

## Interpretation of the Emerging Accounting Issues (E) Working Group

### INT 06-14: Reporting of Litigation Costs Incurred for Lines of Business in which Legal Expenses Are the Only Insured Peril

#### ISSUE NULLIFIED BY SSAP NO. 55

#### INT 06-14 Dates Discussed

December 10, 2006; March 10, 2007; June 2, 2007

#### INT 06-14 References

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

#### INT 06-14 Issue

1. SSAP No. 55 provides guidance on the reporting of losses or claims expenses and for the reporting of loss adjustment expenses or claims adjustment expenses.
2. In the situation where the policy coverage provided under the insurance policy is for reimbursement of the insured's legal expenses, how should those costs be reported? For example, would the costs go under loss expenses or loss adjusting expenses?
3. SSAP No. 55 provides the following (emphasis added):
  56. 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:
    - a. 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;
4. In the case under consideration here, the "insured event" is the incurral of legal expenses.

#### INT 06-14 Discussion

5. The Emerging Accounting Issues (E) Working Group sought the input of the Casualty Actuarial (C) Task Force on this issue and incorporated their input into this interpretation. As the only insured event is the incurral of legal expenses, the Working Group concluded the amounts should be classified as losses.
6. Furthermore, for policies where coverage is provided for both indemnification of the insured's own legal defense costs and indemnification for third party damages or judgments resulting from lawsuits (e.g., for Director's & Officer's policies), we also believe that the legal defense component should be included as losses. The distinction we draw here is that for traditional liability policies, the insurer provides the legal defense against the claim through a "duty to defend" clause.
7. The definition of loss adjustment expenses in SSAP No. 55 incorporates the costs expended by the insurer to defend and litigate claims brought against the insured, including attorney fees "owing to a duty to defend" (SSAP No. 55, paragraph 56.c.i.(f)). In some Director's & Officer's type policy coverages, there is a duty to indemnify the insured for their legal defense costs through inclusion of such legal costs in the definition of covered damages or losses, but no duty to defend. The insurer does not provide the legal defense. However, should the insurer hire

or use its own counsel to be involved in a particular lawsuit or claim (for example to participate in settlement negotiations), those costs would be included as loss adjustment expenses.

8. In summary, 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, or 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.

9. The Working Group notes that this Interpretation is not intended to change the classifications of legal expenses for existing long tailed lines of liability coverage, such as medical mal practice and workers' compensation insurance.

#### **INT 06-14 Status**

10. No further discussion is planned.