AMERICAN ACADEMY *of* ACTUARIES

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Chair, Statutory Accounting Principles Working Group
Financial Condition (E) Committee
National Association of Insurance Commissioners
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Mr. Bruggeman,

On behalf of the American Academy of Actuaries'[1] Health Practice Financial Reporting Committee, I would like to provide the following comments regarding the National Association of Insurance Commissioners (NAIC) Statutory Accounting Principles Working Group's (SAPWG) proposed modifications to the Maintenance Agenda Submission Form that addresses Accounting Standards Update (ASU) 2011-06: Fees Paid to the Federal Government by Health Insurers.

From an actuarial perspective, the need to set up a liability is tied to the balance between revenue streams and expense streams.[2] Further, in premium rate setting, it is important to consider when to establish contract reserves for individual health insurance[3]. Some of the assessments under the Affordable Care Act (ACA) have led to specific timing differences—receipt of funds from policyholders may occur before payment of assessments. As such, it would be appropriate for a liability to be established by the carrier to avoid any confusion by users of the year-end financial statements.

Failure to establish any liability on Dec. 31, 2013 (as was proposed by the guidance from the August 2012 statement from SAPWG) could result in the year-end 2013 financial statements showing free surplus due to premium amounts collected from policyholders in 2013 to fund assessments, which would not be paid out until 2014. This approach could mislead users of financial statements as to the level of free surplus on Dec. 31, 2013 and the year-to-year trends in surplus. Without an offsetting liability increase, surplus would appear to increase from 2012 to 2013, and then decrease from 2013 to 2014 as the payments are made without an offsetting liability decrease. Alternative approaches to addressing this risk could involve having the carrier make a specific allocation of its surplus in regards to future ACA assessments.

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[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualifications, practice, and professionalism standards for actuaries in the United States.

[2] Actuarial Mathematics discusses this as an "equivalence principle" while Chapter 6 of Individual Health Insurance describes it as "Reserves and liabilities are used to adjust for these timing differences, so that financial reports can accurately measure various aspects of that operation."

[3] See 4.A(1)b of the *Health Insurance Reserves Model Regulation*.

In 2014 and later, the current SAPWG proposal includes the establishment of a liability during the data year that, for many carriers, may exceed the monies already received to pay for these assessments. While this may have some appeal from a liability recognition standpoint, modifying the accounting requirements at this point in time does not allow carriers to establish appropriate premium loadings for policyholders. This policy also has adverse year-to-year trends in surplus. It would show surplus decreasing from 2013 to 2014 as the liability is established without recovering those fees in premiums, and then increase in subsequent years as carriers build loads into the premiums charged to policyholders.

Requiring carriers to establish a liability at the end of the data year for amounts already received from policyholders to fund ACA assessments (including the health insurer fee and the temporary reinsurance program collections) would result in the fewest unintended consequences. This liability could take the form of an unearned premium liability or a contract reserve. In either case, it is likely that the liability would need to be actuarially estimated on a non-seriatim basis, due to carrier recordkeeping limitations, particularly in the large group market. In subsequent periods, carriers could continue to establish a liability on this basis or the greater of this basis and the phase in of the liability included in the March 2013 SAPWG proposal (depending on the SAPWG's view of what is the appropriate long-term liability). This compromise could limit the false positives under the August 2012 SAPWG proposal in which carriers would report free surplus at the end of the data year based on advance collections from policyholders. It also would limit the false negatives under the March 2013 SAPWG proposal in which carriers would report a decline in surplus while future premiums would be loaded to fund those liabilities. This is similar to how block rating of individual health insurance products contemplates future premiums to cover the declining morbidity under existing insurance contracts.

We understand there are concerns about whether this approach could hide insolvencies for carriers that are unable to effectively load the assessments into future policyholder premiums. We believe this concern is addressed by current premium deficiency reserve requirements, in which a projection of premiums and expenses would show whether a carrier could cover future assessments effectively. As such, if a carrier has not included the future assessment into current policyholder premiums successfully and does not have sufficient other margins to cover such assessments, a premium deficiency reserve would have to be established to account for any differential.

If regulators believe the normal premium deficiency reserve process is insufficient to address this concern, in addition to the liability indicated above, there could be a requirement for further deficiency reserve analysis specifically focused on loadings for health insurer fees and temporary reinsurance program collections compared to future payments. This analysis would determine the carrier's ability to fund these future payments and require the establishment of a liability if future payments cannot be funded when the following year's projected enrollment and premiums are known—after year end during the development of financial statements.

Thank you for the opportunity to provide comments. Should you have any questions, please contact Tim Mahony, the Academy's state health analyst at 202.223.8196, or Mahony@actuary.org.

Sincerely,

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