

## Insurance Premium Definition

Insurance permeates our everyday lives. We have insurance on the vehicles we drive, the homes and apartments we live in, and the boats and other toys we own. Health insurance even allows us to have insurance on our bodies!

Every insurance policy we own comes with an insurance premium. What is an insurance premium, what is a good insurance premium definition, and how an insurance premium is derived are common questions among people who have insurance. Although much insurance jargon seems confusing, once we understand basic definitions insurance terminology becomes very simple.

### What is an insurance premium?

The most common question regarding insurance premiums is "what is an insurance premium"? A good insurance premium definition is the amount of money you (the insured) have to pay for the policy. Most of the time, insurance premium refers to the out-of-pocket expense you will pay over the life of the policy. In other words, it's the total amount of money that will be paid to the insurance company to maintain coverage for the duration of the policy.

For example, let's say you purchase a one-year H03 home insurance policy for \$1,200 and expect to pay the policy monthly (\$100 a month). Most insurance companies would quote you a premium of ,200 rather than a month.

Although the above example is true, it really doesn't matter whether an insurance company refers to the insurance premium as an annual, bi-annual, or monthly figure. The main takeaway is that the insurance premium is the just the amount of money that you have to pay to keep the policy in effect.

### What determines an insurance premium?

Now that we have a better answer to the question what is an insurance premium and have laid out a good insurance premium definition, it's time to discuss how insurance premiums are determined. Unfortunately, this is a very difficult question to answer, and has to do with insurance underwriters.

Insurance underwriters are responsible for identifying and calculating the risk of loss and assigning the insurance premium to each policy (among the many other things that underwriters are also responsible for). When an underwriter takes this responsibility he or she is looking for every possible factor that could lead to higher or lower losses.

Each insurance company has different underwriters and different opinions about what might lead to greater insurance risk. As a result, every company is different when it comes to what goes into its insurance risk and premium calculations.

Despite the diverse methods of risk calculation, there are many common factors that most insurance companies have deemed to directly affect the loss ratio of an insurance policy. The following are the most common factors that affect the loss ratio and ultimately the premium:

- **Location.** Location is often the single most important factor when determining premiums. For example, all else being equal, the home insurance premium for a home located in the middle of Wyoming should be vastly different than the home insurance premium for a home located on Florida's coastline.
- **Age.** Age means different things for different types of policies. Car insurance premiums are lower when vehicles are old. Home insurance premiums are lower when homes are new. Life insurance premiums are lower when a person is young.
- **Credit Score.** A correlation has been found by many insurance carriers between a person's credit score and the number of claims they have filed. As a result, credit can have a large impact on premiums.

- **Claims History.** If a person has filed many claims in the past, many insurance companies believe like there is a higher likelihood of claims in the future. As a result, most companies look at your claims history over the last 3 to 5 years to determine your premium.
- **Demographics.** Your sex, education, marital status and age all play a crucial role in determining what insurance premium you are likely to receive. Typically the more stable a trait makes you, the better your insurance premium will be.
- **Health habits.** This primarily applies to life and health insurance. The amount of exercise you get, the foods you eat, and the activities you do in your free time could affect your premium.
- **Customization.** How custom your house, autos, life policy, or health policy is can have a huge impact on your insurance premium. Typically the more custom/unique, the more expensive the premium.

The above factors are just a few of the possible factors that insurance companies may use to determine your insurance premium. Most likely you'll never know all the factors that your insurance company used to derive your premium, but a basic understanding of the main factors should help you have a better understand to the question "what is an insurance premium", and "what determines the insurance premium that you pay" for all your insurance policies.