



Southwestern Insurance Information Service

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The Facts About Credit Information and Insurance

The use of credit history, one of many underwriting tools to help identify people who could have insurance losses, is not a new concept and one that has received strict scrutiny from insurance regulators and consumer advocates around the country. Some insurers have used individual credit histories in underwriting insurance since the 1980s and the Fair Credit Reporting Act strictly regulates the use of credit reports by insurers.

The relationship between how a person handles their personal finances and the possibility of insurance losses has been established and accepted for many years. People with their financial house in order tend to have fewer losses. Insurance companies need to charge premiums that are adequate to pay for expected losses. Any information that improves the ability to assess risk lessens the extent to which those who present high potential risk are subsidized by those who present lower potential risk.

Over the years, there have been a host of independent studies to determine the link between credit histories and insurance losses.

One of the first major studies was conducted in 1996 by Tillinghast-Towers Perrin at the request of the National Association of Insurance Commissioners. The findings of the study indicated a 99 percent probability that there is a relationship between credit scores and the likelihood of someone filing a claim.

In 2003, The University of Texas McCombs School of Business completed a study of the relationship between credit and insurance losses. The study was based on a database of 150,000 automobile insurance policies. The study concluded that there is a significant connection between credit scores of individual insurance consumers and losses incurred for that policy. Overall, lower credit scores were associated with larger losses.

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The Virginia Bureau of Insurance issued a report in December 1999 to the Virginia Assembly on the use of credit information. The Bureau examined the development and application of one scoring system and came to the following conclusion. “Based on the Bureau’s findings, there appears to be concrete data indicating that a correlation exists between credit scores and losses. From this purely statistical perspective, therefore, the Bureau is unable to make a recommendation prohibiting the use of credit scores in the underwriting process.”

The most exhaustive study of this issue was conducted by the Texas Department of Insurance, released in January 2005 and looked at data for 2.2 million insurance policyholders. The data used in this study surpasses statistical information used in many other published studies and includes race and ethnicity at the individual level rather than the aggregate level used in previous studies (zip codes, census tract data). The study methods, findings and conclusions were peer reviewed by two leading universities and the Texas Office of Public Insurance Counsel.

Among the conclusions of this study is “Preliminary findings indicate a strong relationship between credit scores and claims experience. Poor credit scores are associated with increased claims activity.”

In January 2005, the Dr. Robert Hartwig, Senior Vice President and Chief Economist for the Insurance Information Institute analyzed the Texas Department of Insurance study and came to the following conclusions:

- The average loss per vehicle for people with the worst credit scores is double that of people with the best scores for this group.
- Homeowners insurance loss ratios for people with the worst credit scores are triple that of people with the best scores for this group.
- Drivers with the best credit are involved in about 40 percent fewer accidents than those with the worst credit for this group.
- Those with the poorest credit histories generated auto losses more than double that of those with the best scores.

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Even though insurance scoring models do not consider ethnicity, religion, marital status, handicap, address, nationality, age, income or public assistance sources of income, some critics believe that the use of credit information by insurers may negatively impact certain ethnic groups or people of lower income.

Dr. Hartwig's analysis included statistics that show homeownership among minorities has risen up to 48 percent between 1994 and 2003, to record high levels. This clearly illustrates that minority groups are purchasing homes and are using their good credit to purchase the insurance to protect those homes.

This study also shows that between 1995 and 2001 homeownership rates have increased much faster for minority groups than for whites.

- Hispanic American homeownership increased 45.9 percent.
- African American homeownership increased 23.2 percent.
- White Americans owning homes increased 10.7 percent.

Because you can't buy a home without insurance, the statistics show that insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.

By using credit information, insurance companies have reported they are able to accept some customers that would have been denied coverage using more traditional underwriting criteria.

The Texas law related to use of credit in insurance scoring is among the strongest and most consumerprotective in the country. People with little credit history, credit problems due to medical bill collections or extraordinary life events and multiple inquiries for the purchase of a car or home are not negatively impacted by the use of credit scoring in insurance.

From all the studies cited, it would be logical to conclude that restricting the use of credit histories would result in financially prudent policyholders, many of whom are minorities or in low income households, subsidizing those who are less responsible and pose greater risks.

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