Statutory Issue Paper No. 65

Property and Casualty Contracts

STATUS
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Original SSAP and Current Authoritative Guidance: SSAP No. 65

Type of Issue:
Property and Casualty

retroactive dates where applicable. See paragraphs 7 and 8 for guidance for when premium shall be earned and losses shall be recorded.

Claims-Made Policies

5. When an insured obtains claims-made coverage they are normally replacing existing coverage. The existing coverage may have been a claims-made policy or an occurrence policy. In either case, in an effort to reduce premium costs, the insured may request that the claims-made coverage only cover claims reported within the effective dates of the policy that occur after a specified date. This specified date is referred to as the retroactive date of the claims-made policy. This exclusion eliminates duplicate coverage when converting from occurrence coverage to claims-made coverage.

6. The amount of the liability recorded for an insured event shall be determined in accordance with the provisions of paragraphs 6 through 12 of *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (Issue Paper No. 55).

7. Premiums shall be recognized in accordance with *Issue Paper No. 53—Property Casualty Contracts - Premiums* (Issue Paper No. 53) unless the policy contains tail coverage as discussed in the following paragraphs.

8. An insured may be provided an extended reporting option to allow extended reporting of events. The extended reporting feature is commonly referred to as "tail coverage." Extended reporting provisions provided on a claims-made policy modify the exposure period of the underlying contract and can be for a defined period (e.g., six months, one year, five years, etc.) or can be for an indefinite period.

9. Issue Paper No. 53 states *"Premiums from property and casualty contracts shall be recognized in the statement of operations, as earned premium using either the daily pro-rata or monthly pro-rata methods...unless a different method is specified in issue papers for specific types of property and casualty contracts."* Therefore, when extended reporting provisions for a defined period are provided to the holder of a claims-made policy, the insurer shall establish an unearned premium reserve. This liability shall represent the amount of premium charged for the tail coverage that has not yet expired and shall be earned over the tail period regardless of when the tail coverage is elected. When the claims costs and loss adjustment expenses anticipated to be reported during the extended reporting period, together with expected dividends to policyholders and maintenance cost exceed the recorded unearned premium reserve for a claims-made policy, a premium deficiency reserve shall be recognized in accordance with Issue Paper No. 53.

10. When extended reporting provisions are for an undefined or indefinite period the policy has effectively been converted to an occurrence type policy. In such instances the premiums shall be recognized in accordance with Issue Paper No. 53 over the basic coverage period and the insurer shall establish a liability for all insured events that have occurred through the end of the policy period whether or not they have been reported. In establishing such reserves the insurer shall follow the guidance prescribed in Issue Paper No. 55.

Discounting

11. With the exception of fixed and determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted.

12. Tabular reserves are indemnity reserves that are calculated using discounts determined with reference to actuarial tables which incorporate interest and contingencies such as mortality, remarriage, inflation, or recovery from disability applied to a reasonably determinable payment stream. This definition shall not include medical loss reserves or any loss adjustment expense reserves.

13. When establishing discounted loss reserve liabilities using a non-tabular method the liability shall be determined in accordance with *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves* (Actuarial Standard of Practice No. 20) but in no event shall the rate used exceed the lesser of the following two standards:

a. If the company's statutory invested assets are at least equal to the total of all policyholder reserves, the company's net rate of return on statutory invested assets, less 1.5%, otherwise, the company's average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned, as indicated by line 8 of the Underwriting and Investment Exhibit of the Annual Statement, by the average of the insurer's current and prior year total assets, as indicated on page 2 of the most currently filed annual financial statement; or

b. The current yield to maturity on a United States Treasury debt instrument with maturities consistent with the expected payout of the liabilities.

14. In accordance with *Issue Paper No. 3—Accounting Changes* (Issue Paper No. 3), a change in the discount rate used in discounting loss reserves shall be accounted for as a change in estimate. The provisions of Issue Paper No. 3 require changes in estimates to be included in the statement of operations in the period the change becomes known.

15. Insurers shall disclose the impact of discounting on the reserves for each line of business and reserve category, if any, the discount rate being utilized, and the tables used if applicable, as well as the impact of any change in the discount rate from the prior period. The disclosures required by paragraph 44 of this issue paper shall be made separately for tabular discounting and non-tabular discounting.

Structured Settlements

16. Structured settlements are periodic fixed payments to a claimant for a determinable period, or for life, for the settlement of a claim. Frequently a reporting entity will purchase an annuity to fund these future payments. Reporting entities may purchase an annuity in which the reporting entity is the owner and payee, or may purchase an annuity whereby the claimant is the payee. When annuities are purchased to fund periodic fixed payments they shall be accounted for as follows:

a. When the reporting entity is the owner and payee, no reduction shall be made to loss reserves and the annuity shall be recorded at its present value and accounted for as an other-than-invested asset as it meets the definition of an asset described in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets.* Income from these annuities shall be treated as miscellaneous income. The present value of the annuity and the related amortization schedule shall be obtained from the issuing life insurance company at the time the annuity is purchased.

b. When a reporting entity has purchased an annuity and the claimant is the payee, the reporting shall reduce the loss reserve to the extent that the annuity provides for funding of future payments. The cost of these annuities shall be recorded as paid losses in such instances.

17. For each year that full financial statements are presented insurers shall disclose the following in accordance with paragraph 43 of this issue paper:

a. The amount of reserves no longer carried by the insurer because it has purchased annuities with the claimant as payee and the extent to which an insurer is contingently liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities.

b. The name, location and aggregate statement value of annuities due from any life insurer to the extent that the aggregate value of those annuities, equal or exceed 1% of the reporting entity's policyholders' surplus. This disclosure shall include all annuities for which the company has not obtained a release of liability from the claimant as a result of the purchase of an annuity. The company shall also disclose whether such life insurers are licensed in the company's state of domicile.

Excess Statutory Reserve

18. Current statutory guidance requires insurers to record an excess statutory reserve computed in accordance with the NAIC Annual Statement Instructions to Schedule P - Part 7. The types of insurance that currently are subject to the excess reserve are:

- auto liability
- other liability
- medical malpractice
- workers' compensation
- credit coverages

19. This issue paper eliminates the requirement to record excess statutory reserves. Excess statutory reserves do not meet the definition of a liability as set forth in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5) which states:

> For purposes of statutory accounting, a "liability" shall be defined as certain or probable[1] future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of past transaction(s) or event(s). A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable[1] future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes but is not limited to liabilities arising from policyholder obligations (e.g. policyholders benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a Company's financial statements when incurred.
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> [1] *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6), states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that *in FASB Statement 5, Accounting for Contingencies*, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved...
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Policies with Coverage Periods Equal to or in Excess of Thirteen Months

20. Some property and casualty insurance contracts are written for coverage periods that equal or exceed thirteen months. These contracts may be single premium or fixed premium policies. These contracts generally are not subject to cancellation or premium modification by the insurer. The most common types of coverages with such periods offered by insurers are home warranty and mechanical breakdown. Revenues are generally not received in proportion to the level of exposure or period of exposure. In order to recognize the economic results of the contract over the contract period, statutory accounting must focus on establishing a liability for the estimated future policy benefits while taking into account estimated future premiums to be received. Insurers that issue such policies shall report unearned premiums in accordance with paragraph 47 of this issue paper. This guidance is primarily focused on home warranty and mechanical breakdown coverages and is not intended to include multiple year contracts comprised of single year policies each of which have separate premiums and annual aggregate

deductibles. This issue paper rejects current statut

Drafting Notes/Comments

- Reinsurance is addressed in *Issue Paper No. 75—Property and Casualty Reinsurance*.
- Title insurance is addressed in *Issue Paper No. 57—Title Insurance*.
- Discounting is prohibited by Issue Paper No. 55 unless it is specifically provided for in a specific issue paper.
- Financial guaranty insurance is addressed in *Issue Paper No. 69—Financial Guaranty Insurance*.

43. The NAIC Annual Statement Instructions, Note 14, provide the following guidance with respect to disclosure of structured settlements:

14. Structured Settlements

a. Instruction:

If the company has purchased annuities, under which the company is owner and payee, to fund future payments that are fixed or determinable by settlement provisions or by workings of statutes, the present value of such annuities shall be disclosed as assets under “Aggregate write-ins for other-than-invested assets” on Page 2 of the annual statement. The present value of the annuities should be obtained from the issuing life insurance company at the time the annuity is purchased. At the same time, an amortization schedule should be obtained since annual adjustments to the annuity's carrying value are necessary. If the total value of all annuities due from one life insurer equals or exceeds I percent of the Company's policyholders' surplus, list: the life insurer's name and location (headquarters); whether the life insurer is licensed in the company's state of domicile (i.e., yes or no is the requested response); and the statement value (i.e., present value) of the annuity(ies). The requested information is illustrated below. In addition, show the aggregate amount (i.e.. present value) of annuities due from all life insurers.

Illustration:

Life Insurance Company and Location	Licensed in Company's State of Domicile Yes/No	Statement Value (i.e., Present Value) of Annuities

b. Instruction:

If the company has purchased annuities of which the claimant is payee but for which the company is contingently liable, the amount of such contingent liability shall be disclosed in the Notes to Financial Statements, Note #8. This contingent liability is the amount of the liability due to the various claimants that have been offset by the purchase of the annuity. This liability may be measured by the amortized value (i.e., the present value obtained from the life insurer) of the annuities offsetting the liabilities. If the total value (i.e., present value) of all annuities due from one life insurer equals or exceeds I percent of the company's policyholders' surplus, list the life insurer's name and location (headquarters) and the amount of the reserve eliminated when the annuity was purchased. Report the total amount of loss reserves eliminated by annuities. This reserve is measured by the amortized value of the annuities offsetting the reserve. The requested information is illustrated below. In addition, show the aggregate amount (i.e., the present value which is obtained from the life insurer) of annuities due from all life insurers.

Illustration:

Life Insurance Company and Location	Loss Reserves Eliminated by Annuities
i. Total	$

44. The NAIC Annual Statement Instructions, Note 19, provide the following guidance with respect to discounting:

19. Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses

Instruction:

State whether or not any of the liabilities for unpaid losses or unpaid loss adjustment expenses are discounted, including liabilities for Workers' Compensation. If the company

Tabular Discount
Included in

(6.2)	Medical Malpractice – claims-made				
(7)	Special Liability				
(8.1)	Other Liability – occurrence				
(8.2)	Other Liability – claims-made				
(9)	Special Property				
(10)	Auto Physical Damage				
(11)	Fidelity, Surety				
(12)	Other (including Credit, Accident & Health)				
(13)	International				
(14)	Reinsurance A				
(15)	Reinsurance B				
(16)	Reinsurance C				
(17)	Reinsurance D				

The amount of policyholder dividends declared and unpaid should be recorded as a liability in the annual statement. Incurred policyholder dividends are reported in the Statement of Income; the amount so reported includes the paid amount (typically recorded as paid in the ledger asset reconciliation) plus the amount accrued at the end of the year (the dividends declared and unpaid), less the amount accrued at the beginning of the year.

46. The NAIC Annual Statement Instructions, Note 24, provide the following guidance with respect to environmental disclosures:

24. Asbestos/Environmental (Mass Tort) Reserves

Instruction:

If the company is potentially exposed to asbestos and/or environmental claims (mass tort), full disclosure of the reserving me

portfolio yield rate less 1.5% as indicated by dividing the net investment income earned, as indicated by line 8 of the Underwriting and Investment Exhibit of the NAIC Annual Statement, by the average of the insurer's current and prior year total assets, as indicated on page 2 of the most currently filed annual financial statement; or

(ii) the current yield to maturity on a United States Treasury debt instrument maturing in five (5) years as of the valuation date.

For the purposes of tests (2) and (3) above, "expenses" shall include all incurred and anticipated expenses related to the issuance and maintenance of the policy, including loss adjustment

3.31 As discussed in FASB Statement No. 60, some premiums are subject to subsequent adjustment (for example, retrospectively rated or other experience-rated insurance contracts). In

Accounting for exit costs
Financial statement disclosures and disclosure of certain information outside the basic financial statements

Salvage and Subrogation
4.30 After a claim has been settled, the possibility of salvage or subrogation may exist. Perhaps the simplest approach to determining the anticipated receivable is to estimate loss reserves using loss data that is net of salvage and subrogation recoveries. Many of the reserving methods for losses and loss adjustment expenses, however, can also be used to estimate salvage and subrogation recoveries.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapters 10, 11, 12, 14, 17 and 21
- NAIC Annual Statement Instructions to Schedule P
- *Issue Paper No. 3—Accounting Changes*
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force*
- *Issue Paper No. 53—Property Casualty Contracts - Premiums*
- *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*
- *Issue Paper No. 57—Title Insurance*
- *Issue Paper No. 66—Accounting for Retrospectively Rated Contracts*
- NAIC Annual Statement Instructions to notes 14, 19, and 24
- Minutes to the Financial Condition (EX4) Subcommittee meeting of June 7, 1995.

Generally Accepted Accounting Principles

- *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*
- *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
- *AICPA Audit and Accounting Guide: Property & Casualty Insurance Companies*
- *AICPA Statement of Position 94-5, Disclosure of Certain Matters in the Financial Statements of Insurance Enterprises*

State Regulations

- Texas Alternative Calculation for Schedule P reserves for High Deductible Plans
- Arkansas Insurance Department Bulletin 14-93 Guidelines for Implementation of Large Deductible Workers' Compensation Programs
- Florida Regulations FAC Rule 4-189.006 Guidelines for Large Deductible Workers' Compensation Filings
- Massachusetts Regulations 211 CMR 113.04 Workers' Compensation Deductibles Plan

Other Sources of Information

- *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves*