APA-2

ALABAMA MEDICAID AGENCY

NOTICE OF INTENDED ACTION

RULE NO. & TITLE: 560-X-62-.25 Surplus Notes

INTENDED ACTION: Add New Rule 560-X-62-.25

SUBSTANCE OF PROPOSED ACTION: The above referenced rule is being created to allow Regional Care Organizations to utilize surplus notes in order to meet financial solvency requirements.

TIME, PLACE, MANNER OF PRESENTING VIEWS: Written or oral comments may be submitted to the Alabama Medicaid Agency, 501 Dexter Avenue, Post Office Box 5624, Montgomery, Alabama 36103-5624. Agency business hours are 8:00 a.m. to 5:00 p.m. Monday through Friday.

FINAL DATE FOR COMMENT AND COMPLETION OF NOTICE:. Written/Oral comments concerning this change must be received by the Alabama Medicaid Agency no later than December 4, 2015.

CONTACT PERSON AT AGENCY: Stephanie Lindsay, Administrative Secretary, Alabama Medicaid Agency, 501 Dexter Avenue, Post Office Box 5624, Montgomery, Alabama 36103-5624.

Stephanie McGee Azar
Acting Commissioner

Rule No. 560-X-62-.25 Surplus Notes – NEW RULE

(1) The proceeds of a surplus note issued by an RCO in compliance with this rule shall be eligible to be reported as capital or surplus or restricted reserves required by Rule No. 560-X-62-.16. Such a surplus note shall not be treated as a liability of the RCO for purposes of a determination of the amount of the capital and surplus of the RCO pursuant to the rules of the Medicaid Agency.

(2) A surplus note shall be repayable only out of the issuing RCO's capital and surplus in excess of the stated minimum capital and surplus set forth in the surplus note. For purposes of this rule, "stated minimum capital and surplus" means the amount of capital and surplus of an RCO which may not be used for payments of interest or principal of the surplus note and which amount must be at least 110% of the minimum capital and surplus required by Rule No. 560-X-62-.16. If an RCO has provided a performance bond to the Agency in compliance with Rule No. 560-X-62-.16, the portion of the penal sum of such performance bond that is properly allocable to the satisfaction of the RCO's capital and surplus requirements under Rule No. 560-X-62-.16 shall be deemed to constitute capital and surplus for purposes of this rule.

(3) Proceeds received by an RCO in respect of a surplus note must be in the form of cash or other admitted assets having readily determinable values and liquidity satisfactory to the Medicaid Agency.

(4) All surplus notes issued by an RCO are subject to the prior approval of the Medicaid Agency, regardless of amount, and an application therefor shall be filed at least 30 days prior to the proposed date of the issuance of the surplus note by the RCO.

(5) All payments of principal and interest by the RCO and all transfers of a surplus note by the note holder are subject to the prior approval of the Medicaid Agency regardless of amount. An application therefor shall be filed at least 30 days prior to the date of the proposed payment or transfer.

(6) The Medicaid Agency shall prescribe a maximum interest rate or rates for surplus notes issued by RCOs. Such maximum interest rate or rates may be variable or fixed and shall be commercially reasonable, as determined by the Medicaid Agency in its sole discretion. The Medicaid Agency may adjust the maximum interest rate or rates from time to time as it deems appropriate.

(7) No surplus note shall include any stated maturity of principal or any installment thereof sooner than the date that is 30 days after the latest date that the risk contract between the Medicaid Agency and the RCO could by its terms expire, including any extension periods. Any payment of principal of a surplus note, whether at the stated maturity thereof or prior thereto, shall require the approval of the Medicaid Agency in accordance with sections 5 and 8(e) of this rule. This section shall not prevent an elective prepayment of principal of a surplus note made in compliance with this rule and in accordance with the terms of the surplus note.

(8) A surplus note must contain the following provisions:

(a) The surplus note must be subordinated to the claims of enrollees, providers, and all other classes of creditors of the RCO, other than surplus note holders;

(b) The note holder may be paid only out of the portion of the RCO's capital and surplus that exceeds the stated minimum capital and surplus;

(c) The stated minimum capital and surplus shall be at least 110% of the minimum capital and surplus required by Rule No. 560-X-62-.16;

(d) The surplus note must have a stated rate of interest not higher than the applicable maximum interest rate in effect at the time of the issuance of the surplus note, as prescribed by the Medicaid Agency in accordance with section 6 of this rule; and

(e) All payments of principal and interest by the RCO and all transfers of the surplus note by the note holder shall be subject to the prior approval of the Medicaid Agency. The Medicaid Agency may withhold its approval of any payment of principal or interest or any transfer of a surplus note if and so long as the RCO is in material violation or breach of any provision of Sections 22-6-150, *et seq.* of the Alabama Code, the rules of the Medicaid Agency, or the risk contract between the Medicaid Agency and the RCO, as determined by the Medicaid Agency in its sole discretion.

(9) For purposes of a determination of the amount of capital and surplus of an RCO pursuant to Section 22-6-151 of the Alabama Code and Rule No. 560-X-62-.16, surplus notes shall be accounted for as follows:

(a) Interest shall not be recorded as a liability nor an expense until approval for payment of such interest has been granted by the Medicaid Agency. All interest, including interest in arrears, shall be expensed when approved for payment. Unapproved interest shall not be reported through operations, shall not be represented as an addition to the principal or notional amount of the instrument, and shall not accrue further interest, i.e. interest on interest.

(b) As of the date of approval of principal payment by the Medicaid Agency, the issuer shall reclassify such approved payments from surplus to liabilities.

(c) Costs of issuing surplus notes shall be charged to operations when incurred.

(d) Discount or premium, if any, shall be reported as a direct deduction from or addition to the face amount of the note. Such discount or premium shall be charged or credited concurrent with approved interest payments on the surplus note and in the same proportion or percentage as the approved interest payment is to the total estimated interest to be paid on the surplus note.

(10) The written application for approval of the issuance of a surplus note shall include the following:

(a) The nature and purpose of the transaction;

(b) The identities of all parties to the transaction;

(c) A list of each officer or director of the RCO who has a direct or indirect equity interest in the note holder or serves as an officer or director of the note holder, or who has any other direct or indirect pecuniary interest in the transaction, together with a description of each such interest;

(d) A copy of any agreement between the parties relating to the transaction;

(e) Evidence that the transaction will not adversely affect the interests of the RCO's enrollees or the State; and

(f) Such other information as the Medicaid Agency may require.

(11) The written application for approval of the payment of interest or principal shall include at least the following:

(a) The amounts of any payments between the parties to the transaction;

(b) The identities of all parties to the transaction;

(c) Evidence that the payment is appropriate considering the financial condition of the RCO;

(d) A current financial statement dated not earlier than 60 days before the application date which demonstrates the existence of sufficient capital and surplus in excess of the stated minimum capital and surplus; and

(e) A certification by the chief executive officer of the RCO that the RCO's current total capital and surplus is in such amount that payment as of the payment date will be only from capital and surplus in excess of the stated minimum capital and surplus and will not adversely affect the RCO's current financial condition.

(12) Applications for approval of the issuance, transfer, or payment of interest or principal of a surplus note must meet the following standards:

(a) The terms shall be fair and equitable;

(b) The books, accounts, and records of each party shall be so maintained as to clearly and accurately disclose the precise nature and details of the transaction;

(c) The RCO's capital and surplus following a payment of interest or principal shall be in excess of the stated minimum capital and surplus, reasonable in relation to the RCO's outstanding liabilities, and adequate to satisfy its financial needs; and

(d) The RCO shall not be in material violation or breach of any provision of Sections 22-6-150, *et seq.* of the Alabama Code, the rules of the Medicaid Agency, or the risk contract between the Medicaid Agency and the RCO, as determined by the Medicaid Agency in its sole

discretion. Notwithstanding anything in this rule to the contrary, the Medicaid Agency's approval of the issuance, transfer, or payment of interest or principal of a surplus note shall not constitute a determination by the Medicaid Agency that the RCO is in compliance with any law, regulation, or the risk contract, and the Medicaid Agency shall not be deemed to have waived any authority, right, or remedy by reason of any such approval.

(13) Notwithstanding anything in this rule to the contrary, the provisions of this rule concerning accounting for surplus notes issued by an RCO shall apply only with respect to a determination of the capital and surplus of an RCO pursuant to Section 22-6-151 of the Alabama Code and the rules of the Medicaid Agency. No provision of this rule is intended to affect an RCO's financial statements prepared in accordance with Generally Accepted Accounting Principles.

Author: Sharon Weaver, Administrator, Administrative Procedures Office.
Statutory Authority: Code of Alabama, 1975 Section 22-6-150 *et seq.*
History: New Rule: Filed October 21, 2015.