

## MINUTES OF THE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE

The meeting was called to order by Chairperson Senator Ruth Teichman at 9:30 a.m. on February 21, 2003 in Room 234-N of the Capitol.

All members were present except: Senator Brungardt, excused; Senator Buhler, excused; Senator Corbin, excused; Senator Feleciano, excused; Senator Steineger, excused.

Committee staff present: Ken Wilke, Office of the Revisor of Statutes  
Dr. Bill Wolff, Kansas Legislative Research Department  
Marlene Putnam, Committee Secretary

Conferees appearing before the committee: Lamont Boyd, Fair, Isaac's Global Financial Services

Others attending: See attached list

Senator Teichman introduced Lamont Boyd, CPCU, Solutions Market Manager for Fair, Issac's Global Financial Services. Mr. Boyd reported that consumers have become increasingly aware of credit risk scores-the scores, based on information in a consumer's credit report that lenders use in their decision-making processes.

- **Insurance Credit score is Different.** A different kind of a score is used by many leading personal lines insurers to help evaluate the risk of insurance applicants and policyholders. This score, generically called an insurance risk score is also based on current credit report data and calculations using models built by Fair, Isaac . However, there are important distinctions. The credit risk models are built to predict the likelihood of delinquency or non-payment of a loan.
- **The insurance risk models** predict the likely loss on any individual. Most insurers use an insurance risk score along with motor vehicle report, claims report, home condition, and other kinds of information in their decision making process. Scores are generally not used in isolation to set pricing or to deny insurance to an individual..


Statistics prove a person who chooses to manage their credit well also tends to manage their risk well and tends to have fewer losses. Don't know why, but the opposite is also the case. Those who don't manage their credit well tend to not manage risk well. I don't know why this is the case, but it happens over and over, he related.

- Data elements **NOT** used in Insurance Scores.
- Income
- Age
- Gender
- Health Status
- Marital Status
- Nationality
- Net Worth
- Occupation
- Race
- Religion
- Location

(See attachment 1)

Meeting Adjourned

2-21-04



**Insurance Bureau Scoring**  
Effectively Using Consumer Credit Information For Insurance Underwriting

Lamont D. Boyd, CPCU  
Fair, Isaac & Company, Inc.

*Key difference*

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**Fair, Isaac & Company, Inc.**

- Founded in 1956, by
  - William R. Fair
  - Earl J. Isaac
- Initially
  - Better credit decisions by statistics than by traditional judgmental methods
- Now
  - Better Decisions Through Data

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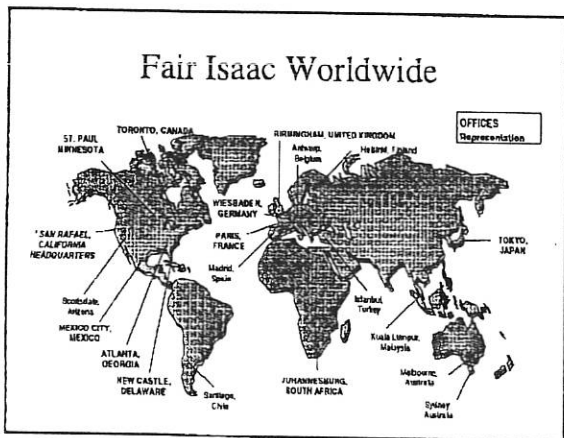
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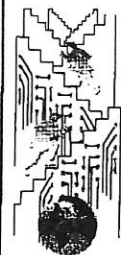
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Attachment 1*

### Fair, Isaac & Company, Inc.



- Industries served
  - Insurance, Finance Services, Government, Healthcare, E-Business, Telecommunications
- Global experience
  - Offices and representation on six continents

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### Industry Penetration



- 24 of 25 largest credit card issuers
- 75 of 100 largest US banks
- All of the major home mortgage lenders
- 350+ insurers

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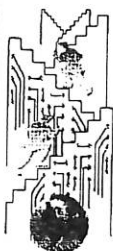
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### Fair, Isaac & Company, Inc.



- Participation in NAIC White Paper - "Credit Reports and Insurance Underwriting"
- NAIC Subgroup visited Fair, Isaac 8/95
- Tillinghast study confirmed strong relationship of Insurance Bureau Scores to loss ratio relativities

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### Credit Data

- Fair Credit Reporting Act (FCRA)
  - Original statute in 1970
  - Major amendments in 1996; effective September 30, 1997
  - Allows consumers access to their files and specifies a complaint procedure




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### Credit Data

- Fair Credit Reporting Act (FCRA) (cont'd)
  - Requires users to have permissible purpose and requires FCRA adverse action notices
  - Imposes accuracy obligations on furnishers of information




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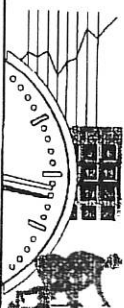
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### Data Elements Not Used in Insurance Bureau Scoring Models

- Income
- Age
- Gender
- Health Status
- Marital Status
- Nationality
- Net Worth
- Occupation
- Race
- Religion
- Location




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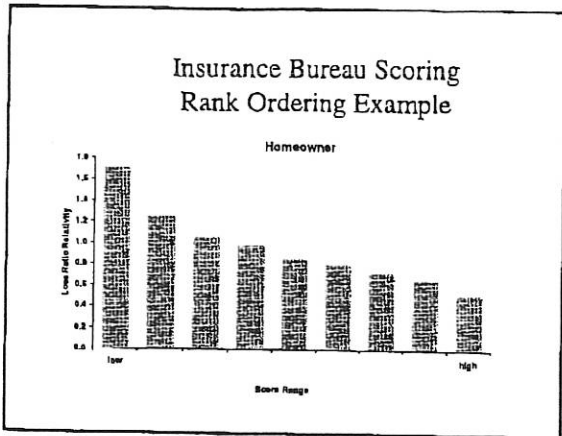
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### Summary



- FCRA makes consumer credit information available for Insurance Underwriting and Marketing
- Tillinghast Study confirms loss ratio relativities and Insurance Bureau Scores relationship
- Insurance Bureau Scores summarize credit history succinctly and nothing else

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### Summary



- Relationship between how people manage their credit and how they manage their risk is significant
  - Responsible credit managers are responsible risk managers

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### Summary

- Insurance Bureau Scores provide a fair underwriting tool
  - Insurance Bureau Scores do not unfairly discriminate
  - Insurance Bureau Scores do not look at race, creed, gender, marital status, income, age, etc.
  - Insurance Bureau Scores can be used to remedy unfair discrimination




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### Summary

- Scoring leads to precision underwriting
  - Insurance Bureau Scores facilitate consistent and objective underwriting
- Insurance Bureau Scores help to reduce premium subsidies/inequity




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### Summary

- What can be done to improve scores?
  - Pay bills on time. If you've missed payments, get current and stay current
  - Keep balances low on credit cards and other revolving credit
  - Apply for and open new credit accounts only as needed
  - No quick fix
    - Improving your score will take time
    - Insurance Bureau Scores reflect payment patterns over time with more emphasis on recent information




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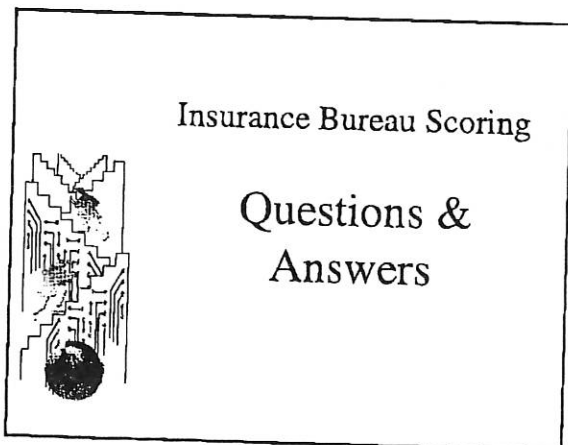
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# ANSWERS

## to Your Questions About Insurance Bureau Scores

### [1] WHAT IS AN INSURANCE BUREAU SCORE?

*YOUR SCORE WILL IMPROVE OVER TIME THROUGH A PATTERN OF RESPONSIBLE CREDIT USE.*

An Insurance Bureau Score is a snapshot of a consumer's insurance risk picture at a particular point in time based on credit report information. Insurers use Insurance Bureau Scores along with motor vehicle records, loss reports or application information to evaluate new and renewal auto and homeowner insurance policies. It helps them decide, "If we accept this applicant or renew this policy, will we likely be exposed to more losses than our collected premiums will allow us to handle?"

Insurance Bureau Scores are based solely on information in consumer credit reports. The scores are dynamic, changing as new information is added to a consumer's credit report. Insurers will typically ask for a current score when they receive a new application for insurance so they have the most recent information available.

### [2] WHERE DO INSURANCE BUREAU SCORES COME FROM?

Insurance Bureau Scores are based on information from consumer credit reports that insurers get from the three major credit bureaus: Equifax, Experian (formerly known as TRW) and Trans Union. Information used in scoring includes:

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

*AN INSURANCE BUREAU SCORE IS A SNAPSHOT OF YOUR INSURANCE RISK PICTURE AT A PARTICULAR POINT IN TIME BASED ON CREDIT REPORT INFORMATION.*

### [3] WHAT'S NOT INCLUDED IN AN INSURANCE BUREAU SCORE?

Insurance Bureau Scores do not use the following information:

- Ethnic group
- Religion
- Gender
- Familial Status
- Handicap
- Nationality
- Age
- Marital Status
- Income
- Address

*REVIEW YOUR CREDIT REPORTS ONCE A YEAR AND REPORT ANY ERRORS TO THE CREDIT BUREAUS.*

### [4] WHY DO INSURANCE COMPANIES USE INSURANCE BUREAU SCORES?

Insurance companies use scores to help them issue new and renewal insurance policies. Insurance Bureau Scores provide an objective, accurate and consistent tool that insurers use with other applicant information to better anticipate claims, while streamlining the decision process so they can issue policies more efficiently. By better anticipating claims, insurers can better control risk, enabling them to offer insurance coverage to more consumers at a fairer cost.

*INSURANCE BUREAU SCORES PROVIDE UNDERWRITERS AN OBJECTIVE, ACCURATE AND CONSISTENT TOOL THAT, USED WITH OTHER UNDERWRITING INFORMATION, HELPS THEM ISSUE NEW AND RENEWAL INSURANCE POLICIES.*

### [5] HOW DO YOU KNOW IT WORKS?

Independent tests by insurance companies and a major consulting firm compared Insurance Bureau Scores against the claims history of policyholders. The tests demonstrated that the scores do predict the likelihood of claims.

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# ANSWERS

## to Your Questions About Insurance Bureau Scores

### [6] HOW CAN I FIND OUT MY SCORE?

While you can get copies of your credit reports from credit bureaus, only insurance companies can get Insurance Bureau Scores. However, your insurance company or its agent can tell you the main reasons behind your score.

Keep in mind that your score is one of many pieces of information an underwriter uses to review a policy. Factors like motor vehicle reports and application information also impact an insurer's decision. Also, remember that the score changes as new information is added to your credit report.

### [7] HOW CAN I IMPROVE MY SCORE?

An Insurance Bureau Score is a snapshot of your insurance risk picture based on information in your credit report that reflects your credit payment patterns over time, with more emphasis on recent information. To improve a score, you should:

- Pay bills on time. Delinquent payments and collections can have a major negative impact on a score.
- Keep balances low on unsecured revolving debt like credit cards. High outstanding debt can affect a score.
- Apply for and open new credit accounts only as needed.

You can increase your score over time by using credit responsibly. It's also a good idea to periodically obtain a copy of your credit reports from the three major credit bureaus to check for any inaccuracies.

### [8] WHAT IF I AM TURNED DOWN FOR INSURANCE?

If consumer credit information played a role in an insurer's decision to decline your insurance policy, the federal Fair Credit Reporting Act (FCRA) requires that the insurer tell you, and give you the name of the credit bureau that provided the information. In these situations, you are entitled by law to receive a free copy of your credit report to review, in order to help you understand how to better manage your credit or to challenge any errors that might appear on your report.

### [9] WHAT IF THE INFORMATION IN MY CREDIT REPORT IS WRONG?

If you find errors in your credit report, you should report the errors to the credit bureau. By law, the credit bureau must investigate and respond to your request within 30 days. If you are in the process of applying for an insurance policy, you should immediately notify your insurance company about any incorrect information in your report. Small errors may have little or no effect on the score. If there are significant errors, the insurance company may choose to disregard the score and rely more on other underwriting information to make a decision on your application.

Make sure the information in your credit report is correct by reviewing your credit report from each credit bureau at least once a year. Call these numbers to order a copy (*a fee may be required*):

Equifax: (800) 685-1111

Trans Union: (800) 888-4213

Experian (formerly TRW): (888) 397-3742

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### SCORING FACTS AND FALLACIES

**FALLACY:** With scoring, computers are making the underwriting decisions.

**FACT:** Computers don't make underwriting decisions, people do. While a computer does calculate an Insurance Bureau Score, the score is only one of several pieces of information that underwriters use to help make a decision on new and renewal policies. Some insurance companies use scores to help them decide when to ask for more information from the applicant.

**FALLACY:** A poor score will haunt me forever.

**FACT:** Just the opposite is true. An Insurance Bureau Score is a snapshot of your insurance risk picture at a particular point in time. Your score changes as new information is added to your credit bureau file. Over time, your score changes gradually as you change the way you handle your credit responsibilities. Because recent credit information is more predictive than older information, past credit problems will impact your score less as time passes. Insurance companies typically request a current score when you submit a new application so they have the most recent information available.

**FALLACY:** Insurance Bureau Scores are unfair to minorities.

**FACT:** Insurance Bureau Scores do not consider ethnic group, religion, gender, marital status, nationality, age, income or address. Only credit-related information is included, and its use is governed by the FCRA and Equal Credit Opportunity Act.

Insurance Bureau Scores have proven to be an accurate and consistent measure of insurance risk for all people who have some credit history. In other words, at a given score both non-minority and minority applicants present an equal level of insurance risk, or the likelihood of future insurance claims.

**FALLACY:** Scoring is an invasion of my privacy.

**FACT:** Insurance companies have used consumer credit information to assist in their underwriting decisions since the FCRA was enacted in 1970. An Insurance Bureau Score is simply a number that provides an objective and consistent summary of that credit information. In fact, by using scores, some insurance companies don't need to ask for as much information on their application forms.

**FALLACY:** My Insurance Bureau Score will be hurt if I contact several insurance companies who each access my credit report.

**FACT:** Insurance company requests or "inquiries" are not considered by Insurance Bureau Scores and will not affect your score.



# Insurance Risk Scores: Forecasting Claim Performance Through the Use of Credit Data

By LAMONT D. BOYD



In the past several years, consumers have become increasingly aware of credit risk scores – the scores, based on information in a consumer’s credit report that lenders use in their decision-making processes. A credit risk score is a number that quantifies a consumer’s credit risk at a specific point in time. Fair, Isaac and Co., Inc. provides predictive technology for decision-making solutions to the financial services industry and builds mathematical models to develop FICO® scores, the most well known of credit risk scores. These scores are available from any of the major credit reporting agencies (Equifax, Experian and TransUnion).

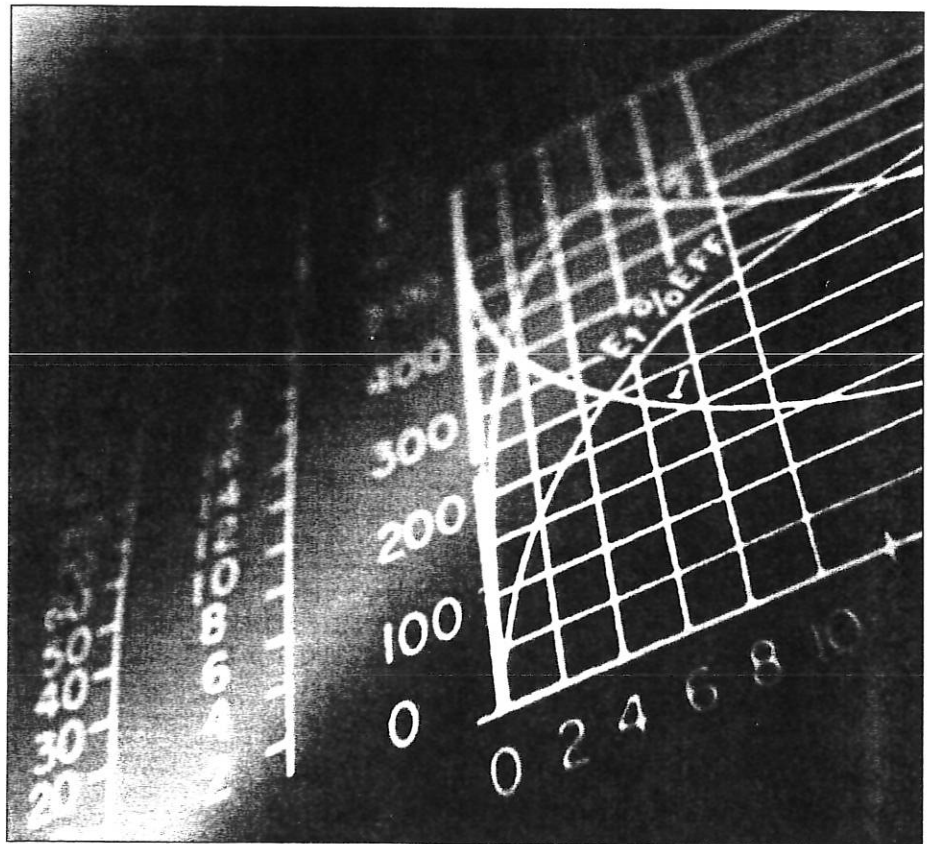
These models evaluate current credit data on an individual consumer to produce a score that predicts the likelihood that the consumer will become delinquent on a credit obligation in the near future. Credit risk scores range from an estimated low of 300 (most risky) to a high of approximately 850 (least risky). They are used by financial institutions and retail credit grantors for all kinds of decisions: whether or not a consumer gets a credit

card, what kind of an interest rate a consumer might qualify for on a mortgage loan, or whether or not the consumer’s credit limit is raised.

## Insurance Credit Score is Different

A different kind of a score is used by many leading personal lines insurers to help evaluate the risk of insurance applicants and policyholders. This score, generically called an insurance risk score (different credit bureaus have different names for the scores they sell), is also based on current credit report data and calculations using models built by Fair, Isaac.

However, there are important distinctions. The credit risk models are built to predict the likelihood of delinquency or non-payment of a loan. The insurance risk models, by contrast, are built to predict the likely loss ratio relativity on any particular individual. A loss ratio is the ratio of losses to premiums of an applicant or book of business and is generally expressed in terms of percentages. For example, if an insurance company paid



\$700 in claims on a policyholder that paid \$1,000 in premiums, the loss ratio for that policyholder would be 70 percent.

Loss ratio relativity, on the other hand, is the ratio of an individual or subgroup's loss ratio to that of the entire group. Loss ratio relativity is generally expressed as a decimal. For instance, if a policyholder had a loss ratio of 140 percent and the overall population's loss ratio was 70 percent, the policyholder would have a loss ratio relativity of 2.0, representing a loss rate for the individual of two times the average loss rate for the overall population. Insurance risk scores range from the 100's to the 900's: the higher the score, the lower the likely loss ratio relativity and the better the risk.

To develop the bureau-based insurance risk score models, Fair, Isaac follows rigorous statistical methodology and gathers data on millions of consumers and multi-millions of dollars in claims. In the model development process, advanced technology is used to empirically determine the correlation of hundreds of credit variables (for example, the number of 60 day delinquencies a consumer has in his or her credit file), with later claim performance.

The variables determined to be most predictive of future losses are used to build the models, which are then deployed through the bureaus (some models are also available via ChoicePoint®). The final models forecast the likely loss ratio relativity of each new applicant at the time of application, or in the case of a policyholder, at the time of renewal. To ensure higher accuracy, many separate models are built for the major types of both property insurance and auto insurance. Insurers that choose to add credit data to the mix of information they evaluate when making decisions can purchase a score when they purchase the credit bureau report.

### Use of Insurance Risk Scores

Insurance risk scores are also used in different ways than a credit grantor would use a credit risk score. When a personal lines insurer makes an evalua-

tion, a person's credit risk score is one of many factors. For example, most insurers use an insurance risk score along with a motor vehicle report, claims report, home condition and other kinds of information in their decision making process.

Scores are generally not used in isolation to set pricing or to deny insurance to an individual. They are often used to streamline resource use and to reduce the costs of ordering information. For example, a company may set a policy that determines that it will not order motor vehicle or claims reports on new business applications above a certain high cutoff score, thereby saving a large sum of money. Or, the insurer may determine it needs to focus on more careful underwriting review and collect additional information on applicants who fall below a certain score.

In fact, for over a decade insurers have used bureau-based insurance risk scores because of the benefits they bring. Among the advantages of insurance risk scores:

- **Consistency.** Insurance risk scores are usually applied in an automated environment, in combination with the insurer's rules and other criteria. All applicants are thus treated according to a consistently applied standard.
- **Fairer decisions.** Insurance risk scores are completely non-discriminatory and use no data on gender, nationality, ethnic group, address or income. Only credit-related information is included, and its use is governed by the Fair Credit Reporting Act (FCRA).
- **Better decisions.** Insurers can better forecast future performance on one individual or an entire book of business, leading to improved management and higher quality books of business.
- **Efficiency.** Streamlined operations and better use of underwriting and other resources allow insurers to pass savings along to policyholders. Also, applicants and policyholders enjoy the added benefit of faster decision-making.

### Liabilities of Insurance Risk Scores

One objection raised to the use of insurance risk scores in underwriting decisions is, "I can see why a score based on credit data can forecast credit performance, but I don't see how it can forecast insurance claim performance." If one looks at it from the perspective of responsibility, however, it is perhaps not surprising that poor credit reflects a greater degree of claims risk, and vice versa. Individuals who use credit wisely also may take better care of their automobiles and homes and in general, behave with greater prudence.

One should note that the predictive power of the scores is not claimed to be based on a causal relationship, rather that it is based on empirical correlation, and this correlation can be validated. The consistently high performance of the insurance risk score models has been validated many times, in fact, both by Fair, Isaac and by independent entities—including Tillinghast-Towers-Perrin actuarial consultants and the Virginia Bureau of Insurance. Furthermore, while there are other insurance scores available, only Fair, Isaac insurance bureau scores were the subject of the Tillinghast-Towers-Perrin study, and therefore, the high performance reported in this study should only be attributed to Fair, Isaac's scores.

The real proof of their efficacy, however, is that hundreds of leading insurers in the US and Canada who use insurance risk scores continue to see improved results. As insurers continue in their quest to improve operational efficiency, better manage their book of business, and offer the best value to their customers, more and more of them are listening to what scores have to say.

*Lamont D. Boyd, CPCU serves as Solutions Market Manager for Fair, Isaac's Global Financial Services. In his position, Mr. Boyd is responsible for the identification of opportunities that make use of Fair, Isaac's credit-based insurance scoring technology for the insurance industry. Prior to joining Fair, Isaac in 1993, Mr. Boyd served 19 years with a major property and casualty insurer. He is currently chairman of the CPCU Society's Information Technology Section.*