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General

The purpose of this note is to provide Staff with a contemporaneous business situation that illustrates the challenges of applying the Current Expected Credit Loss model (“CECL”, Topic 326-20) to reinsurance recoverables. The business situation relates to the Affordable Care Act (ACA) and the three risk mitigating provisions in the ACA designed to stabilize the results of insurers participating in state and national insurance exchanges until they become self-sustaining. The three mechanisms include the following:

- **Reinsurance** – designed as a risk mitigating mechanism to address high-risk participants that by the design of the ACA are not required to provide the insurer with their health status or claim history and are charged the same premiums as other individuals in their age band. The mechanism has attachment points and caps and is funded by levies on health insurance plans (“plans”) including self-insured plans that use a third-party administrator

- **Risk Corridors** – designed as a risk transferring mechanism whereby plans with a risk corridor ratio (as defined in the ACA) between 92% and 97% share 50% of their plan’s gain with the Department of Health and Human Services (HHS) and plans with a risk corridor ratio between 103% and 108% cede 50% of their plan’s loss to HHS

- **Risk Adjustment** – designed as a risk transferring mechanism between plans operating within a state wherein plans with lower than average actuarial risk make payments to those plans with higher than average actuarial risk

The reinsurance and risk corridor mechanisms are applicable in 2014 – 2016, whereas the risk adjustment mechanism is permanent. The reinsurance and risk adjustment mechanisms are designed to be self-funded whereas the risk corridors, depending on the performance of all ACA plans may need to be funded by HHS.
**Late 2015 Developments**

On November 19th, the nation’s largest U.S. health insurer, United Healthcare Group (UHG) issued a revision to previous earnings guidance citing the historical and continued expected underperformance of its ACA related business that is expected to generate operating losses of $500 million in 2016; $275 million of which is recognizable in 2015, the year in which UHG became contractually obligated to provide coverage to applicants for the 2016 plan year.

The underperformance was attributed to the following:

- Less participants (about half) in state and federal exchanges than originally anticipated
- Individuals participating in state and federal exchanges tend to have more significant unmet medical needs
- Participants with medical needs enroll to have needs met and then allow policies to lapse
- For the risk corridor program there were not enough “profitable” plans to subsidize the “underperforming” plans and because there was no special funding provided in the most recent Congressional Budget Resolution, only 12.6% of amounts requested by underperforming plans were received from HHS

As a result of the preceding, UHG announced that it has suspended marketing of its individual ACA exchange plans, and reduced or eliminated commissions to brokers who sell the coverage in various markets.

**Reinsurance Receivables/Recoverables**

We believe the ACA related reinsurance program is a good example of a large, complex, highly customized program where the realizability of the reinsurance recoverable would not be enhanced by applying the CECL model. More specifically, the performance of that element of the ACA risk mitigating factors would be best assessed on an individual, current basis considering all facts and circumstances supporting the value of the reinsurance recoverable, including the following:

- Availability of funds to discharge cessions – since there is no history for this program, ceding companies would look to the attachment points, qualifying losses under the program, and available funds to pay covered losses
- Due to the high degree of uncertainty in the healthcare industry as it adapts to the introduction of the ACA which has both direct and indirect impacts on health insurance providers, it is necessary to evaluate all material arrangements (including reinsurance) on an individual contractual basis
- The degree of underperformance of the ACA program and the inability to fund the risk corridor mechanism places uncertainty on the other risk mitigating mechanisms and whether funds from reinsurance or risk adjustment mechanisms would be reallocated to the risk corridor.
Although this topic has yet to be addressed as part of the Fatal Flaw process we wanted to take the opportunity to share with Staff a relevant contemporaneous situation that illustrates the issue with including reinsurance in the scope of the impairment standard. The issue extends well beyond health insurers, to both life and non-life insurers which have extensive reinsurance arrangements with state and federal entities. These reinsurance arrangements have unique, highly customized terms and financial components which leads to the necessity to evaluate recoverables emerging from these agreements on an individual agreement basis. Therefore, we urge the Staff to reconsider the inclusion of reinsurance recoverables in the scope of the Impairment standard as we believe investors may be best served by continuing to apply the existing impairment model to reinsurance recoverables that considers the facts and circumstances present in each underlying agreement.

We welcome the opportunity to discuss the issue in more depth with the Board and Staff.

Please contact me if you would like to discuss our comments in more detail.

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