**Statutory Accounting Principles (E) Working Group**
**Maintenance Agenda Submission Form**
**Form A**

**Issue:**
High-Cost Risk Pooling in ACA Risk Adjustment

**Check (applicable entity):**

| | P/C | Life | Health |
|---|---|---|---|
| Modification of existing SSAP | ☐ | ☐ | ☒ |
| New Issue or SSAP | ☐ | ☐ | ☐ |
| Interpretation | ☐ | ☐ | ☒ |

**Description of Issue:**
The Patient Protection and Affordable Care Act of 2010 (ACA) introduced a risk adjustment program impacting the individual and small group medical insurance markets, effective in 2014. In December 2016, the U.S. Department of Health and Human Services (HHS) adopted a new regulation that changed how ACA risk adjustment would function, starting in 2018. Specifically, as of 2018 the ACA risk adjustment program will now include a reinsurance-like element called high-cost risk pooling (HCRP).

According to HHS, the new HCRP element of ACA risk adjustment will operate along the following lines:

1. HHS will establish two new HCRP parameters: a threshold and a coinsurance rate. For 2018, the threshold has been set at $1 million, and the coinsurance rate has been set at 60 percent.

2. In the calculation of each issuer's annual risk adjustment transfer amount, the issuer will be reimbursed for a portion (specifically, the coinsurance rate) of actual enrollee-level claims above the threshold. Conforming changes will be made to how each issuer's enrollee-level plan liability risk scores are calculated.

3. In order to maintain the zero-sum nature of risk adjustment across each market in light of the new payments in step 2, each issuer's risk adjustment transfer amount will include an assessment, calculated as a percentage of the issuer's total premiums in the applicable market. The sum of the assessments across all issuers is intended to equal the sum of the payments in step 2 across all issuers.

Conceptually, HCRP can be thought of as a form of reinsurance: The amounts subtracted from an issuer's risk adjustment transfer amount in step 3 are akin to reinsurance premiums that the issuer pays in order to receive protection on claims above the threshold, and the amounts credited to an issuer's risk adjustment transfer amount in step 2 are akin to reinsurance reimbursement for the claims ceded via this reinsurance.

In this vein, there are similarities between HCRP (starting in 2018) and the ACA's transitional reinsurance program (which ran from 2014 to 2016). However, there are several differences. First, the HCRP "reinsurance premiums" and "reinsurance claims" will be administered within the ACA risk adjustment mechanism, rather than being administered as a distinct mechanism as was true for ACA transitional reinsurance. Also, while ACA transitional reinsurance pertained only to the individual market, the HCRP pertains to both the individual and small group markets. Lastly, with HCRP there is intended to be a balance between the total amounts that issuers pay in "reinsurance premiums" and the total benefits they receive in "reinsurance claims." This was not the case with ACA transitional reinsurance, where the presence of external sources of funding implied that the total benefits issuers in the individual market received were significantly in excess of the total amounts issuers in the individual market contributed toward the program.

 

With this background, the question is whether the introduction of the HCRP element of ACA risk adjustment should have any implications for how issuers account for ACA risk adjustment.

**Existing Authoritative Literature:**
SSAP No. 107—*Risk-Sharing Provisions of the Affordable Care Act* discusses the accounting for ACA risk adjustment. It also discusses the accounting for the now-ended ACA transitional reinsurance program.

Paragraphs 4 through 9 of SSAP No. 107 provide a description and overview of ACA risk adjustment. Some of the language in paragraphs 6, 7, and 9 probably should be modified in order to incorporate the introduction of the HCRP element of risk adjustment.

Paragraphs 10 through 13 of SSAP No. 107 provide guidance on the accounting treatment of ACA risk adjustment. Specifically, paragraph 13 states that "risk adjustment payables and receivables shall be accounted for as premium adjustments subject to redetermination." This is clarified further in paragraph 13c, which states that "premium revenue adjustments for the risk adjustment program are estimated for the portion of the policy period that has expired and shall be reported as an immediate adjustment to premium."

Paragraphs 14 through 21 of SSAP No. 107 provide a description and overview of ACA transitional reinsurance. In particular, paragraph 17 likens the ACA transitional reinsurance for the individual market to participation in an involuntary pool, as discussed further in SSAP No. 63—*Underwriting Pools.*

Paragraphs 25 through 37 of SSAP No. 107 provide guidance on how issuers participating in the ACA individual market would account for ACA transitional reinsurance. In particular, paragraph 29 reads in part as follows:

> 29. The transitional reinsurance program differs from an involuntary pool, in that there is not a proportionate sharing of the entire results of a pool. However, the purpose is very similar: to address the additional costs associated with high-risk individuals. … Therefore, SSAP No. 63, paragraph 8, provides additional relevant guidance. As the transitional reinsurance program is a mechanism for sharing the additional costs associated with high-risk individuals, it is accounted for as traditional reinsurance.

As a consequence of this determination, paragraph 30 states that the assessments made by issuers of individual insurance to fund the ACA transitional reinsurance program are to be accounted for as reinsurance ceded premium, and paragraphs 33 through 35 state that the distributions received from the ACA transitional reinsurance program are to be accounted for as reinsurance ceded claim recoveries.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):**
None

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**
The adoption by HHS of high-cost risk pooling within ACA risk adjustment effective in 2018 was published as a final rule in the Federal Register on Dec. 22, 2016, as part of the 2018 Notice of Benefit Payment Parameters (NBPP). Specifically, see Section II.B.6.c.(3).iii of the 2018 NBPP, at pages 94080-94082 of the Federal Register, Vol. 81, No. 246.

**Recommended Conclusion or Future Action on Issue:**
We outline two potential conclusions.

*Alternative #1*
The NAIC had previously concluded that, from the standpoint of issuers in the individual market, the ACA transitional reinsurance program should be treated for accounting purposes as if it were an involuntary pool. The same reasoning would appear to imply that the HCRP element of ACA risk adjustment should be treated for accounting purposes as if it were an involuntary pool.

 

Based on this reasoning, starting in 2018, an issuer in the individual or small group markets would need to decompose its risk adjustment payables and receivables into three pieces:

1. The piece representing proportionate reimbursement for the issuer's claims above the HCRP threshold would be accounted for as a reinsurance ceded claim recovery, consistent with how paragraph 33 of SSAP No. 107 treated payments made to the issuer under ACA transitional reinsurance.

2. The piece representing the percent-of-premium charge to the issuer in order to fund reimbursements across all issuers of claims above the HCRP threshold would be accounted for as reinsurance ceded premium, consistent with how paragraph 30 of SSAP No. 107 treated payments made by the issuer to fund the ACA transitional reinsurance program.

3. The residual piece would be accounted for consistent with existing guidance in paragraph 13 of SSAP No. 107 (i.e., as a premium adjustment subject to redetermination).

Changes to SSAP No. 107 would be warranted in order to implement this accounting approach.

*Alternative #2*
One difference between HCRP and transitional reinsurance is that the HCRP is going to be embedded within risk adjustment, rather than being a separate calculation. As a result of this, it is somewhat unclear at this point in time whether issuers would have reliable information available to them in order to decompose the overall risk adjustment estimate into the three pieces that the proposed accounting approach above would require. An alternative view is that applying involuntary pool accounting to the HCRP element of ACA risk adjustment would introduce unnecessary complexity to issuers' financial statements.

If NAIC were to endorse this view, an interpretation of SSAP No. 107 would be beneficial, in order to clarify that the NAIC wants the existing accounting for ACA risk adjustment to remain unchanged notwithstanding the introduction of the HCRP element in 2018.

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**+Staff Recommendation:**

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**+Staff Review Completed by:**

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* Indicates required information before NAIC staff will accept form as a final document.
+ Indicates sections NAIC staff will complete upon receipt from recommending party.



 