



# INSURANCE CREDIT SCORING

**Think your credit score only determines whether you can get a loan or a mortgage? *Think again.***

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Insurance companies across the state are plugging credit histories into their computers to determine how much consumers will have to pay for home and auto insurance. For several years, insurance companies have concocted secret formulas they claim can connect your credit history to your driving skills or the likelihood that you will file a claim if hail damages the roof of your home.

The credit scoring formulas—or “models” as they are called within the industry—are now available for public inspection. Insurance companies are also required to alert policyholders if the formula results in an adverse action against them—such as being moved to an unregulated subsidiary or dropped altogether.

We now know that insurers are raising rates by as much as 400% based solely on a person’s credit score.

We encourage consumers to shop the market when purchasing insurance for their home or car. A company’s use of personal credit information is an important factor. The bottom line for Texas consumers is making sure credit scoring does not unfairly raise their auto or homeowners rates. The following sections are designed to help consumers determine if and how credit scores are being used to determine their insurance rates.

## **IS YOUR HOME OR AUTO INSURER USING CREDIT SCORING?**

After widespread public outcry against credit scoring, the veil of secrecy over the practice was lifted just enough to let the public see the formulas used to generate credit scores and let us know which companies are using credit scoring.

### **Does My Home or Auto Insurer Use Credit Scoring?**

The Texas Department of Insurance keeps an updated list of which home and auto insurers use credit scoring to determine whether you will be sold a policy and/or how much you will have to pay in premiums. The vast majority of auto and homeowners insurance companies use some form of insurance credit scoring. This list can be viewed at the Department of Insurance website at: <http://tdi.state.tx.us/company/creduse.html>.

### **Does Each Company Use the Same Credit Scoring Formula?**

No, dozens of different formulas—or models—are used in Texas. Some companies create their own credit scoring formulas, but most insurers buy various credit scoring models from ChoicePoint or Fair Isaac Corporation, which are large data analysis and data mining companies. Different credit scoring models will produce different credit scores from the same credit report—and different companies interpret the data in varying ways—making the practice arbitrary and inappropriate.

### **What Criteria are Used in Credit Scoring Formulas?**

Texas Watch has sifted through all of the previously secret formulas—known as credit scoring “models”—to help you understand how insurance companies are using information found in credit reports to determine insurance rates for Texas drivers and homeowners. Credit scoring models are used to turn information found in your consumer credit report into a numerical credit score that insurers use to determine your eligibility and rates.

## **HOW CREDIT SCORING UNFAIRLY RAISES RATES**

### **Discriminatory Practice Used to Raise Rates**

Numerous Texans with good driving records and no insurance claims are finding that their long-time auto insurance company has suddenly and drastically increased their rates. The explanation: insurance credit scoring.

### **What is an Insurance Credit Score?**

An insurance credit score is determined by running information found in your consumer credit report through insurance industry formulas. This insurance credit score is different from the type used by banks or lenders to determine credit worthiness.

### **What Does an Insurance Credit Score Measure?**

The insurance industry claims that the score is an accurate predictor of your insurance risk—how likely it is you will get into an auto accident, suffer flood damage, etc. These industry claims defy common sense, yet the insurance industry refuses to document any cause and effect relationship between credit score and driving ability. How is a person who paid a bill late once, for example, any more likely to be hit by another driver or have a hailstorm ruin their roof?

## How are Insurance Credit Scores Used?

Many auto insurance companies use credit scores. They can be used to determine if you will even be sold a policy, your rates, or whether you qualify for monthly installments. Credit scores can be factored in on new policies, at renewal time, or both. For the first time ever, these scores are finally available for inspection.

## Why is Insurance Credit Scoring Bad for Consumers?

Since insurance credit scoring information is kept secret, consumers and regulators cannot know if it is accurate or being used properly. Insurance credit scores tend to discriminate against senior citizens, racial minorities, small business owners, people with little or no credit, victims of identity theft, people who have been laid off or divorced and people who have experienced a medical catastrophe. Texas Watch is calling on state leaders to ban the use of credit scoring in issuing or renewing insurance policies.

## TOP 10 RIDICULOUS BUT REAL INSURANCE CREDIT SCORING FACTORS

The insurance industry has long claimed it has a secret formula that connects credit scores to driving risk. In 2003 the Texas Legislature decided it was time to uncover those secret formulas, shining the light of day onto the way insurance companies devise their insurance credit scores. Various insurance companies use these criteria in varying weights and levels of importance. But the often contradictory, convoluted criteria adds up to a nightmare for all consumers—from credit deadbeats to financial wizards—and an open opportunity for insurance companies to raise rates, lower coverage and give consumers the run-around.

1. **Guess the Magic Number!** Each insurance company picks an arbitrary magic number of preferred credit cards. Have too few, take a hit; have too many, take a hit. Only consumers who meet that perfect balance see any benefits to their rates. But, one company's magic number might be a penalty for another company.
2. **Don't Open a New Account!** For those consumers trying to reach that magic number, opening a new account will only set them back two steps. Many insurance companies view recently opened accounts as red flags for policyholders. Too bad for young drivers, new homeowners, mortgage refinancers, new utility accounts, new cell phone owners... and the list goes on.
3. **Don't Pay off that House!** Insurance companies like older accounts, giving mortgage holders bonus points on their insurance credit score. But the instant a consumer pays off their 30-year mortgage; they lose their oldest account and might just move down a notch in the insurance company's hierarchy.
4. **Quick Payoff?** Many insurance companies penalize consumers who have just started to pay off an installment loan—even if their payments are current. Somehow being newer into a loan translates into higher driving risk and carries a penalty.

5. **Don't Use that Credit!** Consumers who actually use the credit extended to them might find themselves penalized by their insurance company. Many insurance credit score programs give a lower score to consumers who charge large amounts or carry a balance—even if the balance is paid off every month or paid currently.
6. **Better Use that Credit!** If a consumer has a credit card or account, but doesn't actually charge anything, some companies log a penalty against that policyholder. Dormant accounts can translate into higher auto rates.
7. **36 Months No Interest = Bad Driver!** Financing accounts through furniture stores or other retail outlets often count against consumers in the secret formula world. Anything other than a bank issued credit card sends up red flags against policyholders.
8. **Don't Charge those Tires!** Some insurance companies penalize a consumer for taking out a credit card or paying on installment with an auto parts store, gas company or car dealership. Shouldn't someone who is trying to take care of their automobile be considered a safe driver?
9. **Installment Loans.** According to many insurance companies, any installment loan takes a policyholder down a notch. This is particularly convoluted for a new car owner—drivers who finance cars are required to obtain collision as well as liability insurance. Thanks to the hit they might take because they couldn't plunk down cash for a car, they just might get to pay an extra premium for that additional insurance.
10. **Keep Your Head Down and Don't Ask for Anymore!** Many insurance companies take consumers down a notch in driving skill every time they open a new account. This formula penalizes policyholders every time they rent an apartment, shop for a mortgage, finance a car, take out a school loan—even open an account for phone service.

### **SEE THE CREDIT SCORING MODEL USED BY YOUR INSURER**

You can request a copy of the credit scoring model used by an insurer from the Texas Department of Insurance. If it is not copyrighted, TDI can send it to you by mail. A number of Fair Isaac's models are copyrighted, so they are only available to be viewed at the Texas Department of Insurance in Austin.

**Not all requests for models are free of charge. You may have to pay for copies, postage and time to process the request.**

For TDI to process your request, you must include specific information. Clearly state the name of your insurance company as it is written on your annual policy contract. Just using the name "Farmers," for example, is not enough. The company we call Farmers really has at least 4 auto insurance companies under it and at least 5 homeowners insurance companies under it. Each of these may use a different credit scoring model.

*We recommend that you use the sample letter below to help write your own request.*

[Date]

Open Record Liaison  
Agency Counsel Section  
Legal & Compliance, MC 110-1A  
Texas Department of Insurance  
P.O. Box 149104  
Austin, Texas 78714-9104

Open Records Liaison:

This letter serves as an open records request for a credit scoring model deemed public information by Senate Bill 14.

Specifically, I would like to receive:

- The credit scoring model filed by [Specific Name of Company] for [Auto or Homeowners Insurance].

I would like a copy of the model mailed to me at [Address, City, State, Zip Code]. If you have any questions about this request, you may contact me at [phone number and/or email address]. If there will be any charge for this request, please inform me of the estimated amount before any charges are incurred.

Thank you for your assistance.

Sincerely,  
[Your Name]

### **SAMPLE CREDIT SCORING MODEL**

Insurance companies claim they possess formulas that draw a cause-and-effect link between credit scores and driving risk or the likelihood that you will file a claim if hail damages your roof.

Now that these formulas are available for public inspection, a quick review raises serious questions about how the criteria can be tied to driving risk. Many criteria are contradictory, others penalize consumers who are simply using—not abusing—credit and none are appropriate predictors of driving skill or risk.

Your insurance company is required to tell you if your policy has been changed or dropped due to credit scoring. They are not, however, required to tell you if you are paying a higher rate because of the results of your credit score formula.

The list below offers some examples of real credit scoring criteria used by some insurance companies to determine policyholder eligibility and rates for home and auto insurance. Various insurance companies use these criteria in varying weights and levels of importance.

## Sample Credit Scoring Model Key

(Increasing plus or minus signs indicate increasing magnitude)

+	Increases your credit score (favorable)
—	Decreases your credit score (unfavorable)

Factor	Scale	Effect on Rates and Availability
<p><i>Average number of months all accounts on file have been open:</i></p> <p>600 or more months 400 to 599 months 200 to 399 months 0 to 199 months</p>	<p>++ + — — —</p>	<p>You will be penalized until the average age of the accounts on your credit report reaches the arbitrary threshold chosen by your insurer.</p>
<p><i>Number of accounts opened in the last year:</i></p> <p>0 (no accounts opened) 1 to 2 3 to 4 5 to 7 8 or more</p>	<p>+++ + — — — — — —</p>	<p>Newly opened accounts count against your insurance credit score—even if your payments are current. This criteria penalizes young credit holders, but also consumers who have recently moved.</p>
<p><i>Age of oldest account in months:</i></p> <p>0 to 24 months 25 to 72 months 73 to 192 months 193 to 312 months 313 to 432 months 433 months or more</p>	<p>+++ ++ + — — — — — —</p>	<p>This is a double penalty against new accounts, but it can also raise rates for a homeowner who pays off a 3-year mortgage and closes his or her oldest account.</p>
<p><i>Number of consumer initiated credit inquiries in last 2 years:</i></p> <p>0 (no inquires in last 2 years) 1 2 3 4 5 6 or more</p>	<p>+++ ++ + — — — — — — —</p>	<p>Consumers will take a hit every time they: get cell phone service, rent an apartment, shop for a mortgage, take out a car loan, apply for a credit card, take out a school loan, open an utility account, etc. (Exclusions for multiple inquires on purchases within a 30-day window.)</p>

Factor	Scale	Effect on Rates and Availability
<p><i>Number of credit card accounts open:</i></p> <p>0 to 1 2 3 4 5 6 to 9 10 or more</p>	<p>— ++ +++ ++ — — — — — —</p>	<p>Each different credit scoring model has a “magic number” for how many credit cards you should have to lessen your insurance risk. Two to four credit cards is optimal in most models.</p> <p>If you have more or less than the arbitrary chosen number, your insurance score will decrease.</p>
<p><i>Number of credit card accounts where balance is 75% or greater than limit:</i></p> <p>0 1 to 2 3 to 4 5 or more</p>	<p>++ + — — —</p>	<p>Penalizes people who actually use the credit extended to them—even if their accounts are current or paid off every month.</p>
<p><i>Number of months since last account activity:</i></p> <p>0 (no activity within last month) 1 month 2 months or more</p>	<p>+ — — —</p>	<p>Penalizes consumers who DON'T use the credit extended to them. If a consumer doesn't make a charge or make payments, he or she takes a hit on their auto insurance credit score.</p>
<p><i>Number of installment loan accounts:</i></p> <p>0 1 2 or more</p>	<p>+ — — —</p>	<p>Installment loans are taken out from a bank and allow you to take possession of the property immediately while you pay back the loan in monthly installments (e.g. a car loan). Having an open installment loan can hurt your credit score.</p>
<p><i>Number of accounts in good standing with a balance:</i></p> <p>0 1 2 or more</p>	<p>— + ++</p>	<p>Clearly this factor can hurt people who have not paid their accounts as due, but it can also hurt people who choose not to carry balances on their accounts.</p>

Factor	Scale	Effect on Rates and Availability
<p><i>Number of open retail store or sale finance accounts:</i></p> <p>0 1 2 or more</p>	<p>+ — — —</p>	<p>Insurance companies prefer bank loans. This criteria penalizes consumers who open accounts for furniture sales, department stores or other personal finance companies.</p>
<p><i>Number of open automotive related accounts:</i></p> <p>0 1 2 or more</p>	<p>+ — — —</p>	<p>Penalizes consumers who gain financing through car dealers, auto parts stores, tire stores, or other automotive retailers.</p>
<p><i>Number of open oil company accounts:</i></p> <p>0 1 2 or more</p>	<p>— + +</p>	<p>Penalizes consumers who do not have a gas company credit card.</p>
<p><i>Number of public records (includes bankruptcies, liens, collections, etc.):</i></p> <p>0 1 2 3 or more</p>	<p>+ — — — — — —</p>	<p>Not paying loans as agreed will hurt your credit score.</p>
<p><i>Longest delinquency on an account:</i></p> <p>No delinquencies 30 to 59 days late 60 to 89 days late 90 days or more</p>	<p>+ — — — — — —</p>	<p>Not paying loans as agreed will hurt your credit score.</p>

## CHECK YOUR CREDIT HISTORY AND CORRECT ERRORS

The information in your credit report can influence whether you are offered insurance, the interest rate on your mortgage and even if you are hired for a job, so it is important that you periodically check the credit information collected about you and correct any errors in it.

### Credit Reports and Credit Bureaus

Your *credit report* is a summary of your history of accessing credit and paying debts and bills. Credit reports are generated by *credit bureaus* (also called *credit reporting agencies*). Federal law allows certain entities to obtain your credit report when you apply for a service including banks and other lending institutions as well as insurance companies.

In general, your credit report will contain the following sections:

- **Identifying information** including your name, Social Security number, telephone number, current and previous addresses, birth date and employer.
- **Credit history information** including a list of your credit cards and loans and payment histories. Negative information such as late payments and defaults will remain on your report up to seven years.
- **Public record information** including bankruptcies, foreclosures, tax liens, court-ordered payments and late child support payments. Negative information will remain on your report up to seven years, except for bankruptcies, which may be reported for up to ten years.
- **Inquiry information**, which lists creditors, lenders, insurance companies and others, which have requested your credit report. Inquiries can typically remain on your credit history for two years.

There are three national credit bureaus. Equifax, Experian, and TransUnion, each of which will likely have a credit report for you. Each bureau will likely have slightly different information collected on you, and therefore different findings.

### Order Your Credit Reports

It is a good idea to check all three of your credit reports for errors and omissions about once a year and before applying for loans, so that you will get the best loan terms available to you. Through recent changes in Federal law, consumers are allowed to obtain a free credit report from each of the three major credit reporting agencies.

You can order your free report online at [www.annualcreditreport.com](http://www.annualcreditreport.com). You are also entitled to receive your credit report for free if you suspect that you are a victim of fraud, if you receive welfare, if you are unemployed or if you were recently denied a loan or other benefit based on a credit report.

#### Contact Information:

- **Equifax:** 1-800-685-1111 (general) or 1-800-525-6285 (fraud); P.O. Box 740241, Atlanta, GA 30374; [www.equifax.com](http://www.equifax.com)
- **Experian:** 1-888-397-3742 (general and fraud); P.O. Box 2002, Allen, TX 75013; [www.experian.com](http://www.experian.com)
- **TransUnion:** 1-800-888-4213 (general) or 1-800-680-7289 (fraud); P.O. Box 2000, Chester, PA 19022; [www.transunion.com](http://www.transunion.com)

#### **Correct Errors on Your Credit Report**

By law, you have the right to dispute inaccuracies or omissions and credit bureaus must investigate your complaint (generally within 30 days) and correct any errors. The Federal Trade Commission recommends the following procedures for disputing information on your credit report:

- Make the credit bureau aware of the inaccurate information in writing. Send your letter by certified mail and request a return receipt.
- Include copies (not originals) of any supporting documentation.
- Clearly identify each item on the credit report that you are disputing, state the facts and request a correction.
- Keep a copy of all documents and requests you send to credit bureaus.

*Source: U.S. Federal Deposit Insurance Corporation (FDIC)*