Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Reinsurance Credit**

**Check (applicable entity):**

P/C Life Health

Modification of existing SSAP

New Issue or SSAP

Interpretation

Description of Issue:

Regulators brought to the attention of the Working Group concerns regarding short-duration health reinsurance contracts which were termed quota share treaties but had features that limited the reinsurer’s risk. Concerns were noted that the reinsurance contracts were reported as meeting the “risk transfer” requirements under statutory accounting, but were not meeting “risk-transfer” requirements under U.S. GAAP. In addition, concerns were raised on whether similar reinsurance contracts that may meet risk transfer requirements for statutory accounting were taking a larger reinsurance accounting benefit than appropriate because the risk limiting features in the reinsurance contracts were limiting the actual amount of risks transferred. The Working Group directed NAIC staff to research and prepare an agenda item for subsequent discussion. Subsequent to this direction, the Working Group also received a referral from the Financial Analysis (E) Working Group noting additional concerns with short-duration contacts in particular and with a request that reinsurance disclosures designed to identify contracts with risk limiting features or noncompliant contracts that are required for SSAP No. 62R also be in SSAP No. 61R (See Activity to Date).

This agenda item addresses reinsurance risk transfer and accounting issues for clarification in statutory accounting primarily focused on reinsurance of short-duration products.

**Overview of SSAP No. 61R** *(See Authoritative Literature in appendix for quotes of referenced material)*

1. The scope of SSAP No. 61R is reinsurance of life deposit type and accident and health contracts.
2. While the majority of life contracts are long-duration, health has both long-duration (examples are long-term care and long-term disability) and short-duration products (example is group comprehensive health).
3. SSAP No. 61R explicitly quotes more of the FAS 113 long-duration contract risk transfer guidance.
4. Because SSAP No. 61R has more of a life contract (long-duration) focus it does not explicitly quote as much of short-duration risk transfer guidance from U.S. generally accepted accounting principles (GAAP) as *SSAP No. 62R—Property and Casualty Reinsurance*.
5. SSAP No. 61R adopts the following:
6. GAAP guidance - *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) with modifications; FAS 113 provides general risk transfer guidance but the majority of the guidance is different based on the classification categories of long-duration contracts and short-duration contracts. (FAS 113 requirements were incorporated into FASB codification primarily in ASC 944-20 and the key risk transfers aspects of FAS 113 are unchanged by FASB codification.)
7. Appendix A-791—*Life and Health Reinsurance Agreements* (Appendix A-791) is based on NAIC *Model Law 791—Life and Health Reinsurance Agreements* (Model 791). It provides criteria for reinsurance accounting for proportional reinsurance contracts (see additional detail in following pages). Reinsurance contracts which receive reinsurance accounting under Appendix A-791 do not contain identified features which negate risk transfer. In addition, Appendix A-791 identifies significant risk categories by line of business that must be 100% ceded. The major risk categories are morbidity, mortality, lapse, credit quality, reinvestment and disintermediation. The current version of Model 791 was adopted by the NAIC in 1992.
8. Appendix A-785 is based on NAIC *Model Law 785- Credit for Reinsurance* (Model 785) which contains detailed information regarding when collateral is required and what types of collateral are acceptable in order to obtain credit for reinsurance. In general, collateral is required for unauthorized reinsurers and there is a sliding scale of collateral required for certified reinsurers. Model 785 is not the focus of this agenda item.

**SSAP No. 61R adopts FAS 113 with modifications** *(See Authoritative Literature in appendix for quotes of referenced material)*

SSAP No. 61R, paragraph 78, adopts FAS 113 with modifications noting that the statutory accounting principles established, reflect much more detailed guidance which differ substantially from GAAP. The documented list of statutory accounting modifications from FAS 113 includes 7 listed topics which are summarized below:

1. Reinsurance accounting reserve credits reduce reserves for policies, claims and unpaid claims (¶78.a.);
2. First year and renewal ceding commissions on indemnity reinsurance of new business are recognized as income and ceding commissions on ceded in-force business are included in the calculation of initial gain or loss (¶78b);
3. Initial gains on indemnity reinsurance of in-force blocks of business have unique accounting treatment which restricts the gains to the ceding entity until profits emerge (¶78d).
4. SSAP No. 61R prohibits recognition of a gain or loss in connection with the sale, transfer or reinsurance of an in-force block of business between affiliated entities in a non-economic transaction (¶78e).
5. SSAP No. 61R requires that a liability be established through a provision reducing surplus for unsecured reinsurance recoverables from unauthorized reinsurers (¶78f).
6. SSAP No. 61R prescribes offsetting certain reinsurance premiums (¶78g).
7. SSAP No. 61R, paragraph 78 explicitly notes the modifications to the FAS 113 risk transfer requirements regarding differences in GAAP and SAP classification of investment contracts, but does not note other modifications. The modification identifies contracts with insignificant mortality or morbidity risk.(¶78c).

78c. As discussed in SSAP No. 50, statutory accounting defines deposit-type contracts as those contracts which do not include any mortality or morbidity risk. GAAP defines investment contracts as those that do not subject the insurance enterprise to significant policyholder mortality or morbidity risk. (The distinction is any mortality or morbidity risk for statutory purposes vs. significant mortality or morbidity risk for GAAP purposes.) Therefore, a contract may be considered an investment contract for GAAP purposes, and that same contract may be considered other than deposit-type for statutory purposes. A reinsurance treaty covering contracts that have insignificant mortality or morbidity risk (i.e., contracts classified as other than deposit-type contracts for statutory purposes, but investment contracts for GAAP purposes) that does not transfer that mortality or morbidity risk, but does transfer all of the significant risk inherent in the business being reinsured (e.g., lapse, credit quality, reinvestment or disintermediation risk) qualifies for reinsurance accounting for statutory reporting purposes, but would not qualify for reinsurance accounting treatment for GAAP purposes;

**A-791** *(See Authoritative Literature in appendix for quotes of referenced material)*

The Model 791 proceedings citations (formerly known as the legislative history) notes that in 1985 the model was developed to prohibit reinsurance surplus aid abuses. Major revisions to Model 791 which are consistent with Appendix A-791, were adopted in 1992. The intent of the 1992 revisions was to provide more information to regulators on risk transfer, liability transfer and other considerations in regard to “surplus aid” reinsurance contracts in order to promote more uniformity in their treatment. Included as part of the revision was a name change from “*Model Regulation—Life Reinsurance Agreements*” to “*Life and Health Reinsurance Agreements Model Regulation.*” While a review of the minutes, proceedings citations and the model indicate that Model 791 includes accident and health within its scope; most of the guidance in Model 791 is focused on life and the small amount of health specific guidance provided is secondary.

**Scope** – Appendix A-791 excludes assumption reinsurance, yearly renewable term reinsurance and certain non-proportional reinsurance such as stop loss or catastrophe reinsurance. Appendix A-791 refers the reader to paragraphs 19 and 20 of SSAP No. 61R for yearly renewable term reinsurance and non-proportional reinsurance. **Therefore, the primary focus of Appendix A-791 is proportional reinsurance agreements.**

The preamble to Model 791 notes that there are legitimate forms of surplus relief and forms that are improper. This preamble is similar to paragraph 2.k. of Appendix A-791, but includes additional information regarding intent. This preamble paragraph was noted in the 1992 minutes as significant to enforcing the provisions of the model; however, this paragraph is not included in Appendix A-791.

Appendix A-791 includes reinsurance contract provisions or functions that require deposit accounting by prohibiting reinsurance reserve credit (loss reserve reductions) or establishment of assets related to the reinsurance contracts that contain specified clauses and or functions. Loss reserve reductions and establishment of admitted reinsurance assets is referred to as reinsurance accounting or reinsurance credit. Appendix A-791 also contains a chart which notes “significant risks” inherent in lines of business reinsured. It notes that 100% of the identified significant risks must be reinsured to allow any reinsurance accounting treatment. Appendix A-791, paragraphs 2, 4, and 5 seek to ensure that the reinsurer has taken on the risks that result in the reinsurer “standing in the shoes” meaning that the reinsurer is in the same economic position as the ceding entity. Appendix A-791 also provides guidance that contract features which result in “impermanent” risk transfer or surplus aid which result in deposit accounting.

**Summary of Appendix A-791, by paragraph is below:**

Appendix A-791, paragraph 2 provides a list of items that can prohibit reinsurance accounting (resulting in deposit accounting instead). If any of the noted conditions are present in substance or effect, then the ceding entity is prohibited from establishing assets or reducing liabilities based on that reinsurance contract.

1. Renewal expense allowances are not enough to cover future administrative expenses (unless a liability is established for the present value of the shortfall).
2. Ceding insurer can be deprived of surplus/assets at the reinsurer’s option or automatically on the occurrence of an event (termination for nonpayment of premium or other amounts due is an exception).
3. **Ceding insurer is required to reimburse the reinsurer for negative experience under the contract. Exceptions: netting losses against gains for experience refunds and payments upon voluntary recapture. It notes that a reinsurer cannot force recapture by excessive premium increases.**
4. The ceding insurer must, at scheduled points in time terminate or recapture the contract.
5. **The reinsurance agreement has the possibility of payments from the ceding company that exceed the direct premiums charged to the insured.**
6. **The treaty does not transfer 100% of the identified significant risks inherent in the business being reinsured. A table of product types and significant risks are identified (morbidity, mortality, lapse, credit quality, reinvestment, disintermediation). Short-duration health is required to transfer all of the morbidity and lapse risks.**
7. The assets are not transferred or are not put in a segregated account when credit quality, reinvestment, and disintermediation risk are required to be transferred.
8. Settlements are made less frequently than quarterly.
9. The ceding company must make warranties not reasonably related to the business being reinsured
10. The ceding company must make warranties about the future performance of the business being reinsured.
11. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, **while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect; the expected potential liability to the ceding insurer remains basically unchanged.**

Paragraph 3 provides accounting guidance regarding reinsurance of in-force blocks of business, which requires restriction of surplus gains until profits emerge

Paragraphs 4-5 are contract features that are required to be present to achieve reinsurance accounting.

Paragraph 4: Letter of intent (or signed treaty) must be in place before the as-of date of the financial statement in order to apply reinsurance accounting.

Paragraph 5: Treaty must be signed within 90 days after the execution of a letter of intent.

Appendix A-791 also contains questions and answers for certain paragraphs that were incorporated from actuarial guideline JJJ. The questions and answers provide practical implementation information and are helpful regarding intent of some items. The rest of Actuarial Guideline JJJ was incorporated in *Actuarial Guideline 33 Determining CARVM Reserves for Annuity Contracts with Elective Benefits,* to provide guidance on elective versus non-elective benefits and language which described integrated benefit streams. Therefore, Actuarial Guideline JJJ does not currently exist as a separate guideline.

**Current Issues**

**FAS 113 and Appendix A-791**

The FAS 113 risk transfer guidance is adopted by reference, and is also affected by the modifications to FAS 113 listed in SSAP No. 61R. Such modifications include the differences between GAAP and SAP classification of certain contracts, such as contracts that statutory accounting classifies as other than deposit type contracts and GAAP classifies as investment type contracts. Appendix A-791 plays a crucial role in the application of risk transfer guidance for proportional life and health reinsurance contracts. However, both the FAS 113 and Appendix A-791 have to be reviewed in conjunction with each other. The interaction of SSAP No. 61R guidance with Appendix A-791 needs to be more explicit in SSAP No. 61R.

Appendix A-791 creates differences between GAAP and SAP definitions of risk transfer for proportional life and health reinsurance contracts. The SAP risk transfer threshold for proportional life and health reinsurance contracts can be either higher or lower than GAAP depending on the facts and circumstances. The different standard in Appendix A-791 applies to products that both GAAP and SAP classify as insurance and to products in which there are differences in insurance or non-insurance classification between GAAP and SAP. The provisions of Appendix A-791 result in reinsurance accounting only for proportional reinsurance contracts that 1) do not result in “impermanent” surplus and 2) result in the reinsurer being in a relatively equivalent economic position as the direct writer. Below are some examples of the different results that can occur:

1. GAAP and SAP are different - For a proportional reinsurance on products that both GAAP and SAP classify as an insurance contract, Appendix A-791 creates a different standard for determining risk transfer than GAAP. This standard can be either higher or lower than GAAP risk transfer requirements depending on the facts and circumstances.
   1. Appendix A-791 requires 100% of identified significant risks to be transferred.
   2. Appendix A-791 has several features that are prohibited in reinsurance contracts and also requires certain contractual features. These requirements and prohibitions are to ensure that the reinsurer is in a similar economic position as the ceding entity.
   3. Appendix A-791 does not require reasonable possibility of significant loss to the reinsurer for proportional reinsurance contracts; however, as noted above, a reinsurance contract that complies with Appendix A-791 will result in a reinsurer that is in a similar economic position as the ceding entity.

To the extent a proportional reinsurance contract does not transfer 100% of the identified risks SAP has a higher threshold, because GAAP would allow reinsurance accounting for reinsurance contracts with less than 100% of the identified significant risks provided the reinsurer has reasonable possibility of loss. For these reinsurance contracts SAP (Appendix A-791) would require deposit accounting.

To the extent that a proportional contract transfers 100% of the identified risks and the reinsurer does not have a reasonable possibility of loss, SAP has a lower threshold because it would allow reinsurance accounting and GAAP would require deposit accounting.

To the extent that a proportional contract has reasonable possibility of loss to the reinsurer, but the reinsurance contract contains features prohibited by Appendix A-791, the SAP standard would require deposit accounting and be stricter than GAAP which would allow reinsurance accounting.

1. SAP allows reinsurance accounting in situations that GAAP prohibits - For a life or health product that GAAP classifies as an investment contract and SAP classifies as an insurance contract, SAP allows proportional reinsurance contracts which are compliant with Appendix A-791 to receive reinsurance accounting treatment. GAAP prohibits reinsurance accounting for these underling products because the products do not contain sufficient insurance risk. This is an intentional difference between SSAP No. 61R and FAS 113 and was necessary because some products are classified as life or other than deposit type insurance in statutory accounting based on the inclusion of **any** mortality or morbidity risk. The same products would likely be classified as an investment type contract for GAAP because the morbidity and mortality risk is **not significant**. SSAP No. 61R notes that a FAS 113 modification allows the transfer of risk for other than deposit type products if the reinsurance contract transfers **100%** of the identified significant risks of the contract. Under FAS 113 such a reinsurance contract would not be classified as an investment contract, and not as insurance, due to the insignificant insurance risk. This is an intentional difference that can result in reinsurance accounting treatment for statutory accounting but not for GAAP.

**Nonproportional Guidance in SSAP No. 61R**

The rest of the text on risk transfer in SSAP No. 61R includes some of the FAS 113 long-duration guidance, and the rest of FAS 113 is adopted with the noted modifications by reference. SSAP No. 62R is more explicit on evaluation of non-proportional contracts and contains more of the FAS 113 short-duration risk transfer guidance. As a result, SSAP No. 62R is clearer than SSAP No. 61R regarding risk transfer for reinsurance contracts which transfer less than all of the insurance risks, such as non-proportional reinsurance contracts. SSAP No. 61R, paragraph 38, notes that reinsurance accounting for non-proportional reinsurance contracts is determined in a way that is similar to how property and casualty reinsurance accounting is determined. This agenda item recommends additional language on nonproportional contracts for SSAP No., 61R.

**Amount of Reinsurance Accounting Credit**

Additional language in SSAP No. 61R and SSAP No. 62R is recommended to clarify that reinsurance contracts which pass reinsurance risk transfer can and will result in different reinsurance accounting credit (financial benefits) based on the terms and circumstances of the reinsurance contracts. There appears to be a misunderstanding that passing risk transfer always results in full proportional reinsurance accounting credit. However, a reinsurance contract which passes risk transfer still has to have the amount of reinsurance accounting credit separately determined. An example of this concept is that a catastrophe reinsurance treaty can pass risk transfer and still result in no initial reinsurance accounting credit. Principles-based guidance on the separate calculation of the reinsurance accounting credit would be beneficial for SSAP No. 61R and SSAP No. 62R.

**Provisions of Appendix A-791 that Prohibit Reinsurance Accounting**

1. Expected potential liability remains unchanged

Some of the short-duration reinsurance contracts that were brought to the attention of the Working Group were noted as RBC relief treaties and had a primary purpose of providing capital relief (as opposed to surplus relief). These reinsurance contracts were noted as not having an impact to the ceding entity’s expected liabilities – (e.g., the total liabilities were basically unchanged). Reflecting reinsurance accounting for a proportional reinsurance treaty when the surplus of the ceding entity remain basically unchanged in substance or effect would seem to be a violation of Appendix A-791, paragraph 2.k. Appendix A-791 Life and Health Reinsurance agreements prohibit reducing reinsurance liabilities of establishing reinsurance assets of a ceding entity if:

k. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.

1. All (100%) of the identified significant risks

Note that Appendix A-791, paragraph 2.f. requires **all (100%) of the identified significant risks** to be transferred. To the extent that the reinsuring clause or risk limiting features prevent all of the significant risk identified being transferred, the contract would not be eligible for reinsurance accounting treatment under Appendix A-791.

1. Proportional versus non-proportional reinsurance contracts

Appendix A-791 is for proportional reinsurance contracts and SSAP No. 61R includes additional guidance on risk transfer for non-proportional reinsurance contracts. SSAP No. 61R, paragraph 38 on non-proportional reinsurance, notes that reinsurance accounting credit is determined in a way that is similar to the way property and casualty reinsurance accounting credit is determined. This is because these modes of reinsurance more closely follow property and casualty indemnification principles than life insurance formula basis and these coverages are very similar to excess insurance on property and casualty products. In determining the appropriate reserve credit, the probability of a loss penetrating to the reinsurer's level of coverage (using reasonable assumptions) must be multiplied by the expected amount of recovery. That means that the determination of the amount of acceptable reinsurance accounting credit should take into account the amounts that the reinsurer is reasonably expected to pay.

Reinsurance contracts with large sliding scale commissions, loss corridors and other risk limiting features raise questions regarding whether a reinsurance contract that starts out as being labeled proportional, is proportionate in substance, or if the risk limiting features cause the contract to perform more like a non-proportional contract. Barron’s dictionary of Insurance Terms notes proportional reinsurance is:

A type of reinsurance whereby the reinsurer shares losses in the same proportion as it shares premium and policy amounts.

The FAWG referral, noted in the activity to date section, provides a similar concern and seems to describe a contract that would not be compliant with Appendix A-791 paragraphs 2.k. and 2.f.:

Some of the short-duration health reinsurance contracts that regulators have brought to the attention of the Working Group and noted by the Financial Analysis (E) Working Group utilize loss corridors, sliding scale commissions, or other risk-limiting features to significantly limit the risk transferred to the reinsurer. Often these limitations result in a quota share reinsurance agreement operating more like an excess of loss reinsurance agreement, but the ceding insurer is accounting for the contract as if full, proportional reinsurance were in place. In certain cases, the ceding insurers have lost millions of dollars on certain blocks of business and even reached insolvency, while the reinsurers have continued to recognize profits on the contracts.

Some treaties that were labeled as proportional do not operate proportionately when the risk limiting features in total are considered and some treaties seem to be taking a larger reinsurance accounting credit than the risk transferred under the contract indicates or are taking a reinsurance accounting credit when transfer is not indicated. Note that classifying a contract as proportional when it is not, or taking a reinsurance accounting credit when a contract is not compliant with SSAP No. 61R and Appendix A-791, can result in either an inappropriate reinsurance accounting credit or result in a reinsurance accounting credit that is greater than allowed when the cash flows of the contract are evaluated for the possibility of loss.

Disclosure *(See Authoritative Literature in appendix for quotes of referenced material)*

The short-duration health reinsurance contracts that were brought to the attention of the Working Group members have risk limiting features. *SSAP No. 62R—Property and Casualty Reinsurance,* paragraphs 93-98, began requiring audited disclosures in the statutory annual statement interrogatories and supplements related to reinsurance contracts with risk limiting features in 2006. The purpose of the disclosures is to identify certain reinsurance contracts with risk limiting features with provisions that limit losses below the stated quota share percentage or delay timely reimbursement for further regulatory review. The disclosures also require reporting entities to affirm that they have verified risk transfer in the reinsurance contracts which received prospective reinsurance accounting credit.

The FAWG referral noted health disclosure concerns noting:

While P&C insurers are required to disclose some of these features in the interrogatories, health insurers are not, and FAWG continues to be surprised by the fact that GAAP seems to prevent some of these contracts from being recorded as meeting risk transfer requirements while SAP may not. Although the number of P&C companies reporting these features and differences in GAAP/SAP reporting may be limited, they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers.

This agenda item recommends additional disclosures for SSAP No. 61R

Existing Authoritative Literature:

* *SSAP No. 61R—Life, Deposit-Type, and Accident and Health Reinsurance*
* *SSAP No. 62R—Property and Casualty Reinsurance*
* *Statement of Financial Accounting Standards* *No. 113*, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
* *Appendix A-791 Life and Health Reinsurance Agreements*

In researching reinsurance risk transfer in SSAP No. 61R, staff notes the following key points:

* SSAP No. 61R, paragraph 78 adopts the FAS 113 with modifications.
* FAS 113 requirements were incorporated into FASB codification primarily in ASC 944-20 and the key risk transfers aspects of FAS 113 are unchanged by FASB codification.
* SSAP No. 61R includes a risk transfer discussion that is similar to the long-duration risk transfer discussion in FAS 113, however slightly more GAAP text on risk transfer was explicitly incorporated into SSAP No. 62R.
* In addition to the FAS 113 risk transfer requirements, SSAP No. 61R, paragraph 79 incorporates requirements from the Credit for Reinsurance (Model 785) and the Life and Health Reinsurance (Model 791).
* Model 785 contains detailed information regarding when collateral is required and what types of collateral are acceptable in order to obtain credit for reinsurance. In general, collateral is required for unauthorized reinsurers and there is a sliding scale of collateral required for certified reinsurers.
* Model 791 contains examples of contract clauses that negate risk transfer and identifies significant insurance risk that must be ceded in full. (summarized above)
* Model 791 excludes yearly renewable term (YRT) which is a type of life reinsurance under which the risks, but not the permanent plan reserves, are transferred to the reinsurer for a premium that varies each year with the amount at risk and the ages of the insured. Although the model excludes YRT, most of the requirements from paragraph 2 and 3 of A-791 are required to be followed in SSAP No. 61R. This agenda item is not focused on Yearly Renewable Term reinsurance contracts.

Activity to Date (issues previously addressed by the SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):

At the 2016 Fall National Meeting the chair of the Working Group, Mr. Bruggeman stated that he had been contacted by a regulator regarding the application of reinsurance risk transfer under *SSAP No. 61R—Life, Deposit-Type, and Accident and Health Reinsurance*. The Working Group directed NAIC staff to research this issue and, if necessary, prepare an interpretation or draft changes to SSAP No. 61R for future discussion. In providing more detail on the issue, Mr. Bruggeman stated that reporting entities may be concluding that risk-transfer requirements under U.S. GAAP are higher than the risk-transfer requirements under SSAP No. 61R. As both requirements are based on the same standard in *Statement of Financial Accounting Standards* *No. 113*, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, he stated that this reporting entity interpretation is difficult to substantiate. NAIC staff was directed to provide subsequent information on their research.

Risk Limiting Features (E) Working Group was inactive in 2016, but it is charged with reviewing risk transfer guidance for property and casualty reinsurance. This group will re-activate this year and work on clarifying aspects of Financial Condition Examiner’s Handbook and Financial Analysis Handbook guidance.

The Financial Analysis (E) Working Group (FAWG) provided a referral to the Statutory Accounting Principles (E) Working Group in April 2017, which also noted and risk limiting features concerns and including for property and casualty entities and concerns regarding health disclosures. The following provides a summary of this referral:

The referral notes that the FAWG has recently discussed a number of troubled and potentially troubled insurers that have participated in quota share/proportional reinsurance contracts with significant risk-limiting features. In many of these situations, the motivation for the contracts appears to be surplus relief, without a significant amount of insurance risk being transferred to the reinsurer. The contracts often utilize loss corridors, sliding scale commissions, or other risk-limiting features to significantly limit the risk transferred to the reinsurer. Often these limitations result in a quota share reinsurance agreement operating more like an excess of loss reinsurance agreement, but the ceding insurer is accounting for the contract as if full, proportional reinsurance were in place. In certain cases, the ceding insurers have lost millions of dollars on certain blocks of business and even reached insolvency, while the reinsurers have continued to recognize profits on the contracts. While P&C insurers are required to disclose some of these features in the interrogatories, health insurers are not, and FAWG continues to be surprised by the fact that GAAP seems to prevent some of these contracts from being recorded as meeting risk transfer requirements while SAP may not. Although the number of P&C companies reporting these features and differences in GAAP/SAP reporting may be limited, they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers. Therefore, FAWG suggests further changes to SAP to prevent these situations.

Information or issues (included in *Description of Issue*) not previously contemplated by the SAPWG:

None

**Convergence with International Financial Reporting Standards (IFRS):** Statutory accounting and U.S. GAAP both have differences from IFRS regarding reinsurance risk transfer.

Staff Review Completed by:

Robin Marcotte, NAIC Staff - July 2017

Staff Recommendation:

**NAIC staff recommends that the Working Group receive the referral from the Financial Analysis (E) Working Group, move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 61R, SSAP No. 62R, Appendix A-791 and the Master Glossary as illustrated in Exhibit A (****omitted from the 2019 Summer National Meeting Materials for brevity). The recommended course of action is summarized below, and the related revisions are illustrated on the following pages. The draft revisions and the noted exposure questions are recommended for exposure.**

1. **Risk transfer clarifications *SSAP No. 61R—Life and Health Reinsurance*** – Expose clarifications to the guidance in SSAP No. 61R that emphasize categorizing reinsurance contracts correctly as either being proportional or non-proportional and make more explicit the interaction between Appendix A-791 which identifies the significant risks that must be 100% transferred for proportional reinsurance contracts and the remaining SSAP No. 61R risk transfer guidance. The proposed revisions also emphasize that the reinsurance accounting credit taken for reinsurance contracts that meet risk transfer criteria in SSAP No. 61R/ Appendix A-791 is only for the portion of risks actually transferred. Reinsurance credit should take into account all features of a contract including deductibles, loss ratio corridors, a loss caps, aggregate limits or any similar provisions.
2. **Risk transfer clarifications *SSAP No.* *62R—Property and Casualty Reinsurance*** – Expose clarifications to the risk transfer guidance in SSAP No. 62R to make the existing guidance more clear reinsurance accounting credit taken for reinsurance contracts that meet risk transfer criteria only for the portion of risks actually transferred. These clarifications are intended to be consistent with the existing concepts highlighted in the SSAP No. 62R, paragraph 93 disclosure. This guidance notes that reinsurance contracts, which contain features that limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions), should reduce the amount of reinsurance accounting credit taken by the effects of any applicable limiting provision(s).
3. **Disclosures** – Expose disclosures, for 2018 reporting year in SSAP No. 61R based on the existing reinsurance disclosures in SSAP No. 62R in paragraphs 93-98 (adapted as needed using concepts from A-791). The disclosures would be to assist regulators in identifying reinsurance contracts that may require from additional regulatory scrutiny regarding risk transfer and or compliance with A-791.

Exposure questions- Request comments regarding the scoping of the disclosures in SSAP No. 61R.

1. **Updates to terminology** –
   1. Expose updates to the glossary in SSAP No. 61R for specific terms including the definition of proportional and non-proportional.
   2. Expose clarifications to the existing descriptions of proportional and nonproportional in SSAP No. 62R, paragraph 5 which are consistent with the proposed revisions to SSAP No. 61R (along with edits to subparagraph numbering).
   3. Expose updates to the Master Glossary to define how to classify short-duration and long-duration for statutory accounting. These are GAAP terms (quoted in Authoritative literature) which have historically not been adopted in statutory accounting, however, recent updates to SSAP No. 35R also referenced this terminology.

**Exposure questions** – Request comments on the current SSAP No. 61R glossary definitions, which are currently defined in a life specific context: coinsurance, modified coinsurance and retention. Request comments on if adding short-duration and long-duration terms (modified for statutory accounting differences in classification) to the Master Glossary would be useful especially in the context of adopted GAAP guidance.

1. **Appendix A-791 updates to include the Model 791 preamble** – Expose updates to Appendix A-791 to incorporate language from the preamble of Model Law 791. This language from the model is indicative of the intent behind the Model, which was to prevent reinsurance accounting for reinsurance contracts that provide temporary surplus aid without transferring all of the significant risks so that the expected potential liability of the ceding insurer remains “basically unchanged.” This includes much of the existing language in paragraph 2.k. of Appendix A-791, but also provides additional detail regarding intent.

Exposure questions – Request comments on whether additional clarifications are needed on the interaction of Appendix A-791 and the risk transfer guidance or if the proposed changes to SSAP No. 61R are sufficient. Would adding to the questions and answers in A-791 regarding application be useful? If so, what questions should be addressed?

**Status:**

On August 6, 2017, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance, SSAP No. 62R—Property and Casualty Reinsurance* and *Appendix A-791—Life and Health Reinsurance*, as illustrated in Exhibit A (**omitted from the 2019 Summer National Meeting Materials for brevity**), to clarify reinsurance contracts risk transfer requirements and to provide clarifications that reinsurance accounting credit for contracts that pass risk transfer is only for the amount of risk ceded. The agenda item also updates terminology and incorporates new SSAP No. 61R disclosures to assist in reviewing contracts, similar to existing disclosures in SSAP No. 62R.

On November 6, 2017, the Statutory Accounting Principles (E) Working Group received comments. The Working Group provided the following direction for the next phase of work on this project:

1. NAIC staff was directed to work with Working Group and industry representatives to hold informal drafting calls to refine the exposure drafts for future Working Group consideration. The bi-weekly calls will generally be separate (P/C and Life) as feasible, with some combined calls for consistency issues.
2. The previously exposed revisions to add the GAAP definitions of short duration and long duration contracts to the master glossary would be removed going forward, as the comments from the Interested Parties and the ACLI responded that the proposed additional definitions were not helpful.
3. The suggested revisions to SSAP No. 62R, paragraph 29 on non-proportional reinsurance credit proposed by the interested parties provide a better starting point to redraft this paragraph. NAIC staff was directed to use this language and work with the informal drafting groups to add some non-proportional examples in the next phase of discussion. The proposed starting point language for SSAP No. 62R, paragraph 29 is as follows:

29. Reporting entities shall not record reinsurance credit for non-proportional reinsurance until such time as losses have been incurred on the underlying business, which exceed the attachment point of the applicable reinsurance contract(s).

**Recommendation for 2018 Summer National Meeting Discussion**

The Informal Property and Casualty Drafting Group and an Informal Life and Health Drafting Group both of which include regulators and industry representatives have held several calls and recommend exposing the revisions described below:

1. **Informal Property and Casualty Drafting Group** - The drafting group recommends updates to *SSAP No. 62R—Property and Casualty Reinsurance* to incorporate GAAP guidance to be more consistent with ASC topic 994-20. The proposed revisions specifically incorporate more guidance from *FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* (EITF 93-6) and its related interpretation EITF D-035, *FASB Staff Views on Issue No. 93-6, "Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises.”* SSAP No. 62R already, adopts EITF 93-6 with modification; however, it is incorporated by reference rather than explicitly quoted. As the informal drafting groups agrees that SSAP No. 62R intends to match GAAP to the extent feasible, the drafting group has recommended revisions to SSAP No. 62R text, and the existing Appendix to assist with addressing the concerns noted in the agenda item. These concerns include ensuring that credit for reinsurance reported by the cedant is not greater than the amount of risk ceded.

**Although the subgroup views the revisions as consistent updates, because of the extent of revisions, NAIC staff recommends categorizing these revisions to SSAP No. 62R as substantive and exposing the revisions to SSAP No. 62R as reflected in agenda item 2017-28 - Attachment Q1. (The attachment has several drafting notes to assist with review. These drafting notes are not planned to be in the final document.) During the exposure period, input on the effective date is also requested.**

1. **Informal Life and Health Drafting Group** – The primary issue under discussion is how to provide clear pointers from *SSAP No. 61R—Life and Health Reinsurance* to the Appendix A-791 guidance so that users understand which contracts are subject to the guidance in the appendix, and to identify the contracts which not subject to the appendix. The challenge is providing clear guidance that does not conflict with the existing appendix A-791, which is an accreditation standard model law. The Informal Life and Health Drafting Group recommends a partial exposure to obtain wider feedback on the scope of Appendix A-791 and proposed disclosures. The Informal Life and Health Drafting Group has prepared updates to the Appendix A-791 Q&A to assist with further defining the applicability of the Appendix. The drafting group will continue to work on revisions to the body of the statement, but believes feedback on the exposed QA revisions will assist with drafting further revisions. In addition, the drafting group has prepared disclosures for exposure also.

**NAIC staff recommends exposing revisions to the SSAP No. 61R disclosure and the A-791 Q&A as reflected in agenda item 2017-28 - Attachment Q2. The Informal Life and Health Drafting Group is not recommending adoption of these revisions until the other revisions to the guidance in SSAP No. 61R are developed.**

On August 4, 2018, the Statutory Accounting Principles (E) Working Group:

1. Exposed substantive revisions to *SSAP No. 62R—Property and Casualty Reinsurance* to incorporate guidance from *EITF 93-6,* *Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* and from *EITF D-035, FASB Staff Views on Issue No. 93-6*. (Drafting notes are not planned to be in the final document.) The Working Group also requested, input on the effective date. **See separate document.**
2. Exposed nonsubstantive revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* to incorporate disclosures. The proposed revisions also update the question-and-answer guidance in *Appendix A-791—Life and Health Reinsurance Agreements* to clarify the applicability of A-791. Note that the exposure includes a request for comments on whether the proposed disclosures adequately address the Financial Analysis (E) Working Group referral with a notation, that the feedback will assist with ongoing drafting group work. **See Exhibit B** (**omitted from the 2019 Summer National Meeting Materials for brevity).**

**Comments are requested on the following items related to the exposed SSAP No. 61R disclosures:**

1. The drafting group discussion determined that the prior exposure for SSAP No. 61R, paragraph 83, which was based on SSAP No. 62, paragraph 94 with modifications to be consistent with A-791 was repetitive on compliance with A-791. The subgroup reviewed existing paragraph 94 a-d, in SSAP No. 62R and determined it was not useful in the context of SSAP No. 61R. Regulator and industry input is requested on any additional contract features that should be identified for disclosure.
2. The FAWG, requested disclosures similar to existing disclosures *in SSAP No. 62R—Property and Casualty Reinsurance* for SSAP No. 61R. However, the existing SSAP No. 62R disclosures could not copied into SSAP No. 61R exactly because of variations between product types and the Appendix A-791.Regulator input is requested regarding whether proposed disclosures would be sufficient to address regulatory concerns and or the FAWG request
3. Comments are requested regarding contracts identified for disclosure in paragraph 85 should be identified in the annual statement reinsurance schedule S with a signifier to avoid repeating details in the annual statement note, which may be in the statement schedule.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group adopted, as final, substantive revisions to SSAP No. 62R that clarify the determination of reinsurance credit and incorporate language from *EITF 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* and *EITF D-035, FASB Staff Views on Issue No. 93-6,* with a January 1, 2019 effective date. The Working Group directed NAIC staff to draft an issue paper documenting the substantive revisions. The Working Group directed that comments received from Connecticut and New Jersey regarding *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* and Appendix A-791 be forwarded to the informal Life and Health Reinsurance Drafting Group for subsequent consideration.

**On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to an issue paper to document for historical purposes the adopted revisions to *SSAP No. 62R—Property and Casualty Reinsurance.* Also, onApril 6, 2019, the Working Group received an update from the Informal Life and Health Reinsurance Drafting Group, noting the following:**

Prior Actions - At the 2018 Fall National Meeting, the Working Group heard comments on the exposure recommended by the informal life and health reinsurance drafting group. The revisions proposed updates to the *A-791 Life and Health Reinsurance* QA to clarify the applicability of A-791 and expand questions and answers to address business that has a statutorily required medical loss ratio or similar refund / rebate. In addition, the exposure proposed revised disclosures as requested by the Financial Analysis (E) Working Group. The Working Group directed the subgroup to expand their work to address group term life yearly renewable term (YRT) comments raised in comment letters from two states.

Interim Activity - The informal drafting group updated the membership to address the YRT issues raised and has held four calls. The YRT issues related to group term life risk that were raised are complex. While the informal drafting group does not have a recommendation for exposure at this time, they are making steady progress and appreciate the active engagement from regulators and industry. The primary areas that are being considered for updating are to the A-791 QA guidance and to the YRT guidance in *SSAP No. 61R—Life and Health Reinsurance*, paragraph 19. The drafting group will continue to hold calls on this topic in the interim and intends to have something to recommend for exposure by the 2019 Summer National Meeting.

**Recommendation for 2019 Summer National Meeting Discussion**

*Receive Report of Interim Activity*

The YRT issues related to group term life risk that were raised are complex. The informal drafting group is making steady progress and appreciates the active engagement from regulators and industry. The primary areas that were discussed in the interim were on updating the A-791 QA guidance and to the YRT guidance in *SSAP No. 61R—Life and Health Reinsurance*, paragraph 19.

The Informal Drafting Life and Health Reinsurance Drafting Group met 4 times during the interim year primarily focused on YRT issues. Additional meeting will continue as the Drafting Group works to address YRT issues also works on other topics such as non proportional reinsurance.

**The informal drafting group reviewed prior exposures and their comments and recommends exposure of the following:**

1. **SSAP No. 61R Disclosures -** These disclosures were previously exposed and the comments on the prior exposure have been reviewed by the drafting group. The disclosures are to address the request from the Financial Analysis (E) Working Group for life and health reinsurance contracts to have disclosure, which identify contracts with certain features including, risk limiting features. similar to existing disclosures *in SSAP No. 62R—Property and Casualty Reinsurance* for SSAP No. 61R. However, the existing SSAP No. 62R disclosures could not copied into SSAP No. 61R exactly because of variations between product types and the Appendix A-791. The drafting group also recommends notifying the Financial Analysis (E) Working Group of the exposure.
2. **Two updates to the Appendix A-791 question and answers (QA)**
   1. The informal life and health reinsurance-drafting group identified that the existing phrase “certain non-proportional reinsurance arrangements” in the current A-791 could benefit from additional guidance to promote consistent application. The proposed revisions to the answer below are to help identify non-proportional contracts, which are not subject to the Appendix A-791 The drafting group also reviewed the comments from Connecticut received from the August 2018 exposure and determined not to incorporate the YRT/RBC comments at this time as the YRT discussion is ongoing.
   2. The proposed Appendix A-791 question and answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate. This item was previously exposed, and no questions were received. The drafting group did not recommend any additional revisions.
3. **Add A-791 QA under paragraph 2c on YRT**

Regarding the YRT issues, industry drafted a Q&A in relation to paragraph 2c of A-791 for consideration.  The regulator members agreed to the suggested approach to add the Q&A but eliminated the second part of the Answer that would continue to allow the reinsurer to charge premiums in excess of the underlying direct proportionate premium if the ceding entity established a liability for the excess amount.  After further discussion, the regulator and industry members of the subgroup could not come to agreement.   
  
The industry members prefer to seek ways to explicitly allow the group term life YRT reinsurance contracts to exceed the amount of the underlying direct proportionate premium. The most recent industry proposal was to allow this, provided the ceding entity establishes a liability for the amount of reinsurance premium in excess of the direct premium.  Industry discussed the commercial reasoning and argued that risk would still be transferred.

The regulator members continued to question whether such group term life YRT contracts appropriately transferred risk if a reinsurer could charge premiums in excess of the underlying direct proportionate premium.  It was noted that these contracts generally included other risk limiting features such as loss carry forward provisions and would typically not pass risk transfer requirements under GAAP. They also noted concerns that codifying the industry proposed exception in statutory accounting could result in unintended consequences and appeared to be designed address a commercial concern. Therefore, the regulator members proposed to accept the Q&A drafted by the industry but without wording that would allow reinsurers to charge premiums in excess of the underlying direct proportionate premium. The regulator members of the drafting group have requested exposure of the guidance to allow for specific concerns to be raised and addressed. This guidance provides that group term life YRT contracts which exceed the underlying direct premium are unreasonable and violate the provisions of paragraph 2c of A-791, and therefore, would not be subject to reinsurance accounting.

*August 2019 Recommendation:*

**NAIC Staff recommends that the Working Group receive the drafting group recommendation on interim activity and expose for comment the following items which are illustrated below:**

1. **Disclosures, (previously exposed) Concurrent with the exposure, NAIC staff recommends that the Working Group also notify the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.**
2. **The two A-791 QA items one the topic of certain nonproportional reinsurance contracts covered under the A-791 and medical loss ratios (previously exposed – the drafting group reviewed the comments).**
3. **Regulator proposed revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts. (which are not supported by industry members).**

On August 3, 2019, the Statutory Accounting Principles (E) Working Group adopted, as final, *Issue Paper No. 162—Property and Casualty* to document for historical purposes the revisions related to *SSAP No. 62R—Property and Casualty Reinsurance*, which was adopted at the 2018 Fall National Meeting.

In addition to the issue paper adoption, on August 3, 2019, the Working Group also exposed for comment the following items which are illustrated below:

1. Disclosures, (previously exposed) and concurrent with the exposure, directed notification to the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.
2. The two A-791 QA items related to certain nonproportional reinsurance contracts” covered under the A-791 and medical loss ratios (previously exposed – the drafting group reviewed the comments).
3. Regulator proposed revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts.

**Illustration of proposed revisions to SSAP No. 61R and A-791 exposed on August 3, 2019:**

1. The revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* to incorporate disclosures proposed for exposure are as follows:

*Drafting Note: These disclosures were previously exposed, the shading is for minor edits recommended by the drafting group on June 11, 2019:*

1. Disclosures for paragraphs 82-87, are required to be included with the annual audit report financial statements beginning with the period ended December 31, 201X regarding reinsurance contracts. The disclosures required within paragraphs 82-87 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 201X. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing. *(Drafting Note: From SSAP No. 62R, paragraph 92)*
2. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks. *(Drafting Note: Similar to SSAP No. 62R, paragraph 93, and is also relevant to A-791 evaluations*.)
3. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer’s assumption of risk. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk limiting features. *(Drafting Note: Similar to SSAP No. 62R, paragraph 93.)*
4. Disclose if any reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:
5. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period). (*Drafting Note: From SSAP No. 62R, paragraph 94.e. and Appendix A-791, paragraph 2.e.*)
6. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. *(Drafting Note: From SSAP No. 62R, paragraph 94.f., also relevant to risk transfer guidance in SSAP No. 61R)*
7. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.
   1. Assumption Reinsurance – new for the reporting period.
   2. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured event(s) triggering contract coverage has been recognized.
8. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either: *(Drafting Note: From SSAP No. 62R, paragraph 97)*

a. Accounted for that contract as reinsurance under statutory accounting principles (“SAP”) and as a deposit under generally accepted accounting principles (“GAAP”); or

b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

1. If affirmative disclosure is required for paragraph 86, explain why the contract(s) is treated differently for GAAP and SAP. *(Drafting Note: From SSAP No. 62R, paragraph 98)*

*Drafting Note - These disclosures are expected to begin at existing paragraph 77 in SSAP No. 61R. The paragraph numbering will be updated in the final draft.*

1. **Proposed updates to A-791 QA (previously exposed)**
2. **Update to A-791 QA under paragraph 1 to address the phrase “certain non-proportional”**

1. This Appendix **shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain non-proportional reinsurance such as stop loss or catastrophe reinsurance.**

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt **because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix**. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61R.

To further elaborate on the phrase ”certain non-proportional reinsurance” in paragraph 1, the beginning of the answer notes that contracts such as stop-loss and catastrophe do not normally provide significant surplus relief, and are therefore not subject to the accounting guidance in Appendix A-791. Non-proportional reinsurance agreements are considered not to provide significant surplus relief if they possess all of the following features. For the purposes of defining these features, the term “triggering event” means the event or sequence of events that would lead to a loss being reimbursable by the reinsurer pursuant to the terms of the reinsurance agreement.

1. The triggering event has not occurred at the time of the inception of the reinsurance agreement.

2. The triggering event is materially less likely than not to occur during each settlement period of the reinsurance agreement.

3. There is no initial reinsurance credit for ceded policy reserves and any reinsurance expense allowance or commission is reported so that surplus is not impacted until the related premium is reported as earned.

These criteria shall be evaluated separately for each measurement period under the reinsurance agreement, where the measurement period is that period of time for which the direct writer’s experience is used to determine the amounts owed to and from the reinsurer. If there are carry-forwards of experience debits or credits from one calendar year to the next, then those multiple years will be considered one settlement period.

The fact that the triggering event does eventually occur, is not itself evidence that the second criterion above has not been met. The criterion should be evaluated based on reasonable expectations rather than posteriori results.

1. New Appendix A-791 question and answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate.

Q:  If a company cedes health insurance business that is subject to a Medical Loss Ratio (MLR), or similar statutorily required refunds / rebates, must the reinsurer participate in the payment of any refunds / rebates?

A: The reinsurer needs to participate in the payment of its share of any statutorily required MLR or similar refund or rebate based on loss ratio calculations to the extent that the experience of the health business reinsured, during the period that it is reinsured, contributes to the calculation of the refund. Although the payment of such a refund based on the experience of business that is currently reinsured could result in a reduction of surplus on the part of the ceding insurer, if the reduction in surplus of the ceding insurer is entirely attributable to the experience prior to the effective date of the reinsurance, then it is outside of the contract requirements. Accordingly, such a provision should not cause a reinsurance agreement to be out of compliance with Appendix A-791 of the *Accounting Practices and Procedure Manual*. It is recognized that some refund calculations may involve multiple years.

Furthermore, just as an experience refund is not considered in the determination as to whether a reinsurance agreement is proportional, the requirement for the payment of a refund to policyholders based on a Medical Loss Ratio requirement should also not be considered.

Note: This Q&A only applies to refunds related to a statutory MLR or similar refund or rebate requirement for health insurance and should not be applied to any other situation

1. **Regulator Proposed Revisions Regarding YRT**

Suggested new Q&A on group term life YRT for placement under paragraph 2c of A-791

2c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

Q:  If group term life business is reinsured under a YRT reinsurance agreement (which includes risk limiting features such as with an experience refund provision which offsets refunds against current and/or prior years’ losses (i.e., a “loss carryforward” provision), under what circumstances would any provisions of the reinsurance agreement be considered “unreasonable provisions which allow the reinsurer to reduce its risk under the agreement” thereby violating subsection 2.c.?

A:  Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide.  So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable.  Any provision in the YRT reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable.

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