

# General Provisions Draft 1

## 1.0 Purpose

- 1.1 A collection of brief and generally unrelated provisions that are commonly found in a reinsurance agreement
- 1.2 Note: It is rare for today's reinsurance agreements to actually have an article named General Provisions; many of the provisions outlined as part of the General Provisions article in the ACLI Source Book are frequently found as stand-alone articles in today's reinsurance agreements.

## 2.0 Scope

- 2.1 See description of individual elements

## 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 this is a simple statement of the currency to be used for all financial transactions under the treaty.

### 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. The ceding company can pass the currency risk to the reinsurer by stipulating that the currency used for reporting and settlement be based upon that of the ceding company.
- 5.5 To mitigate the potential currency risk involving two companies of different country's domicile, the treaty structure may employ funds withheld coinsurance. Suggest that the Reader be provided a link to learn more about FW.

## **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 one 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.

4.4 Without limiting the generality of the forgoing the records maintained by the ceding company shall include [list those records the reinsurer expects that as a absolute minimum], must be maintained.

4.5 Usually states the cost of the audit is at the reinsurer's expense. The ceding company and the reinsurer could negotiate who is to pay for in-house costs such as the copying expense and employee time.

4.6 The reinsurer and its representative will not use any information obtained through any inspection for any purpose not relating to the reinsurance.

4.7 The reinsurer will have the right to take copies of books, records and papers of the Company in connection with any reinsurance or claims.

4.8 .The ceding company will keep all such books and records as would reasonably be expected of a prudent insurance company.

- 4.9 The ceding company will make its officers and employees available to reinsurer to provide information concerning the reinsurance.
  - 4.10 This clause relates only to information relating to the Agreement in which it is contained and not across multiple agreements between the same ceding company and reinsurer.
- 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.
  - 5.5 The ceding company and the reinsurer can discuss if the audit process should be limited to once a year.
  - 5.6 The ceding company may benefit from this being a mutual right such as in facultative cessions.
  - 5.7 A further confidentiality notice is usually not needed in relation to the audit but may included language that any information that the reinsurer learns as a result of an audit shall also be considered as “Proprietary Information” (as described in the ACLI book p 57).
  - 5.8 The agreement should specify how much prior notice that the audited company should have prior to the actual audit.
  - 5.9 Is there any benefit to having the ceding company comply with a self-audit and stipulate upon such self-audit the E&O would apply in specific limited circumstances in relation to the block of business that had been audited? – This question really belongs in the E&O section.
  - 5.10 Is the Confidentiality applicable if as a retro?

## 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 of modified coinsurance than for YRT reinsurance.

### 2.0 Scope

- 2.1 **Coinsurance of 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.

## Premium Taxes

### 1.0 Purpose

- 1.1 To define the reinsurer's participation, if any, in the ceding company's premium or federal excise 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 of state premium taxes paid by the ceding company of 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 Frequently (more common than not) 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. However, if a specific rate is not employed, the reinsurer can have a difficult time pricing for the reimbursement provision.
- 5.2 A sufficiently simple administrative approach to determining the appropriate reimbursement must be adopted.

- 5.3 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 if the reinsurer would be reimbursing the ceding company, how it is calculated and how the premium base for excise tax purposes is determined.
- 5.4 The practice of ceding companies asking the reinsurers to participate in premium tax reimbursements for traditional yrt reinsurance agreements is not a common practice.

## Minimum Cession

### 1.0 Purpose

1.1 To define the provision that covers the minimum amount of insurance ceded.

### 2.0 Scope

2.1 This provision is applicable to all reinsurance treaties.

### 3.0 General Elements

3.1 This is an amount below which reinsurance will not be ceded. Usually, the amount is a “nuisance” amount, designed to assure that the expense of administering related reinsurance transactions don’t exceed the value of the reinsurance. With the increased automation of reinsurance administration and reinsurance claim recoveries, use of a minimum cession has decreased significantly.

### 4.0 Variations

Unknown

### 5.0 Common Problems

5.1 The treaty should anticipate that there may be changes in the size of the existing policies.

5.2 The treaty should define “amount” since it can mean several things such as face, or account value.

5.3 Define “minimum Cession” as it relates to the reinsurance treaty such as whether it is a quota share or \$##,### amount.

## **Underwriting Standards, Practices and Procedures**

### 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.
- 1.2 A similar process is sometimes specified for a selection process to be used by the ceding company for underwriting business that it will cede to the reinsurer on a facultative basis.

### 2.0 Scope

- 2.1 The provision would specify the information obtained, how it is analyzed, the underwriting guidelines or standards to be applied, and the practices and 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 standard underwriting guidelines would apply. Reference to the particular underwriting manual used may be included.
- 3.3 The provision would require the reinsurer's consent in writing to any material changes. A specific time limit for providing consent should be included. The ceding company and the reinsurer should agree on a process for obtaining consent from the reinsurer. For example, if the reinsurer does not respond within a certain time period, then the ceding company will assume reinsurer consent. Or, if the reinsurer does not respond within a certain time period, then the ceding company is required to follow-up and that non-response does not imply consent by the reinsurer.

### 4.0 Variations

- 4.1 Guaranteed Issue or Simplified Issue business should be explicitly covered. The ceding company could be required to apply the underwriting guidelines, practices and procedures identified by the ceding company in a questionnaire.
- 4.2 The provision may make reference to a specific underwriting manual that the ceding company must follow.

## 5.0 Common Problems

- 5.1 The ceding company materially deviates from the specified underwriting guidelines or standards without obtaining the reinsurer's consent.
- 5.2 The ceding company materially changes its procedures without obtaining the reinsurer's consent.
- 5.3 The ceding company fails to keep reinsurer informed of all material changes to underwriting and evidence procedures. The ceding company and reinsurer should define what constitutes a "material" change.
- 5.4 Details regarding underwriting are not discussed until after the treaty is effective. Pre-treaty audits and questionnaires can avoid problems in this area.
- 5.5 The reinsurance agreement should include specific language for the remedy for failure to obtain consent.
  - 5.5.1 A treaty provision specifically stating that the reinsurer is not liable for risks that were written contrary to the specified underwriting guidelines or standards could be included.
  - 5.5.2 Another common remedy is that policies written outside of guidelines without written consent from the reinsurer will be automatically excluded from the reinsurance coverage.
- 5.6 It is not unusual to see specific treaty language that would consider professional athletes/actors on a facultative basis only. A definition of what constitutes a profession in athletics and acting should be included. The ceding company and reinsurer also consider these potential policyholders on a catastrophe coverage basis.

## Interest Rates

### 1.0 Purpose

- 1.1 This provision specifies the process to be used for accruing interest on amounts due or past due either party.

### 2.0 Scope

- 2.1 This provision is applicable to all reinsurance treaties.

### 3.0 General Elements

- 3.1 A statement of when and upon what basis interest will be calculated for amounts due on the date the payment becomes due, except as specified elsewhere in the agreement.

### 4.0 Variations

- 4.1 Common bases used are LIBOR and US Treasury rates (such as the 3 year)+ ## basis points. The reinsurance agreement should be specific as to determining the first business day that is used to specify such rate. For example, the 1 year US Treasury on the business day following the last day in the current accounting period.
- 4.2 The reinsurer and ceding company should define a time frame at what time the interest rate on amounts deemed past due should start accumulating.
- 4.3 The reinsurer and ceding company should understand exactly how this amount should be calculated.

### 5.0 Common Problems

- 5.1 The reinsurer has the right to waive the interest charges on amounts past due as specific in "Waiver" clause language, particularly in nuisance amounts or for the benefit of good client relations.