

State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
Division of Insurance
233 Richmond Street
Providence, RI 02903

INSURANCE REGULATION 88

LIFE AND HEALTH REINSURANCE AGREEMENTS

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Section 1 Authority

This Regulation is adopted and promulgated pursuant to R.I. Gen. Laws § 27-4.2-1 *et seq.*

Section 2 Purpose

The purpose of this Regulation is to establish definitions of the risk categories noted in R.I. Gen. Laws § 27-4.2-3A(6) and to set forth an acceptable formula for determining the reserve interest rate adjustment noted in R.I. Gen. Laws § 27-4.2-3(A)(7).

Section 3 Accounting Requirements

- A. No insurer subject to this Regulation shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the Insurance Division of the Department of Business Regulation if, by the terms of the reinsurance agreement, in substance or effect, 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:

Definitions and Risk Categories

- (a) "Morbidity" means the risk that a policyholder will become ill, sick or contract a disease during the effective dates of the policy.
- (b) "Mortality" means the risk that a policyholder will die during the effective dates of the policy.
- (c) "Lapse" means 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" means 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 the interest rate.
- (e) "Reinvestment" means 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" means 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

	<u>a</u>	<u>b</u>	<u>c</u>	<u>d</u>	<u>e</u>	<u>f</u>
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	0	+	+	+	+	+
Dump-In Premiums Allowed	0	+	+	+	+	+

*LTC Long Term Care Insurance

LTD Long Term Disability Insurance

Section 4 Reserve Interest Rate Adjustment Formula

Pursuant to R.I. Gen. Laws § 27-4.2-3(A)(7)(b), 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 settlement. The following is an acceptable formula:

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

Where:

- I is the net investment income (Exhibit 2 of the annual statement).
- CG is the Capital Gains less Capital Losses (Exhibit 4 of the annual statement).
- 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.

Section 5 Retroactive Reinsurance Resulting In Increased Surplus

Any increase in surplus net of federal income tax resulting from arrangements described in R.I. Gen. Laws § 27-4.2-3(C)1 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 thirty four (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. Agreements which involve the reinsurance of business issued prior to the effective date of the agreements should be filed by ceding Company with the Commissioner within thirty days from the date of execution.

EFFECTIVE DATE:	July 23, 1996
AMENDED:	None
REFILED:	December 19, 2001