

Statutory Issue Paper No. 10

Uncollected Premium Balances

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 6

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. This issue paper addresses direct and group billed uncollected premiums for Property and Casualty and Accident and Health policies. It does not address uncollected and deferred premiums for life considerations, which are addressed in a separate issue paper. The Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies and for Life and Accident and Health Insurance Companies (the Manuals) do not provide definitive guidance on when to begin aging premiums. This issue paper puts forth a framework for the accounting and reporting of uncollected premium balances that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. Premium transactions result in amounts due to the reporting entity that meet 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 the remaining admitted 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. To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be accounted for as a nonadmitted asset. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be accounted for as nonadmitted assets.
- b. Amounts determined to be uncollectible shall be written off. If, in accordance with Issue Paper No. 5, it is probable the uncollected premium balance is uncollectible, any uncollectible premiums 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. The following provides additional guidance in determining the nonadmitted portion of uncollected premiums:

- a. Amounts classified as nonadmitted assets collected subsequent to date of the statutory financial statements - Such amounts should not be used to adjust the nonadmitted asset otherwise calculated.

- b. 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 provisions or contract provisions. If the due date for receivables relating to audits 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 premium receivables 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 3.b.ii. and accordingly, the due date for purposes of applying paragraph 2 shall be governed by the contractual due date of the installment.

DISCUSSION

4. 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.

5. Based upon the above concept, uncollected premium 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 income in the period such determination is made. Short-term policies shall also be subject to this collectibility analysis. The adoption of this methodology will more appropriately provide the statutory financial statement reader with an indication of those assets available to meet policyholder obligations. Under the conservatism concept of statutory accounting, uncollected premiums over ninety days due, even if they are determined to be collectible, should be nonadmitted and charged to surplus. Uncollected installment premiums over ninety days due, even if they are determined to be collectible, should be nonadmitted along with all future installments. Additionally, the conservatism concept of statutory accounting will not allow subsequent collection of amounts charged to surplus as nonadmitted assets to reduce the nonadmitted asset. These recoveries will be accounted for in the period received.

6. An exception to the due date guidance 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.

Drafting Notes/Comments

- A separate issue paper addresses deferred and uncollected life and annuity premiums.
- A separate issue paper addresses nonadmitted assets for retrospective premiums on direct or assumed business; this issue was addressed and codified by the NAIC in 1993. Guidance is included in Chapter 22 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies.
- A separate issue paper addresses premiums sold with recourse (premium finance company).
- Reinsurance premiums payable, reinsurance commissions receivable, etc., which are currently reported on the same line item in the Annual Statement are addressed in a separate issue paper.
- Accounting for uncollected agents' balances is addressed in *Issue Paper No. 6—Amounts Due From Agents and Brokers*.
- Accounting for bills receivable is addressed in *Issue Paper No. 21—Bills Receivable For Premiums*.
- Accounting/aging of retrospective premiums currently reported on line 9.2 or 9.3 is addressed in a separate issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

7. The draft discussion material 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. In addition, the proposed version suggests endorsement premiums begin aging from the effective date of the endorsement and installment premiums begin aging from the contractual due date of the installment. This presentation is consistent with GAAP and provides for a conservative aging process.

8. 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.)

9. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, 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.

10. The NAIC Annual Statement Instructions for Property and Casualty Insurance Companies, Exhibit 2 - Analysis of Nonadmitted Assets, Line 24.2 - Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due, provides additional guidance for nonadmitting installment premiums as follows:

This item should include all future installments on all policies for which one or more installments are over three months past due.

11. The Accounting Practices and Procedures Manuals for Property and Casualty and for Life and Accident and Health Insurance Companies do not address when the aging of uncollected premiums is to commence; however, the draft discussion material from previous Property/Casualty codification projects suggested 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.

12. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 18, pages 3 and 4, discusses uncollected premiums as follows:

Accident and Health Policies

Accident and health insurance policies typically provide a grace period after the due date for the premium to be received before the policy is terminated. If the company is relatively assured of collecting the late premium, and has established an appropriate unearned premium reserve, it is permitted to record such due and uncollected premium as an admitted asset.

On accident and health policies, other than group, with premiums payable more frequently than quarterly, all due and unpaid premiums are not admitted if more than one period premium is overdue. Group premiums more than 90 days overdue also are disallowed as an admitted asset.

Because the policyholder can terminate the policy at any time simply by not paying the premium, the company should consider its lapse experience in determining the amount it records as uncollected premiums. Recording older due premiums (although not more than 90 days past due), which have little or no unearned premium reserve, may overstate the company's financial condition.

Generally Accepted Accounting Principles

13. GAAP accounting for 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.

¹ The 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.

14. The FAS 5 criteria above is used in interpreting information such as historical trending and general information about the stability of the insureds in an effort to evaluate the collectibility of the receivable balance. Accounting for contingencies is discussed in more detail in Issue Paper No. 5.

15. GAAP accounting requires the aging of direct billed 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 contractual due date. Although not specifically stated, this guidance can be deduced through review of *FASB Statement of 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. 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, 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.

16. 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 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 contractual due date of the installment.

17. *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

18. The draft discussion material 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 is 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 or bonds, such subsequently charged premiums, if otherwise not themselves more than ninety days overdue, shall be allowed as admitted assets.

19. The same basic concept was also discussed for endorsement premiums and installment premiums. In addition, it 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.

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
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 18

- *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

- No additional guidance obtained from state statutes or regulations.

Other Sources of Information

- Draft discussion material from previous Property/Casualty codification projects

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