DEPARTMENT OF CONSUMER & BUSINESS SERVICES

# Credit Scoring in Insurance - Questions and Answers

**Q: What is credit scoring?**

**A:** Many insurance companies use an individual's credit history to decide whether to issue an auto or home insurance policy or how much to charge. Financial institutions and other businesses also use your credit history. "Credit scoring" in this fact sheet refers to the use of credit information by insurance companies.

**Q: Does Oregon limit how insurers can use my credit information?**

**A:** Yes. The 2003 Oregon Legislature passed Senate Bill 260, which prohibits the use of credit scoring to increase premiums for existing policyholders, and prohibits insurers from using credit records to cancel or not renew existing policyholders. Current law allows insurers to use credit information when deciding whether to issue a policy to a new applicant, but only if the applicant's credit score is used as part of an evaluation system that also relies on other relevant factors such as your driving record or claims history. An insurer can use your credit information up through the first 60 days of the new policy to determine whether it will provide coverage or adjust your premium.

The law also requires insurers to disclose use of credit scoring to new applicants, prohibits the use of certain factors in credit scoring models, and requires insurers to file their credit scoring models with the Insurance Division of the Department of Consumer and Business Services.

**Q: Why do insurance companies want to use my credit information?**

A: Many insurance companies have demonstrated to their satisfaction that your credit information can predict how likely it is you will be in an auto accident or file a homeowner's claim.

**Q: I know my bank checks my credit report when I apply for a loan. Is the credit score my bank uses the same as what my insurer uses?**

**A:** No. Much of the same credit information is used, but your insurance company computes an "insurance score" for you that uses elements of your credit history to measure your insurance risk.

**Q: When did insurers start using credit scoring?**

**A:** Companies selling commercial insurance to businesses have used credit scoring for many years. Insurers began using credit history for “personal lines” of insurance in 1995. Auto insurance and homeowner insurance are examples of “personal lines.”

**Q: Do all insurance companies use credit scoring?**

**A:** Most auto and homeowner insurers – over 95 percent of the market – use credit scoring for new business. Health and life insurers currently don’t use credit scoring.

**Q: Do insurers have to provide documentation to justify their use of credit scoring?**

**A:** Yes. For any factor used to set insurance rates, Oregon law requires insurers to document a statistical correlation between that factor and the risk of loss. Insurers have met that basic standard for credit scoring. They do not have to explain the correlation or demonstrate that a bad credit score will cause someone to have an accident or file a claim. This is the same standard that applies to other rating factors. For example, insurers must demonstrate a statistical correlation between age and risk of loss in order to charge young drivers higher rates, but this does not mean that being young will cause someone to have an accident. It just means that young drivers are statistically more likely to have accidents than older drivers.

**Q: Are all statistical correlations valid predictors of risk?**

**A:** No. Some correlations are called “spurious” because they do not demonstrate an actual relationship between two correlated factors. For example, there is a correlation between gray hair and wealth, but this is spurious because the actual relationship is between age and wealth and gray hair is simply a proxy for age. Some critics of credit scoring claim that credit scoring is this kind of proxy for prohibited rating factors, such as race.

**Q: Does credit scoring unfairly discriminate against minorities or other protected classes?**

**A:** This is a disputed question. Insurance companies maintain that credit scoring is not unfairly discriminatory because it is valid predictor of risk and there is no intent to discriminate since discriminatory information is not available to the insurers. Critics argue that credit scoring is unfairly discriminatory regardless of the insurer’s intent, because minorities and other protected classes have lower credit scores on average than the overall population and therefore are unfairly affected when credit scoring is applied to everyone.

The Federal Trade Commission released a report on July 24, 2007 presenting the results of a study concerning credit-based insurance scores and automobile insurance. The study found these scores are effective predictors of the claims that consumers will file. It also determined that, as a group, African-Americans and Hispanics tend to have lower scores than non-Hispanic whites and Asians. Therefore, the use of scores likely leads to African-Americans and Hispanics paying relatively more for automobile insurance than non-Hispanic whites and Asians. Credit-based insurance scores are calculated based on a consumer's credit history information. The Commission voted 4-1 to issue the report. Copies of the **complete report** are available from the Federal Trade Commission's Web site. There also are no definitive court decisions as to whether a disproportionate impact on minorities or other protected classes would make credit scoring illegal.

**Q: Has the Insurance Division received complaints from consumers about credit scoring?**

**A:** Yes. Here is a breakdown of credit scoring complaints closed by the Insurance Division:

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|---|---|---|---|---|---|---|
| **1999** | 7 | **2002** | 71 | **2005** | 10 | |
| **2000** | 17 | **2003** | 146 | **2006** | 6 | |
| **2001** | 54 | **2004** | 36 | **2007** | 7 | (through October 24) |

**Q: Are insurance companies required to let me know they are using my credit?**

**A:** Yes. If you are applying for insurance, the agent or company must advise you they will be requesting your personal information, including credit information. This may be done orally or in writing by the agent.

**Q: Can I find out more about how the insurance company uses credit?**

**A:** Yes. The agent or company is required to let you know that you can request a written statement describing the company's use of consumers' credit histories. If you request this statement, the insurer is required to provide it to you. However, this statement won't include specific information on how the insurer calculates its premiums based on credit scores.

**Q: If I buy a new policy, how will I know if my credit information is causing my premiums to be higher?**

**A:** If your rate is adversely affected by your credit information, the insurance company is required to send you an adverse decision notice. The notice should include the specific reasons for the decision, information about the credit-reporting agency that provided the credit information, and information about your rights as a consumer.

**Q: If I receive an adverse decision notice, does it mean my credit is worse than average?**

**A:** Not necessarily. Oregon law requires your insurance company to send you an adverse decision notice whenever you could have received a better rate if your credit score was better. This means that you should receive notification in cases where your credit score is above average but not good enough to get the best rate.

**Q: How can I improve my credit score?**

**A:** Many articles are available on various web sites on improving your credit score. First you will want to know what your credit report says. If you have received an adverse decision notice from your insurer, you are entitled to a free copy of your credit report. Ask that the report be provided to you so that you can review it. If you find an error, you should report the error to the appropriate credit bureau.

Some general suggestions from credit reporting companies include: (1) pay your bills on time, (2) do not open a lot of new accounts in a short period of time, (3) keep your credit balances low in relation to your available credit, (4) pay off credit card debt rather than moving it to a lower interest rate credit card, and (5) do not open credit accounts you do not intend to use.

**Q: If I'm shopping around for insurance and several companies check my credit, will that hurt my credit score?**

**A:** Oregon law prohibits insurance companies from using inquiries as a rating factor for insurance, so shopping around shouldn't affect your credit score.

**Q: I have existing policies with an insurance company. Can the company use my credit information to help determine my premiums?**

**A:** No. Insurers are not allowed to re-check your credit information to decide whether to renew an existing policy or to change your premiums.

**Q: What if my credit has improved? Can I request that the insurance company re-check my credit?**

**A:** Yes. Consumers with existing policies can ask the insurance company to re-check their credit. You can request this only once a year.
If your credit has adversely affected your premium on a newly purchased policy, the insurance company must send you a notice. The notice advises you of the adverse action and lets you know you can request your credit be re-checked no more than once a year.

**Q: Can the insurance company cancel me based on my credit information only?**

**A:** No. The insurance company can only use your credit information on a new policy, and can only make decisions in the first 60 days of the policy. If the company decides to cancel your policy in that time, it cannot do so based only on your credit information. Any such decision must be made in combination with other substantive factors.

**Q: What other factors besides credit are used to determine my premiums?**

**A:** Your auto insurance premiums are based on factors such as your driving record, the type of car you drive, and where you live. Your homeowner's premiums are based on factors such as where you live, the cost to replace your home, and your claims history. Your credit information is only one of a number of factors insurers use to determine your premiums.

**Q: Do all insurers use the same factors to determine my premiums?**

**A:** No. Insurers make their own decisions on the factors they use to determine the premiums you will pay, and also differ in terms of the weight they give to these factors. Similarly, insurers have different views on the importance they attach to your credit information and on which factors in your credit information are most significant. How much weight a company gives to these factors helps determine what your premiums will be.

**Q: I've just bought a new car and will be adding it to my auto policy. Can the insurer use my credit information to re-rate my policy?**

**A:** No. The insurance company can use your credit information only on a new policy or if you request it. If a car is being added to an existing policy, the insurance company cannot use credit information as a factor in setting your new premium.

**Q: I've just gone through a divorce. Can the insurer use my credit information to re-rate my policy now that my marital status has changed?**

**A:** No. A law passed by the 2005 Oregon Legislature prevents insurers from re-rating existing policies or customers if their marital status changes due to death or divorce. The only exception might be if you as the customer request a re-rate, which you can do only once a year.

**Q: The insurance company has been rating me based on inaccurate credit information. How can I get my credit information corrected?**

**A:** If you report an error, the credit bureau must investigate the error and get back to you within 30 days. The credit bureau will contact whoever reported the information.
If the investigation shows the information is inaccurate or there is no proof it's true, the credit bureau must correct your credit report. It also must give you a free copy of the report and, if you ask, must send notices of any corrections to anyone who received your report in the past six months. The entity that provided the wrong information must notify all three nationwide credit bureaus so they can correct the information in their reports.

For more information on how to dispute errors in your credit report, go to this Federal Trade Commission Web page at http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre21.htm

**Q: How can I contact the credit bureaus?**

**A:** You can order a free annual credit report from each of the nationwide consumer reporting companies once every 12 months. To order your report, go to www.annualcreditreport.com or call 877-322-8228.

You may also contact the three major national credit-reporting companies:

Equifax
(www.equifax.com)

800-685-1111

Experian
(www.experian.com)
888-397-3742

TransUnion
(www.transunion.com)
800-888-4213

**Q: If I've corrected my credit report, how do I get the insurance company to adjust my premiums?**

**A:** If you successfully challenge information in your credit report, you should notify the insurance company in writing. The insurer will then have to re-rate the policy back to the effective date of the current policy term and be required to charge you the correct amount of premiums you would have been charged if accurate credit information had been used at the start of the current policy term.

**Q: I pay cash for my purchases and do not use credit. Can the insurance company hold this against me?**

**A:** No. If you don't use credit, the insurer can't use this information unless it treats you as if you have neutral credit history, or presents information to the Insurance Division that your lack of credit history relates to the risk for the insurer. Otherwise, the insurer must exclude the use of credit information as a rating factor and only use other rating criteria.

Revised 11-07