

**Discussion of Reinsurance Provisions in a Life Reinsurance  
Agreement**

**August 1, 1994**

**Treaty Committee  
Reinsurance Section  
Society of Actuaries**

## Introduction

The Treaty Committee of the Reinsurance Section was charged with producing a document that could serve as a checklist during treaty preparation and review of a standard life reinsurance agreement. The document produced covers the purpose of each provision, the common elements, common variations and problems that may arise. It is the intent of the Committee for this document to serve as an objective guide only. It does not include an exhaustive listing of common practices nor is it intended to serve as a definitive standard of practice to be used in the resolution of disputes. The Committee recognizes that ceding companies and reinsurers are free to negotiate terms that meet the needs of both parties and may organize the elements of their treaties somewhat differently than presented here. In order to assure a balanced perspective, both the Committee and its group of reviewers have consisted of representatives from ceding companies and reinsurers.

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John Palmer & staff  
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## Accelerated Death Benefits

### 1.0 Purpose

- 1.1 This provision describes the extent and manner of the reinsurer's participation in the ceding company's accelerated death benefit product and program.

### 2.0 Scope

- 2.1 This provision is germane to all life reinsurance treaties covering products or portfolios featuring any type of accelerated death benefit.
- 2.2 The accelerated death benefit is a fairly new benefit so treaty wording describing the basis of coverage would be added by amendment to older treaties or made part of newer treaties. It is preferable that the treaty states whether or not the benefit is retained by the ceding company. This eliminates confusion in interpretation.
- 2.3 The types of accelerated death benefits dealt with include, but are not necessarily limited to:
  - 2.3.1 Accelerated death benefits purchased by the insured at an extra cost above the normal premium for the basic non-accelerated death benefit.

- 2.3.1.1 One form is a so-called "dread disease" benefit under which a portion of the life policy incorporating this benefit, usually 25% or 50%, is payable to the insured if he or she develops any of several dread diseases. Diseases commonly covered are cancer, heart attack, coronary artery disease, stroke and kidney failure. AIDs is sometimes a specified dread disease, but often is not included because of the anti-selection problems it can entail.

It is important to note that the dread disease accelerated death benefit is paid for the occurrence of the event of the disease, and not the severity.

- 2.3.1.2 Long Term Care (LTC) benefits may be another type of additional premium accelerated death benefit (although it can also be offered at no cost as described in Section 2.3.2 below). In the event the insured is required to be admitted to a nursing home, a percentage of the face amount, usually 2%, is paid as a monthly benefit. Reduced benefits may be payable for certain home care programs.

- 2.3.2 Accelerated death benefits granted by the insurer at no cost to the insured payable in the event the insured becomes terminally ill, with life expectancy of less than a specified period, usually six or twelve months, or if the insured is permanently confined to a nursing home.

No premium is required for this type of benefit since the accelerated death benefit is intended to be the actuarial equivalent of the benefit that would be due at the time of death. That is, the policy death benefit is discounted at an interest rate specified or described in the policy (or accelerated death benefit rider) from the expected date of death back to the accelerated date of payment.

- 2.3.3 In lieu of the "no cost" accelerated death benefit privilege described in Section 2.3.2, some companies make benefits available to terminally ill or nursing home confined individuals by means of an interest bearing loan. The money is advanced when the covered event occurs and then is deducted with the accumulated interest at death when the balance of the policy proceeds are paid. With this type of accelerated death benefit, the reinsurer often is not involved in the advance payment, but merely pays the reinsurance death benefit at the time of death, much as it would on a reinsured policy where the insured has made a policy loan on the cash value.

- 2.4 Treaty treatment of premium paying accelerated death benefits (Section 2.3.1) tends to be more extensive than that of "no cost" accelerated death benefits (Section 2.3.2) since in the first instance a distinct reinsurance benefit is involved while in the latter instance an alternate mode of payment is the subject matter.

### 3.0 General Elements

- 3.1 For premium paying accelerated death benefits the following elements are usually included:
- 3.1.1 A statement of the portion of the benefit reinsured.
  - 3.1.2 A statement of the maximum benefit or the maximum reinsurance benefit, if any.
  - 3.1.3 The reinsurance premium will be described.
  - 3.1.4 If less than the full face amount is subject to acceleration, the effect of an accelerated benefit payment on the ceding company's retention, the policy's cash value, the amount of continuing reinsurance, and reinsurance premiums will be described.
  - 3.1.5 The recapture treatment of accelerated policies following a retention increase will be indicated.

- 3.1.6 If the acceleration is serial, as it usually is in nursing home confinement, when reinsurance payments are made, when and how changes are made to retention, amount of reinsurance, and reinsurance premiums will also be described.
- 3.2 For no cost accelerated death benefits the following elements are usually included:
  - 3.2.1 A statement as to whether or not the reinsurer will participate in the acceleration of benefits.
  - 3.2.2 A statement of the reinsurer's share of the accelerated death benefit.
  - 3.2.3 A statement of the maximum benefit or the maximum reinsurance benefit, if any.
  - 3.2.4 The type of acceleration will be stated, that is, as policy discount or as policy lien.
  - 3.2.5 If a discount is to be used, the discount method and interest rate will be described.
  - 3.2.6 If a lien approach is used, the lien interest rate should be stated or described.
- 3.3 The events or conditions triggering acceleration should be stated.
- 3.4 Any limitations on the ceding company's authority to accelerate benefits should be stated.

#### 4.0 Variations

- 4.1 Participation by the reinsurer in this benefit can be for all policies covered under the treaty or it can be limited to specified segments of the ceding company's business. Premium paying accelerated death benefits most commonly are limited to new issues of specified plans of insurance, although it may also be offered by a rider which may be used with virtually any plan. When a rider is employed it may also be available to inforce policies. Discounted accelerated death benefits and liens are usually made available on a broad basis to both new business and inforce policies.
- 4.2 Agreement must be reached on the maximum benefit to be accelerated and how this amount is allocated between the ceding company and the reinsurers. Methods would include allocating 100% to the ceding company first and then the excess to the reinsurers, or proportionate benefits based on amount at risk or face amount.
- 4.3 Administration charges by the ceding company to the insured may be allocated to reinsurers or kept by the ceding company.

- 4.4 A waiver of premium benefit may be available on the accelerated benefit option. This benefit could waive premiums when a regular waiver benefit would not.
- 4.5 Accidental death benefits are excluded from accelerated death benefit payments.
- 4.6 Claims handling not consistent with the claims provision in the treaty should be specified.
- 4.7 Commonly, the reinsurer's claim settlement is in the form of a lump sum. However, periodic payment settlement may be used.

## 5.0 Common Problems

- 5.1 Numerous items have to be negotiated, especially if this benefit is added to inforce policies. These include underwriting method (if any), premium rate basis, discounting method and interest rate and claim settlement methods.
- 5.2 Amounts at risk will change under any of the methods. Amounts at risk will change in successive years under the nursing home benefit. Premiums and reserves will have to be changed to reflect the changed amount at risk.
- 5.3 If premium-paying accelerated death benefits are available by rider to inforce policyholders, the base policy may be reinsured by a reinsurer other than the one reinsuring the accelerated death benefit. The benefit under the base policy and the rider are intertwined and are difficult to separate.
- 5.4 One or more reinsurers may decide not to participate in the accelerated death benefit.
- 5.5 Some accelerated death benefit limits are written on a per policy basis, and some are written on a per life basis. This must be considered when determining accelerated death benefit retention limits and distribution among reinsurers.
- 5.6 If a plan accelerates 100% of a benefit, there should be a follow up to get proof of eventual death-- especially if a reinsurer does not participate in the accelerated death benefit.
- 5.7 Risks ceded on a facultative basis, especially those where the ceding company has no risk, may require special handling at claim time. This is especially true with respect to who has the right to a final decision on claim payment.
- 5.8 An agreement must be made on who pays the accelerated death benefit claim investigation expenses.

**5.9 With no cost, discounted accelerated death benefits, the ceding company at least enjoys the benefit of a favorable public image in exchange for the risk of miscalculating the expected date of death. If the reinsurer does not share in the company's new business none of this inures to the reinsurer's benefit.**



## **Acceptance and Commencement of Reinsurance Liability**

### **1.0 Purpose**

- 1.1 This provision (in conjunction with numerous other provisions such as Basis of Agreement, Scope of Coverage, Application for Reinsurance, and Underwriting Procedures and Evidence Rules) sets out the conditions under which the reinsurer accepts liability for the reinsured portion of a life insurance policy, certificate or rider.**
- 1.2 This provision describes the timing of acceptance of risk by the reinsurer.**
- 1.3 It should be recognized that not all treaties have separate provisions explicitly addressed to the subjects of Acceptance and Commencement of Reinsurance Liability. In some treaties, the applicable provisions are included under other topics throughout the treaties.**

### **2.0 Scope**

- 2.1 Reinsurance may be accepted automatically subject to provisions set out in the treaty governing conditions or requirements such as plan of insurance, retention by the ceding company, maximum amounts in force and applied for, minimum and maximum amounts of automatic reinsurance, adherence to specified underwriting standards, source of business, residence of the proposed insured, portion of the alphabet, etc.**
- 2.2 Reinsurance may be accepted on a facultative-obligatory basis. Conditions similar to those applicable for automatic reinsurance may apply.**
- 2.3 Reinsurance may also be accepted on a facultative basis under which the reinsurer may review the application for insurance along with the underwriting evidence obtained by the ceding company. Most of the conditions applicable to automatic reinsurance do not apply.**
- 2.4 Reinsurance coverage may be affected by the existence of a Conditional Receipt, Conditional Insurance Agreement or Temporary Insurance Agreement.**
- 2.5 The reinsurer's liability normally commences simultaneously with that of the ceding company. In certain situations, however, there may be a period of time during which the ceding company is at risk but the reinsurer is not. Any such limitation should be spelled out very clearly.**
- 2.6 Resumption of liability after policy termination is addressed in a separate provision covering Reinstatements.**

**2.7** The reinsurer's liability on continuations may be covered by a separate provision. In general, the reinsurer's liability continues uninterrupted on cessions which are properly ceded as continuations of policies which were themselves properly reinsured; such continuation coverage normally would not apply automatically to increases in the amount of reinsurance resulting from the continuation.

### **3.0 General Elements**

#### **3.1 Acceptance of Risk**

**3.1.1** In the case of automatic reinsurance, the ceding company agrees to cede a certain predefined class or classes of business to the reinsurer and the reinsurer in turn extends to the ceding company an open-ended offer to accept such business automatically in accordance with the ceding company's underwriting classification up to specified limits and subject to certain treaty provisions, including those referred to in 1.1 above.

**3.1.1.1** If a risk which qualifies for automatic reinsurance has been submitted facultatively to any reinsurer (or, in some cases, to any reinsurer other than the automatic reinsurer), the open-ended offer to reinsure is considered to have terminated immediately upon such facultative submission and such a risk may not thereafter be ceded automatically.

**3.1.1.2** There is a long standing practice in the life insurance/reinsurance industry that, unless there is a specific agreement to the contrary, once a case has been submitted facultatively to any reinsurer such case cannot thereafter qualify for automatic reinsurance. There are differences of opinion in the industry as to whether this rule should apply in all circumstances (at least one reinsurer does not apply the rule at all).

Some take the position that the practice, if it applies at all, should apply on a "per application" or "per policy" basis and not on a "per risk" or "per life" basis.

There is a variety of situations in which some people question the applicability of the practice: (1) the policy applied for and submitted for facultative consideration was not taken out; (2) the original reason for seeking facultative reinsurance no longer applies (e.g., duration from a medical event such as surgery no longer requires a rating, weight reduction to within normal limits, changes in the underwriting standards of the ceding company,

increase in the ceding company's retention limits so that an amount applied for now falls within automatic reinsurance binding limits, increase in automatic or jumbo limits, etc.).

This practice does not often come into play. Nevertheless, due to the divergence of opinions as to its applicability, prospective parties to a reinsurance agreement would be well advised to discuss it during the treaty negotiations.

- 3.1.2** Facultative-obligatory reinsurance is similar to automatic reinsurance in that the reinsurer has in effect extended an open-ended offer to accept reinsurance, in accordance with the underwriting classification of the ceding company, of those risks which the ceding company chooses to submit individually to the reinsurer. The reinsurer is obliged to accept a specified amount of reinsurance on the risk, reduced by any amounts the reinsurer has retained from previously issued policies.
- 3.1.3** For facultative reinsurance, each risk is considered individually and the reinsurer may or may not extend an offer to reinsure. The reinsurer determines the underwriting classification applicable to the risk.
  - 3.1.3.1** A reinsurer may require that the ceding company obtain additional underwriting requirements (e.g., Home Office Speciman). The acceptability of the requirements may be left up to the ceding company or reserved to the reinsurer, according to the terms of the reinsurer's offer to reinsure.
  - 3.1.3.2** A reinsurer may require that the policy be issued with an endorsement or rider (e.g., Aviation Exclusion) in order for reinsurance to become effective.
  - 3.1.3.3** A reinsurer's offer may be conditioned upon the ceding company retaining a specified amount or proportion (e.g., 20% but not in excess of the ceding company's normal retention) of the risk.
  - 3.1.3.4** Facultative offers typically expire after a designated period of time such as 90 or 120 days from either the offer date or the date of the insured's last medical exam. Upon request from the ceding company, such an offer may be "kept open" or extended to give the ceding company more time to place the case.

## **3.2 Commencement of Reinsurance Liability**

**3.2.1 The reinsurer's liability normally commences simultaneously with that of the ceding company. In the case of facultative reinsurance, liability will commence only if the ceding company accepts the reinsurer's offer in accordance with all of the conditions specified therein.**

**3.2.1.1 In the case of automatic or facultative-obligatory reinsurance, it may be required that the ceding company must notify the reinsurer of the commencement of risk within a period of time such as 30 days after delivery of the policy.**

**3.2.1.2 In the case of facultative-obligatory reinsurance, the reinsurer may decline to accept reinsurance (or reduce the amount or reinsurance it will accept) if it has already retained risk on previously issued policies. Some treaties allow this "escape" from liability only if the reinsurer declines reinsurance within a specified time period (e.g., 72 hours) from the time it receives notice of having been "bound" on a risk.**

**3.2.1.3 If the amount of reinsurance on a life to be ceded automatically exceeds a specified limit, the ceding company may be required to give the reinsurer special notice in order to effect reinsurance. One reason for this is to allow the reinsurer to monitor its own records to identify any accumulation of risk on a given life and, if necessary, arrange retrocession coverage.**

**3.2.1.4 In the case of facultative reinsurance, the reinsurer's liability does not begin until all conditions associated with its offer have been satisfied and the ceding company has notified the reinsurer of its acceptance of the reinsurer's offer.**

**3.2.1.5 The treaty may set out specific steps the ceding company must take in order to accept the reinsurer's offer of facultative reinsurance. Methods for accepting such an offer vary, but might include a separate notification of acceptance of the offer or the inclusion of the policy on a reinsurance administrative report and payment of the first reinsurance premium within a certain number of days following the date the policy was placed (or the date of the facultative offer). Strict compliance with the specified method for accepting the offer may be required in order to assure that reinsurance is properly bound.**

#### **4.0 Variations**

- 4.1 A ceding company's retention is generally determined on a "per life" basis, although some treaties permit retention to be determined on a different basis such as "per policy" or "per application".**
- 4.2 A great variety of means of notification of automatic reinsurance to the**
  - 4.2.1 For larger amounts ceded automatically, and possibly for all amounts ceded facultatively, a separate notification within a very short time of issuance of a policy may be required.**
- 4.3 Many ceding companies have negotiated special agreements with their panel of reinsurers, automatic or facultative, to cover early claims, especially those incurred prior to policy delivery or before acceptance of a reinsurer's facultative offer, on a prescribed basis.**
- 4.4 Some treaties or other supplementary agreements may provide for exceptions to the "once facultative, always facultative" rule.**

#### **5.0 Common Problems**

- 5.1 The ceding company may fail to submit required notification of commencement of risk to the reinsurer.**
  - 5.1.2 In the case of facultative reinsurance, the ceding company may deliver a policy but fail to notify the facultative reinsurer of the commencement of risk by delivering a formal cession (or other required notification). In the event of death, the reinsurer may deny liability for the risk.**
- 5.2 A ceding company may choose to retain cash received with an application for insurance (CWA) but nevertheless shop the case facultatively to one or more reinsurers other than the automatic reinsurer. This may bring into play claim liabilities under a Conditional Receipt, Conditional Insurance Agreement or Temporary Insurance Agreement.**
  - 5.2.1 In the absence of a special agreement to the contrary, a facultative reinsurer will not normally consider itself to be on risk under the terms of such a Receipt or Insurance Agreement prior to the time that all conditions specified by the reinsurer have been satisfied and it has been notified of the ceding company's acceptance of its offer.**

- 5.2.2** In such a case, the automatic reinsurer will likely deny coverage in the event of an early death occurring before placement of the policy and reinsurance is effected because a normal condition for a policy to be ceded automatically is that the policy may not have been submitted for facultative reinsurance. Some companies have negotiated special arrangements with their panel of facultative reinsurers to share in such risks. Alternatively, an automatic reinsurer may agree to cover such risks prior to the time that they are placed.
- 5.3** In the case of facultative reinsurance a ceding company may fail to obtain requirements specified (or fulfill other conditions imposed) by the reinsurer on a case submitted facultatively (e.g., reinsurance requires Aviation Exclusion but ceding company delivers policy without such an Exclusion). Because such conditions or requirements are precedent to the commencement of reinsurance, the ceding company may be without reinsurance coverage on the risk.
- 5.4** Reinsurance liability may be denied if the ceding company fails to follow its normal procedures for underwriting and issuing policies.
- 5.4.1** The ceding company may fail to check its alpha index to ascertain whether it has previous insurance in force on a proposed insured and inadvertently cedes an incorrect amount of reinsurance.
- 5.4.1.1** In the case of automatic reinsurance, such an error, if occasional and not systematic, might be correctable. For facultative reinsurance, however, such an error might not be correctable without the consent of the reinsurer.
- 5.4.1.2** For those treaties which provide for "fill up" of retention, failure to check alpha index or other records may cause a ceding company to not recognize a situation where it should have "filled up" its retention as a result of the termination of a previously issued policy. In such a case, the reinsurer would normally deny liability for the amount of reinsurance which should have been recaptured to effect the "fill up".
- 5.4.2** There may be certain circumstances in which the ceding company or its representatives may act, or fail to act, in a manner which causes the reinsurer to deny reinsurance liability. An example might be where the ceding company flagrantly violates its own procedures. The treatment of such occurrences may differ for automatic or facultative reinsurance, may depend upon whether the occurrence is an isolated one or repeated, and may vary according to the proportion of the policy retained by the ceding company. Naturally, the determination of what constitutes "flagrant" behavior is subjective.

- 5.4.2.1** Improper delivery of a policy may give rise to a dispute as to whether the reinsurer is liable. For example, if the ceding company's representative delivers a policy to an applicant for insurance in clear violation of the ceding company's procedures for policy delivery, the reinsurer may reason that such an act goes so far beyond the standard of care expected of the ceding company and its agents that liability is denied.
- 5.4.2.2** Repeated administrative errors may expose the ceding company to liability to its policyholder where none otherwise would exist. Typical situations affecting reinsurance would be in the handling of reinstatements. Where systematic problems have been identified but the ceding company fails to take corrective action, the reinsurer may assert that the ceding company's failure to act to correct the problem relieves the reinsurer of any liability arising from the uncorrected problems.
- 5.4.2.3** The reinstatement of a policy facultatively reinsured without referring the case to the reinsurer for approval could result in a loss of reinsurance coverage on the reinstated policy. The practices of reinsurers vary considerably, and some treaties may not adequately address the treatment of reinstatements of reinsured policies.

## **Application for Reinsurance**

### **1.0 Purpose**

- 1.1 The provision would specify the procedure to be used by the ceding company in notifying the reinsurer of automatic or facultative obligatory reinsurance or in making a request for facultative coverage.**

### **2.0 Scope**

- 2.1 The provision would indicate what information the ceding company is to provide to the reinsurer and the form in which the information is to be conveyed.**

### **3.0 General Elements**

- 3.1 Automatic business - business which the ceding company must cede to the reinsurer and the reinsurer must accept at the ceding company's assessment; therefore notification is necessary rather than application.**

- 3.1.1 The provision would specify the information needed upon commencement of risk for a policy, such as name, date of birth, face amount, rating, etc. Usually, preprinted forms will be provided by the reinsurer, or if the ceding company is administering the business, a sample report format will be provided.**

- 3.1.2 If the ceding company sends summary reports, the frequency would be specified.**

- 3.2 Facultative business - business which the reinsurer will accept only at its own rating or which it may decline to participate in.**

- 3.2.1 The provision would specify that all papers the ceding company has with respect to the insurability of the life be forwarded to the reinsurer for its own assessment.**

- 3.2.2 The provision may specify that the reinsurer can request additional information.**

- 3.2.3 The provision would specify the method the reinsurer would use in communicating its decision to the ceding company.**

- 3.2.4 Any time limitations on facultative offers should be specified.**

- 3.3 Facultative obligatory (Fac/Ob) - business that the ceding company need not offer the reinsurer but that the reinsurer has agreed to accept under certain conditions.**



**3.3.1 Notification details would be similar to those applying to automatic business.**

#### **4.0 Variations**

**4.1 Some automatic reinsurance agreements provide for no specific policy information to be provided, but only annual statement summary information. These arrangements are often referred to as blind pools.**

**4.2 The reinsurer may have the right to request underwriting papers on automatic cases, usually after issue of the case.**

**4.3 Under some facultative arrangements, the ceding company may send underwriting papers covering only the area they want the reinsurer's opinion on, e.g. financial statements when medical situation is standard.**

#### **5.0 Common Problems**

**5.1 If automatic applications are sent via summary reports, especially if less frequently than monthly, the reinsurer may have difficulty preparing its statements in a timely manner.**

**5.2 Implicit time-frames on facultative business may not be understood.**

**5.3 Late reporting of applications can require the use of previous agreements to cover the case.**

**5.4 If partial papers are sent there may be disputes regarding other information.**

**5.5 A facultative application may be sent to the reinsurer for a product not covered by the reinsurer's treaty. This could develop if the product type changes between application and issue.**

## **Arbitration**

### **1.0 Purpose**

- 1.1 This provision stipulates that disputes which cannot be resolved through negotiation between the parties to the reinsurance agreement will be resolved through a process of arbitration rather than by a court of law.**
- 1.2 Arbitration of a dispute involving parties to a reinsurance agreement is thought to be more appropriate, easier, more flexible, faster, and less costly than court proceedings.**
  - 1.2.1 Arbitration is more appropriate than court proceedings because such disputes often involve highly specific technical issues unfamiliar to civil courts. It is believed such issues are better judged by experts in the insurance field. Additionally, arbitration works without public disclosure of confidential business interests.**
  - 1.2.2 Arbitration proceedings also grant considerable freedom in terms of procedures and admissible information. Normally the parties need not observe any particular formalities such as those found in typical court proceedings. Consideration might be given to the "rules of arbitration" as set forth by the American Arbitration Association of New York City.**

### **2.0 Scope**

- 2.1 This provision is intended to provide non-judicial resolution for any unresolved dispute arising under the terms of the reinsurance agreement. Arbitration is the traditional and accepted method of dealing with disputes; resolution through courts is not used.**

### **3.0 General Elements**

- 3.1 Initiation of proceedings - Either party to the reinsurance agreement can initiate proceedings by notifying the other party in writing of its desire to arbitrate, stating the nature of its dispute and the remedy sought. The party to whom notice is sent is often required to respond in writing within a stated timeframe.**
- 3.2 Eligibility - Qualifications for arbitrators typically are stipulated. Usually the arbitrator must be a present or former officer of a life insurance company not currently or formerly affiliated with either party to the reinsurance agreement.**
- 3.3 Selection - Often each party to the reinsurance agreement selects an arbitrator and those two arbitrators select a third. However, there is considerable variation in this process; see item 4.2. Additionally, time**

constraints are often imposed on them selection process to avoid unnecessary delay.

- 3.4 Number - Typically three arbitrators are used.
- 3.5 Arbitration hearing - Often the location and scheduling of the hearing is left to the discretion of the arbitrators, though time constraints are stated to avoid unnecessary delays.
- 3.6 Submission of facts and arguments - The provision might require that each party submit a detailed written statement of facts and arguments to the panel of arbitrators and the other party within a stated time period prior to the hearing.
- 3.7 General basis for decision - Arbitration provisions typically emphasize the gentlemen's agreement nature of the reinsurance relationship indicating that arbitrators shall base their decision on the terms and conditions of the reinsurance agreement plus, as necessary, on the customs and practices of the reinsurance and insurance industry rather than on a strict interpretation of applicable law. The arbitrators will have authority to interpret the agreement.
- 3.8 Notification - The provision should require formal written notification of the decision to all parties involved.
- 3.9 Appeal - Typically the arbitration provision indicates the decision of the arbitrators (by majority vote) is final and that there can be no appeal.
- 3.10 Expense - Usually the arbitrators are allowed to apportion the costs of arbitration as they deem appropriate.

#### 4.0 Variations

- 4.1 Eligibility - Some arbitration provisions exclude officers of the reinsurers of both parties from consideration. Other provisions exclude consultants if they were not formally an officer of an insurance company. Consultants might be considered inappropriate if it is thought they might be unable to remain unbiased. Consideration should be given to whether exclusion of certain categories of employment might narrow the field of potential arbitrators too much.

- 4.1.1 The American Arbitration Association might be considered as a source of qualified arbitrator candidates.

#### 4.2 Selection of Arbitrators

- 4.2.1 Many variations of this process exist from the simple one described in 3.3 to more complex methods involving creation of candidate lists

where opposing parties strike names in turn until final selection is made.

**4.2.2** Should either party fail to appoint an arbitrator, or should the two initial arbitrators be unable to agree on a third arbitrator, then an alternate method (such as that described in 4.2.1) could be used to complete the process. The President of the ACLI has requested that he no longer be named to appoint a third arbitrator when agreement cannot be reached. The President of the American Arbitration Association might be used for this purpose.

**4.3** Arbitration hearing - Some provisions specify the location. Often the parties seek a neutral site (the city in which either party is located might not be considered appropriate).

**4.4** Appeal - Although there is typically no appeal from the arbitrators' decision, any party to the arbitration may petition a court having jurisdiction over the parties and subject matter to reduce the arbitrators' decision to judgement.

**4.5** Expense - Some arbitration provisions specify that each party will bear its own expenses and attorneys' fees in connection with the arbitration.

## **5.0 Common Problems**

**5.1** The parties should determine whether the agreements to arbitrate are enforceable under the laws of each party's state of domicile. Some states will not enforce agreements to arbitrate because public policy in those states is thought to grant citizens of the state a right in all cases to a trial before a court. If the laws of either company's domicile do not enforce agreements to arbitrate and yet both companies want disputes to be arbitrated, they might consider one of two approaches. First, the agreement might explicitly state that it is to be interpreted by the law of a state that does support agreements to arbitrate. Thus the public policy of the problem state won't apply. Or second, if the parties are domiciled in different states, the agreement might explicitly state that any refusal to arbitrate by either party should be submitted to a federal court. Under the federal arbitration act, a federal court would then mandate arbitration.

**5.2** To avoid delays in the process, time limitations should apply to each step from the initial communication of the intent to arbitrate to the notification of the decision.

## **Basis of Agreement**

### **1.0 Purpose**

- 1.1 The provision sets out the general methodology to be used in the reinsurance agreement, e.g. YRT, coinsurance, modco, automatic or facultative.**

### **2.0 Scope**

- 2.1 The provision should cover all benefits to be reinsured and specify the mode of reinsurance for each.**

### **3.0 General Elements**

- 3.1 The provision would indicate whether reinsurance is on an "Original Terms" basis or if only mortality risk was being reinsured by the ceding company. "Original Terms" means the reinsurer shares all risks of the policy (lapse, investment, mortality) in a manner similar to the ceding company.**
- 3.2 The provision would address the reinsurer's liability for dividend payments, cash surrender values and other benefits e.g. excess interest.**

### **4.0 Variations**

- 4.1 With product unbundling the reinsurance of mortality risk only on permanent contracts, using mortality charges determined by the ceding company has become common. Some think of this as YRT (based on the ceding company's terms) and others think of it as coinsurance of the death benefit risk.**
- 4.2 All reinsured benefits need not use the same mode of reinsurance.**

### **5.0 Common Problem**

- 5.1 Differences in interpretation of reinsurance methods between YRT and coinsurance can cause Schedule S problems. Limiting coinsurance to situations where the reinsurer receives the same premium the ceding company receives (except for policy fee and modal loadings) is one approach.**

## **Claims Provisions**

### **1.0 Purpose**

- 1.1 This provision establishes the terms and conditions under which the reinsurer is liable for claims incurred under the reinsurance agreement.**
- 1.2 The provision recognizes the ceding company's authority, and specifies any restrictions on that authority, in handling its claims under the reinsurance agreement.**
- 1.3 The provision also covers the procedures the ceding company must follow in order to obtain claim recovery from the reinsurer.**
- 1.4 Additionally, this provision may establish a basis for which any extra contractual damages that may be rendered against the ceding company are to be shared between the ceding company and the reinsurer for claims incurred on policies subject to the agreement.**
- 1.5 The provision also addresses how the two parties are to share expenses of claim settlement, changes in the amount of insurance benefit due to misstatement of age and/or sex and other various matters.**

### **2.0 Scope**

- 2.1 This provision typically is intended to address issues surrounding a request for policy benefits payable by reason of the death or disability of the insured. Policy benefits available by way or exercise of any nonforfeiture provisions of a reinsured policy are normally covered under a different provision.**

### **3.0 General Elements**

- 3.1 Liability - The liability for insurance benefits reinsured under the reinsurance agreement is normally restricted to the liability of the ceding company for such benefits as limited by the terms and conditions of the particular contract under which the ceding company is liable.**
- 3.2 Notification**
  - 3.2.1 The ceding company is typically required to give the reinsurer prompt notice of any claim for benefits on a policy reinsured under the agreement. Copies of proofs or other documents bearing on such claims, along with a statement showing the amount of the claim, are normally required to be supplied to the reinsurer in support of the claim for benefits reinsured.**

- 3.2.2 The ceding company is typically obligated to notify the reinsurer promptly of its intent to contest, compromise or litigate a claim involving reinsurance.
- 3.2.3 The ceding company is also normally required to provide the reinsurer prompt notice of any legal proceedings initiated against it in response to its denial of a claim on a reinsured policy.
- 3.3 The provision normally provides for both parties to act in good faith in consideration of a claim for benefits on policies reinsured.
- 3.4 Limitations on the authority of the ceding company to settle claims - In indemnity reinsurance, the ceding company remains obligated to its policyholder and therefore has the responsibility to settle claims with the claimant. However, as the ceding company cedes a portion of each risk under the terms of the reinsurance agreement, the authority the ceding company maintains for the settlement of claims under the reinsurance agreement may be limited in various ways. Such variations are covered in item 4.2.
- 3.5 Expenses - In the event a claim for benefits is contested, compromised or litigated, the reinsurer is normally required to share the payment of specific claim expenses involved, unless it declines to participate in the denial of the claim (see item 3.11).
- 3.5.1 Typically the reinsurer participates only in unusual expenses incurred in the assertion of defenses to the policy and then only in the proportion that the reinsured benefit amount bears to the total benefit amount under the policy. Normally, routine investigation and/or administration expenses, including salaries of home office personnel and interpleader expenses, are not covered.
- 3.6 Amount - The reinsurance agreement might limit the total amount the ceding company recovers from all reinsurers on a claim to an amount that does not exceed the amount the ceding company pays the beneficiary for the claim. This would include any prepayment due to accelerated benefits. If such amount is exceeded, the agreement will provide for return of such excess to the reinsurers in proportion to their participation in the risk.
- 3.6.1 Changes in amount - Reinsurance agreements normally indicate that if the amount of insurance benefit provided the beneficiary is increased or reduced due to a misstatement of age or sex of the insured that is established after death, the reinsurer will share such increase or reduction in proportion to the relationship of the reinsurance liability to the total liability on the policy proper to the discovery. Typically the agreement will provide that adjustments of premiums for prior coverage in such cases are made without any adjustment for interest.

- 3.6.2 Contested claims -** If the ceding company's contest, compromise or litigation results in a reduction in its liability, unless the reinsurer has bailed out of the claim the reinsurer normally will share in the reduction in the proportion that the reinsurer's net liability bears to the sum of the net liability of all reinsurers on the insured's date of death.
- 3.6.3 Misrepresentation or suicide -** If a misrepresentation on an application or death by suicide results in the return of policy premiums by the ceding company rather than payment of policy benefits, the reinsurer will normally refund to the ceding company all of the reinsurance premiums paid for that policy. If a death of an insured by suicide results in payment of reduced policy benefits, the reinsurer will pay its share of the reduced policy benefits.
- 3.7 Lump sum payment -** Usually the payment of death proceeds by the reinsurer will be made in a single sum regardless of the ceding company's mode of settlement. Reinsurers normally do not participate in the ceding company's settlement options. Refer to item 5.6 for comments concerning accelerated benefits.
- 3.8 Interest -** It is normal for the reinsurer to reimburse state-required interest on its proportionate share of the ceding company's claim proceeds.
- 3.8.1** The two parties may also agree to additional interest paid by the reinsurer to the ceding company if the reinsurer's claim reimbursement is delayed beyond some defined period. The parties might tie this interest item to a similar interest item for overdue premiums under the reinsurance agreement.
- 3.9 Waiver of premium -** Under a waiver of premium benefit, the reinsurer typically requires the ceding company to continue to pay premiums for the reinsurance coverage and then returns a benefit amount as a reinsurance benefit. Such arrangements might be noted in the reinsurance agreement.
- 3.10 Refund of premium -** Reinsurers may refund any reinsurance premiums unearned as of the date of death. If such refunds are made under the reinsurance agreement, they are typically made without any adjustment for interest.
- 3.11 Bail out -** If the ceding company contests, compromises or litigates a case reinsured under the agreement and the reinsurer does not want to participate in the denial of the claim, the reinsurer may be provided the option to pay its share of the benefit to the ceding company and fix the amount of its settlement at that point. If the agreement provides this option and the reinsurer chooses to exercise it in a claim situation, the reinsurer would not participate in any adjustments to the settlement (in either direction) as a result of litigation thereafter.



- 3.12 Extra-contractual payments - Negotiation of acceptable reinsurance agreement language for this item can prove to be a challenge. Reinsurers agree to indemnify ceding companies for the economic losses which flow from the issuance of a reinsured policy. Thus, extra-contractual damages are outside the basic contractual liability of the reinsurer. Any discussion regarding extra-contractual damages are qualifications of this basic position.**
- 3.12.1 Some reinsurers prefer not to address the issue of extra-contractual payments in the agreement. In order to avoid problem situations later, the parties should discuss the matter and mutually agree whether silence implies that the reinsurer will or will not participate in extra-contractual payments. Other carriers consider silence in the agreement about this issue to be very dangerous and prefer to clearly establish the intent of the parties one way or the other in the written document.**
- 3.12.2 There are a number of kinds of extra contractual payments: the ceding company might gratuitously pay amounts which it is not obligated to pay by the terms of the reinsured policy ("ex gratia payments"); the ceding company might be obligated to pay damages which flow directly from the claim denial ("compensatory damages"); or the ceding company might be obligated to pay damages because of its intentional or negligent conduct ("punitive or exemplary damages").**
- 3.12.3 Most reinsurers decline to participate in ex gratia payments, while many, though not all, are willing to pay their proportionate share of compensatory damages. The most difficult area of negotiation typically centers on the issue of whether the reinsurer will participate in punitive or exemplary damages.**
- 3.12.4 Some reinsurers explicitly state they will have no liability for any punitive or exemplary damages assessed against the ceding company as a result of a claim based on alleged or actual bad faith, failure to exercise good faith or tortious conduct. Expenses incurred in connection with claims for punitive or exemplary damages are also excluded.**
- 3.12.5 There are two ways of thinking about how, as an exception to the general rule in 3.12.4, a reinsurer might participate in punitive or exemplary damages. First, a ceding company might request a reinsurer to provide insurance on the risk that the ceding company might be obligated to pay punitive or exemplary damages. The coverage in this instance is more akin to insurance than to reinsurance (since to be reinsurance the initial loss had to be incurred in connection with a policy benefit), and is more of a casualty benefit than a life benefit (since the insured event is tied to the malfeasance of the ceding company and not to a mortality or**

morbidity risk). It could be that a separate premium is required for this type of coverage.

- 3.12.6** Second, a company might request the reinsurer to bear responsibility for the consequences of the reinsurer's involvement in the actions which give rise to any punitive or exemplary damages assessed against the ceding insurer. Thus, some reinsurers state that while they are not liable for punitive or exemplary damages as stated in 3.12.4., there may be special circumstances involved which could indicate the reinsurer should participate in punitive or exemplary damages and related expenses, and further state that such circumstances are difficult to define in advance, but are generally cases where the reinsurer was an active participant in the act, omission or course of conduct that ultimately resulted in the assessment of the punitive or exemplary damages. The provision might also indicate the division of such damages and expenses. Such division might vary in proportion to the benefit liability of each party or an assessment of each party's role in the particular case.
- 3.12.7** It is important to note that the wording of the provision dealing with punitive or exemplary damages should reflect the amount of freedom, or lack thereof, that the ceding company has to settle reinsured claims without being bound by the reinsurer's involvement. It is also important to note that a distinction can be made between extra-contractual damages which flow solely from the decision to deny a claim and such damages that flow from execution of that denial. While ceding companies and reinsurers may limit the amount of freedom that the ceding company has to deny a claim without reinsurer involvement, typically execution of the decision to deny is within the ceding company's freedom. Therefore, if punitive damages are assessed against a ceding company due to its execution of a denial of a claim, even reinsurers that included wording in 3.12.6 will not share in such punitive damages.
- 3.12.8** It is also important to note that if the reinsurer does agree to participate in punitive or exemplary damages as set forth in 3.12.6 above, its participation is probably limited to "claims-related" punitive or exemplary damages. If punitive or exemplary damages are assessed against the ceding company in connection with other aspects of the reinsured policy (for example, with respect to problems surrounding the underwriting, issue or administration of the policy), the reinsurer will not participate in these damages because it was not an active party in any of these acts.

#### **4.0 Variations**

- 4.1** Notification (3.2) - For a contestable case and/or upon request of the reinsurer, the complete underwriting file might be supplied to the reinsurer in support of a claim for benefits.

## **4.2 Limitations on the authority of the ceding company to settle claims (3.4) -**

**4.2.1 Noncontestable vs. contestable claims - Variation in the limitations on the authority of the ceding company to settle claims may extend from virtually unrestricted authority on noncontestable claims to severely restricted authority on contestable claims, or anywhere in between. Restrictions of authority may involve the ceding company having to obtain one or more of the following from the reinsurer before it is allowed to settle a claim for benefits under a reinsured policy:**

- opinion**
- concurrence**
- advice/consultation**
- recommendation**
- approval**
- direction**

**Note, the degree of the ceding company's obligation to the reinsurer before settlement is permitted has a direct bearing on the wording that will be acceptable to both parties in the area of extra-contractual damages - the greater the degree of control by the reinsurer, the more the wording might reflect reinsurer participation in such damages.**

**4.2.2 If a reinsurer specifies that the ceding company obtain some form of reply from the reinsurer before settlement of a claim, a time restriction might be imposed on the reinsurer for delivery of the reply. Should the reinsurer not respond within the allowed timeframe, the reinsurance agreement might indicate the ceding company is then allowed to assume the reinsurer has no objection to the ceding company's contest or settlement of the reinsured claim.**

**4.2.3 Amount of coverage - Variation in the authority of the ceding company to settle claims might also depend on the amount of benefits at issue, either in absolute dollar terms (i.e., cases exceeding \$x of total benefit) or in the relative portions of benefits retained and reinsured (i.e., if the amount of retained benefit is less than the amount reinsured). The reinsurer might be particularly concerned about a case where the ceding company has no retention. Variation in such authority might also depend upon whether the case has been ceded on an automatic or facultative**

basis originally.

- 4.3 Lump Sum payment (3.7) - Although the reinsurer typically settles claims paid by reason of death in a single sum regardless of the mode of settlement the ceding company uses with the beneficiary, payments required due to the disability of the insured are typically paid by the reinsurer on an agreed-upon periodic basis.
  - 4.3.1 Payments - If the frequency of claims on a block of reinsurance is large, it might be practical to settle claims on a batch basis rather than individually. Such a variation should be defined in the reinsurance agreement.
  - 4.3.2 Interest for payment delays of the reinsurer to the ceding company on lump sum death proceeds might be made at rates other than those payable by the ceding company to the beneficiary. The two parties must negotiate a rate agreeable to the situation.
- 4.4 Offset provisions - some companies prefer to include a reference to an offset provision in the article covering claims. Other companies prefer any such reference in a separate article. Still other companies prefer no such reference at all. The parties should negotiate to establish their position and document it in the treaty appropriately.

## 5.0 Common Problems

- 5.1 For a variety of reasons, the ceding company may not want to investigate a claim as thoroughly as the reinsurer considers appropriate. In the most difficult case, the ceding company might wish to pay a claim that the reinsurer thinks ought to be denied by the ceding company.
- 5.2 A ceding company and the reinsurer may not have reviewed certain issues of claim philosophy at the outset. For example, if the ceding company typically adjusts the death benefit in cases where a smoker has lied to secure coverage at more favorable nonsmoker premium rates and the reinsurer's position is to deny such claims, controversy is likely to develop.
- 5.3 The reinsurance agreement may require the ceding company to act in good faith in settling any claim or suit. Often the determination of what constitutes good faith is ambiguous which can lead to disagreement between the two parties when attempting to resolve a large and/or difficult claim. The parties might well be advised to consider the question of what constitutes acting in good faith and what constitutes acting without good faith for claim settlement purposes while they are in the process of negotiating the reinsurance agreement.
- 5.4 Companies might attempt to anticipate problems associated with inclusion of the provision referred to in 3.12.6 of this checklist. Rather than define those circumstances which will obligate the reinsurer to participate in

punitive or exemplary damages, the provision leaves the matter open to future determination. Also, the term "active party" is not defined. As pointed out in 4.2.1 of this checklist, the relationship between the ceding company and the reinsurer may vary quite significantly. Both parties are advised to agree in advance upon the circumstances which will impose the status of "active party" upon the reinsurer.

- 5.5 There is not complete acceptance of the distinction contained in 3.12.7 between extra-contractual damages that flow from the decision to deny a claim and those that flow from the execution of that denial. The parties are advised to be aware of a potential for disagreement on this issue.
- 5.6 Another issue that might be prudent to address during the process of negotiation of the reinsurance agreement is the issue of accelerated benefits. Although the ceding company may not now accelerate benefits on any reinsured policies, it is possible the ceding company might want to change its position at some future point. The two parties are advised to establish a dialogue on this issue before it arises as it may require a modification to agreement language.
- 5.7 The parties should address how to coordinate claims activities effectively if there is more than one reinsurer involved. Failure to effectively anticipate this issue can lead to difficult circumstances on individual claim situations.
- 5.8 The ceding company should consider whether inclusion of a bail out provision, discussed in 3.11 above, will cause it problems if it disputes a claim after its reinsurer has bailed out. If a reinsurer pays its share of a claim but the ceding company continues to defend the claim, the claimant may discover that the reinsurer has bailed out and try to use that fact against the ceding company.
- 5.9 The checklist above has addressed issues that arise on claims of single life plans. Special wording may be required to properly handle joint life and/or second-to-die plans. For example, such plans may require unique wording to handle such items as simultaneous death, jump in cash values on the first death or the important issue about notification of the reinsurer upon the first death.

## **Continuations**

### **1.0 Purpose**

- 1.1** The purpose of this provision is to define the rights and obligations of the ceding company and the reinsurer when a continuation occurs.

### **2.0 Scope**

- 2.1** A "continuation" can be broadly defined as either:
- a)** a new policy replacing a policy issued earlier that differs from a new policy issued to a newly insured life in at least one of the following characteristics: the company's new business underwriting requirements, full first year commissions, a new suicide period, and a new contestable period; or
  - b)** an inforce policy whose provisions have been significantly modified.
- 2.2** For treaty purposes, "continuation" should be more precisely defined. It can be defined by its characteristics (see 2.1 above), by the specific situations comprising it (see 2.3 through 2.7 below), or by some combination of the two. Alternatively, the treaty may not use the term "continuation" at all. Instead, it could simply deal separately with specific characteristics or situations.
- 2.3** External replacements are not continuations because the same issuing company is not involved.
- 2.4** Internal replacements and policy exchanges are generally considered continuations, except when all of the new business characteristics listed in 2.1 are present.
- 2.5** Reinstatements are not continuations, because the policy is essentially unmodified.
- 2.6** Reduced paid-up, extended term, and decreases generally are not continuations.
- 2.7** Term conversions, re-entries and contractually permitted increases generally qualify as continuations. Because of additional reinsurance considerations, however, they are often covered under their own separate provisions in the reinsurance treaty. As such, if they are discussed as separate provisions in a reinsurance treaty, the treaty language should
- a)** explicitly exclude them from the continuations provision, or

- b) be written to avoid any contradiction or confusion between these provisions and the continuation provision.
- 2.8 Within the scope of continuations as defined above, the treatment set forth in the reinsurance treaty may vary according to the following factors:
- a) Whether the continuation was initiated by the ceding company (e.g. replacement program) or an individual request initiated by the policyholder or agent.
  - b) Whether the change was contractual or noncontractual.
  - c) Whether the continuation is on the same plan type as the original policy or on a new plan type.
  - d) To what extent the new policy characteristics in 2.1 are present.
- 2.9 One of the characteristics of a continuation is the "concurrent" termination of the original policy. It may be advisable to define this more precisely in the treaty language. One approach is to use whatever period of time the ceding company uses to define internal replacements - for example, termination within six months in either direction of the new policy issue date. The ability of the ceding company to administer must be considered.

### 3.0 General Elements

- 3.1 Most treaties contain a statement that when a continuation occurs the policy will continue to be reinsured by the same reinsurer.
- 3.1.1. This statement is usually included as an obligation upon both the ceding company and the reinsurer. The ceding company, for example, is not allowed to take advantage of the continuation by seeking lower rates from a new reinsurer. Similarly, the reinsurer may not cease coverage on the continued lives, just because it may believe that the risks have deteriorated.
  - 3.1.2. Because of the dual purpose described in 3.1.1., the treaty may use two separate statements instead of one.
  - 3.1.3. The treaty may specify that this statement is applicable even when a new policy is on a new plan which is not listed in the schedule of plans covered.
  - 3.1.4. The treaty may specify that this statement does not detract from or modify the various rights and obligations of the two parties contained in other provisions of the treaty. For example, the rights of the ceding company to recapture after a specified duration are not impaired. Duration in this example would be based on the

original issue date, not the date that the continuation occurred. (If a new first year allowance was paid, then duration may be measured from the date of the new policy.)

- 3.2 The treaty may state that when the reinsured portion of an insured risk is shared by more than one reinsurer, the percentage allocations will remain unchanged when a continuation occurs. It is important, in the case of multiple reinsurers, that all treaties handle continuations in a consistent manner.
- 3.3 The treaty may state that the reinsurer shall refund all unearned premiums, not including policy fees, and less applicable allowances, arising from the continuation.
- 3.4 The treaty should specify the reinsurance premiums applicable to continuations.
  - 3.4.1. Generally, the new reinsurance premiums will be based on the treaty's current YRT or coinsurance schedule for either the original or the new plan, with point-in-scale discounts or allowances using the original issue age.
  - 3.4.2. If the original reinsurer is reinsuring all of the newly issued policies on a new plan (i.e., in addition to the continuations with this new plan), then the reinsurance premium on the continuations will be based on the newly priced allowances or discounts, but using original age point-in-scale. Alternatively, the reinsurer may charge a single premium and treat the replacement policy as a new issue for purposes of determining premium allowances.
  - 3.4.3. The new reinsurance premiums may be modified to reflect the degree of new evidence required or new commissions payable.
- 3.5 The treaty may state that the ceding company's retention limit applicable to the continued policy is that applicable to the original policy just prior to the continuation.

#### 4.0 Variations

- 4.1 The elements listed above may not always make sense in a particular continuation situation. If such situations are anticipated when the treaty is written, the standard provisions can be modified to reflect them.
- 4.2 Alternatively, the treaty may contain general language to serve as guidelines for making exceptions to the standard continuation provisions. For example, the treaty may provide for repricing when a substantial volume of continuations occur in a significantly changed pricing environment.



- 4.3 The treaty may contain a statement that the reinsurer is unwilling to provide reinsurance on a continuation, where the original policy is reinsured by another reinsurer, unless the other reinsurer provides a written release.

## 5.0 Common Problems

- 5.1 One common problem is when there are a large number of continuations and the original pricing assumptions are deemed to be inappropriate. See 4.1 and 4.2.
- 5.2 Sometimes the continuation involves a risk classification that does not exist on the original policy. In this case, it may be necessary to develop updated YRT rates.
- 5.2.1 An example would be a nondifferentiated policy being rewritten to a nonsmoker policy, where the existing reinsurance treaty does not distinguish between smokers and nonsmokers.
- 5.2.2 Another example would be a new policy on a joint life basis where the original policy was on a single life plan.
- 5.3 The new policy may be on a plan not covered by the original reinsurer. For administrative reasons, it may be impractical to continue coverage. One solution is to have the reinsurer provide a written release allowing the ceding company to reinsure the continuation with a different reinsurer, presumably the one reinsuring the new business on the new plan.
- 5.4 The ceding company may undertake exchange programs with inadequate attention to reinsurance implications. For example, the exchange program needs to take into account issues such as corporate retention and facultatively reinsured business.
- 5.5 The ceding company does not have adequate capability for identifying and administering continuations.
- 5.6 The new policy may be issued by an affiliate of the ceding company. The ceding company and reinsurer may view continuations differently in this situation.

## **Conversions**

### **1.0 Purpose**

- 1.1 To define how reinsurance is to be handled after a reinsured policy is converted to another policy form.**

### **2.0 Scope**

- 2.1 Applies to situations where a new policy on a new policy form is issued without current evidence of insurability on the basis of a contractual right of conversion in a previously issued policy. Usually the original policy is a term policy permitting conversion to a permanent plan of insurance. Sometimes term to term conversions are permitted.**

### **3.0 General Elements**

- 3.1 The provision should indicate whether the reinsurance coverage is to be continued or terminated following the conversion of a reinsured policy. Normally continuation of coverage is mandated.**
- 3.2 The provision should indicate what the reinsurance mode and premium basis will be for the new policy.**
- 3.3 The recapture period for the conversion policy may be stipulated, usually stating that the recapture terms of the original policy will govern and that duration will be measured from the effective date of the original policy.**

### **4.0 Variations**

- 4.1 The reinsurer normally desires the continuation of the reinsurance on conversions and will stipulate this as a requirement in the treaty. Normally this suits the needs and interests of the ceding company as well. However, in some situations the ceding company may prefer to cancel the reinsurance when conversions occur, such as when the original policy is reinsured on a quota share rather than an excess of retention basis. The reinsurer might accommodate the ceding company in such a situation and permit the termination of the reinsurance by factoring conversions into its termination assumption when pricing the reinsurance on the original policy form. When this is the intended approach, the right of termination should be specified in the treaty.**
- 4.2 If the reinsurance on policies reinsured on a quota share basis is to be terminated on conversion, provision usually is nonetheless made to continue reinsurance coverage with the original reinsurer for the portion of the insurance that would exceed the ceding company's normal retention.**

In such an instance, the retention in effect at the issuance of the policy for the insured's age and rating at that date is usually used. Rarely a reinsurer might agree to use the current retention or current age and rating.

4.3 When reinsurance is continued, if the conversion policy, (i.e. the new policy) is issued on a policy form that is coinsured by the original reinsurer, the reinsurance is normally continued under a coinsurance mode employing the terms applicable to that policy form. Usually point-in-scale allowances are applied measuring duration from the effective date of the original policy.

4.4 When reinsurance is continued, if the conversion policy is issued on a policy form that is not coinsured by the original reinsurer, the reinsurance is normally continued under a YRT mode using point-in-scale rates with duration measured from the effective date of the original policy. If the original policy had been reinsured under a YRT mode, the conversion policy normally employs the same YRT premium schedule. If the original policy had been coinsured, the treaty may not specify the YRT schedule to be used, especially if a steady flow of conversions is not anticipated. Normally the reinsurer will expect to use a YRT scale that was in use at the time the original policy was issued to provide the closest "equivalency" or pricing possible. If the ceding company has reinsured any of its other business on a YRT basis, the reinsurer may agree to use the rates in place for that business for mutual convenience.

## 5.0 Common Problems

5.1 When a policy reinsured by one reinsurer is converted to a policy form reinsured with another reinsurer, the ceding company and the original reinsurer experience a divergence of interests. The reinsurer feels entitled to the preservation of its interest in the original reinsured policy, i.e. the continuation of its reinsurance. The ceding company, on the other hand, may be reinsuring the new policy form with another reinsurer because that reinsurer is providing more attractive financial terms than the original reinsurer was prepared to offer. Under these circumstances, it is only natural for the ceding company to prefer to transfer the reinsurance to the new reinsurer. Nonetheless, it has become almost universally accepted that, due to the reinsurer's obligations to continue reinsurance coverage on the non-converting policies, no matter what the experience is, the ceding company is also obligated to continue the reinsurance on the converted policies with the original reinsurer. To make this resolution more palatable to the ceding company, the original reinsurer may agree to provide the same terms as the new reinsurer, or its own coinsurance terms, or attractive YRT rates. It might also agree to recapture subject to a fee or even waive its rights to the continuation, especially if conversions are expected to be infrequent.

- 5.2** The absence of specific preagreed upon terms for the handling of conversions may lead to significant difficulties when the need for terms materializes.
- 5.3** When entering into the original reinsurance agreement, both parties might feel conversions will be infrequent and therefore relatively unimportant. If the ceding company subsequently adopts a policy of promoting conversions, the previously agreed to treatment of the conversions can become inappropriate.

## **Currency**

### **1.0 Purpose**

- 1.1 The intent of this provision is to stipulate the monetary basis for financial transactions and balances in reinsurance treaties.**
- 1.2 Most, but not all, treaties governing Ordinary Life reinsurance have a currency provision.**

### **2.0 Scope**

- 2.1 This provision is applicable to any reinsurance treaty, but especially appropriate if the ceding company and the reinsurer are domiciled in different countries, or if the ceding company is active in foreign markets.**

### **3.0 General Elements**

- 3.1 Usually, just a simple statement of the currency to be used for all financial transactions under the treaty is included.**

### **4.0 Variations**

- 4.1 Usually the currency used is the one employed in the original policy.**
- 4.2 If a currency other than the one of the original policy is to be used, a conversion method should be specified:—**
- 4.3 All variations should specify that premiums, claims and liabilities should be in the same currency.**

### **5.0 Common Problems**

- 5.1 Ledger accounts should be established to keep currencies separated.**
- 5.2 Bank accounts should also keep currencies separated.**
- 5.3 Reinsurance billings should distinguish the currency bases.**
- 5.4 If a currency other than that used in the original policy is used, a currency exchange rate fluctuation risk is introduced.**

## Definitions

**Assumption Reinsurance:** The form of reinsurance under which the reinsurer steps into the shoes of the ceding company, the original insurer, and directly assumes all the service and financial obligations of the original insurer on the block of business being assumed. Unlike indemnity reinsurance (q.v.), assumption reinsurance makes the assuming company (reinsurer) directly liable to the policyholders. After the assumption, the reinsured business no longer appears on the books of the original insurer. In some instances, the original insurer may continue to administer and service the business but, if it does so, it does it as the agent of the reinsurer.

It is often used when the original insurer wishes to exit a line of business or market. It is sometimes used at the direction of insurance regulatory authorities, to safeguard the interest of policyholders when an original insurer becomes financially impaired or otherwise unable to perform.

**Automatic Reinsurance:** Reinsurance that is ceded in accordance with an automatic reinsurance agreement or treaty under which the original insurer agrees to cede and the reinsurer agrees to accept a predetermined class of business, such as insurance issued on a particular plan. The reinsurance is ceded on the underwriting judgement of the ceding company without a case by case concurrence of the reinsurer, up to a specified amount, the automatic limit. The ceding company normally is required to keep its full stipulated retention for the class of business involved on any case ceded automatically. Often certain defined types of cases are not eligible for automatic treatment. Cases in excess of the automatic limits or otherwise ineligible for automatic cover can usually be submitted for facultative consideration (q.v.).

**Bordereau Reinsurance:** A form of reinsurance administration, without the use of individual policy documents, in which the ceding company provides the reinsurer with details of each life reinsured in list format, either on paper or by electronic medium. Summary information, possibly including reserves, may be included.

**Bulk Reinsurance:** A form of reinsurance administration under which only summary information, without any individual data, is provided to the reinsurer by the ceding company.

**Catastrophe Reinsurance:** It is a form of non proportional reinsurance offering the ceding company protection against excess losses from multiple claims arising out of a single event. Typically reinsurance benefits will be paid if at least a specified minimum number of claims exceeding a minimum threshold amount of benefits arises out of a single event. When these conditions are met, the ceding company is reimbursed for a percentage (often 100%) of the claims over the threshold attachment point up to the maximum reinsurance benefit specified in the treaty.

It is a form of reinsurance commonly used in the Group Insurance field and other areas where there might be a known or unknown concentration of risks.

**Ceding Company:** An insurance company that secures reinsurance protection from another insurer, a reinsurer, (q.v.) against some or all of the risks it has assumed under a policy or policies it has issued or reinsured.

**Entire Agreement Provision:** A concept introduced into the NAIC Model Regulation adopted October, 1992, governing Life and Health Reinsurance Agreements. The Model Regulation requires that all coinsurance and modified coinsurance treaties contain provisions which provide that:

- (1) 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
- (2) Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.

**Facultative Reinsurance:** The word "facultative" means optional. When it is used to describe reinsurance, it refers to reinsurance that is optional for both parties: The ceding company has no obligation to cede the business to the reinsurer and the reinsurer has no obligation to accept it. Thus it is reinsurance that the ceding company chooses to submit to a reinsurer for its consideration and which may be ceded to the reinsurer only if the reinsurer makes an offer to reinsure. The underwriting classification assigned to the risk is determined by the reinsurer. Facultative reinsurance may be ceded under the facultative terms of an automatic treaty for risks that the ceding company cannot or does not wish to cede automatically, or it may be ceded under a purely facultative treaty.

When a case is submitted to one or more reinsurers for facultative consideration, any automatic coverage the case may have been eligible for normally is considered terminated. If a facultative application is submitted to more than one reinsurer, the facultative reinsurance coverage does not commence until the ceding company has accepted an offer made by one of the reinsurers.

**Facultative/Obligatory Reinsurance:** A form of reinsurance that shares aspects of both facultative and automatic reinsurance. As with facultative reinsurance, the ceding company has no obligation to offer specific cases to the reinsurer. However, once a case is offered to the facultative/obligatory reinsurer, the case is treated largely as if it were automatic. The reinsurer receives no underwriting information and is offered the case at the ceding company's rating with the option to accept or reject the case. While not always stated in the treaty, it is usually understood that the case will be rejected by the reinsurer only if the reinsurer does not have available capacity (i.e. its own retention and automatic retrocession facilities).

This form of reinsurance is more commonly used among reinsurers in placing retrocession on large cases.

**Indemnity Reinsurance:** The form of reinsurance under which the ceding company secures reinsurance as a partial or total offset on the risks assumed on policies it has issued or reinsured. Under indemnity reinsurance the reinsurer has no relationship with the original policyholders; the ceding company continues to administer and service the insurance on which it has secured reinsurance and remains fully responsible for all the interests of the policyholders. If the reinsurer can not or does not honor its obligations to the ceding company, the ceding company would still be fully liable to its policyholders.

Indemnity reinsurance may be employed, not only between a direct writing company and a reinsurer, but also between two reinsurers when retrocession of risks is being implemented. In such instances, the same principles apply: the retrocessionaire has no relationship with the original issuing company, the direct writer; the original issuing company has no recourse to the retrocessionaire but only to the reinsurer to whom the original issuing company had ceded its reinsurance.

Also see Assumption Reinsurance.

**Jumbo Limit:** A limitation on the ceding company's authority to cede specific cases on an automatic basis. If the amount of insurance currently being applied for with the ceding company and all other companies, together with the amount of insurance in force with all companies, exceeds the jumbo limit specified in the automatic treaty, the case may not be ceded automatically. Generally, whether explicitly stated in the treaty or not, amounts of inforce insurance to be replaced are included in the jumbo limit determination.

Reinsurers employ a jumbo limit for two reasons. First, they recognize that their own automatic capacity on a case may already be filled from other clients on a life with a large amount of inforce insurance. Secondly, they often feel the underwriting demands of cases with large lines of inforce and applied for insurance are subtle and difficult. Having considerable experience in the large amount market, reinsurers often wish to share in the underwriting evaluation of these cases.

Jumbo limits are sometimes overlooked by the ceding company's underwriters. Where this occurs, the validity of the reinsurance is in jeopardy at claim time.

**Loss Carryforward:** Under reinsurance arrangements subject to experience refunds, negative results in one year may be carried forward as a negative element in the refund calculation of subsequent years. Sometimes the losses may be carried forward indefinitely until amortized by subsequent positive results; often there are restrictions on the period for which losses are carried forward.

**Mode of Reinsurance:** This refers to the structure of the reinsurance arrangements, that is, whether it be Risk Premium (Yearly Renewable Term (q.v.), Monthly Renewable Term), Coinsurance (q.v.) or Modified Coinsurance reinsurance (q.v.). It may also be referred to as method or type of reinsurance.



**Yearly Renewable Term (YRT):** Also referred to as Risk Premium Reinsurance, it is a form of reinsurance where only the mortality risk is transferred to the reinsurer. The amount of reinsurance, which may change annually, is the reinsured portion of the risk amount (q.v), normally the death benefit less the accumulated policy value (usually the cash value or terminal reserve). Under level term policies with no cash values, the terminal reserves are usually ignored, producing a level reinsured risk amount. The reinsurance premium is a one year term rate taken from a table of rates included in the treaty. The rates are normally developed by the reinsurer and are independent of, but usually compatible with, the premium the ceding company charges its insured.

With the advent of monthly cycle unbundled policies, such as Universal Life, a monthly version of YRT has come into use. The reinsured risk amount is normally calculated monthly and the reinsurance premium is usually the mortality charge, the monthly Cost of Insurance, the ceding company charges its own insured, less a discount or expense allowance. These monthly premiums are sometimes paid quarterly.

For administrative convenience the reinsured risk amount may remain fixed for a period of time, or vary according to a predefined formula, rather than directly reflecting the precise change in risk amount.

**Coinsurance:** This is the broadest form of reinsurance under which all risks, on the reinsured portion of the policy, are transferred to the reinsurer. The reinsurer is liable not only for the death benefit but also all the nonforfeiture values. The reinsurer receives its proportionate share of the ceding company's gross premium less a coinsurance allowance for commissions and other expenses. The reinsurer holds the reserve on its portion of the policy and retains any excess investment earnings.

**Modified Coinsurance:** This differs from coinsurance (q.v.) only in that the ceding company retains the policy reserves rather than having the reinsurer accumulate them. Periodically an adjustment is made to the mean reserve on deposit with the ceding company. This is usually done at year end but may be done more frequently. If the reserve increases, the increase in mean reserve less a year's interest on the mean reserve held at the end of the previous year is paid by the reinsurer to the ceding company. If the mean reserve decreases, the decrease and interest are paid by the ceding company to the reinsurer. The appropriate interest rate is defined in the treaty.

**Nonproportional Reinsurance:** Reinsurance that is not secured on individual lives for specific individual amounts of reinsurance but rather reinsurance that protects the ceding company's overall mortality experience on its entire portfolio of business, or at least a broad segment of it. The most common forms of nonproportional reinsurance are stop-loss reinsurance (q.v.) and catastrophe reinsurance (q.v.).

Nonproportional reinsurance is a form of casualty insurance. Usually neither the premium nor continuance of coverage is guaranteed beyond a specified term. (cf. Proportional Reinsurance).

**Oversights:** It is typical for reinsurance treaties to provide that any unintentional errors discovered in any reinsurance transaction, or omission of a transaction, will be corrected and both parties will be restored to the position they would have been in had the error or omission not occurred. Often the errors or omissions to be routinely rectified are limited to "clerical" ones. Errors of judgement are not accorded this protection.

The provision goes to the heart of the confidence and trust the two parties place in one another under a reinsurance agreement. It is, however, not intended to be a completely absolute protection to the parties. Repeated errors or those suggesting lack of diligence or good will would still invite challenge. Any delay in correcting an error immediately upon discovery could also compromise the protection this provision accords the erring party.

**Policy Fee:** In developing YRT reinsurance premium scales, reinsurers often added a policy fee (sometimes called a cession fee) payable to the reinsurer to reflect part or all of their expense loading, thereby making the rates more attractive to companies ceding larger units of reinsurance. With most reinsurance being ceded today on a self administered basis, the practice has diminished in frequency and importance.

YRT policy fees are usually fully earned when due; no portion of the policy fee is refunded to the ceding company if the reinsurance is terminated before the end of the policy year.

Under coinsurance and modified coinsurance, policy fees charged the insured by the ceding company are normally fully retained by the ceding company to offset ceding company expenses.

**Proportional Reinsurance:** Reinsurance on a particular life for a specified amount generally, though not necessarily, secured at the time the policy is issued to the insured. The continuation of coverage guarantees for the reinsurance generally parallel those in the life insurance coverage reinsured. Most life reinsurance conducted in the United States is done so on a proportional basis. (cf. Nonproportional Reinsurance).

**Quota Share:** An approach to allocating liability on reinsured policies between the ceding company and the reinsurer, where both the ceding company and the reinsurer have fixed percentage shares from the first dollar of liability on a policy. This differs from an excess of retention approach to allocating liabilities, where the ceding company first retains for its liability a specified dollar amount, its retention, and only reinsures any excess over this retention amount. Thus, under a 50/50 quota share arrangement, the

ceding company would retain 50% of each issue and reinsure 50%. If the issue amounts could be high enough for the ceding company's 50% share to exceed its normal maximum retention, provision is usually made for the ceding company's actual dollar retention to be limited to its normal published maximum retention.

Quota share reinsurance is a method of involving the reinsurer in every policy issued. The usual motivation is conservation of surplus. It might also be desirable for the ceding company when issuing an experimental product or might be required by the reinsurer to get a better spread of risk in special programs. It is sometimes used when the reinsurer developed the product or otherwise contributed something extraordinary to marketing or sustaining the product.

The quota share concept is often coupled with an excess of retention approach for allocating reinsurance shares to multiple reinsurers. Under a quota share excess of retention arrangement, the ceding company would first keep its retention and then allocate quota shares of the excess to several reinsurers. This approach treats the automatic reinsurance account as a pool with each automatic reinsurer getting its quota share of the automatic pool.

This method gives the ceding company better control over the actual allocation of reinsurance to various reinsurers than an alphabetic split of the account might do. For the reinsurers, it gives a better spread of risk.

**Recapture:** Reinsurance treaties often provide that if a ceding company increases its retention, the ceding company can, under previously agreed to terms, take back (recapture) amounts of insurance previously ceded to fill up its new retention.

The basic conditions under which a company may recapture usually are: 1) ceding company must have kept its then maximum (non-zero) permissible retention when it ceded the reinsurance; 2) the reinsurance has been in force for a sufficient period for the reinsurer to recover its investment in the cession and perhaps even realize some profit (the minimum recapture period will be stated in the treaty); and 3) all eligible policies are being recaptured. Other conditions may also be set.

**Reinsurer:** An insurance company to which another insurance company can transfer, through the mechanism of reinsurance, part or all of its risks under a policy or policies it has issued or reinsured. If the transfer of risk is secured through indemnity reinsurance (q.v.), the reinsurer becomes liable to the ceding company (q.v.), for the reinsured benefits while the original insurer, the ceding company, remains fully liable to its insured policyholders. If the transfer of risk is secured through assumption reinsurance (q.v.), the original insurer steps out of the picture and transfers all of its liabilities and responsibilities to the reinsurer who then is henceforth directly responsible to the original policyholders.

#### **Types of Reinsurers:**

A prime consideration for a ceding company is the recognition that will be accorded to a

reinsurance arrangement by state insurance authorities, that is, whether the ceding company will be permitted to take an offsetting credit for the reinsurance against the ceding company's financial statement liabilities. With respect to this question, reinsurers may be classified as follows. It should be noted that the same reinsurer may be classified differently by the different states in which the ceding company operates.

**Note:** It should be noted that the terms authorized, accredited, licensed, admitted, and accepted reinsurer are sometimes used interchangeably without much distinction.

**Authorized Reinsurer:** A reinsurer which is licensed in the ceding company's state of operation in question. When a company reinsures with an authorized reinsurer, full credit is routinely granted by insurance authorities on the ceding company's financial statements for reserves held by the reinsurer on the business ceded and amounts recoverable under the reinsurance treaty.

**Accredited Reinsurer:** A reinsurer which is not licensed in the ceding company's state of operation in question may be or become accredited in that state. Accreditation procedures and standards vary by state but usually require the reinsurer to show four things: 1) its financial condition meets the standards applied by the ceding company's state to like insurers; 2) it is licensed in at least one state of the United States to transact insurance or reinsurance; 3) it has submitted to that state's jurisdiction and allows its books and records to be examined; and 4) that its directors and management personnel are of acceptable character and experience. Once a reinsurer is accredited by the ceding company's state of operation, that state will normally give full credit to the ceding company for reserves held by the reinsurer on the business ceded and amounts the ceding company shows as recoverable under the reinsurance agreement.

In addition, the NAIC Model Law on Credit for Reinsurance allows credit for reinsurance ceded to a reinsurer which is domiciled and licensed in a state which employs standards regarding credit for reinsurance substantially similar to those applicable under the ceding company's state of operation in question provided the reinsurer maintains at least \$20 million of surplus and submits to the authority of the ceding company's state of operation in question to examine its books and records.

**Unauthorized and Unaccredited Reinsurer:** If a ceding company's reinsurer is neither authorized nor accredited, the ceding company still may be able to take credit in its financial statements for the reinsurance ceded if the reinsurer provides sufficient security for amounts due under the reinsurance treaty. This can usually be accomplished by permitting the ceding company to withhold funds due the reinsurer (funds withheld approach) or by the reinsurer providing the ceding company with a letter of credit, in a form acceptable to the state in question, or by the reinsurer establishing a trust agreement for the benefit of the ceding company.

**Retention:** The portion of a policy which the ceding company retains for its own liability. It is normally expressed in terms of face amount of insurance, especially if more than the mortality risk is reinsured. It is sometimes expressed in terms of risk amount (q.v), particularly with single premium products.

A company's retention is often graded by age and/or underwriting classification. Less frequently special reduced retentions apply to specified risks, such as those engaging in aviation activities or with histories of coronary artery disease.

**Retrocession:** A form of reinsurance under which a reinsurer cedes to another insurer part or all of the reinsurance it has assumed from another company. The original ceding company has no relationship or recourse to the retrocessionaire and the original reinsurer remains fully liable to its client, the original ceding company.

It provides a reinsurer with a method of accommodating its clients with respect to larger risks while still managing its own risk exposure.

**Risk Amount:** Also called the net amount at risk, this is the policy death benefit less the policy value accumulation, usually the terminal reserve or the policy cash value. It is the amount that must come from surplus in the event of a death claim.

Under YRT reinsurance, the reinsured risk amount is the death benefit on the portion of the policy reinsured less accumulated policy values (terminal reserve or cash value, as defined in the treaty). If only the accumulated policy values on the reinsured portion of the policy are used as a decrement to the reinsured risk amount, the approach is described as a proportionate risk retention since in the future both the ceding company's and the reinsurer's share of the risk will fluctuate (usually decline) proportionately. If the accumulated policy values on the entire policy are used as a decrement against the reinsured risk amount, the approach is called a level risk retention since the ceding company's portion of the risk amount will remain static and all fluctuations in the risk amount will be reflected in the reinsurer's portion.

**Stop Loss Reinsurance:** A form of nonproportional reinsurance under which the ceding company receives protection against the risk of its cumulative claims, rather than on any individual policies, exceeding an acceptable level. Typically, such reinsurance coverage might provide that if the ceding company's actual claims exceed its expected mortality, as defined in the treaty, by more than a stated percentage, such as 10%, the reinsurer would reimburse the ceding company for a stated percentage, say 90%, of the excess over this attachment point up to a stated maximum reinsurance benefit. Usually the reinsurance coverage may be terminated or the reinsurance premium increased after the expiry of a limited term, typically one year. Sometimes the ceding company has the option of converting the arrangement to a conventional proportional reinsurance treaty for a portion of the ceding company's retention following a stop-loss reinsurance rate increase or termination by the reinsurer.

**When stop loss protection is used, it is usually combined with conventional proportional reinsurance. By combining the reinsurance coverages, the ceding company will usually feel comfortable with a higher retention than it would using proportional reinsurance alone.**

## **Disability and Accidental Death Benefits**

### **1.0 Purpose**

- 1.1 This provision establishes the terms and conditions under which disability and accidental death benefits are reinsured under the agreement.**
- 1.2 More specifically the provision addresses the portion of the risks reinsured and the reinsurance premiums applicable to those risks.**

### **2.0 Scope**

- 2.1 This provision is typically limited to the purpose in (1.1). Claims relating to these benefits are usually addressed in the Claims Provision.**

### **3.0 General Elements**

#### **3.1 Waiver of Premium Benefit**

- 3.1.1. The reinsurance rates are usually a percentage of the premium charged under the ceding company's policy. Substandard rates are usually a multiple of the standard rates.**
- 3.1.2. The reinsurance benefit is usually the amount of premium waived including any rider or supplementary benefits under the policy times the face amount ceded to the reinsurer divided by the face amount of the policy.**

#### **3.2 Accidental Death Benefit**

- 3.2.1. Reinsurance rates are usually based on a scale developed by the reinsurer and not a percentage of the ceding company's premium rates. Here again substandard rates are usually a multiple of the standard rates.**
- 3.2.2. Usually this benefit can be reinsured with or without a corresponding amount of life insurance as most ceding companies generally fill their retention with life insurance first.**
- 3.2.3. Typically issue age and amount limits are put into the agreement.**

### **4.0 Variations**

- 4.1 In addition to waiver of premium, disability may include third party payor benefit and monthly income benefit.**
- 4.2 Sometimes either or both disability and accidental death benefits may be**

excluded from the reinsurance agreement. They may be reinsured separately or retained by the ceding company.

- 4.3 It is possible to reinsure disability on a basis that is other than proportionate to the life insurance amount reinsured.
- 4.4 Accidental death may not be reinsured without some life insurance being reinsured also. Alternatively, the reinsurer may require the ceding company to fill its retention first with the accidental death benefit.
- 4.5 It is very common for accidental death benefit to be reinsured separately from life insurance under a separate bulk ADB treaty. Typically the reinsurance rates are lower under a bulk arrangement.
- 4.6 For both accidental death and disability benefits, extraordinarily high issue ages, substandard ratings and/or amounts should be mutually agreed upon.
- 4.7 Accidental death benefit reinsurance rates could be a percentage of the ceding company's premium rates in lieu of a separate scale.

## 5.0 Common Problems

- 5.1 On waiver of premium claims, the ceding company may not account for them properly. It should continue to record premium payments and allowances as well as claim payments.



## **Duration of Agreement**

### **1.0 Purpose**

**1.1 This provision establishes the length of time the agreement will run.**

### **2.0 Scope**

**2.1 This provision typically states that coverage will continue indefinitely.**

**2.2 This provision spells out the conditions under which new reinsurance will no longer be ceded under the agreement.**

### **3.0 General Elements**

**3.1 The agreement is unlimited in its duration.**

**3.2 The agreement can be amended at any time by the written agreement of the two parties.**

**3.3 New reinsurance may be terminated, in whole or in part, by either the ceding company or the reinsurer by giving written notice to the other party.**

**3.3.1 Typically, ninety (90) days notice is given. During that time, reinsurance will continue to be ceded and reinsured.**

**3.3.2 Terminating the agreement for new reinsurance does not normally affect existing reinsurance in force. In force business continues to be governed by the terms and conditions of the agreement until it naturally terminates or expires.**

**3.3.3 Terminating existing reinsurance in force generally requires mutual agreement between the ceding company and the reinsurer. It may involve some form of compensation to account for loss of future profits, a reserve transfer etc.**

### **4.0 Variations**

**4.1 The Effective Date is often part of this provision.**

**4.2 Written notice may be required to be in the form of a registered letter. This is a wise precaution whether required or not in order to avoid disputes.**

**4.3 The reinsurer may not be liable under the agreement for any claims or premium refunds which are not reported to the reinsurer within a set period of time such as 180 days following the termination or expiry of all in force insurance reinsured.**

**4.4** It may be provided that termination can occur only as of a fixed date such as December 31, subject to a minimum notice requirement such as 90 or 180 days.

**4.5** A clause sometimes found in treaties with European reinsurers is that termination may occur immediately if a party undergoes a change in control (i.e. ownership).

## **5.0 Common Problems**

**5.1** A potential problem is determining when the ninety (90) day period starts. It may be when the written notice is mailed, when it is received or a date specified in the notice. Some agreements specifically state which day will be the first day of the ninety (90) day period.

## **Effective Date**

### **1.0 Purpose**

- 1.1 This provision establishes the date coverage commences under the agreement.**

### **2.0 Scope**

- 2.1 This provision covers the agreement and all its terms. However, any subsequent amendments will have their own effective dates and may refer back to the original agreement.**

### **3.0 General Elements**

- 3.1 To be eligible for coverage, policies must be applied for on or after the effective date. Due to backdating, a policy may have a policy date before the effective date. This does not affect its coverage as long as it meets the condition above.**
- 3.2 The agreement must be executed by officer(s) of both the ceding company and the reinsurer.**
- 3.3 Amendments have their own effective date and are usually less broad in their coverage. The effective date provision in the amendment should state which provision(s) is (are) being amended.**

### **4.0 Variations**

- 4.1 The effective date is not often a separate provision in the agreement. It is often part of the Duration of Agreement provision. In addition, it may be found on the title page, signature page or in an exhibit detailing the plans covered.**

### **5.0 Common Problems**

- 5.1 The effective date is important in determining whether regulations and tax law changes apply to the agreement. It also governs liability for taking reserve credit in the annual statement. Care should be exercised that the effective date accurately reflects the date the two parties intended the agreement to take effect.**

## **Errors and Omissions**

### **1.0 Purpose**

- 1.1** This section will address what action is to be taken should an error, omission, or oversight be discovered in the reinsurance transaction.

### **2.0 Scope**

- 2.1** Errors and Omissions relates to errors or omissions in the administration of the reinsurance agreement by either party and not to acts or omissions of the ceding company in relation to its policyholders, beneficiaries or other third parties. Coverage for this latter risk may be available under casualty errors and omissions insurance policies.
- 2.2** The treaty might indicate that only clerical errors are to be covered and not "non-clerical errors". A non-clerical error would be a decision which the company took and executed properly but which had negative consequences.

An example of a non-clerical error could be a decision by the ceding company not to check for duplicate policies on a life and therefore be potentially over-retained if duplicate policies are issued. When a life with multiple policies dies the retained death benefit would exceed the company's nominal retention. The ceding company might approach its reinsurers for coverage of this amount, however, since no clerical error was made no reinsurance exists. The management decision in this case increased the company's retention limit; so no reinsurance was present.

A second example of a non-clerical error would be a decision by management not to address administrative problems in a timely manner. In a situation where a reinsurance audit identified that the ceding company was failing to terminate or reduce reinsurance when the direct policies lapse, if the ceding company decided to ignore the problem, they could forfeit the right to recover premiums years later.

- 2.3** The provision should indicate what actions are to be taken upon discovery of an error or omission.
- 2.4** Under common law contract principles, a deviation from the terms of an agreement could result in the non-deviating party being discharged from its obligations. The Errors and Omissions article is intended to mitigate or, in many cases, to avoid this result. The article is based on equitable concepts. This means that the proper handling of an alleged error will focus on fundamental fairness between the parties and this will require a close study of all the facts surrounding the alleged error and require the application of a number of equitable principles, including whether either

party has delayed in responding to the error, has contributed to the problem or failed to deal forthrightly.

### **3.0 General Elements**

- 3.1** The treaty would usually indicate that failure to comply with any of the agreed terms would not invalidate the reinsurance, provided that such failure was a result of oversight on the part of either the reinsurer or ceding company. Both companies would take all possible steps to restore each other to the positions they would have occupied had such an error or oversight not occurred.

The treaty could address the mutual obligation of both ceding company and reinsurer to ensure that all errors, both favorable and unfavorable, are identified and corrected in an equitable manner at the earliest possible date.

The treaty could indicate that the error and omission provision would only apply to oversights, misunderstandings or clerical errors related to the administration of reinsurance covered by the agreement and not to the administration of the insurance provided by the ceding company to its insured.

### **4.0 Variations**

- 4.1** Some reinsurance agreements may call for various actions to be taken to help rectify errors. For example, the reinsurer may provide the ceding company with a list of policies for which it feels the reinsurer is liable. The ceding company can use this list to check for policies that may not have been reported to the reinsurer.
- 4.2** The treaty may contain a provision such that errors of a certain age are no longer rectifiable. For example, claims which occurred more than seven years ago may no longer be reimbursed by the reinsurer.

### **5.0 Common Problems**

- 5.1** Errors are often found long after they are committed. This makes documentation difficult and the passage of time may make it impossible to restore parties to their original positions.
- 5.2** Complete documentation of situations is often not available. Phone calls, for example, may not be documented. It may be impossible to determine a past sequence of events and that may affect the result.
- 5.3** Since large errors are more likely to be found than small errors and since large errors are likely to be claims while small errors are likely to be premiums, it follows that a common error involves claims on policies which

were not reported to the reinsurer. Reinsurers have a natural tendency to feel that overlooked claims are more likely to be discovered than overlooked premiums. Also, information on claims is more likely to be kept for a longer period of time than information on premiums, thereby making correction of premium errors more difficult than correction of claims errors.

- 5.4 The distinction between a clerical error which may be covered and a non-clerical error which would not be covered may not always be clear. Policy replacement activity is a common source of confusion in this area.
- 5.5 Many reinsurance transactions have implicit time limits in them which may not be understood. For example, facultative offers may be viewed as being no longer applicable after a certain number of days, often 90 or 120, but this fact may not be documented. If such a case is reported later one party may claim that the reinsurance was not assigned and the other party may claim that the reinsurance was assigned but notification was overlooked.
- 5.6 In some cases it may not be possible to restore the parties to the position they would have had, had the error not been made. For example, a company fails to enclose an APS on a facultative application. After a claim the omission is discovered and the reinsurer asserts that with the information they would have declined the case. In such a situation the ceding company is not able to approach other reinsurers for possible coverage.
- 5.7 The use of self administration for a great deal of current reinsurance reduced the amount of clerical error but also reduced the amount of clerical oversight present. With a greater reliance on administrative audits to find errors in procedures, the discovery of errors may be later than was the case in the past.
- 5.8 Ceding company errors can result in reinsurers being over-retained, often without the possibility of recourse due to subsequent events which have caused the policy to exceed jumbo limits.
- 5.9 While audits may discover errors before they cause larger problems, they can generally find only systematic errors and not errors involving individual policies.
- 5.10 Changes in ceding company administration systems may cause delays in transmission of information. When administrative functions are backlogged it may not be possible to reconstruct the situation "as if no error had occurred".

## **Experience Refunds**

### **1.0 Purpose**

- 1.1. The purpose of an experience refund is to lower the cost of reinsuring any product subject to the refund if the product realizes better than expected mortality and persistency. An experience refund formula permits a ceding company to benefit from better than expected mortality and persistency on its ceded reinsurance by requiring the reinsurer to return a percentage of its "net reinsurance profits" as defined in the reinsurance agreement.**

### **2.0 Scope**

- 2.1. If the ceding company and reinsurer disagree about the value of the business being reinsured, including an experience refund formula in the agreement is one way to settle the disagreement. Although the reinsurer will typically charge more for reinsurance than if the reinsurance were not subject to experience refunds, if experience on the reinsurance develops profitably, the reinsurer will pay back a portion of its net reinsurance profits to the ceding company which might result in a lower net cost than non-refunding reinsurance.**
- 2.2. Experience refund calculations can be included in reinsurance agreements of all types: yearly renewable term, coinsurance, and modified coinsurance.**

### **3.0 General Elements**

- 3.1. Typically the experience refund formula will specify that a minimum amount of reinsurance premium must be received by the reinsurer before any amount of reinsurance is subject to an experience refund.**
- 3.2. Typically the experience refund formula will establish a limit on the amount of reinsurance on a life that will be included in the ceding company's experience refund account. This limit acts as an extension of the ceding company's retention insofar as it defines the size of a loss in the experience refunding account that the ceding company is willing to have affect its experience refund. The limit is intended to protect the ceding company from unduly large fluctuations in experience that could eliminate all future experience refunds.**
- 3.3. Typically the experience refund formula will indicate that if the ceding company does not want a particular case to be included in its experience refund account, it may submit the case facultatively and indicate on its application for reinsurance that if the policy is ceded to the reinsurer it will be ceded on a non-refunding basis.**

- 3.4. The experience refund formula should clearly define "net reinsurance profits." Typically the definition will take into account all incoming items and outgoing items.**
- 3.4.1. Income will typically include all premiums paid to the reinsurer on policies subject to the formula and any interest on funds being held by the reinsurer such as contingency reserve funds.**
- 3.4.2. Outgoing charges will typically include claims paid, unusual expenses incurred in investigating reinsured claims, commissions and expense allowances paid, premium taxes reimbursed, any increase in reserves, a provision for carrying prior years' losses forward to future experience calculations with interest, and an expense and profit charge related to the reinsurer's home office expenses and a profit margin.**
- 3.5. The experience refund formula should specify the portion of net reinsurance profits that will be returned to the ceding company, which company will calculate the experience, when the calculation will be made, and when the payment, if any, will be made.**

#### **4.0 Variations**

- 4.1. The calculation may permit the reinsurer to create and maintain an experience stabilization or contingency fund to balance experience at different durations. Typically the fund will be a charge against income and will be built up to an ultimate amount. Interest is typically credited to the fund at an agreed-upon rate. Excess losses during a year will be charged against the fund. The parties may agree that the fund may be reduced if experience is favorable for an agreed number of years under the treaty. Finally, the agreement should provide how assets in the fund will ultimately be distributed.**
- 4.2. Agreements may vary regarding the number of years that losses may be carried forward and charged against future years' experience.**

#### **5.0 Common Problems**

- 5.1. If the experience refund formula takes into account increases in reserves, the basis for calculating reserves should be clearly expressed. If a conservative reserving standard is chosen, the ceding company may initially receive a smaller refund.**
- 5.2. Prior to the mid-1980s the parties to a reinsurance agreement might have agreed that if the experience refund calculation produced a negative amount, the ceding company would pay the absolute value of such amount to the reinsurer. This practice is no longer permissible in most states if the ceding company wishes to receive reserve credit for**



the reinsurance ceded pursuant to the agreement.

- 5.3. Regulation may also limit the interest rate that may be charged on loss carryforwards.

## **Extended Term and Reduced Paid-Up Insurance**

### **1.0 Purpose**

- 1.1 This provision is intended to describe how reinsurance is treated when a reinsured policy lapses and is continued under one of these nonforfeiture options.**

### **2.0 Scope**

- 2.1 The provision applies to the reinsurance of permanent plans of insurance with nonforfeiture options, whether reinsured under a coinsurance or a YRT mode of reinsurance. (The treatment of modified coinsurance is the same as for coinsurance).**

### **3.0 General Elements**

- 3.1 With respect to either coinsurance or YRT the provision defines how the retention/reinsurance allocation is made if the amount of insurance is increased because of the existence of dividends or decreased because of a policy loan.**
- 3.2 With respect to coinsurance, the provision defines what payment is due the reinsurer if the amount of reinsurance is increased or what payment is due the ceding company if the amount of reinsurance is decreased. The payment indicated is the change in reserve or cash value on the reinsured portion of the policy.**

### **4.0 Variations**

- 4.1 Increases and decreases in the amount of insurance are usually shared proportionately by the ceding company and the reinsurer.**
- 4.2 Sometimes decreases in the amount of insurance, especially with reduced paid-up benefits, reduce the amount of reinsurance absolutely.**
- 4.3 Sometimes the reinsurance is cancelled if the reinsured portion of the nonforfeiture benefit, especially reduced paid-up insurance, is below a specified dollar amount.**
- 4.4 Sometimes the ceding company has the right to recapture any policy that goes to extended term or reduced paid up.**

### **5.0 Common Problems**

- 5.1 Usually none.**

## **Increasing Death Benefit Products and Riders**

### **1.0 Purpose**

- 1.1 This provision establishes the terms and conditions under which an increase in the death benefit at some future date(s) after original issue date are reinsured under the agreement.**

### **2.0 Scope - These plans fall into three general categories:**

- 2.1 Plans (riders) which allow for optional increases within predetermined limits at specific dates or at the occurrence of an event such as death, birth, marriage, divorce, etc. Typically these are like guaranteed insurability riders.**
- 2.2 Plans which provide for predetermined increases e.g. increasing term riders or return of premium riders.**
- 2.3 Plans with increases that are determined by such factors as a dividend scale or cost of living index e.g. inflation riders, dividend option increases.**

### **3.0 General Elements**

- 3.1 If new evidence of insurability is required then the requirements for new automatic or facultative reinsurance would apply. The new policy or increased amount would be handled the same as a new issue.**
- 3.2 If the increase is not subject to new evidence of insurability then the reinsurer will accept the increase automatically but not to exceed its automatic binding limit due to its own retention considerations.**
  - 3.2.1. If the new reinsured amount arises from the exercise of a guaranteed purchase option, then typically a single premium charge per \$1,000 will be payable in addition to the regular reinsurance premiums.**
  - 3.2.2. If the reinsured amount arises from a predetermined (scheduled) increase, or is triggered by a cost of living index then original age and duration (point -in-scale) reinsurance premiums would be payable.**
- 3.3 A per policy reinsured maximum or cap amount may be put into the agreement due to the uncertainty as to when and how much additional benefit may arise from these increases. Caps may be a percentage of the initial amount or an absolute dollar amount.**

#### **4.0 Variations**

- 4.1 An increase in the death benefit may be on a different life after the death of the primary insured. Usually a new amount is for several times the original amount. This is like a beneficiary purchase option. The original policy is used as a single premium for the new policy. Typically the underwriting on the new life is done at the same time as that of the primary insured. It would seem appropriate to have a cap on the amount of coverage for the new life. Point-in-scale rates may be charged, possibly with an additional single premium.**
- 4.2 The ceding company may fill its retention first before sending the increase to the reinsurer(s).**
- 4.3 The ceding company and its reinsurers may share proportionately in any increase based upon the original amount reinsured.**

#### **5.0 Common Problems**

- 5.1 The ceding company's policy form does not limit increases to a specified maximum but the treaty does.**
- 5.2 The ceding company overlooks increases for reinsurance reporting purposes.**
- 5.3 The ceding company's retention limits have not increased as anticipated leading to over retention.**

## **Insolvency**

### **1.0 Purpose**

- 1.1 This provision describes the rights and responsibilities of the parties to the treaty in the event of an insolvency of either one of those parties.**
- 1.2 The need for the provision arises from the fact that a treaty normally provides indemnity reinsurance under which the reinsurer is obligated to pay only those reinsured claims which are actually paid by the ceding company. In the case of insolvency, the liquidator, receiver, or other statutory successor to the ceding company may not pay valid claims in full, but is authorized to collect reinsurance amounts in full.**

### **2.0 Scope**

- 2.1 An insolvency provision ideally should address the insolvency of both the ceding company and the reinsurer. Many existing insolvency provisions consider only the insolvency of the ceding company.**

### **3.0 General Elements**

#### **3.1 Insolvency of the Ceding Company**

##### **3.1.1 Reinsurer's Responsibilities**

- 3.1.1.1 The reinsurer normally will be required to make any payments in the full amount, without any reduction because of the ceding company's circumstances. Payments usually must be made directly to the ceding company's liquidator, receiver or statutory successor.**
- 3.1.1.2 New York, and some other states, specifically deny the ceding company credit for reinsurance ceded if the agreement does not contain a clause to this effect. The clause is also reflected in the NAIC Insolvency Model.**

##### **3.1.2 Reinsurer's Rights**

- 3.1.2.1 The reinsurer should be notified promptly of any pending claims against the insolvent ceding company on policies which may involve the reinsurance agreement.**
- 3.1.2.2 The reinsurer should have the right to investigate each pending claim and interpose in the claim adjudication process with any defenses it believes may be available to the insolvent entity. This will generally be done at the reinsurer's expense.**

**3.1.2.3** Since the reinsurer has this right of investigation, the expense it incurs is chargeable, subject to court approval, against the ceding company as part of the expense of liquidation. Clearly this expense will be chargeable only to the extent of the proportionate share of the benefit which may accrue to the ceding company. In addition, the benefit to the ceding company must be solely as a result of the defense undertaken by the reinsurer.

**3.1.2.4** If two or more reinsurers are involved in the same claim and a majority elect to interpose a defense, then the expense should be apportioned according to the terms of the reinsurance agreements as if it had been incurred by the ceding company.

## **3.2 Insolvency of the Reinsurer**

**3.2.1** Treaties which include a provision for this contingency generally give the ceding company the option to unilaterally terminate the reinsurance agreement and recapture all reinsured business, without penalty, within a specified time from receipt of notice of the reinsurer's insolvency. Termination should be in writing, specifying an effective date. The effective date could be retroactive to the date of insolvency but a retroactive feature would allow actual experience to be considered before making the recapture decision.

**3.2.2** If the ceding company unilaterally terminates the reinsurance, the reinsurer, its liquidator, receiver or statutory successor would remain liable for any outstanding payments incurred prior to the date of termination.

**3.2.3** If insolvency of the reinsurer is addressed, some treaties include a requirement that the reinsurer immediately notify the ceding company of the event. In this case, notification will usually include the delivery of documentation relating to the proceedings.

**3.2.4** By including this provision, the ceding company avoids the obligation to pay reinsurance premiums to an insolvent entity, with the likelihood of receiving reduced benefits in return.

**3.2.5** The ceding company will generally want to arrange replacement reinsurance for both inforce and new business before it effects recapture, but the price may be significantly different from that paid previously. If the reinsurance is excess of retention, the ceding company will otherwise be over-retained by the amount recaptured.

## **4.0 Variations**

**4.1** Some agreements include a paragraph which defines insolvency for the purposes of this Provision. This is probably only necessary if the definition is for some reason different from insolvency as generally determined by the appropriate state insurance regulators.

### **4.2 Offset**

A clause covering offset is sometimes included in the Insolvency Provision, and sometimes included as a separate treaty provision covering offset alone.

The purpose of the offset provision is to reinforce the rights of the ceding company and the reinsurer to set off debits and credits between them.

Some state regulations, California in particular, now require that any reference to offset be in a separate provision, and specifically not in the insolvency provision. There is no apparent advantage or disadvantage in the use of a separate offset provision.

**4.3** Some agreements specifically state that the contents of the insolvency provision do not change the relationship of the parties or enlarge their obligations in any way in the event of an insolvency.

**4.4** In the event of insolvency of the reinsurer, a possible variation to unilateral termination by the ceding company without penalty would include imposition of an "early recapture fee" by the insolvent reinsurer.

## **5.0 Common Problems**

**5.1** In the event of an insolvency the conservator will generally represent the state insurance regulators. As such, the conservator has significant powers and may choose to disallow, or terminate reinsurance agreements unilaterally regardless of the contents of the insolvency provision or other provisions in the treaty.

**5.2** The parties may be precluded from enforcing a treaty provision which permits the ceding company to terminate reinsurance upon the reinsurer's insolvency. The insurers rehabilitation and liquidation law in some states may state that, notwithstanding any contract provision to the contrary, all agreements in effect as of the date of the entry of an order to liquidate the insurer shall continue in force.

## **Inspection of Records**

### **1.0 Purpose**

- 1.1 To define any right of access of one party to the treaty by the other party.**

### **2.0 Scope**

- 2.1 This provision is applicable to all reinsurance treaties.**

### **3.0 General Elements**

- 3.1 A statement of which party or parties have the right of inspection of the other's records (usually no more than once a year).**
- 3.2 A general statement of what records may be accessed. These records include, but are not limited to, underwriting files, claim files, billing records and valuation records.**

### **4.0 Variations**

- 4.1 Generally the right of inspection is extended to the reinsurer alone. More rarely each party is entitled to inspect the records of the other.**
- 4.2 Usually the statement about records that may be inspected is a general one covering all records that relate to the reinsurance covered by the treaty. Rarely is the access narrowed to specific records.**
- 4.3 Usually the inspection may be made at "any reasonable time" ; sometimes "during normal office hours" is added.**

### **5.0 Common Problems**

- 5.1 Inspection of records occurs during routine and non-routine audits. If the audit is routine, the inspecting company should make the audit review as easy as possible by giving advance notice, providing a schedule and requesting files well in advance.**
- 5.2 A common problem is files or records that cannot be located. If the request is well in advance, most of these problems are eliminated. If the files or records cannot be located, then a decision must be made about the importance of the files or records.**
- 5.3 A company may consider records proprietary information. However, regulations by state, federal and non-governmental authorities may require conformance on issues such as "mirror image reserving" or matching DAC tax liabilities.**



**5.4 An audit of a reinsurance pool shared by several reinsurers may be considered a record. The ceding company and the auditing reinsurer should agree on whether or not this can be shared with the other pool members.**

## **Joint Life**

### **1.0 Purpose**

- 1.1 This provision describes the treatment of reinsurance on policies covering two or more lives.**
- 1.2 Benefits may be paid on either the first or last death.**

### **2.0 Scope**

- 2.1 This discussion addresses the issue of two or more lives covered under one policy.**
- 2.2 Focus is on the differences between a "multiple life" treaty and a "single life" treaty.**

### **3.0 General Elements**

- 3.1 Most of the reinsurance clauses in a joint life treaty are the same as in a single life treaty.**
- 3.2 Joint equal age calculation is usually used to determine direct premiums. Reinsurance premiums may be based on the same joint equal age.**
- 3.3 First to Die**
  - 3.3.1 Most First-to-Die policies have a Simultaneous Death Benefit Option which provides a second death benefit if the second death occurs within 90 days of the first death. Reinsurers will usually have a small separate charge for this benefit.**
  - 3.3.2 Most First-to-Die policies have a Survivors Benefit Option which allows the surviving insured to obtain his or her own policy, without evidence of insurability, within 90 days of the first death. Treaties will usually have a set of rates that would apply to the new policy.**
  - 3.3.3 Most First-to-Die policies have an Exchange or Split Policy Option which allows the ceding company to issue a separate policy to each insured up to some date in the future. The treaty will usually have a set of reinsurance premium rates which would apply to the individual policies.**
- 3.4 Last to Die**
  - 3.4.1 Some Last-to-Die policies can be split into individual policies upon the occurrence of certain events (e.g. divorce, tax law change).**

**3.4.2** In Last-to-Die policies, there are two types of policies. In one, the reserve increases upon the first death, and in the second type the reserve does not increase. In the case where the reserve does not increase, the premiums are based on a joint equal age. In the other case, the reinsurance premium for each individual insured shall equal the appropriate reinsurance rate for that insured's age.

#### **4.0 Variations**

- 4.1** In some First-to-Die policies, after the first death, the policy can continue as a First-to-Die policy with the remaining insureds.
- 4.2** For First-to-Die policies, reinsurance premiums may be based on single life coverage using single life rates based on the issue age of the insured being reinsured.
- 4.3** On Last Survivor policies, the joint equal age may be translated into an "equivalent single age"; in which case, single life YRT rates can be used to approximate a joint life scale.

#### **5.0 Common Problems**

- 5.1** If a company's policies are ceded to multiple reinsurers on the basis of an alpha split, there could be problems in determining which reinsurer should receive the policy.
- 5.2** Ceding company may have difficulty in setting its retention limit on a joint policy, if it has various amounts of insurance in force on the lives.
- 5.3** Question of whether the ceding company needs to be notified of the first death in a Last-to-Die policy (e.g. death during contestable period). If the information is available, it can provide data for studies. If the first death occurs during contestable period, knowing about it may help the ceding company identify a potential misrepresentation problem.
- 5.4** Some states require that a single life policy be issued to the survivor, in the event of suicide during the contestable period, under a Last-to-Die policy. What if the surviving insured is uninsurable?
- 5.5** How to handle exclusions (e.g. aviation exclusion rider) can be an issue.

## **Letters of Credit**

### **1.0 Purpose**

- 1.1 This provision sets out the conditions under which Letters of Credit would be required and what characteristics they should have.**

### **2.0 Scope**

- 2.1 The treaty should indicate the conditions which would require the reinsurer to provide a Letter of Credit to the ceding company; e.g. Letters of Credit might be required for outstanding claims but not for reserves.**
- 2.2 The treaty should specify what recoverables and/or reserves would be covered by a Letter of Credit.**
- 2.3 The treaty would include under what circumstances the ceding company could draw upon the Letter of Credit. These circumstances are often rigidly defined by state regulations.**
- 2.4 The treaty would define "qualified" acceptable financial institutions on which the Letter of Credit should be issued and drawn.**

### **3.0 General Elements**

- 3.1 The treaty would indicate which jurisdictions are involved, e.g. those where the reinsurer is not licensed.**
- 3.2 The treaty should specify that all conditions required of the Letter of Credit would be met: evergreen nature, unconditional, irrevocable, notice period.**
- 3.3 The treaty should specify for what purposes the Letter of Credit can be drawn on, e.g. unreimbursed claims, but not expenses. Uses for other purposes should be excluded.**
- 3.4 Dates by which Letters of Credit are required should be indicated, e.g. quarterly, annually.**

### **4.0 Variations**

- 4.1 Regulatory interest in Letters of Credit is quite high with various states such as New York, California and Illinois having their own specific requirements for Letters of Credit. Items usually specified in regulation include:**

- a. Letters of Credit cannot be revoked by the reinsurer.
- b. No other documents are involved in describing a Letter of Credit.
- c. Drawing on the Letter of Credit must be within the ceding company's control.
- d. Letter of Credit must be "evergreen", that is, not cancelable at the end of its term, unless 30 days notice is given to the ceding company.

4.2 The effective date of Letters of Credit and when they are provided are items to which a great deal of attention can be paid, especially for new treaties. New York State requires that the Letter of Credit be in place before the "as of" date and be provided to the company within 30 days.

4.3 Actual conditions vary by states and reference to the actual state law will be necessary.

## 5.0 Common Problems

5.1 Having regulatory authorities allow the Letter of Credit may be an issue. This would require that the specific state rules for Letters of Credit be followed. Some states have effectively banned the use of Letters of Credit via regulatory actions.

5.2 The financial institution on which the Letter of Credit is drawn must be considered "qualified". Some lists of approved institutions have been drafted.

5.3 Reaching an understanding between the ceding company and the Reinsurer on the circumstances under which a Letter of Credit will be drawn upon is the most important point in avoiding problems.

## **Modified Coinsurance Mean Reserve Adjustment**

### **1.0 Purpose**

- 1.1. Under a modified coinsurance agreement the ceding company retains, maintains and owns all reserves and all of the assets in relation to the reserves on the policies reinsured.**
- 1.2. Since the ceding company holds the reserves, an adjustment needs to be made, typically to reimburse the reinsurer for investment income it would have earned had it actually held the reserves.**

### **2.0 Scope**

- 2.1. This adjustment is found only in modified coinsurance agreements.**
- 2.2. The description of the adjustment is typically found in its own section of the agreement labeled "Reserve Adjustment."**

### **3.0 General Elements**

- 3.1. When the modified coinsurance premium is paid by the ceding company:**
  - a. The reinsurer pays the ceding company an amount equal to any increase in the ceding company's statutory mean reserve, or**
  - b. The ceding company pays the reinsurer an amount equal to any decrease in the ceding company's statutory mean reserve.**
  - c. The ceding company also pays the reinsurer interest on the statutory mean reserve calculated as of the prior year end.**
- 3.2. The calculations are normally done annually but could be performed more frequently, such as quarterly.**
- 3.3. The agreement should specify the basis for computing the reserves and the interest rate applied to the reserves. Typically, the reserve basis is the same as the reinsured policies' valuation basis. The method for determining the interest credited to the reserves is subject to negotiation and varies considerably.**
- 3.4. In requesting claim reimbursement, the ceding company shall on its next settlement date pay the reinsurer the reinsured portion of the current policy year's statutory mean reserve net of interest from the date of death to the next policy anniversary at the net interest crediting rate.**

#### **4.0 Variations**

- 4.1. In setting the interest rate to be credited to the mean statutory reserves the parties should keep in mind the NAIC Life and Health Reinsurance Agreements Model regulation which sets forth a "safe harbor" formula for determining the reserve interest rate adjustment under certain agreements.**
- 4.2. The parties might agree to calculate the reserve adjustment and settlements more frequently than annually. Whether they do so depends in part upon the ability of the ceding company to calculate reserves more frequently and the expected magnitude of the reserve adjustment and other settlements.**
- 4.3. It may be agreed that claims will be reimbursed on a net rather than a gross basis. This means that a policy's reserve is to be subtracted from the claim reimbursement amount. In this case, the reinsured portion of the policy reserve would not need to be paid with the next settlement.**

#### **5.0 Common Problems**

- 5.1. If the assets supporting the policies being reinsured involve a credit quality, reinvestment or disintermediation risk, the reinsurer may be obligated to participate in these risks in accordance with the NAIC Life and Health Reinsurance Agreements Model regulation. In such case, the ceding company is obligated to segregate the assets in a trust or escrow account or otherwise establish a mechanism satisfactory to the ceding company's domestic insurance commissioner which legally segregates, by contract or contract provision, the underlying assets.**

## **Offset**

### **1.0 Purpose**

- 1.1 This provision establishes that the ceding company or the reinsurer may offset any mutual debts and credits due from one party to the other.**

### **2.0 Scope**

- 2.1 This provision covers any amount due between the parties, sometimes even amounts arising under other agreements.**

- 2.2 Amounts may be offset even if one of the parties to the agreement is insolvent.**

### **3.0 General Elements**

- 3.1 The ceding company or the reinsurer may offset any balance due under the agreement against amounts owed to it by the other party. This includes, but it is not limited to, premiums, allowances, commissions, claims and expenses.**

- 3.2 Only mutual debts and credits are eligible for offset.**

- 3.2.1 "Mutuality" is a critical element in determining the validity of an offset in an insolvency. There must be both mutuality of capacity and mutuality of time.**

- 3.2.2 Mutuality of capacity refers to the relationship between the parties. Mutual legal capacity must exist such as in a reinsurance agreement where both the ceding company and reinsurer are debtors and creditors of one another. If one party were viewed, for example, as a trustee of monies held by it, it would not stand in a mutual relationship to amounts owed it as a general creditor. Most states also allow offset between debts arising out of multiple agreements as long as the agreements are between the same parties. However, the NAIC Model Rehabilitation and Liquidation Act prohibits offsets in cases where the parties both cede and assume business. Also, offsets are not allowed between one party and an affiliate of the other because of a lack of mutuality of the debts and the parties.**

- 3.2.3 Mutuality of time refers to fixing the date of issuance of the order of liquidation or rehabilitation. It establishes pre-liquidation and post-liquidation debts. Only debts in the same time period may be offset against one another.**

- 3.3 Guidance on offset can be found in both the Model Act referred to above and in the NAIC's Rehabilitation and Liquidations Handbook. In particular,**



the Model Act lists six categories of prohibited offsets.

#### **4.0 Variations**

- 4.1 Offset is sometimes not a separate provision in the agreement. It is often part of the Insolvency provision.**
  - 4.1.1 Some state statues, California in particular, now require that any reference to offset be in a separate provision, and specifically not in the Insolvency provision. Other than this, there is no apparent advantage or disadvantage in the use of a separate Offset provision.**
- 4.2 It may be agreed that claims will not be offset until normal claims procedures have been followed.**
- 4.3 The extent of any offset may be limited by the law of either party's state of domicile.**
- 4.4 Offset may be allowed even though there is no explicit offset provision in the agreement.**

#### **5.0 Common Problems**

- 5.1 Most states provide by statute the right to offset debts and credits. Offset is also strongly supported by the common law. If both parties are solvent then generally there is no problem and offset is seen as promoting efficiencies. The controversy arises when either party is insolvent and the other party tries to exercise the right to offset.**
  - 5.1.1 One reason given for disallowing offsets is that they create a preference or priority for the reinsurer. Preferences are generally disallowed under state insolvency rules. The question of whether an offset is a preference is determined by the courts. Another reason given to deny offsets is that they diminish the obligation to an insolvent ceding company.**
  - 5.1.2 Conversely, without offsets, the reinsurance market would be tighter. Smaller firms would face higher barriers to entry as due diligence requirements increased.**
- 5.2 There have been several court cases involving reinsurance offset where the ceding company was insolvent. So far the results have been mixed and different decisions have been handed down on substantially the same issues. Most decisions have been appealed. It is likely offset will continue to be an issue for both the courts and the state legislatures.**

## **Parties to Agreement**

### **1.0 Purpose**

**1.1 This provision defines the contractual relationship under the agreement.**

### **2.0 Scope**

**2.1 This provision relates only to the contractual rights of the ceding company and reinsurer. This protects the reinsurer from direct actions taken by a party other than the ceding company.**

### **3.0 General Elements**

**3.1 The agreement is solely between the ceding company and the reinsurer.**

**3.2 There is no right or legal relation or obligation between the reinsurer and any other parties besides the ceding company. Examples of other parties are any insured, beneficiary, policy owner, assignee, etc.**

### **4.0 Variations**

**4.1 The Parties to the Agreement provision is sometimes covered in the Liability provision.**

### **5.0 Common Problems**

**Unknown**

## **Policy Changes**

### **1.0 Purpose**

- 1.1 This provision is intended to describe the authority of the ceding company to make policy changes on reinsured policies, and the ceding company's obligations to the reinsurer when such changes are made.**

### **2.0 Scope**

- 2.1 This provision applies to all individual reinsurance agreements.**

### **3.0 General Elements**

- 3.1 The ceding company is normally permitted to make changes in reinsured policies without seeking the concurrence of the reinsurer, except if the change causes the net amount at risk to increase.**
- 3.2 The ceding company is required to give the reinsurer notice of changes affecting reinsurance. Timing of the notice is usually unspecified, being described as "within a reasonable time" or "as soon as practical."**

### **4.0 Variations**

- 4.1 Some treaties use this provision to distinguish between policy reissues that constitute a true new issue, and ones that are a "continuation" of a previous policy. Such provisions will usually stipulate that continuations should not be accorded new business treatment, that is, that the reinsurance must remain with the reinsurer of the original policy regardless of where the new policy form is normally reinsured, and that point-in-scale rather than first year reinsurance rates should be used.**

### **5.0 Common Problems**

- 5.1 While most treaties are silent on when the reinsurer should be consulted before a policy change is executed, the general understanding is that the ceding company is free to make any changes that are consistent with the terms of the policy and the general practices of the ceding company. The reinsurer further anticipates that the general practices of the ceding company will be consistent with the general prudent practices of the insurance industry. To avoid straining the reinsurance relationship, most ceding companies will seek the concurrence of their reinsurers when adopting new, ground breaking practices not current in the industry or when according a specific policy exceptional treatment. Problems can arise when the ceding company and the reinsurer have different ideas of what constitutes an unestablished practice in many gray areas.**

## **Policy Dividends**

### **1.0 Purpose**

- 1.1 This provision describes the circumstances under which, and the extent to which, the parties to the treaty will share in the policy dividends or amounts of insurance arising from such dividends declared by the ceding company on policies reinsured.**
- 1.2 Treaties governing ordinary life reinsurance typically do not have separate provisions explicitly covering the subject of policy dividends. The inclusion of special provisions is generally considered to be more important for coinsurance or modified coinsurance than for YRT reinsurance.**

### **2.0 Scope**

- 2.1 Coinsurance or Modified Coinsurance: A provision covering policy dividends ideally should address the extent to which the reinsurer will share in dividends declared by the ceding company.**
- 2.2 YRT: In the case of YRT, reinsurance amounts or premiums are normally unaffected by dividends declared by the ceding company with respect to policies reinsured. Some ceding companies, on the other hand, desire to reinsure some portion of amounts of insurance arising from paid-up additions or term additions; in such case specific provisions covering the manner in which the reinsurance amounts or premiums are to be determined should be included in the treaty.**

### **3.0 General Elements**

- 3.1 Under a coinsurance or modified coinsurance treaty, it may be provided that the reinsurer will follow the practice of the ceding company without limitation. More commonly, there may be some limitation imposed (e.g., the reinsurer will reimburse dividends up to a specified limit such as the level of the dividend scale in effect at the time the reinsurance agreement became effective as to the policies in question).**

**A major reason for such a limitation is that the ceding company may declare dividends on the basis of experience other than the reinsured policies and the reinsurer may experience less favorable results than those reflected in the ceding company's dividend scale. Under modified coinsurance, the ceding company holds the assets so that the reinsurer does not have control over the investment results which typically make up a major part of dividends. Such a limitation may be subject to periodic update.**

- 3.1.1 The ceding company should promptly notify the reinsurer of any change in the dividend scale applicable to policies reinsured on a**

coinsurance or modified coinsurance basis. This is especially important when the reinsurer has agreed to follow the dividend scale(s) of the ceding company.

**3.2** If the treaty does not provide for the reinsurer to automatically follow any increases in policy dividends declared by the ceding company, the two parties should make a good faith effort to agree on the action to be taken as a result of the change in the dividend scale.

**3.3** It may be provided that the reinsurer will provide a set level of reinsurance allowances in lieu of participating in policy dividends declared by the ceding company.

**3.4** In the case of YRT, it is common to reinsure policies involving term additions on a level net amount at risk basis. This might be true even when the term additions provide more or less than the additional amount of insurance necessary, when added to the base policy net amount at risk, to maintain a level net amount at risk.

**3.4.1** Some reinsurers may insist that the term additions may be reinsured only if they were elected at the time the policy was issued. Any later election might be subject to facultative approval.

#### **4.0 Variations**

Unknown

#### **5.0 Common Problems**

**5.1** The ceding company may fail to timely advise the reinsurer of a change in the applicable dividend scale.

**5.1.1** In the absence of a special agreement to the contrary, a reinsurer will not normally consider itself to be liable for any increases in the dividend scale unless it was consulted in advance and agreed on the action to be taken.

**5.1.2** Even when there are no questions about the extent to which the reinsurer follows the dividend scale(s) of the ceding company, failure to timely advise the reinsurer of changes in such scale(s) may lead to unnecessary administrative or accounting problems because the reinsurer will be unable to verify amounts reported by the ceding company.

**5.1.3** In the case of YRT reinsurance where policy dividends are used to purchase one year term coverage, this commonly results in level net amounts at risk for several years. However, at older ages where the amount of the dividend addition may not be sufficient to maintain a

level net amount at risk, the reduction in the net amount at risk may easily be overlooked.

- 5.2 Effective Sept. 1, 1993, New York Regulation 102 requires the reinsurer to fully reimburse dividends declared by the ceding company.

## **Policy Loans**

### **1.0 Purpose**

- 1.1 This provision describes the circumstances and extent to which the reinsurer will share in policy loans associated with policies reinsured.**
- 1.2 Treaties governing ordinary life reinsurance normally provide that the reinsurer will not share in policy loans. The main reason for this seems to be the administrative complications associated with such loans.**

### **2.0 Scope**

- 2.1 Coinsurance or Modified Coinsurance: Such treaties typically include a provision that the reinsurer will not share in policy loans.**
- 2.2 YRT: In the case of YRT, reinsurance amounts of risk are normally unaffected by the presence or absence of policy loans.**

### **3.0 General Elements**

- 3.1 Under a coinsurance or modified coinsurance treaty, it may be provided that the reinsurer will participate in policy loans. Where this is the case, there should be a clear understanding of the loan interest rate to be credited to the reinsurer.**

## **Policy Rescission**

### **1.0 Purpose**

- 1.1 The intent of such a provision is to describe the responsibilities of, and options available to, the parties to the treaty in the event a policy rescission appears to be warranted.**
- 1.2 Most treaties governing Ordinary Life reinsurance do not have separate provisions explicitly covering the subject of Policy Rescission.**

### **2.0 Scope**

- 2.1 A provision covering policy rescission ideally should address those situations involving circumstances other than a claim. Rescission of a policy in claim status would normally be governed by a separate Claims Provision.**
- 2.2 In the typical case, the ceding company and reinsurer will agree on the action to be taken. The sharing of expenses will then normally be consistent with the sharing of claims expenses.**

### **3.0 General Elements**

- 3.1 The treaty may require the ceding company to promptly notify the reinsurer that a policy may be rescinded, giving the reasons why such an action might be appropriate.**
- 3.2 The treaty may require the ceding company to exercise good faith in such actions and may indicate that the reinsurer is entitled to share in the decision-making process. A typical treaty provision would provide that the ceding company and reinsurer share in the rescission expenses in proportion to the parties' respective liabilities under the policy to be rescinded.**

### **4.0 Variations**

**Unknown**

### **5.0 Common Problems**

- 5.1 The ceding company may fail to timely advise the reinsurer of a situation in which a policy rescission appears to be warranted.**
  - 5.1.1 In the absence of a special agreement to the contrary, a reinsurer will not normally consider itself to be liable for any of the expenses associated with a policy rescission unless it was consulted in advance and agreed on the action to be taken. Failure to timely**



**advise the reinsurer increases the likelihood that the reinsurer will not share in any extraordinary expenses which might result from the attempted rescission.**

## **Policy Surrender Values**

### **1.0 Purpose**

- 1.1** This provision describes the circumstances and extent to which the reinsurer will share in the policy surrender values associated with policies reinsured.
- 1.2** Treaties governing ordinary life reinsurance rarely have separate provisions explicitly covering the subject of policy surrender values. The main reason for this seems to be that it is readily apparent that under coinsurance or modified coinsurance the reinsurer reimburses its proportionate share of surrender values on reinsured policies. Under YRT reinsurance, the only reference to surrender values is likely to be in the wording covering the determination of reinsured amounts at risk.

### **2.0 Scope**

- 2.1** **Coinsurance or Modified Coinsurance:** The provision, if included at all, normally provides that the reinsurer will share in policy surrender values.
- 2.2** **YRT:** In the case of YRT, it is common for reinsurance amounts at risk to be determined on the basis of policy surrender values. Where this is the case, specific provisions covering the manner in which the reinsurance amounts are to be determined should be included in the treaty.

### **3.0 General Elements**

- 3.1** Under a coinsurance or modified coinsurance treaty, it is almost universally the case that the reinsurer reimburses its proportionate share of surrender values allowed by the ceding company without limitation as long as such values are in accord with the reinsured policy provisions.
  - 3.1.1** The ceding company should promptly notify the reinsurer of any changes in the provisions of policies reinsured on a coinsurance or modified coinsurance basis. This is important because the reinsurer typically will have agreed to follow the policy provisions in effect at the time the reinsurance treaty (or later addendum) became effective. In addition, the treaty may provide that automatic coverage is suspended if there is a significant change in policy provisions on plans of insurance covered by the treaty.
- 3.2** In the case of YRT, it is common to reinsure policies on a net amount at risk (NAR) basis with the NAR based on the policy surrender value. This same approach may apply to extended term insurance (ETI) if the ceding company provides a cash value on such ETI. As the cash value decreases, the reinsured NAR will increase, ultimately approaching the amount of ETI in effect at the time the nonforfeiture option became effective.

#### **4.0 Variations**

- 4.1** Upon recapture of a cession covered by a coinsurance or modified coinsurance treaty, it may be provided that the reinsurer will pay the cash value to the ceding company. Alternatively, some treaties may provide for payment of the policy reserve. In either case, there may be a separate recapture charge.
- 4.2** When the reinsurance premium depends on a NAR based on policy surrender values, for administrative convenience the surrender value may be assumed to be constant for a period of time (e.g., five years). Alternatively, a schedule of projected surrender values may be used. These methods are more common for universal life than for traditional products.

#### **5.0 Common Problems**

- 5.1** Problems involving surrender values can be minimized if the ceding company provides the reinsurer with schedules of surrender values applicable to each plan of insurance reinsured and informs the reinsurer on a timely basis of policy terminations.

## **Premium Reporting**

### **1.0 Purpose**

- 1.1 This provision details how reinsurance premiums are calculated and paid.**

### **2.0 Scope**

- 2.1 The treaty should indicate whether the reinsurer or the ceding company shall prepare the premium billing.**
- 2.2 The method of calculating the basic premiums should be specified. If the business is reinsured on a YRT basis reference may be made to the reinsurance risk amount determination. Whether the business is reinsured on a coinsurance, modified coinsurance or YRT basis, a copy of the premium rates, commissions or allowances should be included in the treaty.**
- 2.3 Modified Coinsurance: Several "premium-like" payments may be made under modco agreements for items such as reserve transfers and interest on reserves. They are outside the scope of this article.**

### **3.0 General Elements**

- 3.1 Extra Premium: The treaty should specify whether extra premiums are determined as a multiple of the basic premiums or whether table extras are to be used.**
- 3.2 Commissions: The treaty should indicate whether commissions, allowances or other adjustments are to apply to the reinsurance premium rates. Commission terms may vary between basic premiums, riders and temporary and permanent flat extras.**
- 3.3 Commission chargeback: The treaty should specify if there are any special payments required when a policy lapses. These could often occur if commissions in excess of 100% first year were payable.**
- 3.4 Frequency: The treaty should state when the premium calculation is to be provided and how long thereafter the ceding company has to pay the premium. Reinsurance premiums may have a different frequency than ceding company premiums.**

**The treaty should specify which premiums are due during each billing period. For example, it might be renewals during the current month and first year policies reported the previous month.**

- 3.5 Refunds: The treaty should specify if premiums are refundable should a policy cease before the premium paying period has ended. Refunds may be different if the termination is due to lapse or death. Provisions with respect to refunding YRT policy fees may be different than base premiums.
- 3.6 Notice on non-payment: The treaty should include provisions with respect to the reinsurer's option to terminate the reinsurance if premiums are not paid.

Generally a time period for the reinsurer to give notice of termination would be included. After notice has been given, the ceding company may pay the premiums and reinsurance would be unaffected. If reinsurance terminates, the ceding company may have a period during which it can reinstate. Who is on risk during this period should be specified.

#### 4.0 Variations

- 4.1 Premium treatment in coinsurance and YRT situations is often different. If allowances are being given off of a standard YRT scale, only the net amount may be recorded. In coinsurance situations, the gross premium, allowances and net premium would usually all be reported. The reinsurance of the mortality risk under Universal Life policies has elements of both coinsurance (use of ceding company rate) and YRT (usually report "net" amount).
- 4.2 Substandard table extra premiums are often not payable for the entire duration of the contract but cease at age 65 or 20 years after underwriting, whichever is later.
- 4.3 Commissions on benefits, riders and extra premiums are often different than on the base plan. Commissions on extra premiums may be different between table extras, multiple extras, permanent flat extras, and temporary flat extras.
- 4.4 Premiums for interim term coverage may be calculated on a special basis, for example using the ultimate YRT rate in YRT treaties.
- 4.5 The refundability of premiums on lapse or death may be different for policy fees than for basic premiums.

#### 5.0 Problems

- 5.1 If the reinsurer is preparing the billing, the bills will often be prepared before all policy adjustments are available to the reinsurer. In such cases the ceding company may wish to make adjustments to the reinsurer's premium billing. This will often be inconvenient and the treaty should specify how premium changes resulting from policy adjustments will be accounted for.
- 5.2 Late payment of premiums may become a problem. Some reinsurance treaties specify interest charges if premiums are late by more than a certain

number of days. In such cases the interest rate or a method of determination should be specified. Payment of interest may be waived if below a minimum amount.

## Premium Taxes

### 1.0 Purpose

- 1.1 To define the reinsurer's participation, if any, in the ceding company's premium tax liabilities.

### 2.0 Scope

- 2.1 This provision is applicable to all reinsurance treaties.

### 3.0 General Elements

- 3.1 A statement of whether or not the reinsurer will reimburse the ceding company for state premium taxes paid by the ceding company on the portion of its premium paid to the reinsurer as a reinsurance premium.
- 3.2 Reimbursement is usually not provided for unless the reinsurer itself is not taxed directly on its own premiums.
- 3.3 The tax rate or the approach to determining the appropriate tax rate is usually stated.

### 4.0 Variations

- 4.1 A stipulated tax rate may be specified, or the actual tax rate for premiums from each state from which reinsurance arises might be used, or the ceding company's average premium tax might be used, or the ceding company may be given a choice between the actual rate and the average rate.
- 4.2 Not uncommonly the net reinsurance premium will be set at a level that recognizes the ceding company's premium tax liability and the treaty will provide for no separate tax reimbursement.
- 4.3 Some treaties will impose a time limit, such as two years, after which the reinsurer would not be obligated to honor a request for reimbursement.

### 5.0 Common Problems

- 5.1 If a stipulated tax rate is employed, the ceding company may find it has inadequate reimbursements if premium tax rates are increased or if it expands into new states with higher premium tax rates.
- 5.2 A sufficiently simple administrative approach to determining the appropriate reimbursement must be adopted.
- 5.3 New taxes not contemplated at the time the reinsurance treaty is initiated may be imposed at a later date. At the time of the writing of this section, we

are witnessing the emergence of the Federal Deferred Acquisition Cost Tax. The requirements of this tax are evolving slowly, but ultimately the appropriate responsibilities of both the ceding company and the reinsurer must be addressed and incorporated into reinsurance treaties. Similar problems could arise with other new taxes.

- 5.4 If the reinsurer is a foreign company subject to Federal Excise Tax, the reinsurance treaty should address the responsibilities of the ceding company to the reinsurer. The treaty should state who is legally responsible for the excise tax, how it is calculated and how the premium base for excise tax purposes is determined.



## **Production and Persistency Bonuses**

### **1.0 Purpose**

- 1.1. A reinsurer might pay production bonuses to reward a ceding company for producing a volume of reinsurance above an agreed threshold level.**
- 1.2. A reinsurer might pay persistency bonuses to reward a ceding company if its policies experience a lapse rate below an agreed threshold level.**

### **2.0 Scope**

- 2.1. Both types of bonuses are rare in the 1990s. They were developed when reinsurers had a limited number of rate scales to offer ceding companies. In order to adjust rates for a specific company's better than average persistency or larger than normal volume, a reinsurer would offer the ceding company discounts from its normal rates in the form of production or persistency bonuses.**
- 2.2. Today, if a reinsurer anticipates that a ceding company will have better than average persistency or larger than normal volume, it can customize its basic rate scale for the company. The ceding company still is rewarded, but the reward appears as a more competitive basic rate rather than by means of a separate persistency or production bonus.**

### **3.0 General Elements**

- 3.1. Production bonuses are typically defined in terms of the new face amount of reinsurance booked by the reinsurer during the calendar year in excess of some threshold level. For example, the reinsurance agreement might stipulate that the reinsurer will pay a production bonus of \$.xx for each \$1,000 of new reinsurance ceded by the ceding company to the reinsurer during the year in excess of a defined threshold, plus an additional bonus of \$.yy for all new reinsurance ceded in excess of a still higher threshold. Reinsurance of certain plans might be excluded from the bonus calculation.**
- 3.2. Persistency bonuses are typically paid on the volume of reinsurance that renews with the reinsurer during a calendar year. The agreement might define the term "persistency rate" to mean, for example, the total face amount of reinsurance reaching its second or later anniversary date as a percentage of the total face amount of reinsurance ceded to the reinsurer during the calendar year. The agreement might then establish the bonus that is to be paid by the reinsurer as a function of the persistency rate achieved and the volume of reinsurance renewing with the reinsurer. The persistency bonus will typically be calculated**

and paid an agreed number of years following a calendar year in which policies are issued. Reinsurance satisfying certain conditions (for example, reinsurance in excess of a defined amount on any one life) might be excluded from the persistency bonus calculation.

#### **4.0 Variations**

- 4.1. A reinsurer might reserve the right to change the basis for a bonus calculation from time to time as its experience studies indicate changes are warranted. Such changes could be made unilaterally.**

#### **5.0 Common Problems**

- 5.1. The amount of production and persistency bonuses paid by the reinsurer depend upon the accuracy of administrative data exchanged pursuant to the reinsurance agreement. If the administrative data is not exchanged on a timely basis or is in error, the amount of bonuses paid will likely be affected. While this is true for both types of bonus, problems are more likely to occur with respect to persistency bonuses.**

## **Reinsurance Rate Guarantees**

### **1.0 Purpose**

- 1.1** In some reinsurance treaties, the reinsurance premium rates on inforce policies cannot be changed by either the ceding company or the reinsurer on a unilateral basis. In other treaties, however, such unilateral changes may be made, under specified conditions, by either or both parties. These conditions are normally set forth in the Reinsurance Rate Guarantees provision.

The purposes for allowing such changes include avoiding deficiency reserves, reflecting changes to indeterminate direct policy elements, and adjusting for changes in the actual or expected experience on the block of business reinsured.

### **2.0 Scope of Provision**

- 2.1** This provision covers the treatment of rate guarantees for Ordinary business reinsured on either a YRT or coinsurance basis. For purposes of this discussion, the YRT rate is the actual YRT premium (net of any stated discount) payable from the ceding company to the reinsurer. The gross coinsurance rate is the reinsured portion of a specified direct policy premium or cost of insurance rate. The net coinsurance rate is the gross rate less the expense allowance.

### **3.0 Deficiency Reserves**

The reinsurer may be required to hold deficiency reserves when guaranteed reinsurance premiums are less than statutorily defined minimum levels. They can be avoided by removing or modifying such guarantees.

#### **3.1. YRT**

- 3.1.1.** If the treaty allows the YRT rates to be raised unilaterally by the reinsurer, then the reinsurer is not required to hold deficiency reserves on otherwise deficient YRT rates. Generally the right to raise rates is subject to maximums equal to statutory valuation premiums.
- 3.1.2.** The existence of deficiencies and the nature of guarantees on the YRT rate are not directly related to the existence of deficiencies or the nature of guarantees on the direct policy premium rates.

#### **3.2. Coinsurance**

- 3.2.1.** Under a coinsurance arrangement, the existence and extent of the reinsurer's premium deficiency is statutorily based on the level of the

gross coinsurance rates. Therefore, the coinsurance premiums collected by the reinsurer are normally deficient to the same extent that the direct policy premiums collected by the ceding company are deficient. It follows that a relaxation of the reinsurance rate guarantees - in other words, letting the reinsurer unilaterally lower the expense allowances - will have no effect on the level of the reinsurer's deficiency.

- 3.2.2. One possible solution to eliminating the reinsurer's premium deficiency would be to create a structure where the gross coinsurance premiums are not directly linked to the direct policy premiums. Except for such special cases as use of a different pricing band for reinsurance, this would involve the creation of a new reinsurance method which is beyond the scope of this discussion.
- 3.2.3. When the direct policy premiums are deficient in a coinsurance arrangement, the treaty may state whether the reinsurer will hold its share of the premium deficiency reserves. If the reinsurer holds deficiency reserves, it may need to coordinate the reserve amount it holds with the reserve credit taken by the ceding company. The reinsurer, however, may prefer that the treaty be silent on this subject. The reinsurer is then free to determine its own deficiency reserves without having to coordinate or communicate with the ceding company. (Note: There are reporting requirements such as Schedule S and New York Regulation 20 which disclose the ceded reserve credit and the assumed reserve; so some coordination between the ceding company and the reinsurer may be necessary.) The valuation basis of deficiency reserve may also need to be established in the treaty if there are significant differences between the ceding company's basis and the reinsurer's basis.
- 3.2.4. Notwithstanding the requirements mentioned in the previous paragraph, there may be a difference in deficiency reserves between ceding company and reinsurer. Some of the situations in which this might occur include the following: (a) The reinsurer is domiciled in a jurisdiction with different reserve requirements than those applicable to the ceding company; (b) The reinsurance premiums are based on a different band; (c) The reinsurance premiums have a different guarantee structure; (d) The coinsurance is on the COI charges under UL policies; (e) Term riders are being coinsured where the rider premiums are deficient but the unreinsured base policy premiums are not deficient (i.e., the ceding company can offset sufficiencies against deficiencies, but the reinsurer cannot); or (f) the reinsurer does not share proportionately in policy fees.
- 3.2.5. Perhaps the best solution to the deficiency reserve problem in a coinsurance situation is to remove the deficiency problem of the ceding company. This can often be accomplished by making the direct policy premiums indeterminate.

#### **4.0 Reflecting Changes to Indeterminate Direct Policy Elements**

Direct policy elements can be considered indeterminate if the ceding company has the unilateral right to modify them on inforce policies. For the purposes of this discussion, such elements will be restricted to direct policy premiums and to direct policy cost of insurance charges on universal life policies. When such flexibility exists on the direct side, it is often desirable to allow similar flexibility in the reinsurance rate guarantees.

##### **4.1. YRT**

Although YRT reinsurance rates are independent of changes to indeterminate direct policy elements, any change to these elements may reflect a revision of the ceding company's expectations with respect to future experience on the policies. The reinsurer, therefore, may wish to have a provision allowing it to raise the inforce YRT rates when such expectations are for worse experience. Similarly, the ceding company may wish to have a corresponding provision allowing it to lower the inforce YRT rates when the expectations are for better experience.

##### **4.2. Coinsurance**

- 4.2.1. Gross coinsurance rates can be directly affected by changes to indeterminate policy elements. Since the expense allowances are normally equal to pre-determined percentages of these rates, they are also directly affected. These allowances, however, are designed to cover ceding company expenses which may or may not vary in the same manner.
- 4.2.2. Either party may wish to include a provision which specifies how such allowances should vary to better match the expense changes resulting from increases or decreases in the indeterminate elements.
- 4.2.3. On the other hand, the reinsurer may want a provision which causes the allowances to vary in a manner which keeps the level of the net coinsurance rates unchanged.
- 4.2.4. The reinsurer may want the right to approve a reduction in the reinsurance premium prior to its effective date. Typically, the ceding company cannot lower the reinsurance premium without the consent of the reinsurer.

#### **5.0 Adjusting for Changes in the Experience on the Business Reinsured**

The appropriateness of inforce reinsurance rates may be affected by changes in the actual or anticipated experience of the reinsured block. Either party may wish to include a provision which specifies how these rates should be adjusted. This can get very complicated, however.

**5.1. The parties should carefully consider whether to leave the treaty silent on this matter, to put in language expressing agreement on general principles only, or to include specific formulas covering each possible situation.**

**5.2. Several issues need to be considered when making these decisions.**

**5.2.1. In YRT situations, should changes to the reinsurance rates be directly linked to changes in the indeterminate elements? This, in turn, may depend on the extent to which the indeterminate element changes are linked to actual or anticipated experience.**

**5.2.2. How will experience be measured? Will it include mortality, persistency, sales volume, total profitability, or some other parameters?**

**5.2.3. How frequently will the calculations be done?**

**5.2.4. What level of statistical credibility will be assigned to experience study results?**

**5.2.5. What will be the basis for expected experience - original pricing assumptions, current pricing assumptions, reinsurance pricing assumptions, etc.?**

**5.2.6. What formulas will be used to translate actual or expected experience into reinsurance rate changes?**

**5.2.7. Should experience studies look at the entire block or just the reinsured portion?**

**5.2.8. To what extent should the application of any formulas be automatic as opposed to discretionary or subject to negotiations?**

**5.2.9. To the extent that profitability is used as a criterion for making changes, how should differences in profit goals, pricing methodologies, pricing assumptions, etc. be reconciled?**

**5.2.10. Should experience refunds be used instead of modified rate guarantees to adjust for actual experience?**

## **6.0 Restrictions on the Rights to Change Inforce Reinsurance Rates**

**As discussed above, there are many situations where either the reinsurer or the ceding company may want a provision giving it the right to unilaterally change the inforce reinsurance rates. In most cases, however, the other party would be unwilling to grant such a right without restrictions.**

**6.1. Examples of such restrictions include the following:**

- 6.1.1. Rate adjustments to avoid deficiency reserves may be limited to the minimum change necessary to eliminate such reserves.**
- 6.1.2. There may be minimum or maximum rates based on specified tables or percentages of current rates.**
- 6.1.3. Rate changes may be subject to actuarial demonstrations based on specific profit or other criteria.**
- 6.1.4. The timing or frequency of such changes may be defined or restricted.**
- 6.1.5. Change in inforce rates may be linked to new business rates.**
- 6.1.6. Changes to YRT rates could be automatically linked to changes in indeterminate direct premium rates.**
- 6.1.7. Changes may be allowed only after the party making the change has given prior written notice (e.g., 90 days) and the other party has the right to require recapture. This approach might not be effective for excess retention situations.**
- 6.1.8. Coinsurance rates could be frozen so that changes to the direct policy premiums would not result in coinsurance rate changes unless the treaty were amended.**

## **Recapture**

### **1.0 Purpose**

- 1.1 This provision establishes the terms and conditions under which eligible reinsurance is recaptured by the ceding company.**

### **2.0 Scope**

- 2.1 This provision is limited to reinsurance coverage which can be recaptured at the ceding company's option.**

### **3.0 General Elements**

- 3.1 Amount of reinsurance to be recaptured on a policy or policies is generally equal to the difference between the ceding company's current retention per life and the retention in existence at the time the reinsurance was originally ceded or last recaptured.**
- 3.2 There is a certain initial period, usually 10-15 years after the reinsurance is originally placed, during which it can not be recaptured, even if the retention is increased prior to the end of that period. The purpose of this initial period is to allow the reinsurer to recover their initial costs.**
- 3.3 A written notice must be given to the reinsurer usually 30 days in advance of the ceding company's intention to recapture on the next anniversary date or on the first anniversary date following the period specified in 3.2 above. Recapture provisions include certain limitations on the ceding company to avoid anti-selection against the reinsurer. Two examples are: if the ceding company elects to recapture, the election must typically be exercised at the time the ceding company increases its retention and typically all policies, regardless of the mortality classification of the risk ceded and whether ceded automatically or facultatively (except as noted in 4.3 below) must be recaptured.**
- 3.4 The reinsurance agreement will typically require that the recaptured policies must be held at the ceding company's own risk except for the cession of catastrophic reinsurance.**

### **4.0 Variations**

- 4.1 Initial period during which recapture cannot occur may vary significantly.**
- 4.2 Ceding company must recapture all eligible business up to its new retention limits, which can vary by age and table rating.**
- 4.3 Business on which the ceding company did not keep its full retention at issue is usually excluded from recapture.**



- 4.4 Most reinsurance agreements require proportionate recapture of business if several reinsurers are involved. The calculation of proportionality is based on all other reinsurance on the life even if other reinsurance agreements do not provide for recapture.**
- 4.5 Recapture of coverage on disabled lives occurs even though the waiver of premium claim stays in effect.**
- 4.6 It specifically deals with the when, how and what amount can be recaptured automatically without the reinsurer's approval. Obviously, the reinsurer and ceding company can enter into "special" arrangements to recapture business under mutually agreed upon conditions.**

## **5.0 Common Problems**

**Unknown**

## **Reductions and Terminations**

### **1.0 Purpose**

- 1.1. This provision addresses how the allocation of liability between ceding company and reinsurer is affected when the amount of insurance in force with the ceding company on an individual life insurance policy is reduced or terminated.**

### **2.0 Scope**

- 2.1. The provision typically does not apply to reductions in insurance resulting from the purchase of reduced paid up or extended term insurance due to the operation of nonforfeiture provisions. These matters are typically dealt with elsewhere in the agreement.**
- 2.2. If a policy reduces or terminates and is subsequently reinstated, the reinstatement of reinsurance is typically addressed elsewhere in the agreement.**
- 2.3. Related topics addressed in other provisions include recapture and risk amount fluctuations.**

### **3.0 General Elements**

- 3.1. Reductions and terminations can be dealt with on a "by life" or "by policy" basis. If on a "by life" basis, reinsurance could be affected if any insurance being provided by the ceding company is reduced or terminated, regardless of whether the specific policy being reinsured is reduced or terminated.**
- 3.2. The purpose of a "by life" reduction is typically to reduce as much reinsurance as is necessary to maintain the ceding company's full retention on the life, although reductions could also be shared proportionately by the ceding company and reinsurers. If the object is to return the ceding company to its full retention, reinsurance will be reduced in an amount equal to the reduction of insurance on the life, but not to exceed the total amount of reinsurance on the life.**
- 3.3. For "by life" reductions, reinsurance is typically reduced on the reduced or terminated policy first. The balance of the reduction, if any, is then applied to any remaining in force policies on the life, typically chronologically according to policy date. "Chronologically according to policy date" can either mean "last-in, first-out" or "first-in, first-out" as agreed to between the parties and specified in the agreement.**
- 3.4. Whenever reinsurance on a particular policy is affected if a number of**

reinsurers are involved, the reduction will affect all reinsurers proportionately (including second excess reinsurers).

- 3.5. If reductions are administered on a "by life" basis, consideration might be given to whether reductions will reduce reinsurance on policies ceded facultatively.
- 3.6. The effective date of the reduction in reinsurance should be set forth. Typically this is the same date that the ceding company policy was reduced or terminated.

#### 4.0 Variations

- 4.1. Reductions and terminations can be dealt with on a "by policy" basis as an administrative expedient. If on a "by policy" basis, the only reinsurance affected is that on the policy being terminated or reduced.
- 4.2. If reductions are on a "by policy" basis, the reduction in reinsurance will equal the lesser of (1) the amount of reduction to the reinsured policy and (2) the amount of reinsurance on that policy.

#### 5.0 Common Problems

- 5.1. When deciding upon the structure of this provision, the ceding company could benefit by assuming that it has issued three policies to the same individual, the first of which is fully retained while the other two are fully reinsured with different reinsurers. If the first policy terminates, the ceding company should consider what adjustments, if any, it would like to see made to its reinsurance program.
- 5.2. If reductions are "by life," the ceding company should determine if its electronic data processing systems can connect all policies to the same life in order to properly administer the reductions article. A "by life" provision is typically a more difficult provision to administer than is a "by policy" reduction provision. This issue might be further complicated if the ceding company has developed a separate administrative system for facultative cessions.
- 5.3. If the ceding company has a number of reinsurance agreements involving multiple reinsurers, it may have difficulty coordinating the reductions articles under its various agreements. The company should ask itself whether all its agreements handle reductions on the same basis.
- 5.4. The ceding company should determine that the agreement discusses the reinsurer's obligation to return unearned premium (less unearned allowances, if any) with respect to reduced reinsurance.

- 5.5. Concurrently issued policies can be a source of problems when analyzing reductions and terminations. Typically, ceding companies treat the policies as one issue and reduce reinsurance in accordance with agreement terms.**
- 5.6. Administration of a "by life" provision can be complicated if the ceding company has retention limits that vary by plan of insurance and it has in-force policies on a life on more than one plan of insurance.**

## **Re-entries**

### **1.0 Purpose**

- 1.1 The purpose of this provision is to define the rights and obligations of the ceding company and the reinsurer when a re-entry occurs.**

### **2.0 Scope**

- 2.1 A re-entry occurs when the premium rates on an inforce select and ultimate policy revert to an earlier select duration (usually first year), based on the current attained age.**

### **3.0 Common Elements**

- 3.1 The insured must provide either full or partial new evidence.**
- 3.2 The treaty should specify to what extent, if any, the reinsurer may participate in determining discretionary elements.**
- 3.3 The treaty should indicate whether or not the recapture period is restarted.**

### **4.0 Variations**

- 4.1 The re-entry (or reversion) may be either contractual or noncontractual.**
- 4.2 The policy may specify the durations, ages, or other circumstances necessary for the election to re-enter.**
- 4.3 The policy may provide full first year compensation upon re-entry, no extra compensation at all, or something in-between.**
- 4.4 If new medical evidence is required, it may at the expense of the policyholder, the insurer, or shared.**
- 4.5 The company may have discretion with respect to some policy elements, such as current premium levels, upon re-entry.**
- 4.6 The suicide and incontestability clauses may or may not be restarted.**

### **5.0 Common Problems**

- 5.1 Re-entry may not be covered adequately during treaty negotiation, thus becoming a significant area for potential disagreement between the ceding company and the reinsurer.**
- 5.2 The reinsurer's participation may be limited by the ceding company's ability to administer.**

**5.3 Many of the problems are similiar to those for continuations.**

## **Reinstatements**

### **1.0 Purpose**

- 1.1 The purpose of this provision is to define the rights and obligations of the ceding company and the reinsurer when a policy is reinstated.**

### **2.0 Scope**

- 2.1 A reinstatement occurs when a policy is put back in force after having lapsed for nonpayment of premium.**
- 2.2 The ceding company may require full or partial new evidence before reinstating the policy.**
- 2.3 The rights of the policyholder with respect to reinstatement may be fully or partially set forth in the policy. The company may retain some discretion with respect to the reinstatement decision.**
- 2.4 Usually back premiums, with or without interest, are required for reinstatement.**
- 2.5 The company is not liable for any claims occurring subsequent to lapsation and prior to reinstatement.**
- 2.6 This provision does not deal with situations where the policyholder does not lapse and the problem occurs strictly between the ceding company and the reinsurer. Such situations involving the reinstatement of reinsurance coverage are usually discussed in the Premiums provision.**

### **3.0 General Elements and Variations**

- 3.1 The treaty usually states that the reinsurer will follow the ceding company's actions on reinstatements.**
- 3.2 Some reinsurers reserve the right to review and approve the evidence of insurability for those policies originally reinsured on a facultative basis.**
- 3.3 The right to review and approve evidence may also be contingent upon the reinsurer's share of the risk (e.g., greater than 50%), or the length of time between lapsation and reinstatement (e.g., greater than 90 days).**
- 3.4 Normally, the reinsurer will be paid back premiums and interest only to the extent the ceding company collects them from the policyholder.**

#### **4.0 Common Problems**

- 4.1 A reinsurer will normally assume that no gap in coverage will be permitted when a policy is reinstated. If this is not the practice of the ceding company, the treaty should specifically address the issue.**
  
- 4.2 Through administrative error, the ceding company may fail to obtain prior approval from the reinsurer before reinstatement of a facultative case or other case on which such approval is required.**



## **Reinsured Risk Amount Determination Provision**

### **1.0 Purpose**

- 1.1. This provision defines the reinsured risk amount for reinsurance benefit and reinsurance premium calculation purposes for coverages where only the mortality risk is reinsured.**

### **2.0 Scope**

- 2.1. The reinsured risk amount is germane to YRT reinsurance and coinsurance of the mortality element in Universal Life and other interest sensitive type products.**
- 2.2. The reinsured risk amount is distinguished from the reinsurance amount. The reinsurance amount can be defined as the face amount of insurance less the ceding company's retention on the policy. Unlike the reinsured risk amount, which usually varies by duration, the reinsurance amount is constant. Automatic coverage is usually expressed in terms of the reinsurance amount. Recapture and reductions also apply to the reinsurance amount. Under single premium plans of insurance, where there is a significant difference between the reinsurance amount and the initial reinsured risk amount, automatic coverage may be expressed in terms of the initial reinsured risk amount rather than the reinsurance amount.**

### **3.0 General Elements**

- 3.1. There is no absolute or necessary definition of the reinsured risk amount; it is simply what the parties agree it to be. However, a definition which produced reinsurance coverage for an amount greater than the ceding company's liability on the policy reinsured or greater than the reinsurance amount, would generally be considered inappropriate and contrary to public policy.**
- 3.2. The basic approach is to attempt to approximate the amount of reinsurance the ceding company needs, that is, the money it would be out of pocket, in excess of its retention, upon the insured death at various points in time. Generally, the death benefit less the retention less the terminal reserve would provide an acceptable result.**

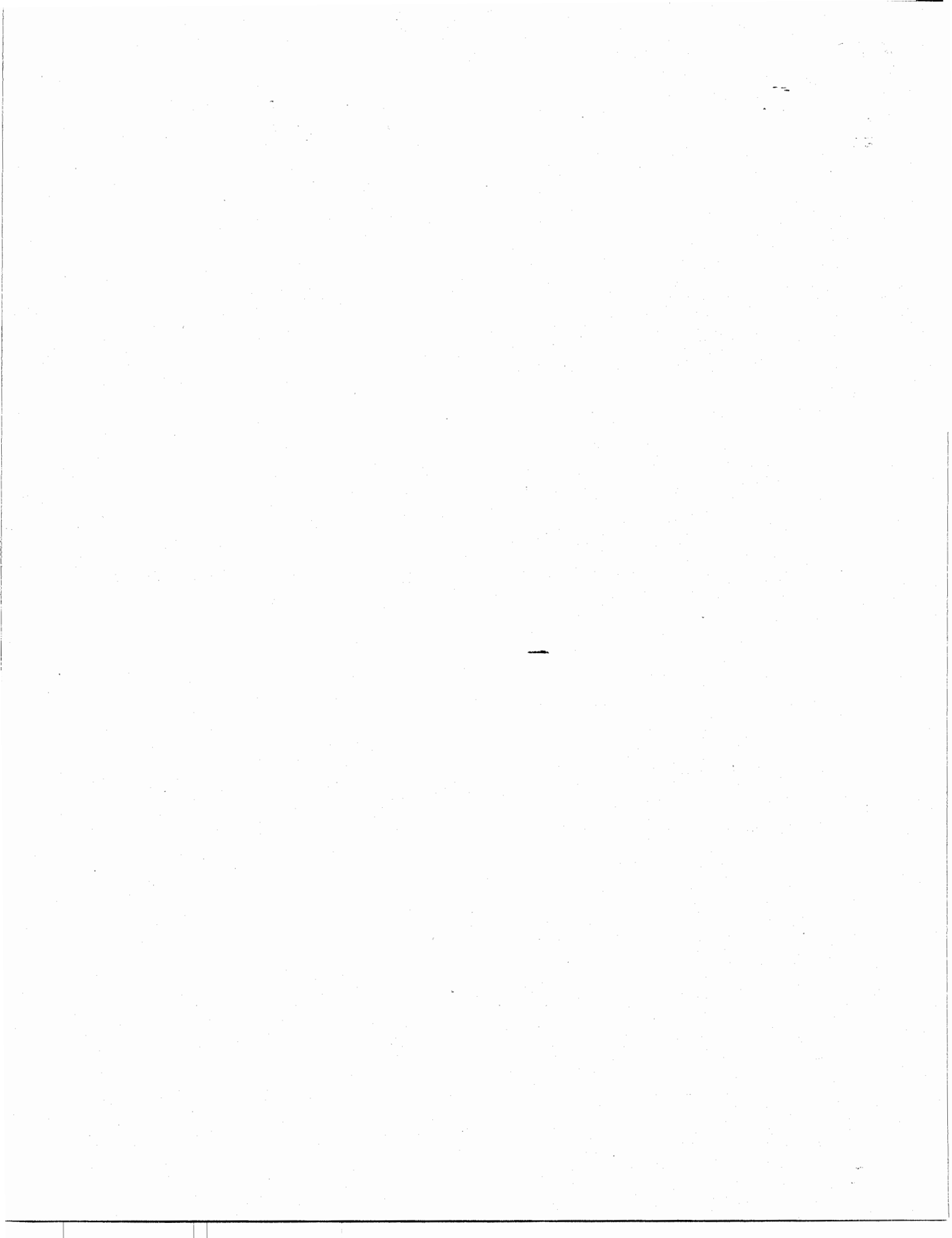
### **4.0 Variations**

- 4.1. "Policy Values" other than the terminal reserve may be used as a decrement in calculating the reinsured risk amount.**
  - 4.1.1. Cash values are commonly used with traditional permanent plans of insurance and almost exclusively with interest sensitive products.**

- 4.1.2. For administration or programming ease, an agreed upon arbitrary, constant amount, such as \$25 or \$50 per thousand per year, may be used as the decrement. When this approach is used, different values may be assigned to different plans of insurance.
- 4.1.3. When terminal reserves or scheduled tabular cash values are used, the precise policy year value may be employed for each duration or a level decrement may be used by making a straight-line interpolation between the policy values of one duration and some future duration.
- 4.1.4. A proportionate risk retention basis may be used where only the policy values attributed to the reinsured portion of the policy are used to reduce the reinsured risk amount. Alternatively, a level risk retention basis may be employed under which the policy values of the whole policy are used to reduce the reinsured risk amount leaving the ceding company's retained risk level at all durations.

## 5.0 Common Problems

- 5.1. Under traditional products both the death benefit and the "policy values" are predictable in advance. Under many contemporary products, such as variable life and universal life, this is not true. A problem therefore arises if such products are to be ceded on an individual cession basis where a schedule of prospective reinsured risk amounts for five or more years is usually required.
  - 5.1.1. The most common solution is to use a projection of estimated risk amounts. The ceding company and the reinsurer must agree in advance how these estimates are to be developed. Often they are based on target premiums and sales illustrations.
  - 5.1.2. The estimated risk amounts can, of course, deviate from the actual risk amounts significantly, especially over a period of time. It may, therefore, be agreed that if the deviation exceeds a specified dollar amount or percentage, the cession will be corrected with a new schedule of projected risk amounts starting from the current actual reinsured risk amount. To avoid frequent cession amendments, it is sometimes agreed that the cession will not be changed more frequently than every two or perhaps three years.
  - 5.1.3. If such products are ceded on a self-administered bordereau basis, no reporting problem exists and the actual risk amounts are used as they emerge.
- 5.2. If the reinsurance premium is annual and the death benefit varies throughout the year, a question arises as to what reinsured risk amount should be used.



## **Reinsurance Reporting**

### **1.0 Purpose**

- 1.1 This provision outlines the documentation that will be provided by the ceding company and the reinsurer in the process of transacting business.**

### **2.0 Scope**

- 2.1 "Applications for reinsurance" is discussed in detail elsewhere in this document.**
- 2.2 The following elements should be addressed:**
  - 2.2.1 Notification of new business, both automatic and facultative**
  - 2.2.2 Premium calculations: Premium rates should be included in the treaty, usually as an appendix. Premium rates may be produced by the ceding company or by the reinsurer. Payment frequency and method of calculating risk amount should be included as well.**
  - 2.2.3 Policy changes: changes in face amount, terminations (lapses, expiries, surrenders, replacements, conversions, reinstatements, recaptures).**

**Under some agreements, terminations may not be reported and premiums are based on amounts in force at various points. This method is commonly used for accidental death coverages. The reinsurer's approval may be needed for reinstatement of facultative policies but not automatic policies.**

- 2.2.4 Claims**

- 2.2.5 Statistical information, e.g., reserves, policy count information for annual statement reporting.**

- 2.3 Sample reporting formats should be included in the treaty.**

### **3.0 General Elements**

- 3.1 Frequency: The frequency with which each item is reported should be specified, e.g., monthly, quarterly. For example new business may be reported quarterly and claims monthly.**
- 3.2 Timeliness: The length of time after the end of the reporting period within which the report must be mailed should be specified, e.g., 15 days after the end of the reporting period.**

- 3.3 Method of Reporting:** The method may be paper records, magnetic tape, or direct computer to computer communication. The choice of method determines which party has responsibility for administration including reserves.
- 3.4 Level of Detail:** It should be clear what information is needed for each reporting element, e.g. is date of birth needed or only age, do premiums need to be separated into first year and renewal? Special attention should be paid to riders and potential future risks such as Guaranteed Insurability Benefit (GIB) coverage.

The Society of Actuaries has developed a reporting format for self administered business which can serve as a guideline. Separate consideration may be needed for facultative business.

#### **4.0 Variations**

- 4.1 Variations in reporting are common.** Most reinsurers accept a variety of formats usually out of necessity, not choice. Software products are often customized per client so a common standard is elusive even with the same software vendor.
- 4.2 Frequency of reporting often varies by product, e.g.,** annually for bulk accidental death coverage and monthly for disability income business.

#### **5.0 Common Problems**

- 5.1 Late reporting occurs frequently.** When a period is 20 days after month end instead of 15 this is not a major problem. When policies are reported very late problems can develop. See Errors and Omissions section. Interest penalties may be present for late payments by either party.
- 5.2 Companies change their reporting format without informing their reinsurers.**
- 5.3 Information may be missing.**
- 5.4 Reinsurers may need information which is not relevant to the ceding company; e.g.,** reinsurer licensed in New York and ceding company not licensed in New York. Deficiency reserves and cash flow testing for annuities may vary by state of domicile. "Small company" rules may apply to the ceding company but not the reinsurer or vice versa.

## **Schedules, Exhibits and Amendments**

- 1.0 Purpose is to clarify, modify, add, or delete items of the basic reinsurance agreement.**
- 2.0 Scope**
  - 2.1 Schedules and Exhibits are used to clarify and explain items of a reinsurance contract that vary or cannot be preset in the basic body of the agreement.**
  - 2.2 Amendments are usually added to a agreement at a date after the effective date of the agreement. An amendment typically adds or deletes items that have changed since the original effective date.**
  - 2.3 Schedules, Exhibits, and Amendments are considered part of the agreement to which they are attached.**
  - 2.4 The new NAIC Model Regulation on Life and Health Reinsurance Agreements provides that for coinsurance and modified coinsurance agreements "any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties."**
- 3.0 General Elements**
  - 3.1 Virtually any subject or item that does vary or cannot be preset or established in the body of the agreement needs to be conventionally put into a Schedule or Exhibit. The possibilities are virtually endless, but some examples are:**
    - Retention Schedule
    - Automatic Acceptance Limits
    - Inforce and Applied for Limits
    - Plans, riders and benefits reinsured
    - Issue Age Limits
    - Reinsurance rates and method of calculating such, both automatic and facultative
    - Special underwriting rules and guidelines
    - How the reinsured amount is determined, e.g., reinsurer's share (alphabet or percentage)
    - Recapture period
    - Cession forms or self-administered formats
    - Etc.

**3.2 Amendments are usually reserved to reflect a change to the agreement that has typically occurred after the effective date of the agreement. Again, the possibilities are virtually unlimited but some examples are:**

- Add new or additional plans to be reinsured under the contract
- Change in retention and automatic acceptance limits
- Change reinsurer's share
- To terminate the agreement as to new business
- Change the method of administration or reporting
- Etc.

#### **4.0 Variations**

Each reinsurer typically has its own style for Schedules, Exhibits, and Amendments. Consequently, it is important that ceding companies review or put together these carefully since they contain some of the most important pieces of the agreement.

#### **5.0 Problems**

**5.1 Difficult to obtain consensus or uniformity among reinsurers for these documents in the agreement. If more than one reinsurer is involved the ceding company may want to either prepare these documents itself or to have one lead reinsurer prepare it for all.**

**5.2 As mentioned under 2.4 as the NAIC Model Regulation for Life and Health Reinsurance Agreements is passed by more states at least for coinsurance and modified coinsurance agreements, informal or side letters of agreement or verbal agreements will no longer be acceptable.**

## **Scope of Coverage**

### **1.0 Purpose**

- 1.1 The provision outlines the coverages that the ceding company is reinsuring with the reinsurer.**

### **2.0 Scope**

- 2.1 The ceding company's retention, both method and amount, should be specified. This is especially important for increasing face amount policies.**

### **3.0 General Elements**

- 3.1 The provision would indicate which products, including any supplementary benefits and riders, are being reinsured, e.g., 10 Year Term. Policy form numbers may be used to avoid confusion if the ceding company has similar products reinsured differently.**
- 3.2 The provision would indicate the time-frame of coverage. Usually only a start date is given with an open-ended finishing date. The controlling event measured by the time-frame should be specified, e.g., application date, policy issue date, etc.**
- 3.3 The provision should specify the method of reinsurance, excess share over the ceding company's retention, or quota-share with the ceding company. The method may change after certain amounts.**
- 3.4 The provision should specify the method of dividing the reinsurance if more than one reinsurer is involved, e.g. alpha split, quota-share split of reinsurance.**
- 3.5 The provision should specify whether the reinsurer will accept the ceding company's underwriting decision, possibly within some limits, or whether the reinsurer must underwrite each policy.**
- 3.6 The provision should indicate any limitations in coverage or areas where coverage is not provided, e.g., company keeping none of the risk.**
- 3.7 The provision would specify variations in coverage by issue age, sex or rating method.**
- 3.8 The provision would specify any geographic limitations.**



#### **4.0 Variations**

- 4.1 Some agreements may require the reinsurer to accept a risk but not require the ceding company to place the risk with the reinsurer. Usually additional restrictions will apply to such cases, e.g., the ceding company has kept its full retention on that policy.**
- 4.2 Coverage may be on a coinsurance basis up to a certain amount and YRT thereafter.**
- 4.3 Some agreements may cover only closed blocks of business.**
- 4.4 Some agreements may cover business sold by affiliated companies.**

#### **5.0 Common Problems**

- 5.1 Some terms used may be imprecise. For example, if coverage is provided at "All Ages" and the ceding company increases its maximum issue age for a product, is coverage still provided?**
- 5.2 Often not all areas of a ceding company may be aware of limitations in an agreement.**
- 5.3 If a previous treaty used application date as the determining factor and the successor treaty uses issue date, an overlap or gap in coverage may exist.**
- 5.4 If application date is used, it may be difficult to fix a date for policies whose underwriting was lengthy due to additional requirements being needed.**
- 5.5 Application date may not be provided by ceding company.**

## **Termination of Reinsurance**

### **1.0 Purpose**

- 1.1 This provision sets forth the terms and conditions under which a reinsurance treaty is terminated.**

### **2.0 Scope**

- 2.1 It covers conditions under which the treaty can be terminated by either the ceding company or the reinsurer for new business only.**
- 2.2 Reinsurance coverage on inforce business can be terminated only for non-payment of reinsurance premium or by mutual agreement. If inforce coverage can be terminated unilaterally by the reinsurer for other reasons, the ceding company may not be able to get a reserve credit.**

### **3.0 General Elements**

- 3.1 Ceding company should be given sufficient time to make other reinsurance arrangements with regard to new business.**
- 3.2 Reasons should be given by either party for terminating the treaty.**
- 3.3 If the treaty covers all the ceding company's new business, coverage may be terminated on all new business or just part of it.**
- 3.4 Typically the treaty is of unlimited duration requiring positive action of either party to terminate it. Alternatively, some treaties come up for renewal on a periodic basis.**
- 3.5 Consideration might be given to the effect of ceding company insolvency on the termination of the treaty. What happens to new business in the process of being issued? The treaty should spell out what would happen in event of insolvency.**
- 3.6 Effective date of termination for treaty should be clearly defined.**
- 3.7 Termination of coverage for non-payment of reinsurance premiums.**
  - 3.7.1 Applies only to coverage with reinsurance premiums in arrears.**
  - 3.7.2 Reinsurer should give ceding company prior notification of intention to terminate so that ceding company can pay back premiums and avoid termination.**

**4.0 Variations**

None recorded

**5.0 Common Problems**

Unknown

## **Underwriting Procedures and Evidence Rules**

### **1.0 Purpose**

- 1.1 The provision specifies the selection process to be used by the ceding company for underwriting business that it will reinsure automatically with the reinsurer.**

### **2.0 Scope**

- 2.1 The provision would specify the information obtained, how it is analyzed and the procedures used to put the coverage into effect.**

### **3.0 General Elements**

- 3.1 Applications, reinstatement rules, and conditional receipt forms may be included in the treaty. Any supplemental questionnaire such as aviation or finances may be included as well.**
- 3.2 The provision usually would state that the ceding company's normal underwriting standards would apply. Reference to the underwriting manual used may be included.**
- 3.3 The provision would require the ceding company to inform the reinsurer of changes in its requirements.**

### **4.0 Variations**

- 4.1 Guaranteed Issue or Simplified Issue business should be explicitly covered.**

### **5.0 Common Problems**

- 5.1 The ceding company deviates inappropriately from normal underwriting rules without getting the reinsurer's approval.**
- 5.2 The ceding company changes its procedures without informing the reinsurer.**
- 5.3 Ceding companies fail to keep reinsurers up-to-date on all underwriting and evidence procedures.**
- 5.4 Details regarding underwriting are not discussed until after the treaty is effective. Pre-treaty audits can avoid problems in this area.**

