



ADMINISTRATIVE RULES OF MONTANA

6.6.3602 ACCOUNTING REQUIREMENTS

- (1) No insurer subject to these rules may, 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:
 - (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) . Renewal 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 insurer 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;
 - (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;
 - (f) The agreement does not involve transfer of all of the significant risk inherent in the business being reinsured.
 - (i) Significant risks include, but are not limited to, the following:
 - (A) Morbidity.

- (B) Mortality.
 - (C) The risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy (lapse risk) .
 - (D) The risk that invested assets supporting the reinsured business will decrease in value, the main hazards being that assets will default or that there will be a decrease in earning power (credit quality risk) . This risk excludes market value declines due to changes in interest rate.
 - (E) 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 (reinvestment risk) .
 - (F) The risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal (disintermediation risk) .
- (ii) Risk categories for types of insurance covered by these rules are summarized in the following chart: (+ denotes significant risk; 0 denotes insignificant risk.)

LINES OF INSURANCE	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	0	+	+	+	+	+

*LTC = Long Term Care Insurance

LTD = Long Term Disability Insurance

- (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 (i) below] 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.
 - (i) Notwithstanding the requirements of (1) (g) , 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 (exclusive of dumped-in premiums) .
 - (ii) Any formula for determining reserve interest rate adjustment must be one which reflects the ceding company's investment earnings and incorporates all realized and unrealized gains and losses reflected in the statement.
 - (h) 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.
 - (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.
- (2) Notwithstanding subsection (1) , 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 the Montana insurance code and rules of the department, including actuarial interpretations or standards adopted by the department.
 - (3) Agreements entered into after the effective date of these rules 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 30 days from the 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 these rules and applicable actuarial standards of practice when determining the proper credit in financial statements filed with the department. The actuary shall maintain adequate documentation and be prepared to describe the actuarial work performed for inclusion in the financial statements and to demonstrate that his or her work conforms to these rules.

- (a) Any increase in surplus net of federal income tax resulting from arrangements described in this subsection 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 of the annual statement) and recognition of the surplus increase as income shall be reflected on a net of tax basis on the line captioned "reserve adjustments on reinsurance ceded" of the annual statement, as earnings emerge from the business reinsured.

Authorizing statute(s): Sec. 33-1-313 and 33-2-1517, MCA

Implementing statute(s): Sec. 33-2-1517, MCA

History: NEW, 1993 MAR p. 2408, Eff. 10/15/93.