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WHITE PAPER

Insurance Rates and Your Credit:
What Every Consumer Should Know

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Insurance Rates and Your Credit: What Every Consumer Should Know

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What is a Credit-Based Insurance Score?

A credit-based insurance score (CBIS) is a rating that's calculated using information in your credit report. There are 3 nationwide credit agencies that maintain credit reports for consumers: Equifax, Experian, and TransUnion.

Most insurance companies use a CBIS to help understand your risk and set rates for certain types of coverage, such as car and home insurance. Each company has its own proprietary method for using your credit information and evaluating it.

Your CBIS is a numerical snapshot of your situation at a particular point in time. The lower your insurance score, the greater risk you pose to an insurer. This report will help you learn how to raise your insurance scores and save money every year on insurance.

Why do insurers use a Credit-Based Insurance Score?

Insurers must remain profitable in order to stay in business and have funds to pay customer claims. Therefore, they favor applicants who are least likely to suffer an insurance loss. Insurers calculate a consumer's risk of filing a claim in order to know whether to insure him or her and at what rate.

Studies by federal and state regulators, universities, independent auditors and insurance companies have shown that consumers with good credit file fewer insurance claims. That means your credit information helps insurers predict how likely you are to have a future accident or insurance loss.

In July 2007, a study by the Federal Trade Commission said,

> "Scores effectively predict the number of claims consumers file and the total cost of those claims. Their use is likely to make the price of insurance better match the risk of loss that consumers pose."

While having a good insurance score doesn't necessarily mean that a policyholder is a good driver or a more responsible homeowner, research shows that those individuals generally file fewer or less expensive insurance claims. As a result, insurers offer consumers with high insurance scores lower rates, instead of charging every customer more.

What is the difference between a Credit-Based Insurance Score and a credit score?

Your CBIS is not the same as your credit score. The two aren't meant to be compared because they factor in different criteria and use different numerical scales.

However, both insurance scores and credit scores use information in your credit report to measure the following:

- A **credit score** measures your creditworthiness, or how likely you are to repay a debt on time.
- An **insurance score** measures your insurance risk, or how likely you are to file a claim and have an insurance loss.

When lenders determine your credit rating, they use your credit history in combination with other factors, such as your income and job history. Insurance companies don't consider your income or job history—they only consider information in your credit report.

However, insurance companies also use your credit history in addition to many other factors. For instance, auto insurance companies consider your driving record, claims history, age or driving experience, gender, type of vehicle, vehicle use, and geographic location to calculate the rate you must pay.

Home insurers base premiums on your insurance score, in addition to your home's age, construction type, location, proximity to a fire station and your claims history.

Can Credit-Based Insurance Scores discriminate against certain groups?

Insurers are prohibited from setting rates that unfairly discriminate against consumers by law in every state. Your CBIS can never be calculated using information such as your age, gender, race, religion, marital status, employment, or any other information that isn't found in your credit report.

What factors affect a Credit-Based Insurance Score?

For the credit portion of your CBIS, the following factors are typically considered:

- Payment history
- Accounts in collections
- Account balances
- Amount of available credit on accounts
- Length of credit history
- Types of credit used
- Credit inquiries (credit card or loan applications)
- Legal actions (such as a judgment or bankruptcy)

If you have poor credit, there's no quick fix. Improving the information in your credit report takes time. However, in many cases, more emphasis is given to recent information.

10 Tips to improve your Credit-Based Insurance Score

1. Pay your bills and credit accounts on time.
2. Get past due accounts caught up so they never go into collections.
3. Keep balances low on credit cards and other revolving credit accounts.
4. Check your credit report at least once a year to correct errors (see the next page for more). Note that you're never penalized for pulling your own credit report.
5. Apply for new credit accounts only when really needed.
6. Shop for a new loan or refinance within a short period of time to minimize the effect of new inquires.
7. Don't apply for several new credit accounts at once.
8. Don't close credit accounts with high credit limits. This lowers your available credit and hurts your scores.
9. Start building credit as early as possible since the length of your credit history is important.
10. You must have credit accounts and use them responsibly to build a strong credit history.

Which states prohibit the use of Credit-Based Insurance Scores?

Insurance is regulated by states, so the laws concerning the use of credit vary depending on where you live. For instance, insurers in Hawaii, California, Massachusetts and Maryland are generally not allowed to use credit in setting rates for either auto insurance, home insurance, or both.

However, no state allows insurers to use credit as the sole basis for denying coverage, increasing rates, canceling or not renewing policies.

How to get a copy of your credit report

Under the Fair Credit Reporting Act, you have the right to get a copy of your credit report from each of the 3 nationwide credit agencies every 12 months at AnnualCreditReport.com or by calling 1-877-322-8228. This is an official credit reporting site that is funded by each of the major agencies (Equifax, Experian, and TransUnion).

It's important to confirm the accuracy of the information in your credit history on a regular basis. Errors in your report may result in you having low credit and insurance scores. Additionally, accounts in your history that you don't recognize may be a sign that you're the victim of identity theft. Report errors right away and make sure that they get corrected.

TIP: It's a good idea to check your credit report before you apply for insurance or a new credit account.

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