

# ASOP No. 11: Treatment of Reinsurance In Financial Reports

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May 17, 2022

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# Presenters

- **Jeremy Starr, MAAA, FSA;** Chairperson, Task Force to Revise ASOP No. 11  
Jeremy Starr Consulting LLC
- **Annette James, MAAA, FSA, FCA,** Member, Task Force to Revise ASOP No. 11  
NovaRest Actuarial Consulting
- **Leonard Mangini, MAAA, FSA, FRM,** Member, Task Force to Revise ASOP No. 11  
Mangini Actuarial and Risk Advisory LLC
- **Moderator: Stephen O'Brien, FSA, MAAA**  
Actuaries Club of Boston Planning Committee

# Jeremy Starr, FSA, MAAA

Jeremy has more than 45 years of reinsurance, corporate finance, and reinsurance intermediary experience. He consults with clients on matters including expert witness services, increasing the effectiveness of ceded reinsurance, reinsurance regulatory issues, diligence for mergers and acquisitions, and as an arbitrator in life reinsurance disputes. His firm also provides Reinsurance Intermediary Services.

Mr. Starr has worked as a senior executive for leading reinsurers, a major direct writer, a small reinsurer and an investment bank.

Jeremy has played a key role in setting and documenting industry standard documents. He was chair of the task force that revised the soon to be effective ASOP 11 on Reinsurance Financial Reports and coauthor of the current ASOP 11. He also authored the Reinsurance chapter of the Society of Actuaries textbook on IFRS 17 accounting.

Jeremy has also chaired of the Reinsurance Section of the SOA, and Reinsurance Committees of the AAA and ACLI.

# Annette James, FSA, FCA, MAAA

Annette is a Principal with NovaRest, Inc. She has over 25 years of senior level actuarial experience, which includes the preparation, review and analysis of financial reports, monitoring and analyzing the financial health of insurance companies and other risk-bearing entities, measuring the impact of health policy alternatives, and health insurance reform. Prior to NovaRest, Annette spent 14 years as the lead actuary at the Nevada Division of Insurance following her experience at three large actuarial consulting firms.

Annette is an active volunteer. She is a member of the Board of Directors of the American Academy of Actuaries, the chair of the health committee of the Actuarial Standards Board and participated in the revisions of ASOP Nos. 5, 42, 11 and 28 (chair). Annette has also participated in several committees of the American Academy of Actuaries (and current chair of the Health Equity Work Group), the Society of Actuaries and the National Association of Insurance Commissioners. Annette is a frequent speaker at national and international actuarial meetings and has authored several articles on actuarial and professionalism topics.



# Leonard Mangini, MAAA, FSA, FRM

Mr. Mangini brings clients over 30 years of expertise, having held senior Financial Reporting, Pricing, Reinsurance, and Risk Management roles at Manulife, ACE, AXA, and USLIFE, He has assisted clients with PBR, IFRS 4, IFRS 17, and US GAAP reporting implementation and audit issues, Product Development, Traditional and Accelerated Underwriting Design, Analysis of Block and Flow Reinsurance, Risk Management, M&A, and Expert Litigation-support at E&Y, Milliman, and now his own advisory firm.

Leonard is heavily involved with the Academy and Society of Actuaries. He is a Member of the Life Practice Council (LPC), the Life Valuation Committee (LVC), the Economic Scenario Group Task Force, and the Asset Adequacy Testing Task Force (AATTF) and previously Chaired the PBR Life Reserve Work Group (LRWG). He has served on five SOA Section Councils including Chairing both the Financial Reporting and Product Development Sections.

Leonard is a Fellow of the Society of Actuaries (FSA), a GARP Financial Risk Manager (FRM), a Member of the Academy (MAAA), and Caribbean Actuarial Association (CAA). He earned an MS in Quantitative Finance and a BS in Math and Physics with a Minor In English.

# Agenda

- ASOP No. 11—financial reports reflecting risk transfer programs for life, annuity and health benefit plans
- Reason for update
- Notable changes
- Highlights of changes to main provisions
- Q&A
- Case studies
- Q&A

# Reason for Update—General

- National—Dodd-Frank, Consumer Protection Act
- Covered agreements
- Accounting standard changes
- Regulatory changes
  - PBR/AOMR
  - NAIC reinsurance model law
  - Own Risk and Solvency Assessment (ORSA)



# Reason for Update—Health

- The Affordable Care Act (ACA)
- Change in risk-sharing landscape:
  - Provider risk sharing arrangements
  - Governmental entities assuming insurance risk
- Increased use of reinsurance for certain health lines, e.g., LTC and ACA-compliant business
- A greater variety of entities assuming health insurance risk

# Notable Changes—Scope

- New Name Reflects Broadened Scope - Treatment of Reinsurance or **Similar Risk Transfer Programs** Involving Life Insurance, **Annuities**, or **Health Benefit Plans** in **Financial Reports**
- Risk transfer programs
  - Traditional reinsurance arrangements
  - Government sponsored reinsurance programs
  - Securitization
  - Stop-loss insurance
  - Provider excess of loss insurance

## Notable Changes—Scope

- Expand beyond regulatory reporting to include internal and external financial reports
  - GAAP and statutory reporting
  - ERM, ORSA
  - Experience studies
  - Asset adequacy analysis report
  - Internal management reports
- Retained and ceded business



# In Scope or Not?

- I price reinsurance proposals for a life reinsurer, does ASOP No. 11 apply?
- I work for a provider that uses excess of loss INSURANCE to mitigate risk. Since we're not an insurance company does ASOP No. 11 apply?
- What if we self-insure health and don't buy stop-loss or risk transfer?
- What if we cede risk to a wholly owned captive?
- I perform statutory financial reporting presented on the Health "Orange Blank," does ASOP No. 11 apply to my actuarial work product?
- I work for a casualty company that writes health benefit plans—not a life or health insurer—can I ignore ASOP No. 11?
- I perform financial analyses in the annuity business unit, does that mean ASOP No. 11 applies to me as well?

## What is a Financial Report?

- A “Financial Report” *conveys performance or experience* of an assuming or ceding entity, at a *specific point in time* or *across an accounting period*.
- *This IS NOT exclusive to financial reporting.*
- ANY Financial Report *impacted by risk transfer*, internal OR external, that is material and relied upon **is in scope**—so it applies to company actuaries AND consultants.

# Aid to Identifying a Financial Report

- Section 2.6 provides a *non-exhaustive list* of Financial Reports such as ORSA, experience studies, and GAAP financials
- *ONE way* to think of this is *ask yourself about your work product*:
  - Am I producing work product involving a risk-bearing entity?
  - Am I creating cash flow projections? ASOP No. 7 can help here.
  - Am I using a stream of cash flows to create point-in-time estimates, such as Loss Ratios, Present Values, Return Measures, or Reserves?
  - Are **reinsurance** or “**reinsurance-like**” risk-mitigation programs involved in the actuarial work product or analysis?
  - If risk-mitigation programs **are not involved**, do such programs impact the results?



# Notable Changes—Guidance

- New ASOP effective December 1, 2022
- New/expanded guidance on:
  - Nonguaranteed reinsurance elements
  - Retained risks
  - Modeling—Interaction with ASOP No. 56
  - Counterparty risk
  - Health benefit plans

# Nonguaranteed Reinsurance Elements

- Definition—Reinsurance cost or value that can be changed by assuming entity or service provider
  - Example: YRT Rates
- Need to assess
  - Impact on future cash flows
  - Need for additional liabilities
  - Offsets such as recapture and increase in direct rates

# Counterparty Risk

- Definition: Risk that **any party** not fulfilling its expected obligations might impact transaction cashflows, for example:
  - Third Party Administrator (TPA)
  - Outside Investment Advisor
  - Managing General Underwriter (MGU)
  - Health Care Providers
  - Other Parties performing services related to the risk transfer
  - Insurers
  - Reinsurers/Retrocessionaires



# Counterparty Risk Considerations

- Ability of counterparty to meet obligations
- Credit risk
- Contractual features that impact risk
  - Performance incentives/disincentives
  - Parental guarantees, letters of credit and/or alternative coverage
- Adherence to performance standards in agreements
  - Timing of reimbursements
  - Investment guidelines
  - Underwriting/Claims standards

## Impact on Retained Risk

- Management of retained risk
- Consistency of assumptions between current and prior reports
- Reasonableness of assumptions individually and in aggregate
- Impact on investment policy
- Services provided by assuming/ceding entity

# Data and Modeling Considerations

Introduces reinsurance-specific considerations within the ASOP and references other existing ASOPs

- Provisions of risk mitigation programs
- Appropriateness of data and model to assignment
- Appropriateness of margins
- Reliance on other experts
- Refers actuaries to ASOP Nos. 23, 25, 41, 56



# Summary of Other Main Provisions

- Understanding of risk transfer program
- Factors to consider in assessing program
- Ongoing appropriateness of program
- Treatment of risks reinsured
- Conditions when program could be terminated
- Additional liabilities
- Reflect accounting regime of report
- Experience analysis

# Late Breaking News Proposed AG on AAT

Proposed Actuarial Guideline AAT “Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves”, effective for statutory reported reserves as of December 31, 2022 and subsequent annual financial statements

Proposed Scope:

- (>\$5B) of General Account Reserves on Exhibits. 5, 6, 7, 8 or
- (>\$500MM) of GA Reserves with (>5%) of supporting assets used in AAT that meet definition of Projected High Net Yield from Section 3.C, *gross of reinsurance*

## **Section 4 – Asset Adequacy Considerations/Documentation Expectations**

- 4G Reinsurance Modeling. Related to reinsurance, relevant communications and disclosures from ASOP No. 11, for instance commentary on collectability and counterparty risk, should be presented in the memorandum.

# Questions





# Case Studies

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# Cast of Characters

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- Lisa King, FSA, MAAA Chief Actuary at Fast Growing Life Insurance Co.
- Joe Junior, ASA career ASA in Fast Growing's corporate actuarial dept.
- Kris Underwood, FALU, MD is Fast Growing's Chief Underwriter
- Herman Muenster, CIE, ARA is Fast Growing's VP of Claims

# Case Study – Life - Statutory

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# Financial Reinsurance – Background

- Fast Growing Life is writing more of its new term product than expected
- To help with the surplus strain it enters a quota share coinsurance agreement with Super Rich Re
  - Super Rich is a newly formed Bermuda reinsurer
  - Much of its capital is held in a trust by its parent Risky Hedge Fund
  - The reinsurance agreement requires Super Rich to post collateral
    - The collateral is partially a trust agreement and partially 1-year letters of credit
  - The ceding allowances are not guaranteed

# Financial Reinsurance – Statutory Year End Analysis

- It is now December 2022
- Lisa has asked Joe to do the year end analysis on the Super Rich treaty
- Joe's actions:
  - looks at last year's report,
  - updates it for this year's experience and
  - Presents it to Lisa for her approval
- What considerations did Joe miss?

# Case Study – Life – Risk Appetite

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## Financial Reinsurance – Change in Risk Appetite

- This year Fast Growing raised additional capital and increased its retention
- Is there guidance on how to evaluate in force reinsurance programs?

# Summary Life Case Studies

- Review laws and regulations
- Counterparty risk needs to be reviewed
- ASOP requires impact on retained business evaluated
- NGRE have potential to change reserves
- Changing risk appetite over time can impact what risks are retained and what risks are reinsured

# Case Study – Health – ACA Market

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# Health Benefit Plans – ACA Market

- Fast Growing Life is evaluating whether it should enter the ACA health insurance market in four states and has hired Hot Shot Actuarial Consulting to help them launch their health products.
- Fast Growing Life has a proposed excess loss agreement with Not So Rich Health Insurance Company to cover the new health business.
- Lisa and Joe are reviewing the internal projections for the health insurance business, prepared by Hot Shot Actuarial. Due to the startup nature of the health business, the reinsurance agreement is an essential part of the company's risk mitigation strategy.
- What are the main considerations for this assignment?

# Summary - Health Case Study

- Applicability of ASOP 11 – goes beyond
  - NAIC statements
  - Traditional reinsurance contracts
- Terms of the risk transfer agreements must be appropriately reflected
- Counterparty risk
- Reliance on experts
- Must fully document work

# Case Study – Life - Planning

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# Traditional Reinsurance and Non-Traditional Business

- Fast Growing Life is expanding into InsurTech using a lean and mean technological and business model given its aggressive risk appetite
- SQYNET Biometrics provides an AI-driven accelerated underwriting algorithm for assessing risks non-traditionally with very high throughput
- Maximum Gross Underwriters is Fast Growing's outsourced MGU, given the "pen" for binding all life insurance risks for this new product line
- Throughput Processing Administrators will serve as Fast Growing's TPA providing rapid Claims Processing and ALL administration services
- Hungry Hedge Fund Re wants flow business and will reinsure anything
- Lisa, Joe, Kris, and Herman are the only internal Fast Growing staff involved
- What are the ASOP 11 considerations for this operation?

## Summary Life Case Studies- Planning/3<sup>rd</sup> Parties

- Definition of Counterparties has been expanded
- Must consider incentives and disincentives on 3<sup>rd</sup> Parties
- Must have a benchmark for expectations
- Consult with Experts for non-Actuarial aspects, such as underwriting, claims, predictive analytics software per ASOP 38
- Document and Disclose the impact of material deviations from expectations of 3<sup>rd</sup> Party Performance on Financial Report
- Document and Disclose changes made to incentives/disincentives, assumptions, models as a result of such discoveries

# Questions?

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