Pro-Rata vs. Short-Rate Cancellation

Pro-rata and Short-rate are two different ways of determining the refund amount that an insured party will receive if their insurance policy is canceled.

Pro-rata cancellation: With pro-rata cancellation, the refund amount is calculated based on the remaining length of the policy. This means the insured only ends up paying for the number of days the insurance contract is actually in effect. Pro-rata cancellation applies when the insurer initiates the cancellation of the policy.

For example, if an insured pays a premium of $1200 for the year, but the policy is cancelled after 6 months on a pro-rata basis, the insurer returns $600 to the insured, 50% of the policy remaining means 50% of the premium is refunded.

Short-rate cancellation: Short-rate cancellation calculation is similar to pro-rata but it includes a penalty as a disincentive for early cancellation. Some policies charge a percentage of the unearned premium amount. This means the total refund would be the unearned premium amount less, for example, 10%. The result is that the penalty amount will be higher if the policy is cancelled when the policy is new than if the policy is cancelled shortly before the policy expiration date.

For example, if an insured pays a premium of $1200 for the year, but the policy is cancelled after 6 months on a Short-rate basis, the insurer returns $600 minus the penalty cost which is outlined in the policy terms and conditions. If the penalty is 10% of the unearned premium then   50% of the policy remaining means 50% of the premium is refunded -minus the 10% of the unearned premium of which is $60 therefore the client si refunded $540

- $1200 is paid, $600 would be refunded but since there is a 10% penalty then client gets $540