**Section 1103.30 Accounting Requirements**

a) No insurer subject to this Part shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the Division if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

1) Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured, unless a liability is established for the present value of the shortfall, using assumptions equal to the applicable statutory reserve bases on the business reinsured. Those expenses include commissions, premium taxes and direct expenses including but not limited to billing, valuation, claims and maintenance expected by the company at the time the business is reinsured;

2) The ceding insurer can be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer, except that termination of the reinsurance agreement by the reinsurer for nonpayment of reinsurance premiums or other amounts due, including but not limited to modified coinsurance reserve adjustments, interest and adjustments on funds withheld, and tax reimbursements, shall not be considered to be a deprivation of surplus;

3) 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 nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary terminations of in-force reinsurance by ceding insurer shall be considered a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions that 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;

4) The ceding insurer shall, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded;

5) The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums or other fees or charges to a reinsurer that are greater than the direct premiums collected by the ceding company;

6) The treaty does not transfer all of the significant risk inherent in the business being reinsured. Exhibit A of this Part identifies, for a representative sampling of products or type of business, the risks considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with Exhibit A;

7) Requirements concerning credit quality, reinvestment or disintermediation risk.

A) The credit quality, reinvestment or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business excepted in subsection (a)(7)(B)) either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust account or escrow account or otherwise establish a mechanism that segregates, by contract or contract provision, the underlying assets.

B) Notwithstanding the requirements of subsection (a)(7)(A), the assets supporting the reserves for the following classes of business and any classes of business that do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of those assets; Health Insurance LTC/LTD, Traditional Non-Par Permanent, Traditional Par Permanent, Adjustable Premium Permanent, Indeterminate Premium Permanent, Universal Life Fixed Premium (no dump-in premiums allowed). The associated formula for determining the reserve interest rate adjustment shall use a formula that reflects the ceding company's investment earnings and incorporates all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

|  |  |  |
| --- | --- | --- |
| Rate | = | 2(I + CG) |
| (X + Y - I - CG) |

i) I is the net investment income

ii) CG is capital gains less capital losses

iii) X is the current year cash and invested assets plus investment income due and accrued less borrowed money

iv) Y is the same as X but for the prior year;

8) Settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within 90 days after the settlement date;

9) The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured;

10) The ceding insurer is required to make representations or warranties about future performance of the business being reinsured;

11) The amount of the total admitted assets of the ceding insurance company less the amount of all funds withheld by any reinsurer as a result of all reinsurance treaties is less than the total gross amount available to policyholders either through the exercise of policy cash surrender or loan provisions;

12) The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding company typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured, and the remaining liability to the ceding insurer remains basically unchanged.

b) Requirements for reinsurance of in-force business.

1) Agreements entered into after January 5, 1994, along with any subsequent amendments to those agreements, that involve the reinsurance of business issued prior to the effective date of the agreements or amendments must meet the requirements of Section 174 of the Illinois Insurance Code [215 ILCS 5/174]. Each filing shall include data detailing the financial impact of the transaction. The ceding insurer's actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this Part and any applicable actuarial standards of practice when determining the proper credit in financial statements filed with the Division. The actuary shall maintain documentation and be prepared to describe the actuarial work performed for inclusion in the financial statements and to demonstrate that such work conforms to this Part.

2) As earnings emerge from the business reinsured, any increase in surplus net of federal income tax resulting from arrangements described in subsection (b)(1) shall be identified separately on the insurer's statutory financial statements as a surplus item in the "Change in Surplus as a result of Reinsurance" line for companies filing on the Life, Accident and Health blank and in the "Aggregate write-ins for gains (or losses) in Surplus" line for companies filing on the Property and Casualty blank and Health blank and recognition of the surplus increase as income shall be reflected on a net of tax basis in the "Commissions and Expense allowances on reinsurance ceded" line for companies filing on the Life, Accident and Health blank and in the "Aggregate write-in for miscellaneous income" for companies filing on the Property and Casualty blank.

For example, on the last date of calendar year N, company XYZ pays a $20 million initial commission and expense allowance to company ABC for reinsuring an existing block of business. Assuming a 34% tax rate, the net increase in surplus at inception is $13.2 million ($20 million - $6.8 million) that is reported on the "Change in Surplus as a result of Reinsurance" line of the Summary of Operations. $6.8 million (34% of $20 million) is reported as income on the "Commissions and Expense allowances on reinsurance ceded" line of the Summary of Operations. At the end of the year N + 1 the business has earned $4 million. ABC has paid $.5 million in profit and risk charges in arrears for the year and has received a $1 million experience refund. Company ABC's annual statement would report $1.65 million (66% of ($4 million - $1 million - $.5 million) up to a maximum of $13.2 million) on the "Commissions and Expense allowances on reinsurance ceded" line of the Summary of Operations, and - $1.65 million on the "Change in Surplus as a result of Reinsurance" line of the Summary of Operations. The experience refund would be reported separately as an "Aggregate write-in for miscellaneous income" item in the Summary of Operations.

(Source: Amended at 30 Ill. Reg. 7766, effective April 6, 2006)