR THEIR REVIEW.

  
General Counsel

560



STATE OF WEST VIRGINIA  
Offices of the Insurance Commissioner

Legal Division

GASTON CAPERTON  
Governor

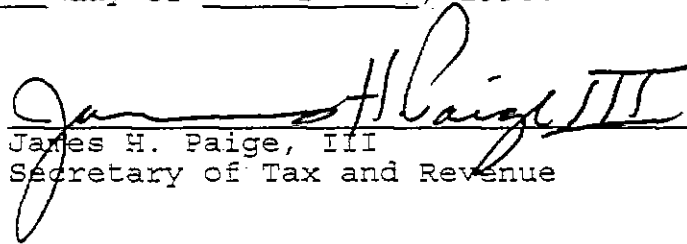
HANLEY C. CLARK  
Insurance Commissioner

CONSENT TO PROPOSAL OF RULE

To Whom It May Concern:

Pursuant to West Virginia Code § 5F-2-2(a)(12), the undersigned hereby grants consent to the proposal of the following rule proposed by the Insurance Commissioner of the State of West Virginia: Title 114, Series 48, relating to Life and Health Reinsurance Agreements.

Signed this 9th day of May, 1996.

  
James H. Paige, III  
Secretary of Tax and Revenue

APPENDIX B

FISCAL NOTE FOR PROPOSED RULES

Rule Title: Life & Health Reinsurance Agreements  
 Title 114, Series 48

Type of Rule:  Legislative  Interpretive  Procedural

Agency: Insurance Commissioner

Address: Post Office Box 50540  
 1124 Smith Street, Greenbrooke Building  
 Charleston, West Virginia 25305-0540

1. Effect of Proposed Rule

	ANNUAL FISCAL YEAR				
	Increase	Decrease	Current	Next	Thereafter
ESTIMATED TOTAL COST	\$ None				
PERSONAL SERVICES	None				
CURRENT EXPENSE	None				
REPAIRS AND ALTERNATIONS	None				
EQUIPMENT	None				
OTHER	None				

2. Explanation of above estimates:

This rule establishes standards to be applied by insurers when preparing financial statements to be submitted to the Office of the Insurance Commissioner. The frequency, timing and contents of those statements (and consequently the time and effort required to prepare or review them) is unaffected by this rule.

3. Objectives of these rules:

The objective of this rule is to adopt the model regulation on Life and Health Reinsurance Agreements that was adopted by the National Association of Insurance Commissioners (NAIC) in September 1992. A rule on this topic is mandated by W. Va. Code § 33-4-15b(g).

Rule Title: Life and Health Reinsurance Agreements  
Title 114, Series 48

4. Explanation of Overall Economic Impact of Proposed Rule.

A. Economic Impact on State Government.

None. This rule simply establishes standards to be applied by insurers in preparing financial statements. The frequency, timing and contents of those statements is unaffected by the rule.

B. Economic Impact on Political Subdivisions; Specific Industries; Specific groups of Citizens.

None. See answer to question 4A above.

C. Economic Impact on Citizens/Public at Large.

None. The rule does not apply to, and has no direct impact on, the public at large.

Date: 13 May 1996

Signature of Agency Head or Authorized Representative

Stanley O. Clark

Insurance Commissioner  
Emergency Rule  
Title 114, Series 48

**LIFE AND HEALTH REINSURANCE AGREEMENTS**

Title 114, Series 48

**BRIEF SUMMARY OF RULE**

On February 15, 1996, the West Virginia Legislature passed House Bill 4387, which took effect ninety (90) days from that date of passage. The bill amended and reenacted section 15b of Article 4, Chapter 33 of the West Virginia Code. That section sets forth accounting standards concerning certain reinsurance agreements, which standards are to be applied by insurers in preparing financial statements that will be submitted to this agency. W. Va. Code § 33-14-15b(h) requires the Insurance Commissioner to promulgate, by July 1, 1996, a rule for the implementation and administration of the aforementioned section. Further, timely adoption of this emergency rule, which conforms to a model regulation on the same topic adopted by the National Association of Insurance Commissioners (NAIC), is necessary to ensure this agency's accreditation by the NAIC.

Insurance Commissioner  
Legislative Rule  
Title 114, Series 48

**LIFE AND HEALTH REINSURANCE AGREEMENTS**

Title 114, Series 48

**STATEMENT OF CIRCUMSTANCES**

On February 15, 1996, the West Virginia Legislature passed House Bill 4387, which amended and reenacted section 15b of Article 4, Chapter 33 of the West Virginia Code. That section sets forth accounting standards concerning certain reinsurance agreements, which standards are to be applied by insurers in preparing financial statements that will be submitted to this agency. W. Va. Code § 33-14-15b(h) requires the Insurance Commissioner to promulgate, by July 1, 1996, a rule for the implementation and administration of the aforementioned section. This proposed legislative rule is also being filed as an emergency rule. The timely adoption of this emergency rule, which conforms to a model regulation on the same topic adopted by the National Association of Insurance Commissioners (NAIC), is necessary to ensure this agency's accreditation by the NAIC.

TO: LEGISLATIVE RULE-MAKING REVIEW COMMITTEE

FROM: OFFICE OF THE INSURANCE COMMISSIONER

DATE: AUGUST 20, 1996

LEGISLATIVE RULE TITLE: LIFE AND HEALTH REINSURANCE AGREEMENTS  
(Series 48)

1. Authorizing statute(s) citation W.Va. Code §§ 33-4-15b(h) and  
33-2-10

2. a. Date filed in State Register with Notice of Hearing:

May 31, 1996

b. What other notice, including advertising, did you give of the hearing?

None

c. Date of hearing(s): Comment period ended on

July 1, 1996

d. Attach list of persons who appeared at hearing, comments received, amendments, reasons for amendments.

Attached \_\_\_\_\_ No comments received XX

e. Date you filed in State Register the agency approved proposed Legislative Rule following public hearing: (be exact)

August 20, 1996

f. Name and phone number of agency person to contact for additional information:

Timothy Hrynick

Associate Counsel

(304) 558-0401

3. If the statute under which you promulgated the submitted rules requires certain findings and determinations to be made as a condition precedent to their promulgation:

a. Give the date upon which you filed in the State Register a notice of the time and place of a hearing for the taking of evidence and a general description of the issues to be decided.

Not applicable

b. Date of hearing: Not applicable

c. On what date did you file in the State Register the findings and determinations required together with the reasons therefor?

Not applicable

d. Attach findings and determinations and reasons:

Attached Not applicable

114CSR48  
TITLE 114  
LEGISLATIVE RULE  
INSURANCE COMMISSIONER

SERIES 48

LIFE AND HEALTH REINSURANCE AGREEMENTS

- §114-48-1. General
- §114-48-2. Preamble
- §114-48-3. Accounting Requirements
- §114-48-4. Written Agreements
- §114-48-5. Existing Agreements
- §114-48-6. Severability

FILED

AUG 20 2 38 PM '96

114CSR48  
TITLE 114  
LEGISLATIVE RULE  
INSURANCE COMMISSIONER

OFFICE OF WEST VIRGINIA  
SECRETARY OF STATE

SERIES 48  
LIFE AND HEALTH REINSURANCE AGREEMENTS

§114-48-1. **General.**

1.1. Scope. -- This rule shall apply to all domestic life and accident and sickness insurers and to all other licensed life and accident and sickness insurers which are not subject to a substantially similar rule in their domiciliary state. This rule shall also similarly apply to licensed property and casualty insurers with respect to their accident and sickness business. This rule shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

1.2. Authority. -- This rule is issued under the authority of W. Va. Code §§33-4-15b(h) and 33-2-10.

1.3. Filing Date. --

1.4. Effective Date. --

§114-48-2. **Preamble.**

2.1. The West Virginia Insurance commissioner recognizes that licensed insurers routinely enter into reinsurance agreements that yield legitimate relief to the ceding insurer from strain to surplus.

2.2. However, it is improper for a licensed insurer, in the capacity of ceding insurer, to enter into reinsurance agreements 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 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 3 of this rule violate:

a. W.Va. Code §33-4-14(a), relating to financial statements which do not properly reflect the financial condition of the ceding insurer;

b. W.Va. Code §33-4-15(c), relating to reinsurance reserve credits, thus

resulting in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded; and

c. W.Va. Code § 33-10-5(j), relating to creating a situation that may be hazardous to policyholders and the people of this state.

**§114-48-3. Accounting Requirements.**

3.1. No insurer subject to this rule shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the commissioner 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, 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.

c. 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.

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. 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.

f. The treaty does not transfer all of the significant risk inherent in the business being reinsured. Table 114-48A 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.

1. The risk categories indicated in Table 114-48A are as follows.

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.

g. 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 paragraph 1 of subdivision g of this subsection) 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.

1. Notwithstanding the requirements of subdivision g of this subsection, 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:

- 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)

2. 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 ninety (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, 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.

3.2. Notwithstanding subsection 3.1 of this rule, an insurer subject to this rule may, with the prior approval of the commissioner, take such reserve credit or establish such asset as the commissioner may deem consistent with applicable insurance statutes and rules, including actuarial interpretations or standards adopted by the commissioner.

3.3. Agreements entered into after the effective date of this rule 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 commissioner 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 rule and any applicable actuarial standards of practice when determining the proper credit in financial statements filed with the commissioner. 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 rule.

3.4. Any increase in surplus net of federal income tax resulting from arrangements described in subsection 3.3 of this rule, 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 as earnings emerge from the business reinsured.

a. (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.

**§114-48-4. Written Agreements.**

4.1. 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 commissioner 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.

4.2. 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.

4.3. -- The reinsurance agreement shall contain provisions which provide that:

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

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.

**§114-48-5. Existing Agreements.**

Insurers subject to this rule shall reduce to zero by December 31, 1998 any reserve credits or assets established with respect to reinsurance agreements entered into prior to the effective date of this rule which, under the provisions of this rule would not be entitled to recognition of the reserve credits or assets; provided, however, that the reinsurance agreements shall have been in compliance with laws or rules in existence immediately preceding the effective date of this rule.

**§114-48-6. Severability.**

If any provision of this rule, or their application to any person or circumstance, is held invalid, that determination shall not affect other provisions or applications of this rule which can be given effect without the invalid provision or application, and to that end the provisions of this rule are separable.

TABLE 114-48A

Product	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

+ - Significant    0 - Insignificant



STATE OF WEST VIRGINIA  
Offices of the Insurance Commissioner

Legal Division

GASTON CAPERTON  
Governor

August 20, 1996

HANLEY C. CLARK  
Insurance Commissioner

**HAND DELIVERED**

Ms. Judy Cooper, Director  
Administrative Law Division  
Office of the Secretary of State  
State Capitol  
Charleston, West Virginia 25305

Dear Ms. Cooper:

Enclosed please find for filing one (1) copy of the following:

- (1) Notice of Agency Approval of a Proposed Rule and Filing with the Legislative Rule-Making Review Committee;
- (2) Consent to Proposed Rule;
- (3) Fiscal Note;
- (4) Brief Summary of the Rule;
- (5) Statement of Circumstances;
- (6) Legislative Rule-Making Review Committee Questionnaire; and
- (7) The agency-approved rule entitled "Life and Health Reinsurance Agreements," (Series 48).

Please contact me if further information is required.

Very truly yours,

Timothy Hrynich  
Associate Counsel

TH/avn  
Enclosures

(G:\tim\cooper48.wpd.)