

FICO® Credit-Based Insurance Scores

1. Most consumers benefit from the use of insurance scores

Lower premiums—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission noted “if credit-based insurance scores are used, more consumers (59%) would be predicted to have a decrease in their premiums than an increase.” According to insurers, up to 75 percent of their policyholders pay lower premiums because of the insurer’s use of credit-based insurance scoring within their underwriting process.

Objective and timely decisions—The use of scoring enables insurers to make more accurate, objective, consistent and timely underwriting and pricing decisions. Insurance scores are snapshots of consumers’ insurance risk based on information in their credit report that reflects their credit-payment patterns over time, with more emphasis on recent information. An insurance score is the result of an objective, statistical analysis of credit report information identifying the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial patterns.

Most consumers have good scores—Most consumers manage their credit obligations well over time and, as a result, have good scores. Insurance scoring helps identify those consumers who present lower risk of loss so insurers can offer them lower insurance premiums. This helps to make insurance coverage more available and affordable to the majority of consumers.

2. Correlation between credit behavior and insurance risk has been proven

FTC concludes these scores are effective risk predictors—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission said, “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.”

Independent studies agree—Separate studies by the Texas Department of Insurance (TDI), the University of Texas, Tillinghast Towers-Perrin, EPIC Consultants and others have proven that credit-based history correlates with the risk of insurance loss. The TDI study included the following key findings: (*source: Insurance Information Institute, January 2005*)

- The average loss per vehicle for people with the worst insurance scores is double that of people with the best credit-based insurance scores.
- Homeowners insurance loss ratios (claims paid/premium paid) for people with the worst insurance scores are triple that of people with the best scores.
- Drivers with the best credit history are involved in about 40 percent fewer accidents than those with the worst credit history.

Scores are based on most accurate data—The data at credit reporting agencies is one of the most accurate sets of consumer data available to insurers. Based on studies, the error rate in credit reports is considerably lower than the error rate found in motor vehicle records.

3. It makes sense that credit habits relate to insurance risk

Overall behavior is consistent—In general, people with good credit habits demonstrate careful behavior overall. This crosses over into their driving habits, care of their automobiles, and care taken in the maintenance and safety of their homes.

4. For insurers the issue is risk, not race

FTC finds scores are not a proxy for race—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission wrote, “Credit-based insurance scores appear to have little effect as a ‘proxy’ for membership in racial and ethnic groups in decisions related to insurance. ...Tests also showed that scores predict insurance risk within racial and ethnic minority groups. ...This within-group effect of scores is inconsistent with the theory that scores are solely a proxy for race and ethnicity.”

Scores are color-blind and objective—An independent study by the Texas Department of Insurance confirmed that credit-based insurance scoring does not discriminate racially or by income. According to that study, a higher percentage of adults in low-income groups and certain minority groups (African-American and Hispanic) have somewhat lower scores compared with the rest of the adult population. However, the study also showed that each group studied receives the full range of insurance scores. This is possible only if insurance scoring is a color-blind, objective process.

5. Scores remain an effective tool during current economic conditions

Scores have shown to be very stable—In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. More and more consumers appear to be realizing the value of prudent financial and credit management practices.

Scores may decline for those directly impacted—As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case, the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.

Scores may change when lenders reduce credit limits:

- FICO® Credit-Based Insurance Scores assess a wide variety of data on credit reports, so the impact to the score from a single factor like credit limit reductions will depend on what other data is on the credit report and the amount of line reduction taken by a lender. The consumer's score could be unchanged, it could go down, or in some cases it could go up in combined response to other changes on the credit report.
- Our ongoing research indicates that lenders have reduced the revolving account limits for a relatively small percent of the population, and those line reductions have also been a relatively small amount for that population.
- An important FICO principle is to let data—rather than judgmental factors—drive any changes to our credit-based insurance scoring models. Our most recent score performance studies indicate that our scores continue to appropriately rank-order consumers based on insurance risk.
- While credit card holders don't control their credit limits, in many cases, they do control their account balances. Recent data shows that a notable number of consumers have reduced their revolving credit usage, helping to minimize any effect from lenders reducing their account limits.
- FICO continues to periodically analyze credit industry activity and its potential impact on our credit-based insurance scores going forward.

6. FICO® Credit-Based Insurance Scores are fair to consumers

Evaluate only statistically-proven data—Our insurance models are built with only depersonalized data and our scores evaluate only credit-related information from consumer credit reports. They do not consider the person's income, age, marital status, gender, race, ethnic group, religion, nationality or location. People who are in identical situations would be charged the same amount for auto or homeowners insurance, irrespective of differences in race, ethnicity or levels of income, under a rating plan that permits the use of credit-based insurance scores in underwriting.

Support anti-discrimination laws—U.S. law requires businesses to avoid deliberate bias against minority groups. Through the use of insurance scoring, only individual consumers who represent potentially higher risk pay higher premiums, regardless of their race or income.

Consumers gain control—Consumers with low credit-based insurance scores can improve their scores by improving their credit habits. Better scores can lead to lower insurance premiums for most consumers.

7. Use of insurance scoring helps stabilize and open the marketplace for consumers

Competition is good for consumers—The use of insurance scores keeps the insurance marketplace competitive, resulting in the availability of lower prices, better service, and more choices for consumers. Underwriters gain opportunities to identify and write insurance for people who in the past they may have declined because of incomplete knowledge or information. Also, a good credit history can offset negative underwriting factors such as a prior loss, thereby enabling someone to get insurance who might otherwise have been denied or charged more.

8. FICO® Credit-Based Insurance Scores are different from FICO® credit-risk scores

Predict very different things—While both types of scores use information from consumer credit reporting agency files, they predict very different outcomes. Credit-risk scores such as FICO® Scores are built to predict the likelihood of delinquency or non-payment of credit obligations. Insurance scores are built to predict the probability of future insurance losses.

Insurance scores apply to customer groups—Individuals can have low insurance scores without ever having filed an insurance claim. That's because insurance scores are applicable to customer groups. Consider that some teenage drivers will never have an accident. As a group, however, teenage drivers experience many accidents. Similarly, as a group, customers with low insurance scores tend to have more losses than those with high scores.

9. Use of insurance scoring frees insurers to focus on exceptional cases

More attention for people with unusual needs—Insurers use insurance scoring to help make routine underwriting and pricing decisions. This frees underwriters to spend more time helping applicants or existing customers who have unusual situations or needs.

10. FICO is committed to helping consumers obtain credit and insurance coverage fairly and affordably

Free educational resources—We have established web sites such as www.insurancescore.com and educational programs to help consumers become better informed about credit-risk and insurance scores. These programs explain the credit behaviors that will help consumers improve their scores.

Every score includes explanation—Each insurance score based on credit reporting agency data is accompanied by up to four (4) score reasons to help consumers who receive an adverse action notice identify where they may have lost points, providing insight into how credit behaviors are impacting scores, underwriting decisions and pricing. Consumers who believe these score reasons misrepresent their credit history can examine their credit reports and request investigation of any information that they find to be inaccurate or incomplete.

Opportunities to address issues—We encourage our clients to use scores responsibly. We also welcome opportunities to address scoring issues with credit grantors, insurance companies, regulatory and legislative bodies, consumer advocates, consumers and the media.

11. FICO recommends the following guidelines to help consumers manage their scores in either a stable or volatile economy

Make all your credit and loan payments on time—The calculation of FICO® Credit-Based Insurance Scores weighs payment history more heavily than any other variable on your credit report. Making all your payments by their due date is a key ingredient for a good score. When money is tight, pay at least the minimum amount due on credit card debt to avoid being reported delinquent. Overdue bills can significantly lower your score, including unpaid debts sent to collection agencies.

Keep credit card balances low—Individuals with good scores come from every income level, and in tough times they tend to scale back their use of credit cards and pay down their debts. If your credit card balances are close to your credit limits, budget your finances to make debt reduction a top priority. Your indebtedness is the second most important factor for scores.

Open new credit cards or loans only when necessary—Opening new credit accounts may cause your score to go down so be cautious about taking on new debt. This includes thinking twice before opening a retail store card just to get an extra 10 percent off your current purchase.

Get your free annual credit report from each national credit reporting agency through www.AnnualCreditReport.com, and check your credit history carefully for errors. Contact the appropriate credit reporting agency if you spot an error so they can investigate it.



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