08/21/2007

Good Credit Equals Good Homeowners Insurance Rates

You know that your credit score is used to determine many things. How good your credit is will determine whether or not you are offered some jobs. It will determine the interest rate you will be charged on auto loans and home mortgages. But did you realize that your credit score is often used today to determine the premium you will pay on homeowners insurance? It’s true. More and more insurers require a credit check before quoting you a premium rate.

Risk Assessment

Why do they do this? The insurance business is all about risk. You pay an insurance company money not because you expect to have an accident, but because there is always a risk of an accident occurring and you want to financially covered if it does. The insurance company therefore has to determine how much to charge you each month or year in order to have enough money on hand to pay for such an accident. These companies are always looking for ways to more accurately assess an individual’s risk factor so they can more precisely price premiums. They realize that each person has a different risk profile. For this reason, they try hard to figure out just how much risk each client represents so that low-risk people do not end up subsidizing accident claims from the high-risk people and so that there is enough money available when a high-risk person does file a homeowners claim.

In order to correlate rates for insurance policies as closely as possible with the actual cost of claims, homeowners insurance companies now often use credit scores in the process. The insurers typically take into account the following aspects of a credit report: outstanding debt, length of credit history, late payments, collections and bankruptcies, and new applications for credit. Information from the past 12 months is weighted most heavily.

Credit Predicts Risk

Why use credit scores? Well, studies conducted by the actuarial consultant firm Tilinghast have shown that there is a 99 percent correlation between insurance scores (based on credit scores) and the loss ratio (cost of claims filed relative to the premium dollars collected.)

But why are credit scores so accurate in predicting the risk factor of someone? Apparently it is because credit behavior generally carries over into everyday life. Those who act responsibly with their finances typically act responsibly when it comes to other things as well, things like home maintenance that help prevent possible accidents. The flip side is also true and studies have proven it. The lower a person’s credit score, the more likely they are to file a homeowner’s insurance claim.

The use of credit scores is actually beneficial to many consumers. It takes the guesswork out of assessing risk resulting in lower premium rates for many consumers. While those with higher scores get lower rates and those with lower scores get higher rates, both often get lower rates than they would have if the insurance underwriter had to guess about their risk profile. All the more reason to protect and improve your credit score before applying for a home loan and homeowners insurance!