

Insurance Credit Scoring

Credit and Insurance

The use of credit-based insurance scores is a benefit to insurance customers. Credit-based insurance scoring helps more accurately price insurance based on a consumer's claim potential. That results in many consumers paying less for insurance than they otherwise would, and enables insurance companies to offer coverage to more consumers than they had in the past.

In July of 2007 after years of extensive research, the Federal Trade Commission (FTC) found that use of credit-based insurance scores leads to more accurate underwriting of auto insurance policies in that there is a correlation between insurance scores and the likelihood of filing an insurance claim.

The FTC report, *Credit Based Insurance Scores: Impacts on Consumers of Automobile Insurance*, also states that credit scores cannot easily be used as a proxy for race and ethnic origin. In other words, credit scoring predicted risk for members of minority groups in much the same way that it predicted risk for members of non-minority groups.

Key findings of the FTC study are:

Credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims. The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer. Thus, on average, higher-risk consumers will pay higher premiums and lower-risk consumers will pay lower premiums.

Several alternative explanations for the source of the correlation between credit-based insurance scores and risk have been suggested. At this time, there is not sufficient evidence to judge which of these explanations, if any, is correct.

Use of credit-based insurance scores may result in benefits for consumers. For example, scores permit insurance companies to evaluate risk with

greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would otherwise not be able to determine an appropriate premium. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums. However, little hard data was submitted or available to quantify the magnitude of these benefits to consumers.

Credit-based insurance scores appear to have little effect as a "proxy" for membership in racial and ethnic groups in decisions related to insurance.

Credit history provides a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. In fact, the use of credit-based insurance scores actually allows insurance companies to offer lower rates by providing discounts to consumers who have proven to manage their finances well. In Michigan, two-thirds of policyholders are experiencing lower rates due to credit-based insurance scoring.

Credit-based insurance scores are developed from information contained in credit reports. A credit-based insurance score provides a numeric assessment of an individual's insurance risk. It reflects credit payment patterns, length of credit history, types of credit and number of new applications for credit. Insurance companies consider only those items from credit reports that are relevant to insurance loss potential. Unlike a lender, an insurance company is not assessing a customer's income and debt, they are evaluating how customers manage their finances and credit granted to them.

In Michigan, the Office of Financial and Insurance Services, the state regulator of insurance, attempted to implement a rule that would ban the use of credit-based insurance scoring in this state. That rule was challenged by the insurance industry. The rule is now being appealed in the Michigan Supreme Court.

Prohibiting the use of credit-based insurance scoring will have a detrimental impact on policyholders. In

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Maryland, policyholders faced double-digit percentage increases in their homeowners insurance because of a 2002 state law that banned the use of insurance credit scoring. In Oregon, voters defeated a ballot proposal last November that would have prohibited the use of credit-based insurance scoring in that state.

To make fair and objective decisions, insurance companies need to have as much information as possible. Credit history provides a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. In fact, the use of credit-based insurance scores actually allow insurance companies to offer lower rates by providing discounts to consumers who have proven to manage their finances well. In Michigan, two-thirds of policyholders are experiencing lower rates due to their credit-based insurance scores.

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The use of credit is a benefit to insurance customers. It helps allocate the cost of coverage based on a consumer's claim potential. Independent studies have proven a strong connection between credit history and the likelihood of an individual filing a claim. These same sources indicate that the use of credit information increases the fairness of insurance, allows many consumers to pay less for insurance than they otherwise would, and enables insurance companies to offer coverage to more consumers than they had in the past.

A 2005 report conducted by the Texas Department of Insurance on credit-based insurance scoring found a direct correlation between credit histories and losses.

The data represented the experience of almost two million vehicle years for personal auto and more than 600,000 house years for homeowners insurance.

The Texas Department of Insurance found:

- Credit-based insurance scores provide insurance companies with additional predictive information, distinct from other rating variables, which can better classify and rate risks based on differences in claim experience.
- For both personal auto liability and homeowners, the difference in claims experience by credit-based insurance score was substantial.
- For personal auto liability, credit-based insurance score varies in importance depending on the model the insurance company is using, but was generally comparable in importance to territory and driving record for predicting claim experience.

Q & A About The Use Of Insurance Credit Score Discounts In Michigan

What does a person's credit have to do with home and auto insurance?

Independent studies have proven a strong connection between credit history and the likelihood of an individual filing a claim. People who use credit wisely are generally responsible in other areas of their lives. Research indicates that people with better credit-based insurance scores have fewer losses and less expensive claims.

Why do insurance companies use credit history in its decision making?

To make fair and objective underwriting decisions, insurance companies need to have as much information as possible. Credit history provides a

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consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. Information such as a person's age, income, ethnic group, religion, gender or marital status is not factored into insurance scores.

How does the use of credit-based insurance scoring discounts benefit insurance consumers?

The use of credit-based insurance scores actually allows insurance companies to offer lower rates by providing discounts to consumers who have proven to manage their finances well. Two-thirds of policyholders have a lower premium because of good credit-based insurance scores.

What is a credit-based insurance scoring discount?

Credit-based insurance scores are different from credit reports or scores used by lenders. An insurance credit score provides a numeric assessment of an individual's credit risk. It reflects credit payment patterns, outstanding debt, length of credit history, types of credit and number of new applications for credit. Insurance companies consider only those items from credit reports that are relevant to insurance loss potential. Unlike a lender, an insurance company is not assessing a customer's income and debt, they are evaluating how customers manage their finances and credit granted to them.

Can a consumer be denied insurance based on credit-based insurance scores?

In Michigan, state law prohibits consumers from being refused insurance based on their insurance credit information. Insurance companies here may, however, offer a discount for a good insurance credit score.

How is a consumer's privacy protected?

Access to specific credit information is very limited. Most insurance companies only see the score, not the information that went into developing it. All companies must follow the Fair Credit Reporting Act and state laws that apply to the use of credit information. These measures ensure there is confidentiality, accuracy and a legitimate need for the information.

Are credit-based insurance scoring discounts reliable?

The Consumer Data Industry Association reports that less than 1 percent of all credit report challenges result in a change once the inquiry has been fully investigated. Studies have found that credit reports are more reliable than motor vehicle records.

How can consumers find out about their credit-based insurance scoring discount?

The use of credit information is not secret. Every existing and potential policyholder deserves to know how a company uses credit information. If you don't feel your agent or company is telling you what you need to know, shop around for another agent or company that will.

Do all insurance companies use credit-based insurance scoring discounts?

Although the majority of insurance companies do use credit-based insurance scores to provide discounts to policyholders, there are some that don't. The Michigan Office of Financial and Insurance Services has a report on its website listing companies that don't use insurance credit scoring, http://www.michigan.gov/cis/0,1607,7-154-10555_12902_15784-111965--,00.html

What can consumers do to improve their credit-based insurance score?

Consumers can improve their credit-based insurance score over time by using credit responsibly. Make sure you pay bills on time, keep balances low and apply for and open new credit accounts only as needed.

What if a policyholder improves his/her credit?

A policyholder can request that the insurance company recalculate his/her credit-based insurance score.