

Credit Scores Can Impact Auto Insurance Renewals

Juan Castillo

Trying to figure out how auto insurance companies set your rate can be a real head-scratcher. You're unlikely to crack the formula, but you can be sure that your credit history is part of the equation, unless you live in one of the few states where insurers can't use it to calculate how much you'll pay.

The insurance industry says using credit scores rewards drivers who have good credit with lower rates. Consumers save from 30% to 59% on their premiums when credit information is used to set rates, according to the Property Casualty Insurers Association of America, a trade group.

But not everyone saves. A NerdWallet analysis of car insurance rates found that having poor credit rather than excellent credit increased insurance prices between 76% and 123% in the three states studied.

What does this mean for you? For starters, if you want to lower your car insurance rates, it can pay to improve your credit.

But whether credit history can be used to set rates at renewal time depends on a maze of state laws. If you have improved your credit, but your insurer doesn't factor that into renewal rates, you could be carrying the pricey baggage of your old credit for a long time.

Location matters

The extent of the use of credit history in pricing auto insurance varies by state: It's the norm when you buy a policy, except in California, Hawaii or Massachusetts, where it isn't allowed.

A few other states prohibit the use of credit information for renewals and cancellations. In Pennsylvania, insurers can use credit information at renewal, but only if it results in a lower rate.

Texas is among some states that stipulate insurers may not use a credit score as the sole reason for denying or not renewing coverage.

Some states require insurance companies to disclose to you if they used credit information in their decisions. In New York, Illinois, Florida and Texas, insurers must provide specific reasons for denying, canceling or not renewing a policy when the decision was based on credit information.

Fifteen states require insurers to recalculate credit scores every three years when setting rates, meaning you have the chance to snag lower prices at renewal time if your credit history has improved. The states are:

Arkansas
Colorado
Florida
Georgia
Iowa

Louisiana
Montana
New England
Nevada
New Mexico

New York
North Dakota
Oklahoma
Tennessee
Virginia

Your state insurance department should be able to tell you what laws apply in your state.
Long-standing debate

In Alaska, proposed legislation approved by the state Senate in March would allow insurers to use credit data when an auto or homeowners insurance policy is renewed. Current Alaska law allows credit scoring

to be used only when consumers first buy a policy.

Alaska's proposed law extends a long-running debate on the use of credit scoring that is playing out as Americans' credit scores are improving slightly.

About 1 in 5 consumers had FICO credit scores of 800 or more (out of 850) in 2015, compared with 16.9% 10 years earlier. Because credit-based insurance scores use the same factors as regular credit scores, they tend to move up or down together. This suggests that some drivers should get insurance savings if credit is used at renewal time.

The Property Casualty Insurers group says most consumers save money with credit scoring when they buy a policy. But in Alaska, that benefit is not available at renewal because credit history can't be used in pricing premiums, according to the trade association.

In Arkansas, which allows insurance scoring at policy renewal, 40% of policyholders have received a discount when renewing their policies since 2003, the group says.

A study by the Arkansas Insurance Department found that 45.9% of 2.1 million auto policies issued in 2014 had lower costs when credit information was used. In 14.8% of cases, the use of credit scoring resulted in rate increases, whereas it didn't affect the outcome in the remaining 39.3%.

When credit scoring was used in setting Arkansas homeowners insurance premiums in the same year, 57.4% had lower costs and 15.7% had increases. There was no effect on the remaining 26.9% of policies, the study found.

Unfair predictor of risk

While insurance companies say credit scoring rewards drivers deemed less risky because they have good credit, some consumer advocates say it's not a good predictor of risk in all cases and it penalizes those who are least able to pay by driving up their insurance costs.

"The people's credit scores can be poor through no fault of their own. There are people who can lose a job, for example, when their company is restructured," says Amy Bach, executive director of United Policyholders, a San Francisco-based advocacy organization for insurance buyers. Bach says a driver's

claim history, driving record and other factors are better predictors of risk than credit scores.

A credit-based insurance score cannot consider any personal information, including race, national origin, religion and gender, according to the National Association of Insurance Commissioners. Bach says credit scoring ends up being used as a proxy for race and income anyway.

“The people who are low income and of color end up with the worst credit scores and end up paying more for their insurance,” Bach says. “It’s not fair.”

Whether you’re buying auto insurance for the first time or renewing your policy, it’s always a smart idea to shop around and compare quotes. Insurance companies vary in how heavily they weigh credit and other factors in their pricing formula, and quotes can vary significantly. NerdWallet’s car insurance comparison tool can help you compare.