Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

**Issue: Premium Refunds and Other Adjustments**

**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 is to provide more explicit guidance on return of premium and other premium adjustments. The discussion during the exposures of *INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends,* highlighted the need for more explicit guidance regarding policyholder refunds and other premium adjustments for accident and health and property and casualty lines of business. The premium adjustments addressed will also address newer policy form types.

*SSAP No. 53—Property and Casualty Contracts – Premiums* provides guidance for premium adjustments due to changes to the level of exposure based on insurance risk. *SSAP No. 66—Retrospectively Rated Contracts* provides guidance for loss sensitive products. Some property and casualty products, which are commonly referred to as data telematics policies, provide premium adjustments for other reasons than what is articulated in the current guidance. One example of a data telematics policy would be the use of an automobile plug-in to determine driving habits of the insured for purposes of policy pricing. As such there is a need to provide principles-based guidance for these types of policies.

Existing Authoritative Literature:

* *SSAP No. 53—Property Casualty Contracts—Premiums*

## SUMMARY CONCLUSION

1. Except as provided for in paragraph 4, written premium is defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the insurance contract. Frequently, insurance contracts are subject to audit by the reporting entity and the amount of premium charged is subject to adjustment based on the actual exposure. Premium adjustments are discussed in paragraphs 10-13 of this statement.
2. For workers’ compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premium is recorded on the basis of that frequency.

(paragraphs 5-8 omitted)

1. Additional premiums charged to policyholders for endorsements and changes in coverage under the contract shall be recorded on the effective date of the endorsement and accounted for in a manner consistent with the methods discussed in paragraphs 4-8. This is done so that, at any point in time, a liability is accrued for unearned premium related to the unexpired portion of the policy endorsement.

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### Earned but Unbilled Premium

1. Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers’ compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations.
2. EBUB shall be adjusted upon completion of the audit and the adjustment shall be recognized as revenue immediately. Upon completion of an audit that results in a return of premiums to the policyholder, earned premiums shall be reduced.
3. Reporting entities shall establish all of the requisite liabilities associated with the asset such as commissions and premium taxes. These liabilities shall be determined based on when premium is earned, not collected[[1]](#footnote-1).
4. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they shall be written off against operations in the period the determination is made.

### Earned but Uncollected Premium

1. Reporting entities may utilize a voluntary procedure whereby policies are not cancelled for non-payment of the premium until after an extended cancellation period (example 30 days), as opposed to the shorter statutory cancellation period. There are other instances when a reporting entity provides coverage for periods when the payment has not been received. Prior to the cancellation of the policy the reporting entity acknowledges it is “at risk” and subject to “actual exposure” for a valid claim despite the fact that the reporting entity may not have received payment of the premium for this exposure. Reporting entities shall record earned but uncollected premium as direct and assumed written premium since the reporting entity is “at risk” and subject to “actual exposure” for the extended period of time when the policy is still in force and effective, whether or not the reporting entity collects a premium for this time period. Earned but uncollected premium would be charged to expenses **“**net gain or (loss) from agents or premium balances charged off” when it is determined to be uncollectible.
* *SSAP No. 54 – Revised—Individual and Group Accident and Health Contracts* provides the following:

Contracts Subject to Redetermination

27. This statement also applies to other contracts which are subject to redetermination such as Federal (and State) Groups - subject to rate adjustments through audits by the Office of Personnel Management (OPM). Reporting entities are required to give Federal Groups the lowest rates that are being charged to similar groups.

28. Amounts due from insureds or subscribers and amounts due to insureds or subscribers under contracts subject to redetermination meet the definitions of assets and liabilities as set forth in SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R, respectively.

29. Contract redeterminations shall be estimated based on the experience to date. The method used to estimate the liability shall be reasonable based on the reporting entity's procedures, and consistent among reporting periods. An examination of contract requirements in relation to the rates being charged and the current status of applicable audits (e.g., OPM, Centers for Medicare and Medicaid Services (or such other name that this entity shall be known as) and other Federal, state or government department) is a common method used to estimate such contract redeterminations.

30. Premium adjustments for contracts subject to redetermination are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Accrued premium adjustments shall be recorded in premium and considerations receivable with a corresponding entry to written premiums. Accrued return premium adjustments shall be recorded as a liability with a corresponding entry to written premiums, the annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; property and casualty reporting entities report as aggregate write-ins for liabilities.

31. If, in accordance with SSAP No. 5R, it is probable that the additional premium adjustment is uncollectible, any uncollectible premium shall be written off against operations in the period the determination is made and the disclosure requirements outlined in SSAP No. 5R shall be made.

32. Premium adjustments for contracts subject to redetermination shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If such premiums are not billed in accordance with the policy provisions or contract provisions, or the policy provisions or contract provisions do not address the due date of such premiums, the accrual shall be nonadmitted. This is consistent with the guidance for audit premiums established in SSAP No. 6.

**SSAP No. 66—Retrospectively Rated contracts is a common area statement and the entire statement is relevant.**

**SUMMARY CONCLUSION**

1. A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy or a formula required by law. The periodic adjustments may involve either the payment of return premium to the insured or payment of an additional premium by the insured, or both, depending on experience. Retrospective rating features are common in certain property and casualty contracts, group life, and group accident and health contracts. Some contracts have retrospective features required by law. Contracts with retrospective rating features are referred to as loss sensitive contracts.
2. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, respectively. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts are admitted assets to the extent they conform to the requirements of this statement.
3. Initial premiums shall be recognized in accordance with *SSAP No. 51R—Life Contracts, SSAP No. 53—Property Casualty Contracts—Premiums,* and *SSAP No. 54R—Individual and Group Accident and Health Contracts*.

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): The development of *INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends* highlighted the need for more explicit guidance regarding policyholder refunds and also highlighted the need for additional guidance regarding changes to property and casualty premium for reasons other than adjustments due to changes to loss sensitivity and adjustments based on the level of insurance risk. Industry comment letters during the exposures noted the need for more explicit and holistic guidance on this topic, particularly within the property and casualty guidance.

**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 Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, initially categorized as nonsubstantive and expose with request for comments / input on the issues described below. In addition, NAIC staff should be directed to draft to guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business. NAIC staff anticipates coordinating with industry representatives in gathering input for developing principles based guidance, particularly for the varieties of data telematics policies.

Comments are requested on the following:

1. NAIC Staff’s preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.
2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.
3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes

Staff Review Completed by:

**Robin Marcotte -** **NAIC Staff**

**July 2020**

**Status:**

On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed the agenda item with a request for comments/input on the issues described above. NAIC staff was also directed to draft guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business.

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1. If an entity feels comfortable enough in their ability to collect the premium that an asset is recorded, they should also book the associated liabilities. Once an estimate of the premium has been made and the entity feels certain that it will be collected, it should also book the liabilities that will be due when they receive the cash. If the premiums were unearned and the policyholder had the ability to cancel, the definition of a liability has not been met. [↑](#footnote-ref-1)