

## Insurance Underwriting and Credit Scores

Although the purchase of auto and homeowners insurance is not optional for most people, insurers can pick and choose who they will cover--and frequently those choices have more to do with finding the "preferred" customer than with an individual's risk.

**U**nfortunately, most families can't function these days without insurance—but insurance companies are not required to sell it to all of us. Texas doesn't even require them to sell it to everyone with a good driving history or a well maintained home.

Auto and homeowners insurance are so important to Texans that they can reasonably be described as "essential" insurance products. But consumers who apply for coverage may be denied, asked to pay more, or placed in an unregulated affiliate and not even told why.

People with few accidents and tickets for auto insurance and people who take good care of their home may or may not be assured access or an affordable rate for coverage. Underwriting guidelines (each company's rules about who they will take as a customer and how much they will charge) are not revealed to consumers.

Texas should fundamentally reform access to auto and homeowners' insurance:

- Require that the factors be open to public review and scrutiny.
- Require prior approval for underwriting standards for essential coverage.
- Establish standards that assure fairness,

### In Short

Insurers insist that credit scores relate to insurance risk, although a bad credit score can clearly result from actions unrelated to a driver's safety or a home's maintenance. People get problem credit when they have a medical emergency, or suffer temporary job loss, but not because they are prone to collisions.

loss mitigation, broad availability of essential coverage, and the spreading of risk.

A system of review and approval of underwriting criteria would require:

- Public review and

TDI approval for underwriting guidelines related to auto and homeowners insurance;

- Data supporting the guideline submitted for public review;
- A hearing to analyze the implications of the use of the guideline--including the implications for risk spreading and availability, whether the guideline predicts future losses and whether it promotes loss mitigation; and
- The impact on those who may have difficulty affording coverage.

### THE USE OF CREDIT SCORES TO UNDERWRITE

The insurance industry claims a correlation exists between credit score and losses. Even assuming this is true, such use of credit scores may be unfair for consumers.

A December 2002 Study by the Consumer Federation of America and the National Credit Reporting Association found large discrepancies between the credit scores reported from the three major bureaus. It also found a substantial amount of missing information — 78 percent of files had a missing revolving account in good standing. More serious errors of commission appeared in a significant portion of files. In 43 percent of the files, reports on the same accounts conflicted in regard to how often consumers had been late by 30 days. In 29 percent of the files, there was conflicting information about how many times the consumer had been 60 days late. And in 24 percent of the files, conflicts existed about 90-day delinquencies. Reported delinquencies have a

large effect on credit scores.

Even some people with correct histories but poor scores experience financial hardship for reasons often beyond their control: divorce, job loss, and catastrophic medical problems. When these events happen, or errors exist, an individual who does not actually present a higher risk of loss than a person with a better score is punished, and ends up subsidizing others by paying a higher rate.

More fundamentally, consumers reasonably wonder whether it is fair for a consumer with a poor driving record but a good credit score to get cheaper insurance, while drivers with clean records but poor credit scores pay more or cannot get coverage at all.

Because of the problems and potential abuses regarding the use of credit scores to underwrite essential insurance, it should be prohibited.

### RECOMMENDATIONS

We recommend the Legislature reform insurance underwriting for essential automobile and homeowners insurance in Texas:

- Require prior approval of underwriting practices for automobile and homeowners insurance;
- Assure the guidelines:
  - (1) promote loss mitigation;
  - (2) do not unfairly impact specific groups (low-income, minorities);
  - (3) fairly spread risk based on probable loss costs; and
- Ban the use of credit scores for auto and homeowners insurance.

