Earned Premium

What is an 'Earned Premium'

An earned premium is the amount of total premiums collected by an insurance company over a period that have been earned based on the ratio of the time passed on the policies to their effective life. This pro-rated amount of "paid in advance" premiums have been earned and now belong to the insurer.

BREAKING DOWN 'Earned Premium'

The premium that a policyholder pays for an insurance contract is not immediately recognized as earnings by the insurer. While the policyholder has met his or her obligation by paying for the policy and thus the benefits that he or she could receive, an insurer has only just begun its obligation when it receives the premium. When the premium is first received it is considered an unearned premium, and is not recognized as profit. As time passes, however, the insurer incrementally changes the status of the premium from “unearned” to “earned”. Until the policy end date is reached the insurer is responsible for any claims made, and only when that date is reached will the entirety of the premium be considered profit.

There are two different methods for calculating earned premiums: the accounting method and the exposure method.

The accounting method is more commonly used, and is how earned premium is shown on the majority of insurers' corporate income statements. The calculation used in this method involves dividing the total premium by 365, and multiplying this by the number of days that have elapsed. For example, an insurer who receives a $1000 premium on a policy that has been in effect for 100 days would have an earned premium of $273.97 ($1,000 / 365 * 100).

The exposure method does not take into account the date that a premium was booked, and instead looks at how premiums were exposed to losses over a given period of time. It is the more complicated method, and involves examining the portion of unearned premium exposed to loss during the period being calculated. The exposure method involves the examination of different risk scenarios (using historical data) that may occur over a period of time – from high risk to low risk scenarios – and applies the resulting exposure to premiums earned.

Premium Balance

The amount of premium that is owed to an insurer for a policy, but which has not yet been paid by the policyholder. The premium balance will decrease in value over the course of the policy term as the policyholder makes installment payments. Policyholders may sometimes request a refund of any unearned premium.

BREAKING DOWN 'Premium Balance'

Many insurers allow policyholders to pay for their policies in installments. Paying the full value of a policy's premium can be expensive to do all at once, and offering different payment structures allows insurers to reach a broader market. This type of policy feature is most often seen in auto insurance, which may offer monthly, quarterly, semi-annual, and annual installments.

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Written Premium

An accounting term in the insurance business used to describe the total premiums on policies issued by an insurance company during a specific period of time regardless of what portions have been earned. Written premiums are the amount of premium charged for a policy that has already become effective.

BREAKING DOWN 'Written Premium'

Written premiums refer to the amount of premiums customers are required to pay for insurance policies written during the accounting period. This is different from premium earned, which is the amount of premiums that a company has earned by providing insurance against various risks during the year. Written premiums may be measured as a gross (before deduction of reinsurance costs) or net (after reinsurance costs) number.

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Developed To Net Premiums Earned

The ratio of developed premiums to net premiums earned over a given time period. Developed to net premiums earned indicates whether an insurance company is charging high enough premiums to cover benefits guaranteed by the policies it writes, referred to as its loss reserves.

BREAKING DOWN 'Developed To Net Premiums Earned'

Insurance companies have to balance the premiums they bring in by writing policies with the benefits that those policies are guaranteeing. They set aside required reserves in order to ensure that they have enough money to pay for future claims, with any money left over after creating a reserve considered to be profit. Insurance companies want to make sure that their loss reserve is enough to cover its liabilities, but not too large so as to limit opportunities for using premiums to bring in more revenue through investment activities.

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Insurance Premium

An insurance premium is the amount of money that an individual or business must pay for an insurance policy. The insurance premium is considered income by the insurance company once it is earned, and also represents a liability in that the insurer must provide coverage for claims being made against the policy.

BREAKING DOWN 'Insurance Premium'

The amount of insurance premium that is required for insurance coverage depends on a variety of factors. Insurance companies examine the type of coverage, the likelihood of a claim being made, the area where the policyholder lives or operates a business, the behavior of the person or business being covered, and the amount of competition that the insurer faces.

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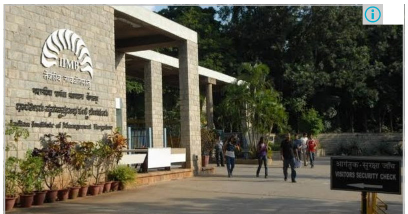
Unearned Premium



Unearned premium is the premium corresponding to the time period remaining on an insurance policy. Unearned premiums are proportionate to the unexpired portion of the insurance and appear as a liability on the insurer's balance sheet, since they would be paid back upon cancellation of the policy.

For example, at the end of the first year of a fully prepaid five-year insurance policy with insurance premiums of $2,000 per year, the insurer has earned a premium of $2,000 and has an unearned premium of $8,000.

BREAKING DOWN 'Unearned Premium'

Unearned premiums are portions of premiums collected in advance by insurance companies and subject to return if a client ends coverage before the term covered by the premium is complete. An unearned premium may be returned when an insured item is declared a total loss and coverage is no longer required, or when the insurance provider cancels the coverage. For example, consider a client who paid an auto insurance premium one year in advance who experiences a complete destruction of his vehicle four months into the coverage period. The insurance company keeps one-third of the annual premium for coverage provided and returns the other two-thirds as unearned premium.

Provisions for Unearned Premium

Provisions in the insurance contract govern the terms for unearned premium. The provisions must follow regulations related to the area where the coverage is offered. A specific formula for calculating the amount of the unearned premium may be required.

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Adjustable Premium

An insurance premium that can move up or down over time based on a policy that is agreed to at the outset of an insurance contract. There are several factors that may cause your adjustable premiums to change, including the varying costs of maintaining the contracts.

Also known as a "variable premium."

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Direct Premiums Written

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Valuation Premium

Guaranteed Cost Premium

Premiums charged for an insurance policy that are not adjusted for loss experience. Guaranteed cost premium represents a flat fee that the insured pays for coverage over a policy period.

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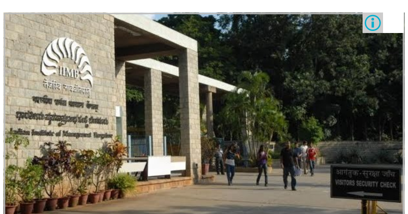

The rate set by a life insurance company based on the value of the company's policy reserves. The

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