Cancellation of Policy

An insurance policy may be canceled before the end of the policy period. This has the effect of ending the policy coverage on the date of the policy cancellation.

Cancellation Methods Three different calculation methods are commonly used. Cancellation methods are typically calculated using a online wheel calculator.[1][2]

Pro Rata A non-penalty method of calculating the return premium of a canceled policy. A return premium factor is calculated by taking the number of days remaining in the policy period divided by the number of total days of the policy. This factor is multiplied by the written premium to arrive with the return premium.

Short Rate (Old Short Rate) A penalty method of calculating the return premium often used when the policy is canceled at the insureds request. It uses a table of factors that results in penalties that can be lower or higher than short rate (90% pro rata) depending upon the date of cancellation.

Short Rate (90% Pro Rata) A penalty method that where the penalty is 10% of the unearned premium.

Cancellation Date The date a policy's coverage is cancelled prior to the normally expiration date of a policy, often resulting in a return premium owed to the insured.

Inception Date The date an insurance policy's coverage is started. Also called effective date or renewal date.

Policy Term The period of time that an insurance policy provides coverage. Most policies have a one year term (365 days) but many other polcies also have a 6 month term. Policy terms can be for any length of time and can be for a short period when the period of risk is also short. Policy terms can also be for a multi-year period.

Return Premium When a policy is canceled before its expiration date a return premium may be owed to the insured. The return premium is generally calculated using a wheel calculator. The return premium is calculated by calculating the unearned premium and then subtracting any unpaid premium and penalty for early cancelation. Short rate (old short rate) and short rate (90% pro rata) are penalty methods of calculating the return premium.

Earned Premium Earned premium is the portion of an insurance written premium which is considered "earned" by the insurer, based on the part of the policy period that the insurance has been in effect, and during which the insurer has been exposed to loss. For instance, if a 365-day policy with a full premium payment at the beginning of the term has been in effect for 120 days, 120/365 of the premium is considered earned. Earned premium will not be returned to the insured if the policy is cancelled.

Unearned Premium Unearned premium is the portion for an insurance written premium which is considered "unearned" by the insurer. It is the written premium less the earned premium. The unearned premium would be returned to the insured if the policy is canceled using pro rata cancellation method, when the policy is cancelled with no penalty.

Written Premium is the premium registered on the books of an insurer or a reinsurer at the time a policy is issued and paid for.