Credit Scoring

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Agenda

- What are Credit-based Insurance Scores?
- What Data is Considered / Not Considered?
- How are They Different from Lending Scores?
- How is Their Use by Insurers Regulated?
- What Objections Have Been Raised?
- What are the Benefits of Insurance Scoring?

What are Credit-based Insurance Scores?

- A numeric representation of relative insurance claim risk based on consumer credit details
- Most are “bowling” scores (higher scores are better and indicate lower risk) but some are “golf” scores
- An objective, consistent, and effective tool used with other risk factors (e.g. prior claims) to better estimate future claims risk and cost

What Variables are Considered?

- How long you’ve had credit established
- The numbers and types of accounts you hold
- Indications of recent activity, such as inquiries and newly opened accounts
- The degree of utilization on accounts, and
- Payment history, including timeliness as well as adverse public records or collection items

What's Not Considered?

- Factors such as gender, marital status, age, address, occupation, or education
- Inquiries made for account review, promotional, or insurance or consumer disclosure purposes
- Multiple inquiries for auto finance or mortgage finance when made within a 30 day period
- Collection items designated as medical on the credit report

How Do They Differ From Lending Scores?

- Insurance Models ≠ Financial Models

• Insurance Models are developed on **historical insurance losses** • Insurance Scores rank order **claim frequency or a similar metric** • Insurance scores are not as dependent on derogatory behavior	• Financial Models are developed on **bad debts or 90+ delinquencies** • Financial Scores rank order the odds of **credit "bads"** • Financial scores are more sensitive to credit delinquencies

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How is Their Use Regulated?

- Equifax is a Consumer Reporting Agency under the federal FCRA, its successors, and state analogues
- We provide credit report disclosure and facilitate dispute resolution
- Because insurance is regulated at the state level, our scores conform to specific state statutes, guidelines, and regulations (e.g. NCOIL)
- We are not an insurance company; we don't set rates or provide advisory services

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What Objections Have Been Raised?

- Earliest objections – the correlation is spurious, or it reflects other rating factors; hasn't been independently verified; scoring algorithms are secret; and consumer pre- and post-notification is missing from application
- Later objections – insurance scores must be a 'proxy' for income and/or race; they could have a 'disparate impact' on protected classes and thus violate good public policy
- Carriers are not able to show causation or to explain why the correlation is present
- Some mistakes were made in the early application of insurance scores, but improvements in practice followed

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What are the Benefits of Insurance Scoring?

- Because carriers can utilize reliable, objective information proven to be valuable in accurately assessing risk, competition in personal lines markets (home and auto) is strong, which means consumers can shop for the best coverage and rates from many providers and distribution systems
- A majority of consumers pay less as a result of credit based insurance scoring. The FTC (auto) study estimated this majority at 59%, and even higher percentages have been reported for some carriers