

This rule was filed as 13 NMAC 2.7.

**TITLE 13       INSURANCE**  
**CHAPTER 2     INSURANCE COMPANY LICENSING AND OPERATION**  
**PART 7         LIFE AND HEALTH REINSURANCE AGREEMENTS**

**13.2.7.1       ISSUING AGENCY:** New Mexico State Corporation Commission [Public Regulation Commission], Department of Insurance, Post Office Box 1269, Santa Fe, NM 87504-1269.  
[7/1/97; Recompiled 11/30/01]

**13.2.7.2       SCOPE:** This rule applies to all domestic life and accident and health insurers and to all other licensed life and accident and health insurers which are not subject to a substantially similar rule in their domiciliary state. This rule similarly applies to licensed property and casualty insurers with respect to their accident and health business. This rule does not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.3       STATUTORY AUTHORITY:** Section 59A-2-9 NMSA 1978.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.4       DURATION:** Permanent.  
[7/1/97; Recompiled 11/30/01]

**13.2.7.5       EFFECTIVE DATE:** January 1, 1994 unless a later date is cited at the end of a section or paragraph. Repromulgated in NMAC format effective July 1, 1997.  
[1/1/94, 7/1/97; Recompiled 11/30/01]  
[Compiler's note: The words *or paragraph*, above, are no longer applicable. Later dates are now cited only at the end of sections, in the history notes appearing in brackets.]

**13.2.7.6       OBJECTIVE:** The superintendent recognizes that licensed insurers routinely enter into reinsurance agreements that yield legitimate relief to the ceding insurer from strain to surplus. However, it is improper for a licensed insurer, in the capacity of ceding insurer, to enter into reinsurance agreements for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, if all of the significant risks inherent in the business being reinsured are not transferred. In substance or effect, the expected potential liability to the ceding insurer remains basically unchanged by the reinsurance transaction, notwithstanding certain risk elements in the reinsurance agreement, such as catastrophic mortality or extraordinary survival. The objective of this rule is to prevent:

- A. violation of Section 59A-16-8 NMSA 1978 relating to financial statements which do not properly reflect the financial condition of the ceding insurer;
  - B. violation of Sections 59A-7-11 and 59A-8-3 NMSA 1978 relating to reinsurance reserve credits, thus resulting in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded; and
  - C. creation of a situation that may be hazardous to policyholders and the people of this state as defined in Section 59A-41-24 NMSA 1978.
- [1/1/94; Recompiled 11/30/01]

**13.2.7.7       DEFINITIONS:** [RESERVED]

**13.2.7.8       ACCOUNTING REQUIREMENTS FOR REINSURANCE CEDED:** No insurer subject to this rule shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the superintendent if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exists:

- A. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured, unless a liability is established for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). 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.

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

C. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the 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.

D. The ceding insurer must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded.

E. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from gross premium less expenses 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 or to a reinsurer and a third party which are greater than the direct premiums collected by the ceding company.

F. The treaty does not transfer all of the significant risk inherent in the business being reinsured (Table A [now 13.2.7.14 NMAC] identifies the risks which are considered to be significant for a representative sampling of products or type of business; for products not specifically included in Table A [now 13.2.7.14 NMAC], the risks determined to be significant shall be consistent with this table.);

G. The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust or escrow account or otherwise establish a mechanism satisfactory to the superintendent which legally segregates, by contract or contract provision, the underlying assets; however, the assets supporting the reserves for the following classes of business and any classes of business which do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of such assets:

- (1) health insurance - long term care/long term disability;
- (2) traditional non-par permanent;
- (3) traditional par permanent;
- (4) adjustable premium permanent;
- (5) indeterminate premium permanent;
- (6) universal life fixed premium (no dump-in premiums allowed).

(a) The associated formula for determining the reserve interest rate adjustment must use a formula which 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:

$$\text{Rate} = \frac{2(I + CG)}{X + Y - I - CG}$$

(b) Where: I is the net investment income (Exhibit 2, Line 16, Column 7); CG is capital gains less capital losses (Exhibit 4, Line 10, Column 6); X is the current year cash and invested assets (Page 2, Line 10A, Column 1) plus investment income due and accrued (Page 2, Line 16, Column 1) less borrowed money (Page 3, Line 22, Column 1); Y is the same as X but for the prior year. (Note that line and exhibit references are for the 1992 annual statement. Be aware that annual statement references may change from year to year);

H. Settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety days of the settlement date.

I. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.

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

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.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.9 EXCEPTION WITH SUPERINTENDENT APPROVAL:** Notwithstanding 13 NMAC 2.7.8 [now 13.2.7.8 NMAC], an insurer subject to this rule, may, with the prior approval of the superintendent, take such reserve credit or establish such asset as the superintendent deems consistent with the Insurance Code and department of insurance rules or regulations, including actuarial interpretations or standards deemed appropriate by the superintendent.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.10 FILING REQUIREMENTS:** Agreements entered into after the effective date of this rule which involve the reinsurance of business issued prior to the effective date of the agreements, including any subsequent amendments, shall be filed by the ceding company with the superintendent within thirty days from its date of execution. Each filing shall include data detailing the financial impact of the transaction. The ceding insurer's actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this rule and any applicable actuarial standards of practice when determining the proper credit to be taken in financial statements filed with the superintendent. The actuary should maintain adequate documentation and be prepared upon request to describe the actuarial work performed for inclusion in the financial statements and to demonstrate that such work conforms to this rule.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.11 SURPLUS INCREASE REQUIREMENTS:** Any increase in surplus net of federal income tax resulting from arrangements described in 13 NMAC 2.7.10 [now 13.2.7.10 NMAC] shall be identified separately on the insurer's statutory financial statement as a surplus item (aggregate write-ins for gains and losses in surplus in the capital and surplus account, page 4 of the annual statement) and recognition of the surplus increase as income shall be reflected on a net-of-tax basis on the "reinsurance ceded" line, page 4 of the annual statement as earnings emerge from the business reinsured. [For example, on the last day 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 percent tax rate, the net increase in surplus at inception is \$13.2 million (\$20 million - \$6.8 million) which is reported on the "aggregate write-ins for gains and losses in surplus" line in the capital and surplus account. \$6.8 million (34 percent 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 year N+1 the business has earned \$4 million. ABC had 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 percent of (\$4 million - \$1 million - \$.5 million) up to a maximum of \$13.2 million) on the "commissions and expense allowance on in reinsurance ceded" line of the summary of operations, and \$1.65 million on the "aggregate write-ins for gains and losses in surplus" line of the capital and surplus account. The experience refund would be reported separately as a miscellaneous income item in the summary of operations.]  
[1/1/94; Recompiled 11/30/01]

**13.2.7.12 WRITTEN AGREEMENTS:**

A. No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any financial statement filed with the superintendent, unless the agreement, amendment or a binding letter of intent has been duly executed by both parties no later than the "as of date" of the financial statement.

B. In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within a reasonable period of time, not exceeding ninety days from the execution date of the letter of intent, in order for credit to be granted for the reinsurance ceded.

C. The reinsurance agreement shall provide that:

(1) the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement; and

(2) any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.13 EXISTING AGREEMENTS:** Insurers subject to this rule shall reduce to zero by December 31, 1995 any reserve credits or assets established with respect to reinsurance agreements entered into prior to the effective date of this rule which, under the provisions of this rule would not be entitled to recognition of the reserve credits or assets; provided, however, that the reinsurance agreements shall have been in compliance with laws or rules in existence immediately preceding the effective date of this rule.  
[1/1/94; Recompiled 11/30/01]

**13.2.7.14 TABLE A -- RISK CATEGORIES:**

- A. Morbidity.
- B. Mortality.
- C. Lapse: This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.
- D. Credit Quality (C1). This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.
- E. Reinvestment (C2). This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.
- F. Disintermediation (C3). This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

	+ = Significant 0 = Insignificant		RISK CATEGORY					
	A	B	C	D	E	F		
Health insurance - other than LTC/LTD*	+	0	+	0	0	0		
Health insurance - LTC/LTD*	+	0	+	+	+	0		
Immediate annuities	0	+	0	+	+	0		
Single premium deferred annuities	0	0	+	+	+	+		
Flexible premium deferred annuities	0	0	+	+	+	+		
Guaranteed interest contracts	0	0	0	+	+	+		
Other annuity deposit business	0	0	+	+	+	+		
Single premium whole life	0	+	+	+	+	+		
Traditional non-par permanent	0	+	+	+	+	+		
Traditional non-par term	0	+	+	0	0	0		
Traditional par permanent	0	+	+	+	+	+		
Traditional par term	0	+	+	0	0	0		
Adjustable premium permanent	0	+	+	+	+	+		
Indeterminate premium permanent	0	+	+	+	+	+		
Universal life flexible premium	0	+	+	+	+	+		
Universal life fixed premium	0	+	+	+	+	+		
Universal life fixed premium - dump-in premiums allowed	0	+	+	+	+	+		

\* LTC = Long Term Care  
LTD = Long Term Disability  
[1/1/94; Recompiled 11/30/01]

**HISTORY OF 13.2.7 NMAC:**

Pre NMAC History: The material in this part was derived from that previously filed with the State Records Center: SCC 93-4-IN, Life and Health Reinsurance Agreements, filed 12/1/93.

History of Repealed Material: [RESERVED.]