

## Interpretation of the Emerging Accounting Issues Working Group

### INT 03-17: Classification of Liabilities from Extra Contractual Obligation Lawsuits

#### ISSUE NULLIFIED BY SSAP NO. 55

#### INT 03-17 Dates Discussed

September 14, 2003; March 14, 2004; June 13, 2004; September 12, 2004; March 10, 2007

#### INT 03-17 References

*SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R)

*SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (SSAP No. 55)

*SSAP No. 85—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (SSAP No. 85)

#### INT 03-17 Issue

1. Insurers are sometimes parties to lawsuits known as extra contractual obligations lawsuits; these include “bad faith” lawsuits. These extra contractual liabilities and expenses may arise out of the handling of an individual claim or a series or a group of claims.
2. The accounting issue is, where should amounts related to bad faith claims and other extra contractual obligations, judgments and court ordered awards be classified on the annual statement? The issue is particularly applicable to property and casualty insurers
3. Per *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R):

#### **Loss Contingencies or Impairments of Assets**

5. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

- a. Probable—The future event or events are likely to occur;
- b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;
- c. Remote—The chance of the future event or events occurring is slight.

6. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

7. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

- a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or

more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

8. This accounting shall be followed even though the application of other prescribed statutory accounting principles or valuation criteria may not require, or does not address, the recording of a particular liability or impairment of an asset (e.g., a known impairment of a bond even though the VOS manual has not recognized the impairment).

9. Additionally, in instances where a judgment, assessment or fine has been rendered against a reporting entity, there is a presumption that the criteria in paragraph 7 a. and 7 b. have been met. The amount of the liability shall include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and shall take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management's intended response to the litigation, claim, or assessment.

4. *Per SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (SSAP No. 55):

3. This statement does not address liabilities for punitive damages. These liabilities shall be recorded in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R).

#### INT 03-17 Discussion

5. On September 12, 2004 the working group reached a consensus that:

a. Adjustment expenses arising from claims related lawsuits such as extra contractual obligations and bad faith lawsuits shall be included in "Adjusting and Other" per SSAP No. 55, paragraph 5.c.ii.;

b. Claims related extra contractual obligations losses and bad faith losses shall be included in losses; and

c. This guidance applies equally to those companies with direct and reinsurance assumed obligations.

6. The working group also agreed that the provisions of this interpretation should be applicable to all lines of business.

7. On March 10, 2007, the working group removed the disclosure requirement in paragraph 5.b. above because a more comprehensive disclosure requirement is now in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. Paragraph 5.b. of INT 03-17 is amended to read:

b. Claims related extra contractual obligations losses and bad faith losses shall be included in losses, and

#### INT 03-17 Status

8. No further discussion is planned.