WHAT EVERY INSURANCE AGENT NEEDS TO KNOW ABOUT CREDIT-BASED INSURANCE SCORES

What every insurance agent needs to know about credit-based insurance scores . . .

Insurance agents have the complex job of being on the front line everyday with consumers. From dealing with complicated claims, to placing a difficult risk, to reassuring a client after a loss, insurance companies rely on the agent community to communicate with policyholders. One of the more difficult current issues that agents and customers are trying to understand is insurance scoring and use of credit reports. The mention of their use may bring to mind questions about privacy, agent liability and consumer protections. Members of the insurance industry recognize the value of providing you with the tools you need to answer such questions. We designed this brochure with the producer community and that goal in mind. It is intended to help you answer questions, and communicate the benefits of insurance scoring to your customers. Understand, however, that this is a rapidly-changing area in which practices vary from company to company.

DEFINITIONS

What are insurance scores and why do only some companies use them?

Research shows that people with certain patterns of behavior in their credit history are more likely to result in losses for the insurance company. While having a good insurance score does not necessarily mean a policyholder is a good driver or more responsible homeowner, research shows that those individuals generally file fewer and/or less expensive claims.

It is important to understand that insurance scores are not credit scores or credit reports — they are distinctly different. Insurance scores are developed differently and predict a different outcome than credit scores. Insurers use a variety of methods to assign scores. In general, though, an insurance score is a number, ranging from 100-900, that predicts the future loss of an individual insurance policyholder or applicant; a credit score, on the other hand, is also a number, generally ranging from 300-850, but it predicts the likelihood of future delinquency on credit accounts of a credit prospect or customer. (A credit report is a summary, produced by a credit bureau, of the data they have on file for a particular consumer.) Like credit score models, insurance score models calculate scores based on credit bureau data only. Yet, unlike credit bureau scores, the insurance score models were developed to predict future insurance losses, with some models examining actual policyholder performance data from insurance companies in conjunction with the corresponding credit data of that policyholder. These scores are very predictive of the frequency and severity of future losses. Overall, insurance scores consider patterns of credit management practices. Single incidents generally have minimal impact.

Every company differs in how and why they use insurance scores – one of the benefits of a competitive marketplace. Companies that use credit information find it helps supplement the underwriting picture so more accurate and precise underwriting decisions are made. This promotes a more competitive market resulting in more affordable rates.

PROCESS

Who are Fair, Isaac, ChoicePoint, TransUnion, Experian and Equifax? How do they differ?

Insurance scores are based on information from consumer credit reports that insurers or modelers get from the three major credit bureaus: Equifax, Experian (formerly TRW) and TransUnion. Fair, Isaac provides statistical models to a wide array of clients, mainly in the financial services arena, including many of the models used to calculate insurance scores. ChoicePoint is an information provider – it provides insurance companies with underwriting and claims information services to assist those companies in assessing insurability. ChoicePoint also provides statistical models.

How do you get an insurance score?

Generally, an insurer sends an inquiry to one of the major credit bureaus. The credit bureau then conducts a process in which specific credit report attributes are input into the model that then produces a score. The score is returned to the inquiring insurer. An insurer can use the score in a variety of ways in its decision-making process.

Consumer credit report information used in scoring includes:

- Payment history, collections, bankruptcies
- Outstanding debt
- Length of credit history
- New applications for credit
- Types of credit in use

History

I've been an agent for over 20 years and have only recently heard about insurer use of credit reports, credit scoring or insurance scoring. Why has there been such a high level of interest over the last few years? Are insurance companies using them more?

Insurance companies have learned that insurance scores are an accurate predictor of future loss likelihood. Over the past few years, new expertise has been developed using computer models that permit analysis of credit reports. To ensure an objective look at credit information, several vendors and insurers developed mathematical models to identify predictive characteristics of loss and then assign weights to these characteristics.

Independent tests by insurance companies and a major consulting firm that compared insurance scores against the claims history of policyholders found that the scores do predict the likelihood of claims. Also, when assessing various scoring models, insurance companies typically conduct a retrospective trial, where they run 1-year old to 2-year old data through the models being evaluated. In these studies, the models demonstrate that the lowest scoring segments have the highest loss ratios and the highest scoring segments have the lowest loss ratios.

Implementation

Why does every insurance company that I work with use insurance scores in a different way?

Just as every company's underwriting guidelines and rating tools are different, insurers use insurance scores in a variety of ways. Some companies only use insurance scores as part of the underwriting decision-making process for new policies. Others may use insurance scoring for renewal policies and rating. *All* companies that use insurance scores, though, use them as a tool to better evaluate risk. More accurate underwriting and rating will lead to a more competitive environment. As an agent, you know that the more competitive the market is, the more your customers will benefit.

INQUIRIES

THERE IS A LOT OF CONFUSION ABOUT THE EFFECT OF NUMEROUS INQUIRIES OR "HITS" ON CREDIT REPORTS. DO A LARGE NUMBER OF "HITS" AFFECT AN INSURANCE SCORE?

One way you may help your customers improve their scores is to educate them on the impact of inquiries. However, it is important to make sure you communicate to your clients that insurance scores consider patterns of credit management practices, while single incidents generally have minimal impact.

THE FOLLOWING OUTLINES THE TYPES OF INQUIRIES:

CONSUMER-INITIATED CREDIT INQUIRIES

Too many inquiries adversely affect an insurance score if the customer initiates or starts them. While a single consumer-initiated inquiry has little negative effect on an insurance score, multiple inquiries in a short period will have a greater impact. There are some exceptions to this rule.

NON-CONSUMER-INITIATED CREDIT INQUIRIES

This type of inquiry includes promotional inquiries, account review inquiries, and also consumer inquiries where the consumer has requested a copy of their own report. These types of inquiries do not affect insurance scores.

INSURANCE INQUIRIES

Insurance inquiries generally do not affect a customer's ability to get a loan. The majority of major credit providers do not use models that evaluate insurance inquiries when calculating scores. Likewise, most insurers use models that do not include insurance inquiries.

For example, under most insurance score models, multiple car dealership or mortgage inquiries in a short period of time are treated as a single inquiry. So, customers can shop around for the best deal – a sign of financial responsibility – without impacting their insurance scores.

IMPACT ON AGENTS

WHAT HAS THE USE OF CREDIT REPORTS ADDED TO MY BUSINESS?
WHAT ARE THE OPERATIONAL BENEFITS?

Agents can look at business that might have been previously rejected and enter new markets with the knowledge that each risk will be more accurately priced. All agents want to write more business — insurance scoring is an accurate tool that can expand your book of business and keep it strong. The use of insurance scores creates operational efficiencies within an agency because it allows quick responses to applications.

MULTIPLE COMPANIES, MULTIPLE SCORES

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

As the use of insurance scores becomes more prevalent, more companies are introducing scoring products into the marketplace. At the same time, many insurers themselves are using their own experience to develop their own scoring models. Think of the insurance scoring process as a menu, in which each insurance company can choose from any combination of the following:

PROVIDES CREDIT DATA	BUILDS SCORING MODELS	RUNS MODELS AGAINST CREDIT FILES	DELIVERS SCORES TO THE FINAL USER
TransUnion	Fair, Isaac	ChoicePoint	ChoicePoint
Equifax	ChoicePoint	TransUnion	TransUnion
Experian	Other Vendors	Other Vendors	Other Vendors
	Company-Specific Models	Company-Specific Report Ordering	Company-Specific Report Ordering

This competition in the marketplace is the reason why a customer may get different scores from different insurers.

FEDERAL FAIR CREDIT REPORTING ACT

What is the Fair Credit Reporting Act ? How does it affect insurance scoring?

The federal Fair Credit Reporting Act (often referred to as the FCRA), enacted over 30 years ago, expressly allows consumer reporting agencies to provide credit information to insurers for their business purposes.

The FCRA, which applies for both new and renewal business, also requires that if insurers take an adverse action on a policy (such as to deny insurance or terminate a policy) and that decision is based in whole or in part on credit information, that fact must be disclosed to the policyholder or applicant. The disclosure must include the name, address, and toll-free telephone number of the consumer reporting agency that supplied the information to the insurer; a notice of the individual's right to dispute any incorrect or incomplete information; and must inform the policyholder that he may request a free copy of his credit report from the consumer reporting agency. These disclosure requirements are the same as those required when an insurer takes an adverse action as a result of a motor vehicle report (MVR).

Generally, compliance with FCRA requirements will be the responsibility of the company. However, as business practices vary, agents may wish to clarify their obligations under the act with each company's legal department.

INCOME AND OTHER ISSUES

Does a person's income or address have an impact on their insurance score?

No. The following information is *NOT* used in any insurance score models:

~~INCOME~~ ~~ETHNIC GROUP~~ ~~RELIGION~~ ~~GENDER~~

~~ADDRESS~~ ~~MARITAL STATUS~~ ~~NATIONALITY~~

CORRECTING MISTAKES ON CREDIT REPORTS

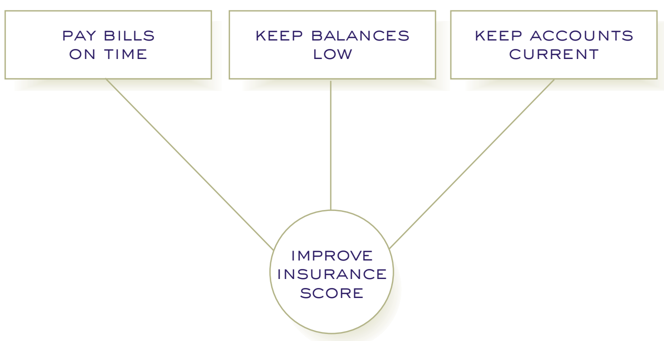
A few of my customers have discovered mistakes on their credit reports. What, if anything, can they do to make changes to their credit reports?

The FCRA gives consumers the right to challenge information in their credit report they believe to be inaccurate. If the information is found to be inaccurate, the *credit bureau* is required to promptly correct the error. Addresses and phone numbers of the three major consumer credit reporting bureaus are listed at the end of this brochure.

IMPROVING SCORES

What can my customers do to improve their scores?

An insurance score is a snapshot of your customer's insurance risk based on information in their credit report that reflects their credit payment patterns over time, generally with more emphasis on recent information. Even though you, as an agent, are not a credit counselor, there are a few things you can tell your customers to improve a score:



Pay bills on time. Delinquent payments and collections can have a major negative impact on an insurance score.

Keep balances low on unsecured revolving debt like credit cards. High outstanding debt can affect an insurance score.

Apply for and open new credit accounts only as needed.

Customers can improve their insurance scores over time by using credit responsibly.* It is also a good idea for customers to periodically obtain a copy of their credit report from the three major credit bureaus to check for any inaccuracies. See the end of this brochure for more details.

* *Insurance companies differ with regard to how often they will recheck a policyholder's score.*

GOOD NEWS

What is the good news about insurer use of credit reports and insurance scores?

There is a lot of good news out there for the majority of your customers – you need to be sure to convey the following messages when talking about insurance scoring:

The use of insurance scores allows insurance companies to give better rates to customers who are less likely to have losses.

The use of credit-based insurance scores has allowed more companies to offer more products to more people. Since insurance scores have been used, competition in the auto insurance market has increased significantly – leading to more choices for consumers.

The federal Fair Credit Reporting Act (FCRA) (15 U.S.C. 1681 et. seq.) provides numerous consumer protections. These include:

- The right to obtain a free copy of your credit report if you are adversely affected (for example, denied coverage) based on information in your credit report
- The right to contest any inaccuracies in your credit report and to have inaccurate information removed

The use of insurance scores allows for objective, consistent and accurate underwriting and/or pricing. With the use of insurance scores, subjectivity is minimized as a formula is applied that evaluates empirically derived data, allowing for an impartial underwriting and/or pricing decision.

The use of credit-based insurance scoring has led to an expansion of eligibility for insurance. There are fewer rejections for underwriting reasons, because use of insurance scores has allowed insurers to write more business.

ADDITIONAL RESOURCES

Equifax (www.equifax.com)
For a copy of your report, call 1-800-685-1111.
To dispute information in your report,
write to: P.O. Box 740241, Atlanta, GA 30374

Experian (www.experian.com)
For a copy of your report, call 1-888-397-3742.

TransUnion (www.tuc.com)
For a copy of your report, call 1-800-888-1213.
If you have a copy of your report and wish to discuss it, call 1-800-916-8800.
To dispute information in your report, write to:
P.O. Box 34012, Fullerton, CA 92831
(for residents of the West & Southwest U.S.)
P.O. Box 2000
Chester , PA 19022
(for residents of all other regions)

Consumer Data Industry Association (CDIA)
(www.cdiaonline.org)
Contact CDIA for information on the credit report dispute resolution process.
Phone 202-408-8011

ChoicePoint (www.choicepoint.net)

Fair, Isaac (www.fairisaac.com)

Federal Trade Commission (www.ftc.gov)

Education efforts courtesy of:
Alliance of American Insurers (www.allianceai.org)

American Insurance Association (www.aiadc.org)

National Association of Independent Insurers
(www.naii.org)