Unearned Premium

What is '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.

Reasons for Not Returning Unearned Premium

In certain circumstances, an insurance company may not have to issue a refund for unearned premium. For example, if the policyholder has falsified information on the application for obtaining insurance coverage, the provider may not be required to refund any part of the earned or unearned premiums collected. Policies typically outline the conditions that must be met when applying for and receiving the unearned portion of a premium.

Insurance providers may not have to return a portion of unearned premium when a policyholder terminates the coverage for no given reason, or for reasons such as securing a similar policy with a different provider. It is best for the policyholder to wait until the coverage period of the last paid premium is close before switching insurance companies. However, if the insured can prove the provider did not honor the terms and conditions described in the provisions of the policy, any unused portion of the premium should be refunded.

Unearned Premium and Balance Sheet

Because canceling a policy may mean issuing a refund, unearned premiums appear as liabilities on an insurance company’s balance sheet. For example, an insurance company receives $600 on January 27 for coverage from February 1 to July 31. As of January 31, the $600 has not been earned. The insurance company reports the $600 in its cash account and reports $600 as a current liability in its unearned premium revenue account. As the company earns the premium, the provider moves the amount earned from the liability account to a revenue account on its income statement.

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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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Unearned Discount

Interest that has been collected on a loan by a lending institution but has not yet been counted as income (or earnings). Instead, it is initially recorded as a liability. If the loan is paid off early, the unearned interest portion must be returned to the borrower.

Also called unearned interest.

BREAKING DOWN 'Unearned Discount'

An unearned discount account recognizes interest deductions before being classified as income earned throughout the term of the outstanding debt. Over time, then, the unearned discount creates an increase in the lender's profit and a subsequent decrease in liability.

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Advance Premium Fund

Insurance companies who receive advance premiums must account for the unearned portion of these premiums as a separate liablity item on their balance sheets. This item is commonly referred to as the advance premium fund or account. As the premium is earned, it is run through the income statement.

BREAKING DOWN 'Advance Premium Fund'

Advance premium accounting rules are strictly regulated by the various states, since it can be a large item for smaller companies and is a direct offset to capital. A common way to calculate unearned premiums is by prorating the premiums by the number of days within the period.

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Unearned Interest

Interest that has been collected on a loan by a lending institution but has not yet been counted as income (or earnings). Instead, it is initially recorded as a liability. If the loan is paid off early, the unearned interest portion must be returned to the borrower.

Also called "unearned discount".

BREAKING DOWN 'Unearned Interest'

Unearned interest is an accounting method used by lending institutions to deal with long-term, fixed-income securities. Initially recorded as a liability, the unearned interest will eventually be recorded as income in the lending institution's books over the life of the loan as time passes and the interest is earned.

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Unearned Income

Unearned income describes any personal income that comes from investments and other sources unrelated to employment services. Examples of unearned income include interest from a savings account, bond interest, alimony and dividends from stock. This type of income differs from traditionally earned income, which is the income earned from active work or business activity.

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Unearned Revenue

Insurance Premium

Net Premiums Written

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.

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What is Unearned Revenue?

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Insurance Premium

Net Premiums Written

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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Insurance Premium

Net Premiums Written

period of time, less premiums ceded to reinsurance companies, plus any reinsurance assumed. Net premiums written represents how much of the premiums the company gets to keep for assuming risk.

BREAKING DOWN 'Net Premiums Written'

Determining how strong an insurance company is can be difficult, as it depends on the types of policies and the risks associated with those policies. One way to see how healthy a company is involves looking at changes to its net premiums written from year to year. An increase in net premiums written represents an increase in new insurance policies written, while a decrease indicates that fewer policies were originated. Decreases in net premiums written could be the result of competitors entering the market and taking up market share, or because premiums are not competitive with what other companies are offering. Companies that offer policies to a larger pool of people may reduce the possibility of declines.

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