Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Salvage - Legal Recoveries

**Check (applicable entity):**

P/C Life Health

Modification of Existing SSAP

New Issue or SSAP

Interpretation

Description of Issue:

This agenda item recommends nonsubstantive revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* to clarify that salvage and subrogation estimates and recoveries can include amounts related to both claims/ losses and loss adjusting expenses. The corresponding estimates should be reported as a reduction of losses and/or loss adjusting expense (LAE) reserves. Once the amounts for salvage and subrogation and coordination of benefits recoveries (COB) are received, they are reported as a reduction of paid losses and LAE depending on the nature of the costs being recovered.

SSAP No. 55 contains salvage and subrogation guidance. Key points of the guidance regarding salvage, subrogation and COB are as follows:

* Salvage, subrogation and coordination of benefits recoveries are estimated using the same techniques used for estimating unpaid claims/losses and unpaid loss adjusting expenses.
* Separate recoverables are not established. Estimated salvage, subrogation and coordination of benefit recoveries (net of associated expenses) are deducted from the liability for unpaid claims or losses (for reporting entities that choose to anticipate such recoveries).
* Salvage, subrogation and coordination of benefits recoveries received (net of associated expenses) are reported as a reduction to paid losses/claims.

This agenda item is in response to an industry request. The proposed clarification provides additional detail regarding loss adjusting expenses for salvage, subrogation and coordination of benefits that is believed to be consistent with current practice by a majority of reporting entities. For example, if legal fees are recovered in a subrogation lawsuit, it is believed that such amounts are currently being reported as reduction in paid adjusting expenses for legal fees. SSAP No. 55 does not explicitly discuss the recovery of loss adjusting expenses in the discussion of salvage, subrogation and COB. However, the property and casualty annual statement instructions, which are level two on the statutory hierarchy of authoritative literature, includes an explicit reference to reduce loss adjusting expenses for such amounts in the Schedule P instructions (See Existing Authoritative Literature below).

Existing Authoritative Literature:

SSAP No. 55 provides the following (bolding added for emphasis):

**General**

1. 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*.
2. Various analytical techniques can be used to estimate the liability for IBNR claims, future development on reported losses/claims, and loss/claim adjustment expenses. These techniques generally consist of statistical analysis of historical experience and are commonly referred to as loss reserve projections. The estimation process is generally performed by line of business, grouping contracts with like characteristics and policy provisions. The decision to use a particular projection method and the results obtained from that method shall be evaluated by considering the inherent assumptions underlying the method and the appropriateness of those assumptions to the circumstances. No single projection method is inherently better than any other in all circumstances. The results of more than one method should be considered.
3. For each line of business and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses, and loss/claim adjustment expenses. Because the ultimate settlement of claims (including IBNR for death claims and accident and health claims) is subject to future events, no single claim or loss and loss/claim adjustment expense reserve can be considered accurate with certainty. Management’s analysis of the reasonableness of claim or loss and loss/claim adjustment expense reserve estimates shall include an analysis of the amount of variability in the estimate. If, for a particular line of business, management develops its estimate considering a range of claim or loss and loss/claim adjustment expense reserve estimates bounded by a high and a low estimate, management’s best estimate of the liability within that range shall be recorded. The high and low ends of the range shall not correspond to an absolute best-and-worst case scenario of ultimate settlements because such estimates may be the result of unlikely assumptions. Management’s range shall be realistic and, therefore, shall not include the set of all possible outcomes but only those outcomes that are considered reasonable. Management shall also follow the concept of conservatism included in the Preamble when determining estimates for claims reserves. However, there is not a specific requirement to include a provision for adverse deviation in claims.
4. In the rare instances when, for a particular line of business, after considering the relative probability of the points within management’s estimated range, it is determined that no point within management’s estimate of the range is a better estimate than any other point, the midpoint within management’s estimate of the range shall be accrued. It is anticipated that using the midpoint in a range will be applicable only when there is a continuous range of possible values, and no amount within that range is any more probable than any other. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be accrued. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine its best estimate of the liability.
5. **If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with paragraphs  11-13 of this statement. Estimated salvage and subrogation recoveries (net of associated expenses) shall be deducted from the liability for unpaid claims or losses. If a reporting entity chooses to anticipate coordination of benefits (COB) recoverables of Individual and Group Accident and Health Contracts, the recoverables shall be estimated in a manner consistent with paragraphs 11-13 of this statement and shall be deducted from the liability for unpaid claims or losses. A separate receivable shall not be established for these recoverables. In addition, all of these recoverables are also subject to the impairment guidelines established in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and an entity shall not reduce its reserves for any recoverables deemed to be impaired. Salvage and subrogation recoveries received (net of associated expenses) are reported as a reduction to paid losses/claims. Coordination of benefits (COB) recoveries received of Individual and Group Accident and Health Contracts (net of associated expenses) are reported as a reduction to paid claims.**
6. Changes in estimates of the liabilities for unpaid claims or losses and loss/claim adjustment expenses resulting from the continuous review process, including the consideration of differences between estimated and actual payments, shall be considered a change in estimate and shall be recorded in accordance with *SSAP No. 3—Accounting Changes* *and Corrections of Errors*. SSAP No. 3 requires changes in estimates to be included in the statement of operations in the period the change becomes known. This guidance also applies to the period subsequent to the March 1 filing deadline for annual financial statements through the filing deadline of June 1 for audited annual financial statements.

**Disclosures**

1. The financial statements shall include the following disclosures for each year full financial statements are presented. The disclosure requirement in paragraph 17.d. is also applicable to the interim financial statements if there is a material change from the amounts reported in the annual filing. Life and annuity contracts are not subject to this disclosure requirement.
2. The balance in the liabilities for unpaid claims and unpaid losses and loss/claim adjustment expense reserves at the beginning and end of each year presented;
3. Incurred claims, losses, and loss/claim adjustment expenses with separate disclosures of the provision for insured or covered events of the current year and increases or decreases in the provision for insured or covered events of prior years;
4. Payments of claims, losses, and loss/claim adjustment expenses with separate disclosures of payments of losses and loss/claim adjustment expenses attributable to insured or covered events of the current year and insured or covered events of prior years;
5. The reasons for the change in the provision for incurred claims, losses, and loss/claim adjustment expenses attributable to insured or covered events of prior years. The disclosure should indicate whether additional premiums or return premiums have been accrued as a result of the prior-year effects. (For Title reporting entities, “provision” refers to the known claims reserve included in Line 1 of the Liabilities page, and “prior years” refers to prior report years);
6. Information about significant changes in methodologies and assumptions used in calculating the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements for the most recent reporting period presented;
7. A summary of management’s policies and methodologies for estimating the liabilities for losses and loss/claim adjustment expenses, including discussion of claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures;
8. Disclosure of the amount paid and reserved for losses and loss/claim adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis (the reserves required to be disclosed in this section shall exclude amounts relating to policies specifically written to cover asbestos and environmental exposures). Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement; and
9. **Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims or losses**.

The Property and Casualty Annual Statement Instructions for Schedule P, Part 1 discuss salvage and subrogation regarding loss reserve and paid claims and then provide additional detail regarding losses and loss adjusting expenses in a later paragraph as excerpted below (bolding added for emphasis);

Cumulative salvage and subrogation received and losses and expenses paid should be reported for each specific year. For “prior,” report only salvage and subrogation received and losses and expenses paid in current year.

In Schedule P, Part 1, salvage and subrogation received should be reported net of reinsurance, if any. Loss payments are to be reported net of salvage and subrogation received in Schedule P.

Adjusting & Other Payments, Column 9, should only reflect ceded recoveries made in 1997 and subsequent. Adjusting & Other Payments, Column 8, should reflect net payments in 1996 and prior and direct and assumed payments for 1997 and

subsequent.

Premiums earned and losses paid, unpaid, and incurred should reconcile with the Statement of Income page. The workpapers that show a reconciliation explaining reinsurance, discounting, and salvage and subrogation adjustments should be available for examination on request.

Report in Column 23 the estimated amount of anticipated salvage and subrogation that has been taken as credit (netted) in the reserves for **unpaid losses and loss adjustment expenses** reported in Column 24. (Note: Column 23 is a memo column only as the amounts contained therein have already been taken into consideration in Columns 13 through 20.)

**The Life and Health Annual Statement Instructions for Note 36 (matches SSAP No. 55, paragraph 17h disclosure.)**

**36. Loss/Claim Adjustment Expenses**

Instruction:

The financial statement shall include the following disclosures for each year full financial statements are presented. Life and annuity contracts are not subject to this disclosure requirement:

* The balance in the liabilities for unpaid loss/claim adjustment expense reserves at the beginning and end of each year presented.
* Incurred loss/claim adjustment expenses with separate disclosures of the provision for insured or covered events of the current year and increases or decreases in the provision for insured or covered events of prior years.
* Payments of loss/claim adjustment expenses with separate disclosure of payment of loss/claim adjustment expenses attributable to insured or covered events of the current year and insured or covered events of prior years.
* **Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims or losses.**

Illustration:

The balance in the **liability for unpaid accident and health claim adjustment expenses** as of and was $ and $ , respectively.

The Company incurred $ and paid $ of **claim adjustment expenses** in the current year, of which

$ of the paid amount was attributable to insured or covered events of prior years. The Company did not increase or decrease the provision for insured events of prior years.

The Company took into account estimated anticipated salvage and subrogation of the liability for unpaid claims/losses and reduced such liability by $ .

**The Health Annual Statement Instructions for note 31 matches SSAP No. 55, paragraph 17h disclosure.**

**31. Anticipated Salvage and Subrogation**

Instruction:

**Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims or losses. Refer to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* for accounting guidance.**

Illustration:

The Company took into account estimated anticipated salvage and subrogation in its determination of the liability for unpaid claims/losses and reduced such liability by $\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

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:**

None

**Convergence with International Financial Reporting Standards (IFRS):Not applicable.**

Staff Review Completed by:

Robin Marcotte

**NAIC Staff**

**August 2021**

Staff Recommendation:

**NAIC staff recommends that the Working Group** **move this agenda item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 55, which clarify that subrogation recoveries should be reported as a reduction of losses and/or loss adjusting expense LAE reserves, depending on the nature of the costs being recovered. In addition, updates to the disclosure in paragraph 17h are recommended. In conjunction, with the agenda item, NAIC staff should be directed to coordinate develop conforming revisions to the annual statement instructions. While NAIC staff believes the proposed clarification is consistent with the current practice of most entities, the Working Group should notify the Casualty Actuarial and Statistical (C) Task Force, the Life Actuarial (A) Task Force and the Health Actuarial (B) Task Force of the exposure.**

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

**General**

1. 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.
2. Various analytical techniques can be used to estimate the liability for IBNR claims, future development on reported losses/claims, and loss/claim adjustment expenses. These techniques generally consist of statistical analysis of historical experience and are commonly referred to as loss reserve projections. The estimation process is generally performed by line of business, grouping contracts with like characteristics and policy provisions. The decision to use a particular projection method and the results obtained from that method shall be evaluated by considering the inherent assumptions underlying the method and the appropriateness of those assumptions to the circumstances. No single projection method is inherently better than any other in all circumstances. The results of more than one method should be considered.
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4. In the rare instances when, for a particular line of business, after considering the relative probability of the points within management's estimated range, it is determined that no point within management’s estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued. It is anticipated that using the midpoint in a range will be applicable only when there is a continuous range of possible values, and no amount within that range is any more probable than any other. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine its best estimate of the liability.
5. If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with paragraphs 10-12 of this statement. Estimated salvage and subrogation recoveries (net of associated recovery expenses) shall be deducted from the liability for unpaid claims, unpaid losses, and unpaid loss/claim adjustment expenses, depending on the whether the subrogation represents a recovery of claims/losses or loss/claims adjustment expenses. If a reporting entity chooses to anticipate coordination of benefits (COB ) recoverables of Individual and Group Accident and Health Contracts, the recoverables shall be estimated in a manner consistent with paragraphs 11-13 of this statement and shall be deducted from the liability for unpaid claims or losses. A separate receivable shall not be established for these recoverables. In addition, all of these recoverables are also subject to the impairment guidelines established in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) and an entity shall not reduce its reserves for any recoverables deemed to be impaired. Salvage and subrogation recoveries received (net of associated recovery expenses) are reported as a reduction to paid losses/claims and/or paid loss/claim adjustment expenses. Coordination of benefits (COB) recoveries received of Individual and Group Accident and Health Contracts (net of associated recovery expenses) are reported as a reduction to paid claims.

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4. Payments of claims, losses, and loss/claim adjustment expenses with separate disclosures of payments of losses and loss/claim adjustment expenses attributable to insured or covered events of the current year and insured or covered events of prior years;
5. The reasons for the change in the provision for incurred claims, losses, and loss/claim adjustment expenses attributable to insured or covered events of prior years. The disclosure should indicate whether additional premiums or return premiums have been accrued as a result of the prior-year effects. (For Title reporting entities, “provision” refers to the known claims reserve included in Line 1 of the Liabilities page, and “prior years” refers to prior report years);
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8. Disclosure of the amount paid and reserved for losses and loss/claim adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis (the reserves required to be disclosed in this section shall exclude amounts relating to policies specifically written to cover asbestos and environmental exposures). Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement; and
9. Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims, losses or their associated adjusting expenses.

**Status:**

On August 26, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and took the following actions:

1. Exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, as illustrated above, to clarify that subrogation recoveries should be reported as a reduction of losses and/or loss adjusting expense (LAE reserves), depending on the nature of the costs being recovered. In addition, updates to the disclosure in paragraph 17.h. were exposed.
2. Directed NAIC staff to coordinate develop conforming revisions to the Annual Statement instructions.
3. Directed notification of the exposure to the following actuarial Task Forces:
   1. Casualty Actuarial and Statistical (C) Task Force,
   2. Life Actuarial (A) Task Force, and
   3. Health Actuarial (B) Task Force

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/9. August 26/Exposures/21-13 Salvage legal fees.docx