

# Insurance Credit Scoring

## What is it?

Insurance credit score models were developed to predict future insurance losses by comparing actual policyholder loss performance data from insurance companies, with the corresponding credit bureau data of those same policyholders. These models assign a credit score, generally ranging from 100 to 900. A high insurance credit score indicates that an individual is a member of a group that is historically less likely to have future losses. A low insurance credit score indicates that an individual is a member of a group that is historically more likely to have future losses. As with all classification systems, individual performance may vary from that of the group. Assigning entities to a classification group is a common practice in the underwriting and pricing of Personal Lines insurance. This ensures entities are paying premiums based upon their chance-of-loss.

## Why are insurance companies using credit-based insurance scores?

Most insurance companies are looking for ways to keep premiums both competitive and profitable. Numerous studies have shown insurance credit scores are an accurate predictor of a classification group's likelihood to submit future claims. Independent tests were conducted to compare insurance credit scores against the claims history of policyholders. The tests found that the scores do predict the likelihood of claims. By using these scores, a company can price their policies based upon the chance of future loss. This means individuals with a lower chance of future loss will pay less for their coverage.

## The Process

### Where do insurance credit scores come from?

Scores are based on information from consumer credit reports that insurers or statistical modelers get from the three major credit bureaus: Equifax, Experian (formerly known as TRW) and TransUnion. Another company, Fair Isaac, provides the majority of the statistical models used to calculate insurance credit scores. ChoicePoint also provides statistical modeling, as well as underwriting claims information services to assist insurance companies in assessing insurability.

### How are insurance credit scores computed?

Generally, an insurer sends an inquiry to one of several vendors. The vendor then conducts a process in which specific credit report attributes are put into the model (for that individual insurance company), which then produces a score. The model assigns values to certain attributes or situations that reduce or increase the score. Negative attributes are assigned for situations such as bills that are paid late or go unpaid, high balances maintained on credit cards, collection agency entries, etc. The greater the number of negative attributes, the lower the score. The score is returned to the inquiring insurer and the insurer can then use the score in its decision-making processes.

## Implementation

### Why does the same customer get different scores from different companies?

As the use of insurance credit scoring has increased, the major credit bureaus and other credit consulting companies are introducing new products into the marketplace. At the same time, many companies are developing their own models for insurance credit scoring. The insurance credit scoring process can be viewed as a menu from which each insurance company can choose items. Although each company will have access to the same credit information, the combinations they choose will likely be different. Because of the competitive marketplace, each company wants to develop their own combination. This competition is the reason why a customer may get different scores from different insurers.

**Even if an applicant gets the similar scores from different companies, the companies seem to use the score in different ways. Why is that?**

Just as every company's underwriting guidelines and rating tools are different, insurers use insurance scores in a variety of ways. Many companies use insurance credit scores as a tool to better evaluate risk. Because competition in the Indiana insurance industry is so intense, companies will naturally try to develop different ways to utilize insurance scores to attract and retain the most profitable policyholders.

**When does Indiana Farmers Mutual use insurance credit scoring?**

Insurance scores are ordered on all Personal Lines new business. In addition, any renewal policy with losses (two or more claims in a 3-year period) or payment issues (cancelled for non-payment, insufficient funds, etc.) may be credit scored.

Every policy will automatically be re-scored at least every three years. Policyholders are permitted to request re-scoring once per year (at renewal). If the score improves significantly, the policyholder may be eligible for an upgrade (i.e. a better Program, reduced premium, etc). If the score is significantly worse (lower), the policyholder may be placed in a more expensive program, depending upon the risk characteristics (loss history, driving record, payment history, etc.). However, we will make no changes based solely on a low score.

**How does Indiana Farmers Mutual use the scores?**

For Automobile policies, the score is used to determine which Program (there are four available) an individual qualifies for and the Program then determines the premium for the policy.

For Homeowners policies, the score is used to determine which Rate Tier (there are 10 available) an individual qualifies for and then the Rate Tier determines the premium for the policy.

Note: A bankruptcy in the past 5 years, for any applicant (or either spouse), is not eligible for any Auto or Homeowners Program.

## **Multiple Scores**

**If a husband and wife have different scores, which one is utilized?**

Over time, a husband and wife will find their scores to be similar. However, if the scores are different, Indiana Farmers Mutual will utilize the highest (most favorable) of the two. The exception to this is if either spouse has had a bankruptcy within the past 5 years – and in this situation, the account is not eligible for any of our Auto or Homeowners Programs.

## **Low Insurance Scores**

**Do a large number of credit inquiries affect a credit score?**

Inquiries or "hits" are tallied whenever a consumer's credit report is accessed for the purpose of determining the consumer's credit performance. For example, whenever an individual applies for a credit card or a home equity loan, the credit check performed is considered an inquiry. As with virtually all credit checks, applications for additional credit have an impact on insurance scores. It should be noted that insurance inquiries are reflected on the credit report, but are not used in developing a score. However, it is also important for insurance customers to know that **insurance scores consider patterns of several credit management practices**, while single incidents generally have minimal impact.

**Do unsolicited invitations for credit cards affect the score?**

No. These solicitations are not considered as “hits.” Only consumer-initiated applications for credit are considered “hits.”

**What if an individual shops around for the best interest rates?**

Some consumers will apply for credit at multiple locations, looking for the best interest rate. In those situations, the applications are lumped together so that they do not create multiple “hits”, if they are completed within a 30-day time period.

**What about those who shop around for the best insurance rates? Will those insurance company inquiries create multiple “hits”?**

No. These inquiries are displayed on the credit report but are not used in calculating the score.

**What about those individuals for whom a score cannot be calculated?**

If no score can be developed, this normally means the individual does not have a recent credit history. These situations are handled in the following manner: for an Automobile policy, credit scoring is ignored with traditional Underwriting Guidelines being used to determine Program Eligibility **and** for a Homeowners policy, the individual is placed in the Rate Tier that reflects the experience of the group of individuals for which a score cannot be developed.

**Can a large open credit line create a bad score?**

A large available credit limit may adversely affect an insurance credit score. Simply put, **the whole concept of insurance scoring is about managing assets.** Those who manage their financial assets well are less likely to require the use of asset protection. Insurance is asset protection. Groups of individuals who establish available amounts of credit, which are extraordinarily high, are statistically more likely to incur difficulties in managing their assets.

## **Improving Insurance Credit Scores**

**What can an individual do to improve their insurance credit score?**

An insurance credit score is a snapshot of an individual’s chance-of-loss potential -- based on the information in their credit report that reflects their credit payment patterns over time, with more emphasis on recent information. The following are a few steps consumers can take to help improve their insurance credit score:

1. **Pay bills on time.** Delinquent payments and collections can have a major negative impact on an insurance score.
2. **Keep balances low on unsecured revolving debt like credit cards.** High outstanding debt can affect an insurance score.
3. **Apply for and open new credit accounts only as needed.** Individuals should maintain the necessary minimum number of credit cards, as well as other credit accounts.
4. **Close “0-balance” credit cards.** These should be closed in writing, and written confirmation should be received and retained. You may want to consider keeping open your oldest credit cards – this may have a positive impact on your score.
5. **Annually request a copy of credit report.** Review for accuracy and correct all errors in writing.

## Agent Access to Scores

### Why can't the agent receive the actual score?

The value of a score is meaningless without a detailed knowledge of how the company plans to utilize that score. As companies use different models, the actual raw score would be meaningless by itself. Therefore, we translate the score into a Credit Bureau Score Code or a Rate Tier – which then determines the premium for the policy.

## Fair Credit Reporting Act (FCRA)

### What are the FCRA implications?

The Fair Credit Reporting Act (FCRA) requires that applicants be informed about the consumer reports that were used to make decisions on their insurability. If an adverse decision (rejection or higher price) is made based upon an unfavorable MVR (Motor Vehicle Report), CLUE (Comprehensive Loss Underwriting) Report and/or Insurance Credit Score, the applicant must be given an opportunity to review the report for accuracy. Consumers may request a copy of their credit report through one of the following contacts:

### Contacts

<b>ChoicePoint</b>	<b>800-456-6432</b>	<b>Experian</b>	<b>888-397-3742</b>
<b>Equifax</b>	<b>800-685-1111</b>	<b>TransUnion</b>	<b>800-888-4213 or 800-916-8800</b>

## Discrimination Issues

### Are insurance credit scores unfair to minorities, women, or people who live in certain neighborhoods?

No. Quite possibly the best aspect of utilizing insurance scores is that they are objective. Consumers have the ability to control or improve their own rating based on their individual efforts. The following information is **not** used in any insurance credit scoring models:

- Ethnicity
- Income
- Religious Beliefs
- Gender
- Marital Status
- Nationality
- Age
- Address

## Summary

- Classifying risks into groups with actuarially similar chance of loss characteristics is a common practice in the underwriting and pricing of Personal Lines insurance.
- It permits those with a lower chance of loss to appropriately pay less for their insurance protection.
- Insurance credit scoring classifies risks according to their ability to manage financial responsibility.
- Insurance credit scores can be improved through active management of the factors that are used to develop a score.