Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Prepayments to Service and Claims Adjusting Providers**

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

This agenda item seeks to address a regulator inquiry regarding prepayments to providers of claims and adjusting services in which the service provider is prepaid by the insurer. While the initial inquiry for this agenda item was a prepaid roadside assistance provider, the accounting issues are relevant to other providers of claims and adjusting services as well.

The prepayments can take a variety of forms and the provider can take on a variety of duties, but in the example provided, the roadside assistance provider was being prepaid a flat fee for a minimum number of vehicles/ policies regardless of claims incurred or sales. The provider additionally received a flat fee per vehicle if actual sales exceed the negotiated minimum number of vehicles. The provider, who is not an insurer, was contracted to provide roadside assistance and administer and settle claims using only the prepaid amounts. So, to use a health care analogy, the provider accepts a “capitated” payment to administer and settle claims.

Roadside assistance is a common feature or rider to many automobile insurance policies that has been available for several years. Roadside assistance provides towing and other services such as jumpstarting car batteries, unlocking doors and gas refills for the insured. Discussions with industry representatives indicate that in most cases, roadside assistance providers may have rates that are negotiated, but providers are not typically prepaid. Rather, when the insured calls for assistance negotiated rate providers are dispatched and subsequently paid at negotiated rates as the claims for assistance are incurred. This agenda item is focused on prepayments to providers.

To provide a fictional numeric example, the minimum annual payment to the provider was for 50,000 vehicles at $10 per vehicle, with additional payments per vehicle required if sales exceed the initial fees. The provider in this example, was also responsible for administering claims and dispatching service in exchange for the “capitated” fee. Therefore, the roadside assistance provider would not bill the insurer further when claims are incurred.

The guidance in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, paragraphs 4 and 5 (excerpted in the Authoritative Literature section) are relevant to the timing of claims recognition and payment of loss adjustment expenses. The guidance provides that claims are recognized when incurred. The existing guidance indicates that paying a third party in advance to adjust claims in the future does not decrease the claims adjustment liability. The claim adjustment liability is only reduced when the claim has been adjusted, not when it is prepaid. In accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, prepayments to a third party do not meet the right of offset requirements.

The statutory accounting and reporting questions at issue are how the direct writer accounts for and reports the prepaid claims and adjusting expenses initially and subsequently. The existing guidance notes that claim adjusting expenses are not reduced for payments to third parties. The guidance in SSAP No. 55 indicates liabilities shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to managed care providers. The prepaid expenses under consideration may include a prepayment for claims administration and or a prepayment for the claims.

In reviewing the annual statement instructions for the Underwriting and Expense Exhibit, Part 3, and the related instructions for property and casualty expenses, the initial prepayment to the provider seems be consistent with miscellaneous underwriting expense.

For policies that purchase the coverage and incurred a claim, it seems appropriate to reclassify a proportionate percentage of the initial prepayment to claims incurred and loss adjustment expenses as losses are incurred and adjusted. However, it would be inappropriate to allocate claims expense and claims adjusting expenses to policies that did not purchase the coverage and inappropriate to allocate the costs of the provider to claims or claims adjusting expenses prior to incurring the claims. Therefore, in the event of prepayment to a third-party provider, some of the costs may remain in miscellaneous adjusting expense.

Existing Authoritative Literature:

# *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses,* paragraphs 4 and 5 includes the following:

SUMMARY CONCLUSION

4.            Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

**General**

10. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and *SSAP No. 65—Property and Casualty Contracts*.

The guidance in SSAP No. 55, paragraph 5 was incorporated from *INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses*, which was nullified when the guidance was moved to SSAP No. 55.

* *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* provides the following:

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt(INT 09-08). A valid right of setoff exists only when all the following conditions are met:

1. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;
2. The reporting party has the right to set off the amount owed with the amount owed by the other party;
3. The reporting party intends to setoff; and
4. The right of setoff is enforceable at law.
* *Property and Casualty Annual Statement Instructions* *Underwriting and Investment Exhibit Part 3 – Expenses* provides the following:

A company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification items (salaries, rent, postage, etc.) as if these costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

A company that pays any non-affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification item as follows:

a. Payments for claims handling or adjustment services are allocated to Loss Adjustment Expenses (Column 1) in the Underwriting and Investment Exhibit, Part 3. If the total of such expenses incurred equals or exceeds 10% of the total incurred Loss Adjustment Expenses (Line 25, Column 1), the company shall allocate these costs to the appropriate expense classification items as if these costs had been borne directly by the company. If such expenses are less than 10% of the total, they may be reported on Line 1 of Column 1.

b. Payments for services other than claims handling or adjustment services are allocated to the appropriate expense classification items as if these costs had been borne directly by the company, if the total of such fees paid equals or exceeds 10% of the total incurred Other Underwriting Expenses (Line 25, Column 2). If the total is less than 10%, the payments may be reported on Line 2 if the fees are calculated as a percentage of premiums, or on Line 3 if the fees are not calculated as a percentage of premiums.

The total management and service fees incurred attributable to affiliates and non-affiliates is reported in the footnote to the Underwriting and Investment Exhibit, Part 3 of the annual statement, and the method(s) used for allocation shall be disclosed in the Notes to the Financial Statements. The company shall use the same allocation method(s) on a consistent basis. Refer to *SSAP No. 70—Allocation of Expenses* for accounting guidance.

Exclude from investment expenses brokerage and other related fees, to the extent they are included in the actual cost of a bond upon acquisition. Refer to *SSAP No. 26R—Bonds* for accounting guidance.

Include all other internal costs or costs paid to an affiliated company related to origination, purchase or commitment to purchase bonds.

For the purpose of establishing uniformity in classifications of expenses in reporting entities’ statements and reports filed with the Insurance Departments, the company shall observe the instructions contained in the Appendix of these instructions for the Uniform Classification of Expenses.

Activity to Details of Write‑ins Aggregated at Line 24 for Miscellaneous Expenses

List separately each category of miscellaneous expenses for which there is no pre‑printed line on Underwriting and Investment Exhibit, Part 3.

* *Property and Casualty Annual Statement Instructions* *Underwriting Appendix Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers* provides the following:

**1.1 Direct**

Include: The Following Expenses When in Connection with the Investigation and Adjustment of Policy Claims:

Independent Adjusters: Fees and expenses of independent adjusters or settling agents

Legal: Fees and expenses of lawyers for legal services in the defense, trial, or appeal of suits, or for other legal services

Bonds: Premium costs of bonds

Appeal Costs and Expenses: Appeal bond premiums, charges for printing records, charges for printing briefs, court fees and incidental to appeals

General Court Costs and Fees: Entry fees and other court costs, and other fees not includible in Losses (Note: Interest and costs assessed as part of or subsequent to judgment are includible in Losses.)

Medical Testimony: Fees and expenses of medical witnesses of attendance or testimony at trials or hearings (“Medical” includes physicians, surgeons, chiropractors, chiropodists, dentists, osteopaths, veterinarians, and hospital representatives.)

Expert Witnesses: Fees and expenses of expert witnesses for attendance or testimony at trials or hearings

Lay Witnesses: Fees and expenses of lay witnesses for attendance or testimony at trials or hearings

Services of Process: Constables, sheriffs, and other fees and expenses for service of process, including subpoenas

Transcripts of Testimony: Stenographers’ fees and fees for transcripts of testimony

Medical Examinations: Fees for medical examinations, fees for performing autopsies, fees for impartial examination, x-rays, etc., for the purpose of trial and determining questions of liability (This does not include fees for medical examinations, x‑rays, etc., made to determine necessary treatment, or made solely to determine the extent or continuation of disability, or first aid charges, as such fees and charges are includible in Losses.)

Miscellaneous: Costs of appraisals, expert examinations, surveys, plans, estimates, photographs, maps, weather reports, detective reports, audits, credit or character reports, watchmen (Charges for hospital records and records of other kinds, notary fees, certified copies of certificates and legal documents, charges for Claim Adjustment Services by underwriting syndicates, pools, and associations)

Exclude: Compensation to employees (see Salaries)

Expenses of salaried employees (see Travel and Travel Items)

Items includible in Allowances to Managers and Agents

Payments to State Industrial Commissions (see Taxes, Licenses, and Fees)

Payments to claim adjusting organizations except where the expense is billed specifically to individual companies (see Boards, Bureaus, and Associations)

Cost of services of medical examiners for underwriting purposes (see Surveys and Underwriting Reports)

Salvage and subrogation recovery expense, rewards, lost and found advertising, expenses for disposal of salvage (Such expenses shall be deducted from salvage.)

Any expenses which by these instructions are includible elsewhere

Separation of Claim Adjustment Services:

The Statistical Plans filed by certain rating bureaus contain definitions of “Allocated Loss Adjustment Expenses” which exclude for rating purposes certain types of claim adjustment services as defined herein. For the lines of business thus affected, companies that are members of such rating bureaus shall maintain records necessary to the reporting of Claim Adjustment Services—Direct, as follows:

a. As defined in Statistical Plans

b. Other than as defined in Statistical Plans

**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:** June 2017 updates to the *AICPA Revenue Recognition Guide noted in Issue #9- 1: Considerations for applying the scope exception in FASB ASC 606-10-15-2 and 606-10-15-4 to Contracts within the Scope of ASC 944* contains some discussion on roadside assistance that is tangential but does not address the prepayments under discussion. The updates were issued in response to questions regarding Accounting Standards Update (ASU) *2016-20: Technical Corrections and Improvements to Topic 606, Revenue from Contracts from Customers*.

At issue was whether to bifurcate insurance contracts within the scope of *Topic 944, Financial Services— Insurance* that contain noninsurance elements and account for them within the scope of *Topic 606, Revenue from Contracts from Customers*. Roadside assistance provided with an automobile insurance policy was listed as an example of activities performed by an insurance entity, included in contracts within the scope of FASB Topic 944, that  Financial Reporting Executive Committee (FinREC) believes generally should be considered fulfillment activities (that either mitigate risks to the insurer or contain costs related to services to fulfill the insurer’s obligation) that are not within the scope of FASB Topic 606, but should be considered part of the insurance contract within the scope of FASB Topic 944. Roadside assistance was noted as mitigating the risk of a further accident or damage to the insured automobile.

**Convergence with International Financial Reporting Standards (IFRS):**  During the development of *IFRS 17, Insurance Contracts*, the International Accounting Standards Board (IASB) had discussions regarding classification for the revenue which are not on point to roadside assistance prepayments. Similar to the AICPA issue noted above, the issue was whether roadside assistance sold as part of an insurance policy should be included within the scope of insurance contracts or whether it should be accounted for separately as fee for service. The IFRS 17 issued in May 2017 notes that some fixed-fee service contracts meet the definition of an insurance contract (for example, automobile roadside assistance) and IFRS 17 provides an option to use *IFRS 15, Revenue from Contracts with Customers* to account for as fee for service.

Staff Review Completed by:

Robin Marcotte, NAIC Staff - September 2018

Staff Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 55 to provide guidance as follows:

1. The initial prepayment for providers of claims adjusting expense and claim payment is recognized as a miscellaneous underwriting expense.
2. Subsequently, for direct policies that purchased the related insurance coverage which used the claims or adjusting services incur losses which are paid, a proportionate percentage of the initial provider prepayment amounts are reclassified from miscellaneous underwriting expense to claims adjustment expense and or claims expense, as applicable
3. To the extent that additional amounts are prepaid for direct policies that did not purchase services, the prepaid expenses shall remain in miscellaneous underwriting expenses.

Note that NAIC staff envisions that additional annual statement instruction clarifications may be indicated after the Working Group finalizes guidance.

Proposed revisions to SSAP No. 55 recommended for November 2018 exposure:

4.            Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

* 1. Prepayments to third party administrators, management companies or other entities for unpaid losses/claims, except for capitated payments for manage care contracts, shall not reduce losses/claims and shall be initially reported as miscellaneous underwriting expenses. When incurred losses/claims are paid, claims prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the losses/claims cost from miscellaneous underwriting expenses to loss/claim expenses paid. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.
	2. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

1. Prepayments to third party administrators, management companies or other entities, except for capitated payments for manage care contracts, for unpaid losses/ claims adjusting expenses shall be initially reported as miscellaneous underwriting expenses.
2. When incurred losses/claims adjusting expenses are paid, prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the adjusting expenses from miscellaneous underwriting expenses to paid loss /claim adjusting expenses. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.

**Status:**

On November 15, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, as shown above, to provide guidance clarifying that prepayments to providers of claims and adjusting services shall be recognized as miscellaneous underwriting expenses, with guidance for reclassification as claims adjustment expense or claims expense, as applicable, as claims are paid. During the November 2018 Working Group discussion, it was highlighted that the proposed treatment is different than recognizing a nonadmitted prepaid asset, as the amounts are not expected to be material. Comments were requested on this difference and if the amounts are expected to be material.

**Spring 2019 National Meeting discussion:**

**NAIC staff recommends re-exposure of modified proposed language which was developed with interested parties input as illustrated below and in the agenda item.** The interested parties responded to the request for comments and noted a preference to “nonadmit a prepaid asset” for prepaid loss and LAE, which is consistent with existing guidance, instead of the to the previously exposed “expense and reclassify as amounts are paid” approach. NAIC staff has proposed a modification to the interested parties’ proposed language to exclude the reference to *SSAP No. 84—Health Care and Government Insured Plan Receivables* which is not currently referenced in SSAP No. 55. In addition, NAIC staff has recommended guidance regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed modified language, developed with interested parties’ input as described above, which requires nonadmittance for prepaid loss and LAE. This guidance is consistent with existing statutory accounting principles and was revised from the previously exposed “expense and reclassify as amounts are paid” approach. In addition, guidance was exposed regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered. The exposed language is illustrated below.

**2019 Spring National Meeting exposure:**

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

4.            Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

a. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies or other entities for unpaid claims, losses and losses/claims adjustment expenses, except for capitated payments for managed care contracts, shall not reduce losses/claims and shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. When the benefit has been provided to the policyholder or claimant, the claims prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts), are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim expenses paid based on the amount of losses/claims cost incurred to provide the benefit.

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. When the prepaid benefit as described in paragraph 4 has been provided to the policyholder or the claimant, the associated prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts) are reclassified proportionately from the prepaid nonadmitted asset to paid loss /claim adjusting expenses based on the amount of losses/claims cost incurred to provide the benefit. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 55, as illustrated below, that emphasize existing guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted. Prepayments to third party administrators, which are not for claims or loss adjusting expense, are “miscellaneous underwriting expenses.” The revisions also add a reference to *SSAP No. 84—Health Care and Government Insured Plan Receivables* regarding prepayments to providers.

**2019 Summer National Meeting exposure:**

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

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

a. The liability for unpaid losses and claims shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims on non-capitated payments under managed care contracts shall be established in an amount necessary to pay the losses/ claims irrespective of payments made to third-party administrators, etc. The liability for claims on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers. As loss or claims payments occur, from the third- party administrators, management companies or other entities, to the policyholder or claimant, (except for capitated payments for managed care contracts) paid claims, losses or paid loss/paid claim adjusting liabilities are reduced. Note that guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts are addressed in *SSAP No. 84—Health Care and Government Insured Plan Receivables.*

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses - Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses - Life/ Health (Exhibit 2 – General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses)- health (Underwriting and Investment Exhibit Part 3)

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses - Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses - Life/ Health (Exhibit 2 – General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses) - health (Underwriting and Investment Exhibit Part 3).

**For Fall 2019 National Meeting Discussion:**

**NAIC Staff recommends that the Working Group expose revisions incorporating the majority of interested parties’ comments as reflected below as tracked changes to SSAP No. 55** (rather than as reflected as changes to the Summer 2019 exposure). **Interested parties’ comments primarily delete the exposed guidance and move the same or similar concepts into the broad product guidance for property and casualty, life and health or health in SSAP No. 55.** These revisions are to reinstate annual statement references by entity type and to adjust scoping language and make the SSAP No. 29 prepaid guidance consistent. Note that shading reflects staff proposed variations in wording from the interested parties proposed wording that accomplishes a similar intent.

On December 7, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, as illustrated below, that incorporate interested parties’ recommendations to separate the guidance by product type and emphasize guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The revisions emphasize existing guidance that claims that related liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted. Note that shading reflects staff proposed variations in wording from the interested parties’ proposed wording that accomplishes a similar intent.

**Fall**

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

**SUMMARY CONCLUSION**

1. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Until claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.
2. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which the liability is established net of capitated payments to providers.

**Property/Casualty**

1. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:
	1. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the reporting entity as of the statement date;
2. Incurred But Not Reported Losses (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the reporting entity as of the statement date. As a practical matter, IBNR may include losses that have been reported to the reporting entity but have not yet been entered to the claims system or bulk provisions. Bulk provisions are reserves included with other IBNR reserves to reflect deficiencies in known case reserves;
3. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses defined in paragraphs 6.a. and 6.b. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage. Loss adjustment expenses can be classified into two broad categories: Defense and Cost Containment (DCC) and Adjusting and Other (AO):
	1. DCC include defense1, litigation, and medical cost containment expenses, whether internal or external. DCC include, but are not limited to, the following items:
		1. Surveillance expenses;
		2. Fixed amounts for medical cost containment expenses;
		3. Litigation management expenses;
		4. Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by accident year;
		5. Fees or salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in defense of a claim, and fees or salaries for rehabilitation nurses, if such cost is not included in losses;
		6. Attorney fees incurred owing to a duty to defend, even when other coverage does not exist; and
		7. The cost of engaging experts;
	2. AO are those expenses other than DCC as defined in (i) above assigned to the expense group “Loss Adjustment Expense.” AO include, but are not limited to, the following items:
		1. Fees and expenses of adjusters and settling agents;
		2. Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by calendar year;
		3. Attorney fees incurred in the determination of coverage, including litigation between the reporting entity and the policyholder;

1 Legal defense costs incurred under the definition of covered damages or losses as the only insured peril would be accounted for as losses, while legal defense costs incurred under a duty to defend would be accounted for as Defense and Cost Containment (DCC). For policies where legal costs are the only insured peril, the insurer would record the legal costs that reimburse the policyholder as loss and, to the extent the insurer participated in the defense, would record its legal costs as DCC. This is not intended to change the classifications of legal expenses for existing long tailed lines of liability coverage, such as medical malpractice and workers’ compensation insurance.

1. Fees and salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in the capacity of an adjuster; and
2. Adjustment expenses arising from claims related lawsuits such as extra contractual obligations and bad faith lawsuits.
3. The contractual terms for arrangements (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be evaluated to determine if the arrangement meets the criteria to be reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/ claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.
4. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as aggregate write-in for miscellaneous underwriting benefits in the Underwriting and Investment exhibit Part 3.

**Life, Accident and Health**

1. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:
	1. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54R.
	2. Claim Liabilities for Life/Accident and Health Contracts:
		1. Due and Unpaid Claims: Claims for which payments are due as of the statement date;
		2. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity’s past experience with similar resisted claims;
		3. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;
		4. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.
	3. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in paragraphs 7.a. and 7.b. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
	4. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in paragraph 7.b. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.
	5. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Managed Care**

1. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:
	1. Claims unpaid for Managed Care Reporting Entities:
		1. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;
		2. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;
		3. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;
	2. Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in paragraph 8.a. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
	3. Liabilities for percentage withholds (“withholds”) from payments made to contracted providers;
	4. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk-sharing arrangements whereby the health entity agrees to share savings with contracted providers.

e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Managed Care and Accident and Health**

*Drafting Note: New guidance is issued within par. 9, which is underlined. Existing par 9 is renumbered to par. 10, and all other pars within existing guidance (i.e., pars. 10 – 23, will be renumbered to 11 – 24, respectively.*

9. In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

1. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.
2. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/ claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.
3. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as (1) Aggregate write ins for expenses - Life/ Health (Exhibit 2 – General expenses) or (2) Aggregate write ins for expenses (General Administrative Expenses) - Health (Underwriting and Investment Exhibit Part 3)

Note that this guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in *SSAP No. 84—Health Care and Government Insured Plan Receivables.*

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