



## ACTUARIAL STANDARDS BOARD

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### •EXPOSURE DRAFT•

#### Actuarial Standard of Practice No. 11

### Reinsurance Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports

Comment Deadline:  
June 30, 2020

Developed by the  
Task Force to Revise ASOP No. 11 of the  
Life Committee of the  
Actuarial Standards Board

Approved for Exposure by the  
Actuarial Standards Board  
November 2019

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November 2019

**TO:** Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in the Reinsurance Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports

**FROM:** Actuarial Standards Board (ASB)

**SUBJ:** Proposed Revision of Actuarial Standard of Practice (ASOP) No. 11

This document contains an exposure draft of a proposed revision of ASOP No. 11, now titled *Reinsurance Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports*. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each written comment letter or e-mail received by the comment deadline will receive consideration by the drafting committee and the ASB.

The ASB accepts comments by either electronic or conventional mail. The preferred form is e-mail, as it eases the task of grouping comments by section. However, please feel free to use either form. If you wish to use e-mail, please send a message to **comments@actuary.org**. You may include your comments either in the body of the message or as an attachment prepared in any commonly used word processing format. **Please do not embed your comments in the exposure draft and do not password protect any attachments. If the attachment is in the form of a PDF, please do not “copy protect” the PDF.** Include the phrase “ASB COMMENTS” in the subject line of your message. Please note: Any message not containing this exact phrase in the subject line will be deleted by our system’s spam filter. Also, please indicate in the body of the e-mail if your comments are being submitted on your own behalf or on behalf of a company or organization.

If you wish to use conventional mail, please send comments to the following address:

ASOP No. 11 Revision  
Actuarial Standards Board  
1850 M Street, NW, Suite 300  
Washington, DC 20036-5805

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Comments received after the deadline may not be considered. Anonymous comments will not be considered by the ASB nor posted to the website. Comments will be posted in the order that they are received. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

For more information on the exposure process, please see the ASB Procedures Manual.

**Deadline** for receipt of responses in the ASB office: **June 30, 2020**

### History of the Standard

The ASB adopted the original ASOP No. 11, then titled *The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements*, in 1989. Prior to adoption of the standard, Recommendation No. 4 and Interpretation No. 4-A of the *Financial Reporting Recommendations and Interpretations* of the American Academy of Actuaries covered certain aspects of generally accepted accounting principles (GAAP) financial reporting on reinsurance ceded by life and health insurance companies. The original standard superseded Recommendation No. 4 and Interpretation No. 4-A.

By the early 2000s, reinsurance practice and related accounting guidance had evolved significantly and included the following:

- For GAAP financial statements
  - Statement of Financial Accounting Standard (SFAS) No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, issued in 1992;
  - American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-7, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*, issued in 1998; and
  - Derivatives Implementation Group (DIG) for Financial Accounting Standard 133 Implementation Issue Number B36, issued in 2003.
- For statutory accounting, Statutory Statement of Accounting Principles (SSAP) No. 61 (issued in 2001) and other statutory guidance, including Appendix A-785 (credit for reinsurance) and Appendix A-791 (life and health reinsurance agreements) of statutory codification.

As a result, in 2005 the ASB decided to revise ASOP No. 11. In the 2005 revision, the scope was changed to apply to reinsurance transactions involving life and health insurance, rather than to life and health insurance company financial statements, as well as to life and health insurance reinsured by property/casualty companies. Furthermore, if a company entered into a transaction that involved reinsurance of both life/health insurance and property/casualty insurance, the 2005 revision stated that the actuary should determine whether ASOP No. 11, ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*, or aspects of both are most appropriate to determine the proper treatment of the transaction.

Since 2005, significant new guidelines and requirements for life insurance policies and annuity contracts have emerged, including the following:

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### General Changes

- Dodd–Frank Wall Street Reform and Consumer Protection Act;
- Covered Agreement with the European Union; and
- Covered Agreement with the United Kingdom.

### GAAP Changes

- GAAP – Accounting Standard Update 2018-12 (ASU 2018-12).

### Statutory Changes

- Principle-based reserving (PBR) and the accompanying *Valuation Manual*;
- Actuarial Guideline 48, *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)*, and Term and Universal Life Insurance Reserve Financing Model Regulation (Model 787);
- Amendments and recent developments in the Credit for Reinsurance Model Law and Regulation and the Nonadmitted and Reinsurance Reform Act;
- State by state requirements for the appointed actuary; and
- Own Risk and Solvency Assessment.

New requirements and practices related to health benefit plans have also emerged, including the following:

- The Patient Protection and Affordable Care Act (ACA);
- Increased prevalence of risk sharing with providers;
- Increased prevalence of governmental entities assuming insurance risk;
- Increased use of reinsurance for certain health lines of business, for example, long-term care and ACA-compliant business; and
- A greater variety of entities assuming health insurance risk.

The guidance in the standard is being updated to reflect emerging practices driven by this new environment.

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### Notable Changes from the Existing ASOP

Notable changes made to the exposure draft are summarized below. Additional changes were made to improve readability, clarity, or consistency.

1. The title of the ASOP was changed to reflect the expanded scope.
2. In section 1.2, the scope was clarified and expanded to cover internal and external financial reports as defined in section 2.4, rather than only financial statements.
3. Guidance was clarified and expanded throughout section 3.
4. The guidance related to health benefit plans was reviewed and expanded throughout section 3.
5. Guidance was added on the financial reporting aspects of nonguaranteed reinsurance elements in sections 3.2.1(a).
6. Guidance was added on the impact of reinsurance on retained business in section 3.2.2.
7. Guidance related to counterparty risk was added in section 3.3.
8. Guidance was added on the impact of nonguaranteed elements of the policies being reinsured in sections 3.5, 3.7(a), and 3.7(b).
9. Disclosures were added in sections 3 and 4 to match the clarifications and expansions made in section 3.

### Request for Comments

The ASB appreciates comments and suggestions on all areas of this proposed standard. Rationale and recommended language for any suggested changes would be helpful.

In addition, the ASB would like to draw the readers' attention to the following questions:

1. Is the scope description relating to the inclusion of self-insurance clear? If not, what wording would make it clearer?
2. Is the guidance sufficient given current laws, regulations, and accounting rules? If not, please explain what should be added.

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3. Are there any areas where the guidance is inconsistent with current practice? If so, please explain or provide examples.
4. Are there areas where the guidance creates issues with any reinsurance regulatory requirements? If so, please explain or provide examples.
5. Are there areas where the guidance creates conflict or introduces ambiguity with reinsurance-related guidance in other ASOPs? If so, please explain or provide examples.

The ASB voted in November 2019 to approve this exposure draft.

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Task Force to Revise ASOP No. 11

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*The Actuarial Standards Board (ASB) sets standards for appropriate actuarial practice in the United States through the development and promulgation of Actuarial Standards of Practice (ASOPs). These ASOPs describe the procedures an actuary should follow when performing actuarial services and identify what the actuary should disclose when communicating the results of those services.*

**ACTUARIAL STANDARD OF PRACTICE NO. 11**

**REINSURANCE INVOLVING LIFE INSURANCE, ANNUITIES,  
OR HEALTH BENEFIT PLANS IN FINANCIAL REPORTS**

**STANDARD OF PRACTICE**

Section 1. Purpose, Scope, Cross References, and Effective Date

- 1.1 Purpose—This actuarial standard of practice (ASOP or standard) provides guidance to actuaries when performing actuarial services with respect to **financial reports** that reflect **reinsurance programs** that involve life insurance, annuities, or **health benefit plans**.
- 1.2 Scope—This standard applies to actuaries when performing actuarial services in connection with preparing, determining, analyzing, or reviewing **financial reports** for internal or external use that reflect **reinsurance programs** on life insurance, annuities, or **health benefit plans**. Throughout this ASOP, the word “preparing” includes determining, analyzing, or reviewing.

To the extent that life insurance, annuities, or **health benefit plans** are reinsured by a property/casualty company or through risk financing systems (such as government-sponsored reinsurance pools and programs, or securitization products), this standard will apply. To the extent that self-insured plans buy third-party insurance, then this ASOP applies. To the extent that a self-insured plan is a stand-alone product with no third-party involvement, then this ASOP does not apply. If a **reinsurance program** involves both life/annuities/health and property/casualty insurance or coverages, the actuary should use professional judgment to determine whether this standard; ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*; or aspects of all three ASOPs apply.

When performing actuarial services with respect to **financial reports** involving a **reinsurance program**, the actuary should refer to the guidance in other ASOPs related to directly written business along with accounting rules, laws, and regulations that are specific to reinsurance.

If the actuary departs from the guidance set forth in this standard in order to comply with applicable law (statutes, regulations, and other legally binding authority), or for any other reason the actuary deems appropriate, the actuary should refer to section 4. If a conflict exists between this standard and applicable law, the actuary should comply with applicable law.

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- 1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.
- 1.4 Effective Date—This standard is effective for actuarial services performed in connection with **financial reports** issued on or after 18 months following adoption by the ASB.

Section 2. Definitions

The terms below are defined for use in this actuarial standard of practice and appear in bold throughout the ASOP.

- 2.1 Collectability of Reinsurance Proceeds—The ability of the **counterparty** to obtain funds owed to it according to the terms of the **reinsurance program**.
- 2.2 Counterparty—Another entity involved in the **reinsurance program** including, but not limited to, ceding entity, assuming entity, or a **service provider**.
- 2.3 Counterparty Risk—The risk that any **counterparty** does not fulfill its contractual obligations.
- 2.4 Financial Report—A report that conveys the performance or experience of a life or health risk-bearing entity at a specific point in time or over an accounting or measurement period that is provided to an internal or external party and on which the principal is expected to rely. The **financial report** may be based on any financial reporting regime appropriate to the assignment. Examples of **financial reports** include, but are not limited to, statutory financial statements, own risk and solvency assessment (ORSA) reports, enterprise risk management (ERM) reports, GAAP financial statements, asset adequacy analysis reports, and experience study reports.
- 2.5 Health Benefit Plan—A contract, such as an insurance policy, or other financial arrangement providing medical, prescription drug, dental, vision, disability income, long-term care, critical illness, accidental death and dismemberment, or other health-related benefits, whether on a reimbursement, indemnity, or service benefit basis, regardless of the form of the risk-bearing entity.
- 2.6 Model—A simplified representation of relationships among real world variables, entities, or events using statistical, financial, economic, mathematical, or scientific concepts and equations.
- 2.7 Net Liabilities—Reserves (net of reinsurance reserve credits), plus any other liabilities (such as amounts due the assuming entities), less any other assets arising from a

- reinsurance program** (such as amounts receivable from assuming entities or deferred acquisition costs), for the reinsured block of business.
- 2.8 **Net Retained Business**—The portion of the business written or assumed by the ceding entity that is not subject to the **reinsurance program**.
- 2.9 **Nonguaranteed Reinsurance Elements**—Any premium, charge, or benefit within a **reinsurance program** that affects reinsurance costs or values, is not guaranteed in the **reinsurance program**, and can be changed at the discretion of the assuming entity or **service provider**. A **nonguaranteed reinsurance element** may provide a more favorable value to the ceding entity than an element that is guaranteed in the policy. Examples of **nonguaranteed reinsurance elements** are the premiums in a yearly renewable term **reinsurance agreement** that are defined as nonguaranteed and **service provider** fees that can be contractually changed.
- 2.10 **Nonproportional Feature**—A feature of a **reinsurance agreement** in which the reinsuring entity agrees to reimburse the ceding entity for losses above a predetermined aggregate level and up to an aggregate reimbursement limit. Examples of such **nonproportional features** include aggregate claim limits, deductibles, limited coverage periods, stop-loss coverage, layers of claims covered (such as claims starting and ending at defined levels), and separate but related **reinsurance agreements** (i.e., where the results of one **reinsurance agreement** affect the operation of the other).
- 2.11 **Reinsurance Agreement**—An agreement whereby one or more elements of risk contained in insurance contracts are transferred from a ceding entity to an assuming (or reinsuring) entity in return for some consideration. This applies equally to a situation where the ceding entity is an assuming entity and the assuming entity is a retrocessionaire.
- 2.12 **Reinsurance Assumed**—Reinsurance as it affects the entity accepting the risk under a **reinsurance agreement**. This applies equally to an assuming entity and to an assuming entity that is a retrocessionaire.
- 2.13 **Reinsurance Ceded**—Reinsurance as it affects the entity transferring the risk under a **reinsurance agreement**. This applies equally to a ceding entity and to a ceding entity that is an assuming entity (for example, assuming entity ceding to a retrocessionaire).
- 2.14 **Reinsurance Program**—The combination of the **reinsurance agreement(s)**, its associated service contracts, and their implementation. Activities under a **reinsurance program** include but are not limited to sales, underwriting, claims adjudication, and administration, which might be affected by volume-based or performance-based fees or commissions.
- 2.15 **Service Provider**—An entity other than the assuming entity and ceding entity providing contractual services related to a **reinsurance agreement**, such as reinsurance intermediaries, managing general underwriters, captive manager, third-party administrators (TPAs), claims managers, investment advisors, investment managers,

information technology providers (such as cloud data services and credit reporting agencies), and trustees.

**Section 3. Analysis of Issues and Recommended Practices**

- 3.1 **Reinsurance Program Features**—When preparing **financial reports**, the actuary should take into account the material aspects of relevant **reinsurance program(s)**, including the following:
- a. the risks transferred in the **reinsurance agreements**;
  - b. the structure of the **reinsurance agreement**. The structure includes but is not limited to the type of the **reinsurance agreement** (for example, coinsurance), whether the risk(s) transferred are in the form of a proportional or **nonproportional feature**, or the parameters (quota share percentage, issue age, attachment point, etc.) associated with the reinsured portion(s) of the business; and
  - c. the responsibilities of any **service providers**, if applicable.
- 3.2 **Financial Reports**—When preparing **financial reports**, the actuary should take into account the risks reinsured and the risks retained under the terms and conditions of any **reinsurance program**.
- 3.2.1 **Impact of Risks Reinsured**—When evaluating the impact of risks reinsured under a **reinsurance program**, the actuary should take into account the following:
- a. how the terms and conditions of the **reinsurance program**, including **nonguaranteed reinsurance elements**, impact the expected cash flows. Examples of items that may impact cash flows include but are not limited to premiums, risk fees, allowances, benefits, expenses, experience refunds, investment income, modified coinsurance reserve adjustments, **nonproportional features**, policyholder dividends and other nonguaranteed elements of the policies being reinsured, provider risk-sharing agreements, termination provisions of the **reinsurance agreement**, and volume or other bonuses (including any contingent payments);
  - b. how activities that are performed by **service providers** impact reinsurance cash flows;
  - c. penalties, if any, for not performing as required under the terms and conditions of the **reinsurance program**, such as interest penalties, and the likelihood of such penalties;
  - d. the impact on reinsurance cash flows, if any, of the contractual activities performed by the assuming and ceding entities participating in the

- reinsurance agreement** (for example, the ability of the assuming entity to influence the timing, size, and nature of potential rates charged by the ceding entity to policyholders, or claims handling practices, or the ability of the ceding entity to change nonguaranteed elements of the policies being reinsured);
- e. the impact of **counterparty risk** to a **reinsurance program** on reinsurance cash flows (for more on **counterparty risk**, see section 3.3);
  - f. how the **collectability of reinsurance proceeds** associated with the **reinsurance program** impacts cash flows. Considerations include but are not limited to the ability of the assuming entity to meet its obligations, the impact of state or federal law on the **collectability of reinsurance proceeds** or the ability of the assuming entity to interpret direct policy language to impact the amount of claims reimbursed or the ability of the ceding entity to meet its obligations under the **reinsurance program**;
  - g. the impact of incentives or disincentives, if any, on the performance of the **reinsurance program** activities (for example, compensation of employees, fees to third parties, or the terms and conditions of the **reinsurance program**);
  - h. the impact on reinsurance cash flows of the investment policy of the holder or manager of the assets under the **reinsurance agreement**. When determining whether the investment policy impacts cash flows, the actuary should take into account the following:
    - 1. the contractual, legal, market, or regulatory constraints;
    - 2. the impact of deviation from the expected investment policy on cash flows; and
    - 3. influence of points 3.2.1(h)1 and 2 on future anticipated investment policies, such as the ability to reinvest future cash flows in similar assets;
  - i. the impact on reinsurance cash flows of operational risks such as poor training, inadequate or malfunctioning technology, unreliable data, and poor processes;
  - j. how the terms and conditions of the **reinsurance program** are reflected in the **model(s)** or the implementation of the **model(s)** used to prepare the **financial reports**; and
  - k. how the assumptions used in the **model**:

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1. appropriately reflect the terms and conditions of the **reinsurance program**. When making this determination, the actuary should identify and take into account the following:
    - i. the purpose of the assignment;
    - ii. the guidance in ASOP No. 23, *Data Quality*, on the consideration and the choice of data underlying the assumptions; and
    - iii. the guidance in ASOP No. 25, *Credibility Procedures*, on the consideration of the credibility of data underlying the assumptions.
  2. are reasonably consistent with other assumptions used in the current and prior **financial reports** and are reasonable in aggregate, and if not, whether there is justification for using different assumptions and methods based on, for example, the timing and nature of the **financial report**;
  3. appropriately reflect company experience or market estimates; and
  4. contain appropriate margins, for example, for uncertainty, statistical error, and/or conservatism.
- 3.2.2 Impact of Risks Retained—When evaluating the impact of risks retained under the terms and conditions of any **reinsurance program**, the actuary should take into account the following:
- a. the potential impact on assumptions associated with the **net retained business** that are potentially impacted by the existence of a **reinsurance program**. For example, policies below an excess of retention **reinsurance program** may be managed differently due to the presence of reinsurance on the excess of retention business, or the assuming entity may have the ability to influence the timing, size, and nature of potential rates charged by the ceding entity to all policyholders;
  - b. the consistency of assumptions and methods regarding risks associated with the **net retained business** that are impacted by the existence of a **reinsurance program** with other assumptions and methods used in the current and prior **financial reports** or the justification for using different assumptions and methods based on, for example, the timing and nature of the **financial report**;
  - c. the reasonableness, in aggregate, of assumptions regarding risks associated with the **net retained business** that are impacted by the existence of a

**reinsurance program** or the justification for using different assumptions before and after reflecting the **reinsurance program** in the **financial reports**;

- d. the impact of the **reinsurance program** on the investment policy of the holder or manager of the assets associated with the **net retained business**. When determining whether the **reinsurance program** impacts the investment policy, the actuary should consider the following:
  1. the contractual, legal, market, or regulatory constraints;
  2. the impact of deviation from the expected investment policy on cash flows; and
  3. the influence of points 1 and 2 on future anticipated investment policies, such as the ability to reinvest future cash flows in similar assets;
- e. the impact of the **reinsurance program** on **net retained business** as reflected in the **model** used in the **financial report** and the consistency of this impact relative to other **models**, both past and current, used by the entity; and
- f. the impact on the cash flows of the **net retained business** caused by the contractual activities performed by the assuming and ceding entities participating in the **reinsurance agreement** (for example, the ability of the assuming entity to influence the timing, size, and nature of potential rates charged by the ceding entity to policyholders, or claims handling practices).

In addition to the guidance in section 3.2, the actuary should follow the financial reporting regime's requirements for taking account of any credit in the **financial report** for the risk mitigation impact of reinsurance. For example, for principle-based reserves (PBR), the credit is calculated based upon the difference between cash flows before and after the impact of reinsurance.

3.3 Assessing and Analyzing the Impact of Counterparty Risk—The actuary should take into account the material **counterparty risks** that could impact the **financial report** including, but not limited to, the following:

- a. the ability of an entity to meet its obligations under the **reinsurance program**;
- b. the **collectability of reinsurance proceeds** or lag time in collection of any funds owed under the **reinsurance program**, such as reinsurance claims or reinsurance premiums;
- c. performance risk of **counterparties** who are performing specific services related to the **reinsurance agreement**, such as a **counterparty** not performing to

established guidelines, a TPA not paying claims on time, or an investment manager not adhering to investment guidelines;

- d. any collateral that has been posted in relation to the **reinsurance agreement** and its amount, quality, and permitted uses, as defined by regulation and the **reinsurance agreement**;
- e. the measurement of the effectiveness of the procedures designed to identify or mitigate the **counterparty risk**;
- f. the **counterparty's** financial health, stability, enterprise risk management (ERM) practices, and changes therein. Examples include financial strength ratings, investment policy, required capital, capital, and the risk level of the types of business written or assumed;
- g. any **counterparty** contractual features or risk management policies that might affect the risk, such as parental guarantees, letters of credit, or alternative coverage; and
- h. the holder or manager, if different from the owner, of the assets under the **reinsurance agreement** and the implications of this arrangement.

3.4 Assessing and Analyzing the Risks Being Transferred in a Reinsurance Program—When preparing a **financial report** to evaluate the risks being transferred in a **reinsurance program**, the actuary should consider the terms and conditions of the **reinsurance program**. The actuary should also consider how the risks being transferred compare to their principal's risk appetite, including the following:

- a. a comparison of the principal's original goals for its **reinsurance programs** versus the **reinsurance programs'** actual performance;
- b. the degree of risk mitigation or acceptance that reflects the principal's risk tolerances and risk appetite as of the time of the **financial report**; and
- c. any material change in the principal's risk mitigation or acceptance goals. The actuary may also recommend modifications to the **reinsurance program** to meet the principal's goals as of the time of the **financial report**.

When preparing a **financial report** to evaluate a **reinsurance program** for the purposes of ERM or own risk and solvency assessment (ORSA), the actuary should refer to ASOP Nos. 46, *Risk Evaluation in Enterprise Risk Management*, and 47, *Risk Treatment in Enterprise Risk Management*.

3.5 Treatment of Reinsurance Risks—When preparing values related to a **reinsurance program** in a **financial report**, the actuary should take into account the purposes of the **financial report**, factoring in the applicable accounting and regulatory requirements or

guidance, as well as the terms and conditions of the **reinsurance program** and its associated risks. Examples of risks associated with the **reinsurance program** include but are not limited to **counterparty risk**, lack of **reinsurance program** controls, untimely payments, volatility of experience refunds, nonguaranteed elements of the policies being reinsured, the structure of the **reinsurance agreement**, and investment philosophy.

- 3.5.1 Treatment of Reinsurance Ceded—The actuary should prepare values related to **reinsurance ceded** directly without relying upon the values of financial statement items held by the assuming entity. The actuary may use data provided by the assuming entity in calculating financial statement values (see ASOP No. 52, *Principle-Based Reserves for Life Products under the NAIC Valuation Manual*, and sections 3.10-3.14 of this ASOP). Because the ceding entity and the assuming entity each establish and test statement liabilities and assets independently, it is possible for the value of the **net liabilities** held by the ceding entity, plus those held by the assuming entity on a reinsured contract, to be more or less than the amount that would have been held if the ceding entity had not reinsured the contract. For example, the two **counterparties** may have different expectations for assumptions that impact liabilities or investment returns.
- 3.5.2 Treatment of Reinsurance Assumed—The actuary should consider the following regarding the treatment of **reinsurance assumed**:
- a. whether adjustments to data are needed based on the quality and credibility of data when preparing a **financial report** or other information exchanged between the **counterparties**. When doing so, the actuary should refer to ASOP Nos. 23 and 25 for guidance;
  - b. the features and risks of the business assumed, such as lack of control over the ceding entity's investment philosophy, nonguaranteed elements of the policies being reinsured, other risk-sharing arrangements, dividends, marketing, underwriting practices, or claims adjudication and management practices, or in-force management practices; and
  - c. the features and risks of the **reinsurance program** referenced in section 3.2.
- 3.6 Termination of Reinsurance Programs—The actuary should consider the impact of the potential termination of **reinsurance programs** on the obligations of the **counterparties** and whether the assumption(s), input(s), or methodology used to determine the values in the **financial report** should be modified.

When preparing **financial reports**, the actuary should consider situations that may cause the obligation of the parties to terminate and whether the parties have any remaining obligations post termination. When doing so, the actuary should take into account the following:

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- a. the terms and conditions of the **reinsurance program**;
- b. the regulatory and financial reporting regime governing the **financial report**;
- c. the known business practices of the **counterparties**; and
- d. the current and potential internal and external environments faced by the **counterparties**. When doing so, the actuary should also consider whether scenario testing is necessary.

Termination events that the actuary should consider include but are not limited to the following:

1. **reinsurance agreements** that end prior to underlying risk terminating;
2. termination due to regulatory intervention;
3. termination due to inability of ceding entity to pay reinsurance premiums;
4. termination due to assuming entity exercising rights to change the **reinsurance agreement**;
5. recapture or commutation specified or permitted by the **reinsurance agreement**;
6. termination due to the financial difficulties of an assuming entity;
7. partial termination of **reinsurance agreement** due to a partial recapture;
8. partial termination of **reinsurance agreements** due to ceding entity losing license; and
9. termination due to inability of **service providers** to perform as specified in their agreement.

3.7 Additional Liabilities, Reserves, or Allocation of Capital—The actuary should consider whether the terms and conditions of the **reinsurance program** create the need for additional liabilities, reserves, or allocation of capital to be established. When considering this issue, the actuary should use assumptions consistent with the purpose of the **financial report**. Examples of situations where additional liabilities, reserves, or allocation of capital may be needed include but are not limited to the following:

- a. an assuming entity having the right to change **nonguaranteed reinsurance elements** on in-force business without a corresponding right by the ceding entity to change nonguaranteed elements of the policies being reinsured or terminate the **reinsurance agreement**;

- b. recapture by a ceding entity due to an assuming entity changing **nonguaranteed reinsurance elements** on in-force business; or
- c. an assuming entity's inability to post the amount of collateral required by agreement or regulation.

3.8 **Accounting Guidance**—When preparing values in the **financial report** that reflect the terms of a **reinsurance program**, the actuary should consider applicable accounting guidance. The actuary should determine whether a particular **reinsurance agreement** qualifies as reinsurance for statutory, GAAP, or other purposes, and how this may affect the accounting treatment. The actuary may seek the advice of experts in making this determination. When relying on experts, the actuary should refer to section 3.14.

3.9 **Experience Analysis**—When preparing a **financial report** to analyze the actual-to-expected financial experience of a **reinsurance agreement**, the actuary should establish a baseline to be used as a source of comparison. An example of a baseline is the results of the final **model** used in analyzing the reinsurance proposal at the time of entering the **reinsurance agreement**.

Examples of how to analyze actual-to-expected financial experience include loss ratios and actual-to-expected mortality experience. The actuary should use professional judgment and consider the needs of the principal when deciding which form of analysis to choose.

3.10 **Reliance on Data or Other Information Supplied by Others**—When relying on data or other information supplied by others, the actuary should refer to ASOP Nos. 23 and 41, *Actuarial Communications*, for guidance. In addition, where the actuary relies on others for data in preparing PBR, the actuary should comply with specific requirements of the *Valuation Manual*. The actuary should disclose the extent of any such reliance.

3.11 **Reliance on Assumptions or Methods Selected by Another Party**—When relying on assumptions or methods supplied by another party, the actuary should review the assumptions or methods for reasonableness and consistency. For further guidance, the actuary should refer to ASOP No. 41. The actuary should disclose the extent of any such reliance.

3.12 **Reliance on Models Developed by Others**—If the actuary relies on a **model** designed, developed, or modified by others, such as a vendor or colleague, the actuary should disclose the extent of any such reliance. In addition, the actuary should make a reasonable attempt to have a basic understanding of the **model**, including but not limited to the following, as appropriate:

- a. the designer's or developer's original intended purpose for the **model**;
- b. the general operation of the **model**;
- c. major sensitivities and dependencies within the **model**; and

- d. key strengths and limitations of the **model**.

When relying on **models** developed by others, the actuary should review the **model** for compliance with the applicable sections of this standard and adjust the **model** as necessary to make it comply with the standard. If the actuary adjusts the **model**, the actuary should document and disclose the adjustments.

- 3.13 Reliance on Another Actuary—The actuary may rely on another actuary who has provided input to the **financial report**. The relying actuary should evaluate the reasonableness and appropriateness of the information supplied by the other actuary and be satisfied that the other actuary’s work was performed in accordance with this ASOP. The actuary should disclose the extent of any such reliance on another actuary.
- 3.14 Reliance on Experts—An actuary may rely on experts in preparing the **financial report**. In determining the appropriate level of reliance, the actuary should consider the following:
- a. whether the individual or individuals upon whom the actuary is relying are experts in the applicable field;
  - b. the extent to which the input provided for the **financial report** has been reviewed or opined on by experts in the applicable field;
  - c. whether there are legal, regulatory, professional, industry, or other standards that apply to the creation of the input for the **financial report** supplied by the expert, and whether the input has been represented as having met such standards. For example, it is often the case in reinsurance that an accountant or a lawyer are relied upon to determine whether a **reinsurance agreement** meets regulatory requirements to be accounted for as reinsurance; and
  - d. whether the input to the **financial report** supplied by the expert was relevant and useful to the purpose of the **financial report**.

The actuary should disclose the extent of any such reliance.

- 3.15 Documentation—In addition to the documentation requirements throughout the rest of section 3, the actuary should consider creating and retaining documentation to support compliance with the requirements of section 3 and the disclosure requirements of section 4. When preparing such documentation, the actuary should create documentation in a form such that another actuary qualified in the same practice area could assess the reasonableness of the actuary’s work or could assume the assignment if necessary. The degree of such documentation should be based on the professional judgment of the actuary and may vary with the complexity and purpose of the actuarial services. In addition, the actuary should refer to ASOP No. 41, section 3.8, for guidance related to the retention of file material other than that which is to be disclosed under section 4.

Section 4. Communications and Disclosures

- 4.1 Required Disclosures in an Actuarial Report—When issuing an actuarial report to which this standard applies, the actuary should refer to ASOP Nos. 23, 25, 41, 46, 47, and 52. In addition, the actuary should disclose the following in such actuarial reports:
- a. features of the **reinsurance program(s)** being analyzed in the **financial report**, as discussed in section 3.1;
  - b. material impacts on the **financial report** caused by the terms of the **reinsurance program(s)** or the practices of any of the parties to the **reinsurance program(s)** as discussed in section 3.2;
  - c. material assumptions used in the **financial report** that are inconsistent either across time or different lines of business, and an explanation for the inconsistency, as discussed in sections 3.2.1(k)(2), 3.2.2(a), and 3.2.2(b);
  - d. description of the **model** and assumptions, including a summary of how the **model** and assumptions meet the conditions in sections 3.2.1(k), 3.2.2(e), or 3.12;
  - e. unresolved concerns the actuary has about reinsurance information (for example, reinsurance settlement data, in-force information, and legal agreements) that, in the actuary’s professional judgment, could have a material effect on the actuarial work product, as discussed in sections 3.2.1(i), 3.3, and 3.5;
  - f. the impact of the following risks on the results presented in the report:
    - i. variation in assumptions or methods over time, if any, as discussed in sections 3.2.1(k)(2), 3.2.2(a), 3.2.2(b), and 3.7;
    - ii. **nonguaranteed reinsurance elements** in a **reinsurance agreement**, as discussed in sections 3.2.1(a), 3.2.1(d), 3.5, 3.7(a), and 3.7(b);
    - iii. **counterparty risk**, as discussed in section 3.2.1(e) and 3.3; and
    - iv. non-performance of **service providers**, if any, as discussed in sections 3.2.1(b), 3.2.1(g), 3.2.1(h), 3.2.2(d), and 3.3;
  - g. the potential impact of risks associated with the **reinsurance program**, as discussed in sections 3.2, 3.3, 3.4, 3.5, 3.6, and 3.7;
  - h. additional reserves that needed to be established due to the nature of the **reinsurance agreement** and the rationale for such additional reserves, as discussed in section 3.7;

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- i. the extent of reliance on data or other information supplied by others, if any, used in the preparation of the **financial report**, including reliance on data for determining PBR, as discussed in section 3.10;
  - j. the extent of reliance on others for assumptions or methods used in **financial reports**, including any adjustments made to assumptions or methods, and the steps taken to review the assumptions or methods for reasonableness and consistency, as discussed in section 3.11;
  - k. the extent of reliance on **models** developed by others, if any, as discussed in section 3.12;
  - l. adjustments made to the **model** supplied by another party and upon which the actuary is relying, as discussed in section 3.12;
  - m. the extent of reliance on other actuaries, if any, for input used in the preparation of the **financial report**, as discussed in section 3.13; and
  - n. the extent of reliance on experts, if any, for input used in the preparation of the **financial report**, as discussed in section 3.14.
- 4.2 Additional Disclosures in an Actuarial Report—The actuary should include the following, when applicable, in an actuarial report:
- a. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);
  - b. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and
  - c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary’s professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.

## **Appendix 1**

### **Background and Current Practices**

*Note:* The following material is provided for informational purposes and is not part of the standard of practice.

#### Background

Actuarial practice with respect to reinsurance, as well as the complexity of reinsurance programs, has evolved significantly since the 2005 version of ASOP No. 11, the last time the ASOP was adopted. Significant new laws, regulations, and accounting requirements for life insurance policies, annuity contracts, and health benefit plans have also emerged. These refinements have led to this revision of ASOP No. 11.

Financial reports involving reinsurance must comply with many accounting requirements, laws, and regulations. These requirements relate to, for example, whether the reinsurance agreement should be accounted for as reinsurance or as a deposit, the nature and amount of collateral that is required for a reserve credit to be allowed in the financial report, and the types of assets that must back certain kinds of reserves.

The presentation of the components of the net liabilities may vary under different accounting principles. For example, reserves other than principle-based reserves (PBR) are shown net of reinsurance ceded in statutory financial reports. PBR are first calculated pre-reinsurance, then post-reinsurance, with the difference being the reinsurance reserve credit. Reserves are generally presented on a gross basis before reinsurance in GAAP financial reports with the reinsurance credit reported as an offsetting asset. This difference in presentation affects the analysis that goes into a financial report.

Requirements relating to risk transfer must also be met in order to receive reinsurance accounting treatment under the requirements of Statutory Statement of Accounting Principles (SSAP) No. 61R, which incorporates related guidance in Appendices A-785 and A-791 of the *NAIC Accounting Practices and Procedures Manual*.

Statutory accounting requires any increase in after-tax initial surplus impact from the reinsurance of an existing block of business to be reflected directly through surplus at the inception of the reinsurance agreement. The resulting impact to surplus is then amortized into income over the life of the reinsured business. If the initial impact of a reinsurance program is negative, that impact flows immediately through earnings.

While assumption and indemnity reinsurance are both labeled as reinsurance, they are two different forms of transactions. With indemnity reinsurance, the policyholder's relationship remains with the ceding entity. An assumption reinsurance transaction is a sale of business such that the policyholder's direct relationship is with the "assuming entity." This difference results in a different financial statement presentation for the two types of transactions. The presentation in

financial reports differs for assumption reinsurance agreements and indemnity reinsurance agreements. Under indemnity reinsurance agreements, the ceding entity remains legally responsible for all policyholder obligations of the reinsured policies. The assuming entity indemnifies, or protects, the ceding entity against one or more of the risks in the reinsured policies. Under an assumption reinsurance agreement, the ceding entity is relieved of responsibility for the policies reinsured, and the contracts are accounted for by the assuming entity in the same manner as direct business. The assuming entity assumes all of the obligations formerly assumed by the ceding entity. Typically, regulatory and policyholder approval is required. When a company intends to enter into an assumption reinsurance agreement, an indemnity reinsurance agreement may be used for policies not yet covered by the assumption reinsurance agreement.

The ceding entity is responsible for assessing the collectability of reinsurance proceeds, including determining whether the portion that is non-collectable should be written down. Considerations include financial strength and liquidity of the assuming entity, court or arbitration findings, and other market forces.

Since the 2005 version of this ASOP was adopted, revisions and new model regulations have significantly changed the nature of reinsurance. One example is the Term and Universal Life Insurance Reserve Financing Model Regulation (Model 787). For reinsurance agreements completed after a certain date for level term and universal life with secondary guarantee policies, Model 787 requires that the calculation of reserves be broken into two pieces and that each piece has a specified type of assets to back them.

The first piece is reserves calculated using the Actuarial Method, a method similar to PBR, but not identical (for example, exclusion testing to determine whether to calculate reserves on a deterministic or stochastic basis is not permitted). These reserves are to be backed by primary securities, defined in the model as certain highly rated securities. Any excess in statutorily required reserves over those calculated using the Actuarial Method would be backed by a combination of primary and other securities. These securities may include any investments acceptable to the company's domiciliary regulator.

Under the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), if a state is accredited by the National Association of Insurance Commissioners (NAIC) or has solvency standards similar to those mandated by the NAIC, reinsurance reserve credit cannot be denied by other states. In other words, if a ceding entity's domestic regulator complies with these requirements, a foreign jurisdiction cannot deny reinsurance credit. Further, for an insurer that is predominantly an assuming entity and is domiciled in an NAIC-accredited state or in one that has solvency standards similar to those mandated by the NAIC, its sole solvency regulator is its domiciliary regulator. Further, no other state can require it to produce financial reports other than those required by their domiciliary regulator.

Another aspect of the Dodd–Frank Act is a provision that allows the U.S. to negotiate an agreement (called a covered agreement) with another country or jurisdiction that will impact the provision of reinsurance by companies domiciled in the other jurisdiction. Two such agreements have been negotiated, one with the E.U. and the other with the U.K. A feature of both of these agreements is

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that no collateral need be posted under certain conditions. This affects the financial report analysis by allowing the ceding entity to reduce the amount of reserves held backing reinsured business, without having to require the counterparty to establish collateral if the reinsurance agreement and the parties to the reinsurance agreement meet the requirements of the covered agreement.

Statutory collateral requirements have also been modified since this ASOP was last revised. New types of reinsurers have been defined in the regulation, and international agreements have also affected the amount of collateral that must be posted statutorily. Certified reinsurers are non-U.S. entities that are domiciled in a qualified jurisdiction and maintain certain regulatorily mandated conditions. Once certified, depending on the regulatorily assigned rating of the certified reinsurer, the amount of collateral the reinsurer is required to post can be significantly less than the more typical 100 percent requirement on non-certified, non-E.U., non-U.K. reinsurers. An impact of this change is that the ceding entity may have additional counterparty risk due to the lack of 100 percent collateral backing a reinsurance agreement with a non-U.S. entity.

GAAP has experienced numerous changes with respect to reinsurance under ASU 2018-12. Reinsurance assumed is to use the same accounting methodology as direct insurance. Reinsurance ceded is to use assumptions that are consistent with the assumptions used for direct insurance. While ceded Deferred Acquisition Cost (DAC) is still to be netted against direct DAC, impairment testing is no longer required. Cost of reinsurance is to be amortized over the remaining life of the agreement. There is also a delinking of invested assets, and therefore even when a block of business is 100 percent coinsured, the business will remain on the insurer's books for the life of the business. The standard allows for the reinsurance of market risk in products like guaranteed minimum benefits in variable products, under certain conditions. If those conditions are not met, then ASC 815 (Derivatives and Hedging) dealing with embedded derivatives is invoked.

In response to these changes, the ASB decided to revise this ASOP.

### Current Practices

The actuary may perform actuarial services in a variety of areas with respect to reinsurance. The following are some examples of the areas the actuary may deal with regarding reinsurance. Preparation of regulatory reports involves the analysis of an entity's reinsurance program. This includes preparation of items such as the Actuarial Opinion and Memorandum Report and various aspects of a company's GAAP statement. An actuary may also be called upon to identify risks assumed by the entity and how to mitigate those risks. Knowing the nature of and how to analyze an entity's reinsurance program is essential to understanding an entity's risk profile. An actuary may also be called upon to analyze the experience of reinsurance business assumed or ceded by an entity.