ACTUARIAL STANDARDS BOARD

● **EXPOSURE DRAFT** ●

Proposed
Actuarial Standard
of Practice

Pricing Reinsurance or Similar Risk Transfer Transactions Involving Life Insurance, Annuities, or Long-Duration Health Benefit Plans

Comment Deadline:
November 1, 2024

Developed by the
Reinsurance Pricing Task Force of the
Life Committee of the
Actuarial Standards Board

Approved for Exposure by the
Actuarial Standards Board
June 2024

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APPENDIX

June 2024

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Pricing Reinsurance or Similar Risk Transfer Transactions Involving Life Insurance, Annuities, or Long-Duration Health Benefit Plans

FROM: Actuarial Standards Board (ASB)

SUBJECT: Proposed Actuarial Standard of Practice on Pricing Reinsurance or Similar Risk Transfer Transactions Involving Life Insurance, Annuities, or Long-Duration Health Benefit Plans

This document contains the exposure draft of a proposed ASOP, *Pricing Reinsurance or Similar Risk Transfer Transactions Involving Life Insurance, Annuities, or Long-Duration Health Benefit Plans*. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each written comment letter or email received by the comment deadline will receive consideration by the drafting committee and the ASB.

The ASB appreciates comments and suggestions on all areas of this proposed standard. The ASB requests comments be provided using the Comments Template that can be found here and submitted electronically to **comments@actuary.org**. Include the phrase "Reinsurance Pricing ASOP COMMENTS" in the subject line of your message. Also, please indicate in the template whether your comments are being submitted on your own behalf or on behalf of a company.

The ASB posts all signed comments received on 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 on 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 comments: **November 1, 2024**

History of the Standard

In February 2020, the task force revising ASOP No. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports*, identified that only the financial reporting aspects of life insurance, annuity, and long-duration health benefit plan reinsurance are covered by ASOP No. 11 and that no other standard covers the pricing of reinsurance assumed for these products. ASOP No. 54, *Pricing of Life Insurance and Annuity Products*, specifically excludes the pricing of reinsurance assumed from its scope and does not cover any aspect of health benefit plans. The decision was made to specifically exclude reinsurance because the requirements of pricing direct business are different from those of pricing reinsurance business. ASOP No. 54 does include reinsurance ceded as a risk mitigation technique.

Reinsurance is also specifically excluded from ASOP No. 2, *Nonguaranteed Elements for Life Insurance and Annuity Products*. In addition, ASOP No. 2 does not cover health benefit plans. Reinsurance was excluded because the requirements for managing nonguaranteed elements for a direct company are different than for an assuming company.

The ASB recognized that pricing of reinsurance assumed for life, annuities, and health benefit plans as well as management of nonguaranteed reinsurance elements are significant areas of practice that lacked guidance and therefore appointed a task force in April 2021 to develop a new ASOP on pricing reinsurance involving life insurance, annuities, and long-duration health benefit plans from an assuming company perspective.

Request for Comments

The ASB appreciates comments and suggestions on all areas of this proposed standard submitted through the Comments Template. Rationale and recommended wording for any suggested changes would be helpful.

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

1. Does the ASOP scope appropriately cover reinsurance pricing involving life and annuity products? If not, please explain and suggest language.

2. Does the ASOP scope appropriately cover reinsurance pricing involving long-duration health benefit plans? If not, please explain and suggest language.

3. Does the ASOP provide appropriate guidance to cover the scope of reinsurance pricing activities? If not, please explain and suggest language.

4. Does the ASOP provide appropriate guidance related to nontraditional reinsurance or risk transfer activities, for example, captive or affiliate reinsurers and pension risk transfer? If not, please explain and suggest language.

5. Does the ASOP provide appropriate guidance on pricing-related activities (such as administration and treaties) and pricing activities subsequent to initial pricing (such as monitoring and NGE management)? If not, please explain and suggest language.

6. Are there any reinsurance or similar risk transfer structures that do not fit or are not addressed by the guidance provided that should be? If so, please explain and suggest language.

The ASB voted in June 2024 to approve this exposure draft. The ASB thanks members of the ASB Health Committee, who contributed significantly to this draft.

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.

PROPOSED ACTUARIAL STANDARD OF PRACTICE

PRICING REINSURANCE OR SIMILAR RISK TRANSFER TRANSACTIONS INVOLVING LIFE INSURANCE, ANNUITIES, OR LONG-DURATION HEALTH BENEFIT PLANS

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 the **pricing** of **reinsurance transactions** or similar risk transfer transactions from the **assuming entity** perspective involving life insurance, annuities, or **long-duration health benefit plans**.

1.2 Scope—This standard applies to actuaries when performing actuarial services with respect to the **pricing** of **reinsurance transactions** or similar risk transfer transactions from the **assuming entity** perspective involving life insurance, annuities, or **long-duration health benefit plans**.

If the actuary is performing actuarial services that involve reviewing the **pricing** of such transactions from the **assuming entity** perspective, the actuary should follow the guidance in section 3 to the extent practicable within the scope of the actuary's assignment.

This standard does not apply when the actuary's employer is the **assuming entity** and the actuary is **pricing** an **underlying product** on behalf of the **ceding entity**.

This standard does not apply to actuaries performing actuarial services with respect to preparing actuarial appraisals, which is covered by ASOP No. 19, *Appraisals of Casualty, Health, and Life Insurance Businesses*.

This standard does not apply to actuaries performing actuarial services with respect to **pricing** reinsurance or similar risk transfer for property/casualty coverages containing long-duration health benefits, which is covered by ASOP No. 53, *Estimating Future Costs for Prospective Property/Casualty Risk Transfer and Risk Retention*. Examples of such coverages include workers compensation and automobile personal injury protection.

The standard does not include guidance on compliance with federal antitrust laws or the evaluation of other considerations (such as marketing, sales, and competition) that may affect the ultimate price of the **reinsurance transaction**.

If the actuary determines that the guidance in this standard conflicts with an ASOP that applies to all practice areas, this standard governs.

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

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 follow 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 on or after four months after adoption by the Actuarial Standards Board.

Section 2. Definitions

The terms below are defined for use in this standard and appear in bold throughout the standard. The actuary should also refer to ASOP No. 1, *Introductory Actuarial Standard of Practice*, for definitions and discussions of common terms, which do not appear in bold in this standard.

2.1 Assuming Entity—An entity accepting risk from a **ceding entity** through a **reinsurance transaction**.

2.2 Ceding Entity—An entity transferring risk to an **assuming entity** through a **reinsurance transaction**.

2.3 Long-Duration Health Benefit Plan—An insurance policy or other financial arrangement that establishes health-related obligations for an extended period of time. Benefits may begin several years after plan inception and may extend for several years. Benefits may be on a reimbursement, indemnity, or service benefit basis. Examples of **long-duration health benefit plans** include long-term disability income, long-term care, critical illness, and accidental death and dismemberment insurance.

2.4 Model Output—Financial results generated from a model using a set of assumptions. **Model output** may be generated specifically for the **pricing** of the **reinsurance transaction** or another purpose such as an appraisal.

2.5 Nonguaranteed Reinsurance Element—An element of a **reinsurance transaction** that may be changed at the discretion of the **assuming entity**. Examples of **nonguaranteed reinsurance elements** include yearly renewable term premiums, renewal rates or allowances, or **reinsurance transaction** termination.

2.6 Nonguaranteed Reinsurance Element Framework—The practices, methods, and criteria used by the **assuming entity** to determine **nonguaranteed reinsurance elements**.

2.7 Pricing—The initial or subsequent determination of charges for and benefits provided by a potential or existing **reinsurance transaction** including evaluating the profitability and underlying risks of the **reinsurance transaction**. Examples of potential charges and benefits include premiums, ceding commissions, allowances, death benefits, surrender benefits, indemnity benefits, income benefits, or experience refunds.

2.8 Profitability Analysis—An evaluation of the expected financial results of a **reinsurance transaction** using a set of assumptions, a specified model, and any specified **profitability metrics**.

2.9 Profitability Metric—A measurement used to assess the financial results of a **reinsurance transaction**. Examples of **profitability metrics** include internal rate of return, average return on equity, return on assets, profit margin, value of new business or embedded value, and break-even year.

2.10 Reinsurance Agreement—An agreement whereby one or more elements of risk contained in insurance contracts or self-insured benefit plans are transferred from a **ceding entity** to an **assuming entity** in return for some consideration.

2.11 Reinsurance Transaction—A transfer of one or more elements of risk from a **ceding entity** to an **assuming entity** through a **reinsurance agreement**. When the term "**reinsurance transaction"** is used in this standard, the term includes reference to similar risk transfer transactions, such as pension risk transfers, longevity swaps, or acquisitions.

2.12 Risk Capital—The amount of capital a company chooses to hold to meet a business objective, given its risk profile.

2.13 Sensitivity Analysis—An analysis performed by changing an assumption or set of assumptions and comparing the results to those resulting from the baseline assumption(s).

2.14 Stochastic Analysis—An analysis performed using a model that estimates distributions of potential outcomes by allowing random variation in one or more inputs to the model.

2.15 Underlying Product—The source of the risk ceded in a **reinsurance transaction**. Examples of **underlying products** include life insurance, annuities, **long-duration health benefit plans**, pensions, and any associated riders.

Section 3. Analysis of Issues and Recommended Practices

3.1 Pricing Considerations—When **pricing** a **reinsurance transaction**, the actuary should take into account the criteria of the principal and the relevant characteristics of the **reinsurance transaction**, **ceding entity**, and **underlying products**.

3.1.1 Criteria of the Principal—Examples of criteria of the principal include the following:

a. the choice of **profitability metrics**;

b. targets for **profitability metrics**, including any applicable considerations such as short-term versus long-term targets, profit or loss experience to date, situations where profits are expected to be followed by losses, and range of tolerance of profitability;

c. the desired risk profile of the principal, such as available capacity of the **assuming entity**, potential variability in expected outcomes being considered, and level and cost of **risk capital**; and

d. how risk management and **nonguaranteed reinsurance element framework** policies and practices of the principal relate to the **pricing** of the **reinsurance transaction**.

3.1.2 Relevant Characteristics of the Reinsurance Transaction—Examples of relevant characteristics of the **reinsurance transaction** include the following:

a. the current profitability of the existing **reinsurance transaction**, if applicable;

b. the objective(s) of the **reinsurance transaction**;

c. the type of **reinsurance transaction**, such as coinsurance, yearly renewable term (YRT), or stop loss;

d. the structure and parameters of the **reinsurance transaction**, including **reinsurance agreement** provisions, such as duration, renewability, and recapture; automatic or facultative; or first dollar or excess arrangement;

e. risks inherent in the **reinsurance transaction**, including **ceding entity** retention, counterparty, financial, regulatory, operational, and outsourcing risks, such as those related to third-party administrators;

f. potential risk mitigation strategies, such as retrocession and hedging;

g. implications of the **nonguaranteed reinsurance element framework**, such as how and when the **nonguaranteed reinsurance elements** may be adjusted;

h. current and anticipated accounting and tax implications of the **reinsurance transaction**;

i. administration of the **reinsurance transaction**, including any limitations in administrative and valuation systems; and

j. the effects of applicable law on the **reinsurance transaction**.

3.1.3 Relevant Characteristics of the Ceding Entity and Underlying Products of the Reinsurance Transaction—Examples of relevant characteristics of the **ceding entity** and **underlying products** of the **reinsurance transaction** include the following:

a. the financial strength of the **ceding entity**;

b. the past performance of the **underlying products** or related products, if applicable;

c. the implications of the design of the **underlying products**, such as optional riders, policyholder behavior, benefit features, or level of guarantees;

d. the target market, sales volume, and the competitive alternatives to the **underlying products**;

e. how the **underlying products** were or will be sold, such as underwriting, distribution, and marketing;

f. how the **underlying products** were or will be administered, including any limitations in administrative systems and valuation systems;

g. the experience, philosophy, and practices of the **ceding entity** regarding the processes that impact the economics of the **underlying products** of the **reinsurance transaction**, such as its approach to claims practices, business decisions, nonguaranteed elements, and risk mitigation;

h. the effects of applicable law on the **underlying products**; and

i. the tax treatment of the **underlying products** as it applies to both the policyholder and the **ceding entity**.

3.2 Actual Experience from the Reinsurance Transaction—When **pricing** an existing **reinsurance transaction**, the actuary should review actual experience from the **reinsurance transaction**, if available, and take into account the following:

a. how much the actual experience from the **reinsurance transaction** differs from anticipated experience or **pricing** assumptions;

b. how trends in the actual experience of the **reinsurance transaction** are developing, and whether the trends are significant and ongoing;

c. the credibility and quality of the experience data, taking into account any lags in reporting;

d. how closely the established processes were followed (for example, claims, administrative, or underwriting processes); and

e. whether changes to relevant characteristics of the **reinsurance transaction** have occurred that materially impact the anticipated experience of the **reinsurance transaction**.

If the actuary determines that actual experience differs from anticipated experience or **pricing** assumptions, the actuary should consider recommending adjustments to **pricing** assumptions using guidance in section 3.3 and performing a risk analysis using guidance in section 3.5 to assess whether the **reinsurance transaction** is meeting the criteria of the principal.

3.3 Profitability Metrics—When reviewing or recommending the choice of **profitability metrics** for the **pricing** of a **reinsurance transaction**, the actuary should take into account the following:

a. the criteria of the principal;

b. the risks and characteristics of the **reinsurance transaction**;

c. the expected pattern of profits over time (for example, the pattern of gains and losses, however measured);

d. the alignment of the **profitability metric** to the financial objective(s) of the principal;

e. the anticipated duration of the **reinsurance transaction** including consideration of items such as rate guarantee period or recapture provisions;

f. any limitations of the **profitability metric** used at inception or over time for the **reinsurance transaction** being priced; and

g. any other considerations that the actuary determines are relevant.

The actuary should consider using more than one **profitability metric** when **pricing** a **reinsurance transaction**.

When reviewing or recommending targets for **profitability metrics**, the actuary should take into account the risks and characteristics associated with the **reinsurance transaction**.

3.4 Pricing Assumptions—The actuary should use assumptions that are reasonable for the **pricing** of the **reinsurance transaction** and that reflect expected future experience.

3.4.1 Assumption Setting—When setting or reviewing **pricing** assumptions, the actuary should use relevant experience, refer to ASOP No. 23, *Data Quality*, and ASOP No. 25, *Credibility Procedures*, for guidance, and take into account the following, as applicable:

a. mortality or morbidity assumptions that incorporate the effects of risk selection and risk classification, the impact of expected trends, and **underlying product** features such as conversion, guaranteed purchase options, or extension of benefits;

b. sales mix assumptions that reflect the current or anticipated distribution of sales across modeling cells;

c. investment assumptions and economic market assumptions that reflect real-world or market-consistent theory, where appropriate, and that include assumptions for reinvestment, asset default, and investment expenses;

d. effect of policyholder optionality, for example, timing of lapse or amount of partial withdrawal;

e. expense assumption methodology and allocation, as well as anticipated future trends in expenses, such as inflation or expense efficiencies;

f. discount rates for the selected **profitability metric**;

g. the **assuming entity's** and **ceding entity's** capacity and intent with regard to in-force management strategies, for example, the amount of business intended to be written, the **nonguaranteed reinsurance element framework**, and the **ceding entity's** framework for nonguaranteed elements and dividends, as applicable;

h. the impact of the interaction of the assumptions, for example, that mortality may need to be adjusted when lapses are expected to increase; and

i. the extent to which assumptions may be influenced by the relevant characteristics of the **reinsurance transaction** and the **underlying products** as described in sections 3.1.2 and 3.1.3.

3.4.2 Assumption Margins—The actuary should consider including a margin in the assumptions. When setting a margin, the actuary should take into account the following:

a. the degree of uncertainty in the assumptions due to lack of relevant, credible entity or industry experience data to support the assumptions;

b. whether the degree of uncertainty may vary over different periods of time within the time horizon of the model; and

c. whether the level of margins is appropriate for each assumption individually and in aggregate for all assumptions.

3.4.3 Consistency of Assumptions—The actuary should use assumptions that reflect any interdependencies with each other, are consistent with current and anticipated **assuming entity** practices, and, where appropriate, are consistent with similar assumptions used for other purposes within the **assuming entity**. The actuary should take into account any special circumstances that may arise when the **reinsurance transaction** is being assumed by an affiliate or captive when evaluating consistency of assumptions.

3.4.4 Capital Market Assumptions—When analyzing the cost of a benefit that can be replicated using liquid capital market instruments, the actuary should consider comparing the cost of the benefit using market-consistent assumptions to the price of a comparable investment guarantee observed in capital markets to assess how well the results of the analysis align with the profitability goals and risk management policy of the principal.

3.4.5 Adjustments of Assumptions—The actuary should take into account the extent to which actual experience or emerging trends differ from established **pricing** assumptions and consider recommending updates to the **pricing** assumptions.

3.4.6 Documentation of Assumptions, Rationale, and Data Modifications—The actuary should document the assumptions, the rationale for the assumptions including how the views of experts were considered or incorporated, and any modifications made to previous assumptions and data sources. If margins are included in assumptions, the actuary should document the approach used and, where practicable, the margin component of each assumption.

3.5 Considerations with Respect to Models or Model Output—The actuary should use one or more models or sets of **model output** to support the **pricing** of the **reinsurance**

transaction in a manner consistent with the criteria of the principal and that appropriately represents the characteristics of the **reinsurance transaction**.

3.5.1 Model Development, Selection, and Evaluation—When developing, selecting, or evaluating a reinsurance **pricing** model, the actuary should refer to ASOP No. 56, *Modeling*. The actuary should confirm that the model accommodates the characteristics of the **reinsurance transaction** and the selected **profitability metrics** and reasonably simulates the future financial impact of the **reinsurance transaction**.

When developing, selecting, or evaluating the model, the actuary should take into account the following:

a. Time Horizon—The degree to which the model extends over a sufficient time period such that the risks of the **reinsurance transaction** are adequately captured;

b. Characteristics of the Reinsurance Transaction and the Underlying Products—The degree to which the model captures the characteristics of the **reinsurance transaction** and the **underlying products** as described in sections 3.1.2 and 3.1.3;

c. Dynamic Assumptions—The degree to which the model reflects how certain assumptions, such as policyholder behavior assumptions, may vary based on other factors;

d. Granularity—The degree to which the model accommodates the necessary detail of model components, such as time intervals, modeling cell structure, and assumptions that vary by modeling cell to appropriately represent the current or expected profitability and underlying risk of the **reinsurance transaction**;

e. Asset Returns—The degree to which the model accommodates asset returns consistent with how returns are currently or are expected to be recognized and allocated;

f. Economic Scenarios—The degree to which the model accommodates scenarios that represent an appropriate range of future economic conditions;

g. Accounting Bases and Actuarial Methods—The degree to which the model accommodates the accounting standards and practices (for example, statutory, GAAP, and tax) and the actuarial assumptions and methods used to calculate reserves and other actuarial balances that underlie the **profitability metrics** to be used in **pricing** the **reinsurance transaction**;

h. Risk Capital Framework—The degree to which the model accommodates the principal's current or expected **risk capital** framework;

i. Taxes—The degree to which the model accommodates the current or expected tax structure, given the **reinsurance transaction**, the tax position of the **assuming entity**, and the **assuming entity's** tax allocation practices;

j. Risk Evaluation—The degree to which the model accommodates an appropriate method to evaluate risks, as described in section 3.5;

k. Risk Mitigation—The degree to which the model accommodates current or expected risk mitigation strategies to support the **reinsurance transaction**;

l. Model Validation—The degree to which the model is sufficiently transparent to support validation, as described in section 3.7; and

m. Other Items—Any other items the actuary determines are relevant to the model, for example, third-party counterparty risk beyond the **ceding entity** and **assuming entity**.

In addition, the actuary should take into account whether an existing reinsurance **pricing** model needs adjustment to appropriately reflect the **pricing** of the **reinsurance transaction** or needs updated **pricing** assumptions.

The actuary should document how 3.3.1(a)–3.3.1(l) and any other items associated with 3.3.1(m) were taken into account.

In addition, the actuary should document techniques and analysis used to select or evaluate the model, including any adjustments or updates made to or recommended for the model.

3.5.2 Using Model Output—When using **model output** in the **pricing** of a **reinsurance transaction**, the actuary should determine whether the **model output** reasonably reflects the **reinsurance transaction**. When doing so, the actuary should take into account the following, as applicable:

a. the **pricing** assumptions used in the **model output**;

b. the intended purpose of the model that produced the **model output**;

c. the principal's targets for **profitability metrics**;

d. the extent to which the **model output** reflects the risks and characteristics of the **reinsurance transaction** and **underlying products**; and

e. any other information available to assess the **model output**.

If the actuary determines that the **model output** does not reasonably reflect the **reinsurance transaction**, the actuary should review or recommend reviewing model inputs, model assumptions, and modeling methodology and make or recommend adjustments to the model to reasonably reflect the **reinsurance transaction**. Alternatively, the actuary may adjust or recommend adjusting the **model output** to appropriately reflect the **reinsurance transaction**. The actuary should document any analysis or rationale for adjustments made to the model or **model output**.

3.6 Risk Evaluation—When performing a **profitability analysis,** the actuary should evaluate the risks in the **reinsurance transaction**. The actuary should consider using **sensitivity analysis** or **stochastic analysis** to compare results from a baseline **profitability analysis**.

3.6.1 Sensitivity Analysis—The actuary should consider using **sensitivity analysis** to evaluate the impact of variations in assumptions on the results of the **profitability analysis** and should consider performing more analysis for assumptions that have a significant impact on the financial results than for assumptions that have less impact.

3.6.2 Stochastic Analysis—The actuary should consider using **stochastic analysis** to evaluate the distribution of the results of the **profitability analysis** from variations in key assumptions, in particular interest rates and equity returns. When performing **stochastic analysis**, the actuary should

a. take into account the appropriateness of the scenarios being used; and

b. evaluate the results of the **profitability analysis** in aggregate and for a selection of individual scenarios.

The actuary may consider using other risk evaluation techniques, as appropriate.

The actuary should take into account the impact of risk mitigation strategies that are expected to be implemented and the expected effectiveness of those strategies.

3.7 Renewal, Revision, or Closure of a Reinsurance Transaction—When reviewing a **reinsurance transaction**, the actuary may recommend the **reinsurance transaction** be renewed, revised, or closed for new business. The actuary may also recommend revisions be made to **nonguaranteed reinsurance elements**.

When making such recommendations, the actuary should use the results of a **profitability analysis** and take into account the following, if applicable:

a. whether the **profitability analysis** needs to be updated;

b. how the **reinsurance transaction** is performing;

c. how the overall portfolio of **reinsurance transaction**(s) from the **ceding entity** is performing;

d. any competitive pressure or strategic objective;

e. whether any changes to the **nonguaranteed reinsurance elements** or the **reinsurance transaction** are needed and to what extent such changes meet the criteria of the principal;

f. any **reinsurance agreement** limitations to making changes to the **nonguaranteed reinsurance elements**;

g. any business or **reinsurance agreement** implications of making changes to the **nonguaranteed reinsurance elements**, such as triggering a recapture or reputational impacts; and

h. any other considerations the actuary determines to be relevant to the **reinsurance transaction**.

The actuary should document the recommendations and supporting analysis for the recommendations.

3.8 Governance and Controls—The actuary should use, or, if appropriate, may rely on others to use, reasonable governance and controls over the actuarial services provided as part of **pricing** the **reinsurance transaction**. Examples of possible governance and controls include the following:

a. effective oversight of methods, assumptions, and approximations used in **pricing** the **reinsurance transaction**;

b. preservation and protection of the model from unintentional or untested changes;

c. validation of the appropriate use of the inputs in model calculations;

d. validation that values from the models are consistent with independent calculations of such values from outside the model;

e. validation that the model reasonably simulates the expected future financial impact of the **reinsurance transaction** and, if applicable, the **underlying products**;

f. review of assumptions and other aspects of the model by another knowledgeable person who conducts the review in an objective manner;

g. confirmation that **pricing** parameters are correctly implemented, for example, in the **reinsurance agreement** and in the systems that administer and monitor the **reinsurance transaction**; and

h. conformity with applicable law (for example, S*tatement of Statutory Accounting Principle*s [*SSAP*] *No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*) and other agreements (for example, nondisclosure agreement or services agreement).

The actuary should document the governance and controls used by the actuary as part of **pricing** the **reinsurance transaction**.

3.9 Reliance on Another Party—When relying on another party and thereby disclaiming responsibility

a. for data and other information relevant to the use of data, the actuary should refer to ASOP No. 23, *Data Quality*.

b. for a model, the actuary should refer to ASOP No. 56, *Modeling*.

c. for assumptions and methods prescribed by another party, the actuary should review the assumption or method for reasonableness and consistency to the extent practicable and appropriate within the scope of the actuary's assignment.

d. for assumptions and methods not prescribed by another party, or for any other item not addressed above, the actuary should review the item for reasonableness and consistency to the extent practicable and appropriate within the scope of the actuary's assignment. In addition, the actuary should be reasonably satisfied that the reliance is appropriate, taking into account the following, as applicable:

1. when the other party is an actuary, whether the actuary knows that the other party is appropriately qualified and has followed applicable ASOPs;

2. whether the actuary knows that the other party has expertise in the applicable field;

3. whether the actuary knows the other party's stated purpose for the item and the extent to which it is consistent with the actuary's intended purpose; and

4. whether the actuary knows of differences of opinion within the other party's field of expertise that are material to the actuary's use of the item.

3.10 Documentation—In addition to the documentation requirements throughout the rest of section 3, the actuary should consider preparing and retaining documentation to support compliance with the requirements of section 3 and the disclosure requirements of section 4. If preparing documentation, the actuary should consider preparing such documentation in a form such that another actuary qualified in the same practice area could assess the reasonableness of the actuary's work. The amount, form, and detail 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 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, the actuary should refer to ASOP Nos. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports*; 23; 25; 41*, Actuarial Communications*; and 56. In addition, the actuary should disclose the following in such actuarial reports, if applicable:

a. the criteria of the principal (see section 3.1.1);

b. relevant characteristics of the **reinsurance transaction** (see sections 3.1.2 and 3.1.3);

c. result of reviewing actual experience, any adjustments to **pricing** assumptions recommended, and any risk analysis performed (see section 3.2);

d. the **profitability metrics** and targets used in the **profitability analysis** and any limitations of the **profitability metrics** (see section 3.1.1 and 3.3);

e. **pricing** assumptions, including how they were developed, any margins included in the assumption, and the extent to which assumptions are consistent with other assumptions, and any recommended updates to assumptions (see section 3.4);

f. considerations used with respect to the model or **model output**, including any aspects of the model or **model output** that may not meet the criteria of the principal or any adjustments or updates made to or recommended for the model or **model output** related to the **reinsurance transaction** (see section 3.5);

g. the techniques used and the results of the risk evaluation, including the results of the **profitability analysis** and any **sensitivity analysis** or **stochastic analysis** (see section 3.6);

h. recommendations for renewal, revision, or closure of a **reinsurance transaction** and the implications of any recommended **nonguaranteed reinsurance element** changes (see section 3.7);

i. any governance and controls for **pricing** the **reinsurance transaction**, including those used by others (see section 3.8); and

j. any reliance on information provided by another party (see section 3.9).

4.2 Additional Disclosures in an Actuarial Report—The actuary also should include disclosures in an actuarial report in accordance with ASOP No. 41 for the following circumstances:

a. if any material assumption or method was prescribed by applicable law;

b. 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; or

c. if, in the actuary's professional judgment, the actuary has deviated materially from the guidance of this standard.

4.3 Confidential Information—Nothing in this standard is intended to require the actuary to disclose confidential information.

Appendix

Background and Current Practices

Note: This appendix is provided for informational purposes and is not part of the standard of practice.

Background

Reinsurance is a key risk mitigation technique for ceding companies. Reinsurance provides ceding companies with, for example, the ability to write more business, free up capital, mitigate claims volatility, or transfer risk. Reinsurance or risk transfer is a business-to-business transaction. As such, the pricing and management of nonguaranteed reinsurance elements has been left to companies. Although accounting rules for reinsurance exist, such as SSAP 61R and Appendix A-791, these rules mainly identify what reinsurance is and the accounting associated with it.

Over the last 20 years, reinsurance has evolved through the use of financial markets, affiliated companies, offshore entities, and financial reinsurance (such as surplus relief and reserve financing). Although reinsurance has been a key risk mitigation technique, it has been addressed only tangentially through other ASOPs, such as ASOP No. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance*, *Annuities, or Health Benefit Plans in Financial Reports.*

A diverse set of transactions and types of companies are involved in reinsurance. The transactions may involve risks transferred between unaffiliated or affiliated entities, from pension plan sponsors to property/casualty entities, or through risk financing systems (such as securitization products or sponsored reinsurance pools and programs). Transactions have become more complex, such as including yearly renewable term (YRT) in a coinsurance transaction or experience refunds in modified coinsurance. Additionally, the practices reinsurers use to price and manage nonguaranteed reinsurance elements have drawn increased attention.

In addition, risk transfer marketplaces have grown substantially, and many insurers have risk transfer lines of business, such as pension risk transfers, longevity swaps, or acquisitions. Because risk transfers have similar pricing considerations and practices as reinsurance, the definition of a reinsurance transaction in this ASOP includes similar risk transfers.

Current Practices

Pricing reinsurance or similar risk transfer transactions for life insurance, annuities, or long-duration health benefit plans typically requires developing an actuarial model using anticipated experience to measure the risks inherent in the reinsurance transaction and the expected or potential future profit. Setting the assumptions for future experience is typically the responsibility of the actuary. The actuary also reviews actual experience to analyze the reinsurance transaction and may recommend changes to the reinsurance transaction if needed. Impacts to the ceding company flow through to the assuming company and ultimately affect the profitability of the reinsurance transaction. The actuary also assists with model building and evaluating model output to evaluate the reinsurance transaction both at initial pricing and later repricing of the transaction, if applicable.

Examples of existing trends that are expected to affect the pricing of reinsurance of life insurance, annuities, and long-duration health benefit plans include the following:

- Increased complexity in reinsurance structures to address specific reinsurance needs through customized solutions;
- Principle-based approaches in statutory accounting requirements to provide more flexibility and responsibility for actuaries in establishing the assumptions and methods that are used in that context for life insurance and annuity products;
- Changes to health care regulations that affect the ability of long-duration health benefit plans to adjust rates; and
- Risks and opportunities created by new distribution models, disruptive market entrants, and technology.