

How are insurance rates set?

How does insurance work?

People buy insurance coverage to protect themselves from potential future loss. In exchange for payment of a known fee—the insurance premium—the policyholder is able to transfer his or her potential risk to an insurance company, which agrees to pay the insured for such a potential loss.

Insurance works because it allows the cost of large, often catastrophic losses to be spread among many individuals. Insurance companies collect premiums from many individual policyholders, and then pay for those losses from the premiums they have collected. Insurance companies operate successfully because it is unlikely everyone who pays an insurance premium will all suffer a loss or claim—at least not in any given period of time. In a nutshell, insurance pays for the losses of a few by the collected insurance premiums of many.

How are insurance rates determined?

It's a very complex process. Insurance can't be priced like most products because supply and demand, like most money products, it is impossible to protect against. The cost of a loss is often future, happening, or expected, as a fire, a flood, or an accident.

When rates are set, they are based on many factors. In making rates, basically, all the losses or claims are taken into account. The loss experience of the company is the loss experience can be defined as losses divided by the premiums collected. The companies use their loss experience, supplemented by

factors reflecting economic trends, as a guide to the amount they can be expected to pay for future claims and still meet the costs of doing business.

Once the company has determined its estimated future costs, its rates are set based upon a variety of factors. In the case of auto insurance, drivers are categorized into different classifications all based on the history and experience of the loss. For example, young drivers are in a certain geographical classification, which is higher than the loss experience of older drivers in the same classification.

What are the two types of rates that apply to insurance?

Auto insurance rates are based on a number of factors, including where the car is used, the customer's age, marital status, driving experience, and driving record of the driver, and the type and use of the car (miles driven).

Rating territory: The state is divided into rating territories, whose boundaries are determined by such considerations as population density, traffic congestion and other factors which affect exposure to accidents. The premium charged to an individual car owner is affected directly by the number and the total cost of the losses in this rating territory, including the number of thefts in that territory.

Driver classification: Well-documented studies make it clear some groups of drivers,

for one reason or another, are more prone to costly accidents. Age, gender and marital status are reasonable rate-making criteria. The highest rates usually are assigned to youthful drivers who, as a group, have less experience than older drivers.

Statistics indicate that drivers who have been responsible for accidents or have been convicted of serious driving violations are more likely to continue with those habits and have accidents in the future than are drivers with clean driving records. Drivers with bad records generally are charged more because of that expectation to have more claims than the average clean driver.

Use of car: Premium charges are related to the total number of miles a car is driven each year. Cars that are driven to and from the job usually are more vulnerable to accidents than cars used only for pleasure purposes, because they regularly are exposed to heavy traffic conditions. The same is true for cars used for business purposes throughout the day.

Type of car: Certain types of cars cost more to repair or to replace, based on a variety of factors, including ease of repair, cost of parts and the original cost of the car. These factors are taken into consideration when determining auto insurance premiums. New cars, for example, are more costly to repair or to replace than are older, less-expensive vehicles.

If you have any questions about your insurance rates, please feel free to contact our agency to discuss.



Your Professional Insurance Agent ... We want you to know about the insurance you're buying.