

Statutory Issue Paper No. 6

Amounts Due From Agents and Brokers

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 6

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Some reporting entities conduct a significant amount of their business through insurance agents and brokers. For purposes of this issue paper the term agent will be used as reference to both entities. In the ordinary course of business, amounts may be due from or payable to agents by a reporting entity. Business reasons for these transactions vary between each type of entity transacting business with the reporting entity. These variations may be the result of formal contractual requirements, the nature of the insurance products being sold or the services being performed. Statutory accounting for amounts due from agents is not addressed in sufficient detail in either the Accounting Practices and Procedures Manuals for Life and Accident and Health or for Property and Casualty Insurance Companies. Additionally, interpretation and application of accounting practices dealing with amounts due from agents are inconsistent among states. This issue paper establishes a framework for the accounting and reporting of amounts due from agents and brokers (collectively referred to as “agents”) that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. Amounts due from agents can result from various insurance transactions ranging from premiums collected on behalf of the reporting entity to amounts advanced to the agent by the reporting entity to finance agency operations. Premiums owed by the agent shall be reflected net of commissions, if permitted by the contract. In almost all cases these transactions result in an amount due to the reporting entity that meets the definition of an asset as set forth in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*. First, an evaluation shall be made to determine nonadmitted amounts. Next, an evaluation shall be made of such assets in accordance with *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5), to determine whether there is an impairment. This two-step process is set forth below:

- a. The uncollected agent's receivable which is over ninety days due shall be accounted for as a nonadmitted asset regardless of any offsetting amount (e.g., unearned premium).
- b. Remaining amounts determined to be uncollectible shall be written off. If, in accordance with Issue Paper No. 5, it is probable the agent's receivable is uncollectible, any uncollectible agent's receivable shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible and is therefore not written off, disclosure requirements outlined in Issue Paper No. 5 shall be followed.

3. Advances to agents - All such balances, which are primarily encountered in the life insurance industry, are nonadmitted if a) the amounts are in the form of unsecured loans or advances, or b) the contractual terms for repayment are through application of future renewal commissions and/or other credits, or c) the terms of repayment do not provide readily available cash for the satisfaction of policyholder liabilities.

4. The following situations provide additional guidance in determining the nonadmitted portion of agent's balances as discussed above:
- a. Amounts payable to agents under the same contractual agreement - If amounts are both payable to and receivable from an agent, and the contractual agreements between the agent and the reporting entity permit offsetting, then the nonadmitted portion of amounts due from that agent should be calculated on the net balance due.
 - b. Amounts due from agents (affiliated or nonaffiliated) paid prior to the date of the financial statements and repaid to the agent by the reporting entity or one of the reporting entity's affiliates subsequent to the date of the financial statements - Such amounts should be accounted for in accordance with the substance of the transaction (a "wash" transaction) and not its form. Accordingly, the amounts due should be reestablished as an asset and subjected to asset collectibility and nonadmitted asset calculations using the original due date of the receivable. Short-term financing by third parties should also be considered "wash" transactions if the substance of the transaction is to avoid the nonadmitted asset principle set forth above.
 - c. Amounts classified as nonadmitted assets collected subsequent to date of the statutory financial statements - Such amounts shall not be used to adjust the nonadmitted asset otherwise calculated.
 - d. Determination of the Due Date -
 - i. The due date for original and deposit premiums is governed by the effective date of the underlying insurance contract and not the agent/reporting entity contractual relationship.
 - ii. The due date for endorsement and installment premiums is governed by the effective date of the endorsement and the contractual due date of the installment.
 - iii. The due date for audit premiums and retrospective premiums is governed by policy or contract provisions. If the due date for receivables relating to these policies is not addressed by policy provisions or contract provisions, any uncollected premium (either accrued or billed) is nonadmitted.
 - iv. These provisions are to be applied to all balances due except those arising from force placed insurance obtained by a lender for collateral protection, certain policies, known as a Trustee Sales Guarantees (TSGs), issued by title insurance companies to lenders on defaulted real estate loans and crop/hail policies. For forced placed insurance, the due date for purposes of applying paragraph 2 shall be the date of billing. For TSG policies, the due date for purposes of applying paragraph 2 shall be at the expiration of the grace period given to the defaulted debtor, which is provided by statute. Crop/hail premiums are considered installment premiums in accordance with paragraph 4.d.ii. and accordingly, the due date for purposes of applying paragraph 2 shall be governed by the contractual due date of the installment.
 - e. Reconciling items between a Reporting Entity's Account and Agent's Account - If such amounts are over ninety days due, the amounts shall be nonadmitted.

DISCUSSION

5. The Statement of Concepts states:

The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which may be unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

6. Based upon the above concept, agents' balances should reflect only amounts that are available to meet both current and future policyholder obligations when the obligations are due. Therefore, amounts determined to be impaired, regardless of aging, should be charged to operations. The adoption of a write-off/allowance methodology will provide a more appropriate measure of those assets available to meet policyholder obligations.

7. Under the conservatism concept of statutory accounting, premiums and other amounts collected by the agents on behalf of the reporting entity, which are over 90 days due and advances made to an agent, should be treated as nonadmitted assets and charged to surplus. In keeping with the concept of conservatism, subsequent collection of nonadmitted assets should not be considered in the determining period-end nonadmitted assets. These recoveries should be accounted for in the period received.

8. The draft discussion materials from previous Property/Casualty codification projects suggested aging of all original or renewal premiums receivable to begin as of the effective date of the policy regardless of whether the reporting entity is using a direct bill or account current system. In addition, the proposed version requires endorsement premiums and installment premiums to begin aging from the effective date of the endorsement and from the due date of the installment. An exception is provided for force placed insurance and for certain title insurance policies known as TSGs. Force placed insurance is a type of collateral protection insurance typically offered to financial institutions and other lenders that make loans secured by collateral. Coverage is obtained by the lender when the collateral securing a loan becomes uninsured by the borrower. Due to the nature of this specific type of insurance most policies or certificates are not issued, and consequently not billed, until after the effective date of coverage. As a result, the due date for purposes of paragraph 2 is the date of billing. TSGs are title insurance policies issued to lending institutions during the foreclosure process on defaulted real estate loans. TSGs are requested by the lending institution, and premium is booked by the reporting entity at the notice of default date. There is, typically by law, a grace period given to the defaulted debtor to bring the loan current. Since the premium is remitted to the reporting entity from the proceeds of the foreclosed property this grace period results in a lag period before the premium could be collected. As a result, the due date for purposes of paragraph 2 is the date at which the grace period expires.

9. Current statutory accounting for life and accident and health companies generally requires agents' balances to be nonadmitted. This is not consistent with the treatment of such balances for property and casualty companies. The majority of agents' balances for life and accident and health companies consist of advances to agents under agents' contracts. This paper does not recommend a change for these types of balances. Advances to agents under agents' contracts would follow the treatment outlined in the Summary Conclusion above. To the extent the agents' balance consists of amounts other than advances to agents under agents' contracts, the recommended treatment outlined in this paper is theoretically different from existing practice. Adoption of the principles outlined in the Summary Conclusion above for life and accident and health and property and casualty companies will provide necessary consistency without having a significant impact on the conservatism of the statutory financial statements.

Drafting Notes/Comments

- This issue paper does not address nonadmitted assets for retrospective premiums on direct or assumed business as this issue was addressed and codified by the NAIC in 1993. Current guidance is included in Chapter 22 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies. This is addressed in a separate issue paper.
- Reinsurance premiums payable, reinsurance commissions receivable, etc., which are currently reported on the same line in the Annual Statement, are addressed in a separate issue paper.
- In preparing this paper, the following issues were identified as future potential issue paper topics:
- Right of Offset - (agent commissions, reinsurance premiums payable and receivable, etc.)
- Aging/nonadmitting of reinsurance premiums due (governed by Chapter 22)
- Premiums sold with recourse (premium finance company)
- Accounting/aging of retrospective premiums currently reported on line 9.2 or line 9.3 is addressed in a separate issue paper.
- Accounting for uncollected premium balances is addressed in *Issue Paper No. 10—Uncollected Premium Balances*.
- Accounting for bills receivable is addressed in *Issue Paper No. 21—Bills Receivable for Premiums*.
- Sale of premium receivables will be addressed in *Issue Paper No. 42—Sale of Premium Receivables*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:**Statutory Accounting**

10. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 7, *Agents' Balances or Uncollected Premiums*, page 2, paragraph 2, provides the following guidance:

To satisfy the requirements of the annual statement blank, agents' balances or uncollected premiums over three months due are nonadmitted assets. (See Chapter 9 - Nonadmitted Assets, see excerpt below.)

11. Chapter 9, *Nonadmitted Assets*, page 1, point 3, reinforces Chapter 7 by stating the following:

Agents' Balances or Uncollected Premiums Over Three Months Due: The statutes of most states require that agents' balances or uncollected premiums over three months due be nonadmitted because of the uncertainty of collection.

12. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies is silent with respect to when the aging of agents' balances and uncollected premiums is to commence, however, the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force (Emerging Accounting Issues Working Group) reached a consensus in the 89-2 session which states the following:

Aging of Agents' Balances

The issues considered were:

1. In computing the non-admitted portion of agents' balances, should an agents' account current be aged from the dates of the account current statement or from the effective dates of the individual policies billed in the statements?

The consensus of the group was that accounts current should be aged from the dates of the statements.

2. How should balances be aged when the account current system is not used?

The balance should be aged from the effective date of the policy.

13. Chapter 9 of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies discusses the nonadmitting of certain assets as follows:

Some examples of assets which are nonadmitted due to either an uncertainty as to their collectibility or an insufficient basis for determining their valuation or other reasons are:

1. deposits in suspended depositories;
2. agents' debit balances;
3. bills receivable which are not properly secured by collateral;
4. loans on personal security (endorsed or not) which are not properly secured by collateral;
5. cash advanced to or in the hands of officers or agents;
6. travel advances.

Generally Accepted Accounting Principles

14. GAAP accounting for agent balances or uncollectible premiums/receivables is governed by *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), paragraphs 1, 3 and 8:

1. For the purpose of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a "gain contingency") or loss¹ (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

¹The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses.

3. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms probable, reasonably possible, and remote to identify three areas within that range, as follows:
 - a) Probable. The future event or events are likely to occur.
 - b) Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.
 - c) Remote. The chance of the future event or events occurring is slight.
8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income³ if both of the following conditions are met:
 - a) Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.⁴ It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

- b) The amount of loss can be reasonably estimated.

³Paragraphs 23-24 of *APB Opinion No. 9*, "Reporting the Results of Operations," describe the "rare" circumstances in which a prior period adjustment is appropriate. Those paragraphs are not amended by this statement.

⁴Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented.

15. The FAS 5 criteria above, is used in interpreting information such as historical trending and general information about the stability of the agents\insured in an effort to evaluate the adequacy of a premium receivable allowance. Accounting for contingencies is discussed in more detail in Issue Paper No. 5.

16. GAAP accounting requires the aging of agents' balances or uncollected premiums to begin from the effective date of the policy. Aging for endorsement premiums should begin from the endorsement's effective date and installment premiums should begin from the installment's due date. Although not specifically stated, this guidance can be deduced through review of *FASB Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 83, as follows:

83. Further guidance for recognition of revenues and gains is intended to provide an acceptable level of assurance of the existence and amounts of revenues and gains before they are recognized. Revenues and gains of an enterprise during a period are generally measured by the exchange values of the assets (goods or services) or liabilities involved, and recognition involves consideration of two factors (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration.
- a. Realized or realizable. Revenues and gains generally are not recognized until realized or realizable.⁵⁰ Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Readily convertible assets have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price.
 - b. Earned. Revenues are not recognized until earned. An entity's revenue earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations,⁵¹ and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Gains commonly result from transactions and other events that involve no "earning process," and for recognizing gains, being earned is generally less significant than being realized or realizable.

⁵⁰The terms realized and realizable are used in the Boards conceptual framework in precise senses, focusing on conversion or convertibility of noncash assets into cash or claims to cash (Concepts Statement 3, par. 83). Realized has sometimes been used in a different, broader sense: for example, some have used that term to include realizable or to include certain conversions of noncash assets into other assets that are also not cash or claims to cash. APB Statement 4, paragraphs 148-153, used the term realization even more broadly as a synonym for recognition.

⁵¹Most types of revenue are the joint result of many profit-directed activities of an enterprise and revenue is often described as being 'earned' gradually and continuously by the whole of enterprise activities. Earning in this sense is a technical term that refers to the activities that give rise to the revenue-purchasing, manufacturing, selling, rendering service, delivering goods, allowing other entities to use enterprise assets, the occurrence of an event specified in a contract, and so forth. All of the profit-directed activities of an enterprise that comprise the process by which revenue is earned may be called the earning process" (APB Statement 4, par. 149). Concepts Statement 3, paragraph 64, footnote 31, contains the same concept.

17. The renewal or establishment of an insurance policy in exchange for a claim to cash (premium receivable) triggers the realization characteristic of revenue recognition, therefore, the aging of the agents' balance or uncollected premium should commence on the effective date of the new or renewed policy. Endorsement premiums will trigger the realization characteristic on the effective date of the endorsement, while installment premiums will trigger the realization characteristic on the due date of the installment.

18. Although the realization characteristic of revenue recognition may have been triggered, the more important characteristic of earned may not have been, hence, the recording of an unearned premium.

19. *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises (FAS 60)*, also provides some indirect guidance. FAS 60, paragraph 13, requires revenue on short-duration contracts to be recognized over the period of the contract in proportion to the amount of insurance protection provided. The contract period starts with the policy effective date. Therefore, it is reasonable to begin aging from the policy effective date as this is the date when revenue recognition begins.

OTHER SOURCES OF INFORMATION

20. The draft discussion materials from previous Property/Casualty codification projects proposed extensive modifications to the accounting for agents' balances and uncollected premiums. The following represents a summary of those modifications:

When the original or deposit premium are more than ninety days past due based on an aging referenced to effective date and therefore, not admitted, all premiums subsequently charged on the same policies or bonds are similarly not admitted, except that if the amount of such original or deposit premiums does not exceed 20% of the subsequently charged premiums in the same policies of bonds, such subsequently charged premiums, if otherwise not themselves more than ninety days overdue, shall be allowed as admitted assets.

21. The same basic concept was also discussed for endorsement premiums and installment premiums. In addition, this version discussed certain parameters where a greater than ninety day nonadmitted premium could be accounted for as an admitted asset. The modification was stated as follows:

A premium which has been determined to be not admitted may be treated as admitted if it has been collected within forty-five days of the date of determination and not more than ninety days had elapsed from the billing date to the date of determination and further, that not more than one hundred thirty-five days had elapsed from the effective date of the premium to the date of determination.

22. The draft discussion materials from previous Property/Casualty codification projects contradicted the Emerging Accounting Issues Working Group's consensus by proposing the following:

Original or deposit premiums

Aging is always based on the effective date of the policy or bond regardless of whether the insurer is using a direct billing system or an account current system.

Endorsement

Aging is always based on the effective dates of the endorsements.

Installments

Aging is always based on the due date of the installment.

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 7 & 9
- NAIC Annual Statement Instructions for Property and Casualty Insurance Companies
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 9
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*

Generally Accepted Accounting Principles

- *FASB Statement No. 5, Accounting for Contingencies*
- *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*
- *FASB Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises*

State Regulations

- State regulations contain numerous references to amounts due from agents and brokers. Due to the volume, specific references to each state regulation has not been reproduced in this issue paper.

Other Sources of Information

- Draft discussion materials from previous Property/Casualty codification projects
- NAIC Technical Resource Group Proposed Draft Life Codification, Chapter 9