

How are Car Insurance Premiums Calculated?



Just like every other business, an insurance company must cover its costs to remain viable. However, unlike other businesses, not all insurance company costs are known at the time of purchase. They collect premiums to pay for administrative costs, taxes and claims. They also invest the premiums collected to earn investment income, which offsets their claims and administrative expenses.

Insurance companies collect premiums from the many to pay the claims of the few; claims are their largest expense and are mostly unknown at the time of purchase making the costs hard to predict. They consider the actual costs incurred in the past to predict the costs they will pay in the future.



Insurance companies have complex rating calculations to determine how much you pay, however, in simplistic terms your **premium is calculated using this formula:**

$$\text{Base Rate} \times \text{Rating Factors} \times \text{Surcharges \& Discounts}$$

Base Rate

Base rate is the estimated average premium an insurance company needs to charge to cover expected claim costs, expected operating expense costs, and a reasonable provision for profit.

Rating Factors

Insurance companies have access to a significant amount of data they use to predict the risk of you making a claim. There are several rating factors used, including your personal characteristics (age, gender and marital status), and each insurance company will assign different weights or percentages to each. In addition to personal characteristics, insurance companies generally focus on the following four types of rating factors:

1 Your Driving Record



Insurance companies use your driving record to determine how much of a risk you pose on the road. Generally, the better your driving record is, the lower your insurance premium. For example, a driver with at-fault accidents represents a higher risk to an insurance

company. Your premium may also increase if you have more than 1 traffic conviction in the last 3 years such as speeding or careless driving.

When looking at your driving record, insurance companies consider:

- ▶ The number of years you have been licensed for?
- ▶ Number of traffic convictions due to driving infractions, such as speeding tickets?
- ▶ The number of accidents you have had?
- ▶ Have you taken driver training?

2 How Much & Where You Drive



If you live or drive in a city, your premiums will likely be higher due to the increased incidence of vehicle theft or the fact there are more vehicles on the roads resulting in accidents happening more often. In addition,

the more you drive, the higher your risk of being involved in an accident. Insurance companies determine this risk by examining the number of kilometers driven.

3 Your Vehicle



The make, model and year of your vehicle all affect a portion of your insurance premium. Insurance companies consider how much it would cost to replace your vehicle if it was stolen or damaged. Your premium might be lower if the vehicle model has been

statistically proven less likely to be involved in an accident or be stolen. It also might be lower if the vehicle has better safety and handling characteristics, or is less costly to repair.

If you are interested in which vehicles are less expensive to insure, check out the Insurance Bureau of Canada's **How Cars Measure Up**. Generally, premiums are higher for newer vehicles and sports cars, but a vehicle's safety features may help lower the premium.

4 Type & Amount of Coverage



In general, the more coverage you have, the higher your premium. You can customize your policy to suit your needs. For example, adjust your deductible limit or coverages. You can add or remove coverages like collision (pays for damage to your vehicle regardless of

who's at fault) or comprehensive (pays for damage as a result of theft, vandalism, or hail) depending on your needs. If you drive an older vehicle you may remove collision coverage, alternatively if you are leasing or financing your vehicle you may be required to carry collision.

Surcharges & Discounts

Lastly, an insurance company may apply a surcharge based on any have accidents or convictions you may have. Alternatively, you may be eligible for a wide variety of discounts or preferred rates. Ask your broker or agent if you are eligible for discounts such as:

- ▶ Multi policy (bundle home and vehicle together or multiple vehicles);
- ▶ Anti theft system;
- ▶ Winter tire;
- ▶ Membership in a professional association; or
- ▶ Recent graduate of university or college.