

Insurance Scores Help Evaluate Risks

by Mark Hanna

Credit-based insurance scoring is a reliable underwriting tool that insurers use in addition to other characteristics to help accurately match the price of their products to the level of risk posed by any given consumer.

Studies conducted by James E. Monaghan, Fair Issac, Tillinghast Towers-Perrin, the Virginia Bureau of Insurance along with the actual experience of many insurers reveals a clear link between credit-based insurance scores and the risk of loss. What matters is not why insurance scoring predicts losses, but the fact that it does. Few insurance factors have a cause-and-effect relationship with losses, which is why Texas and no other states require a cause-and-effect relationship be shown for an underwriting variable to be lawful and valid. Accidents don't "cause" future accidents. A loss in the past does not "cause" a loss in the future. Insurers consider these factors because groups of people with these characteristics tend to have more losses. People with poor insurance scores tend to have more losses. These studies explain that there is a strong link between financial management behavior and risk-taking behavior and that people under financial stress experience more insurance losses. These explanations make intuitive sense, but the reason insurers use insurance scores is the same as for every other variable they consider: they help predict likelihood of loss.

Insurers need to be able to assess the risk of insurance loss to determine what rate to charge for the coverage provided. The more accurate the information, the closer the insurance company can come to making appropriate decisions. Where information is insufficient, applicants for insurance may pay more for insurance than they would otherwise pay. The use of insurance scoring allows insurers to reward customers who are less likely to incur losses with lower premiums.

The information used in insurance scoring models does not include personal data such as a person's ethnic group, religion, gender, family or marital status, handicaps, nationality, age, address or income. The scoring process relies on information in a person's credit record. Particular emphasis is placed on those items associated with credit management patterns proven to correlate most closely with insurance risk, such as outstanding debt, length of credit history, late payments, collections and bankruptcies, and new applications for credit.

Some people ask what credit-based insurance scores have to do with the likelihood of being hit by a hailstorm. It doesn't. But, it may point to the care and maintenance given to a home's condition and its roof. It is only common sense that insurance scores are less predicable for certain types of losses, such as hailstorms, than for other types of losses. An insured's credit history does not predict if his or her home will be hit by hail. However, even if consumers are subject to similar weather conditions, some will have less damage to their homes if they are properly maintained and have taken appropriate steps towards mitigation of losses. Moreover, in the pricing of homeowners insurance, insurers consider a consumer's potential to have all types of covered losses - not just hailstorms - and that potential varies greatly based on their insurance score.

We recommend that consumers periodically check their credit histories to ensure their accuracy. If any insurance company takes an adverse action based on any consumer's credit report, under federal law, that company must give the consumer notice of how to access the report to ensure its accuracy. All of society has a stake in the accuracy of credit reports. Banks use them, employers use them and insurers use them.

Members of the Texas Legislature are currently looking at several proposed pieces of legislation that would implement safeguards for the use of insurance scores. We welcome any new legislation that will provide both consumers and the insurance industry timely and accurate credit information. Combined with familiar factors such as years of driving experience, previous at-fault accidents, type of car or home, where you live and drive, and whether you have an alarm system, the most accurate credit information available will continue to allow insurers to differentiate between different levels of insurance risks.

In short, credit based insurance scores are actuarially valid, a source of objective information to insurers, predictive of claims, readily available in the market and beneficial to most consumers.

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