

Understanding How Insurance Companies Use Credit Information



If you are shopping for auto or homeowner's insurance, or if your current policy is up for renewal, your insurance company may be looking at your credit history. Here are some tips to help you understand how your credit information may be used and how it may affect your insurance premiums.

A growing number of personal auto and homeowner's insurance companies have begun looking at consumer credit information to decide whether to issue or renew policies, or to decide what premiums to charge for those policies. The following information is provided to help you understand how your credit information is being used for personal auto and homeowner's insurance and how it may affect your insurance purchases.

1. Is it legal for an insurance company to look at my credit information without my permission?

Yes. A federal law, the Fair Credit Reporting Act (FCRA), states that insurance companies have a "permissible purpose" to look at your credit information without your permission. Insurance companies must also comply with state insurance laws when using credit information in the underwriting and rating process.

2. Why are some insurance companies using credit information?

Some insurance companies believe there is a direct statistical relationship between financial stability and losses. They believe that, as a group, consumers who show more financial responsibility have fewer and less costly losses and, therefore, should pay less for their insurance. Conversely, they believe that, as a group, consumers who show less financial responsibility have more and costlier losses and, therefore, should pay more for their insurance.

3. Does using credit information discriminate against lower-income consumers?

Insurance companies that use credit information and entities that have developed credit scoring models state that there is no difference in credit scores among different income levels because there are just as many financially responsible low-income consumers as there are financially responsible high-income consumers. In addition, those companies warrant that factors such as

income, gender, marital status, religion, nationality, age, and location of property are not used in their credit scoring models. At the same time, these entities have not addressed factors that may appear neutral on their face but have a disparate impact on protected categories of consumers. For example, some scoring systems consider the source of credit that a consumer uses, and consumers who rely on finance companies and other subprime lenders may receive lower credit scores. This may have a disproportionate impact on minorities.

4. What kind of credit information are insurance companies using?

Although some insurance companies still look at your actual credit report, most insurance companies that use credit information are using a "credit score." A credit score is a snapshot of your credit at one point in time. Insurance companies and entities that have developed credit scoring models use several factors to determine credit scores. Each factor is assigned a weighted number that, when applied to your specific credit information and added together, equals your final three-digit score ranging from 0-999, depending on the insurance company and the credit scoring model used. Generally, the higher the number, the more financially responsible the consumer. Following is a list of the more common factors used:

- *Major negative items*—Bankruptcy, collections, foreclosures, liens, charge-offs, etc.
- *Past payment history*—Number and frequency of late payments; days elapsed between due date and late payment date.
- *Length of credit history*—Amount of time you've been in the credit system.
- *Homeownership*—Whether you own or rent.
- *Inquiries for credit*—Number of times you've recently applied for new accounts, including mortgage loans, utility accounts, credit card accounts, etc.
- *Number of credit lines open*—Number of major credit cards, department store credit cards, etc., that you've actually opened.
- *Type of credit in use*—Major credit cards, store credit cards, finance company loans, etc.

- *Outstanding debt*—How much you owe compared to how much credit is available to you.

5. How are insurance companies using credit?

Companies are using credit in two ways:

Underwriting—deciding whether to issue you a new policy or to renew your existing policy. Some state laws prohibit insurance companies from refusing to issue you a new policy or from nonrenewing your existing policy based solely on information obtained from your credit report. In addition, some state laws prohibit insurance companies from using your credit information as the sole factor in accepting you and placing you into a specific company within their group of companies.

Rating—deciding what price to charge you for your insurance, either by placing you into a specific rating “tier” or level, or by placing you into a specific company within their group of companies. Some insurance companies use credit information along with other more traditional rating factors such as motor vehicle records and claims history. Where permitted by state law, some insurance companies may use credit alone to determine your rate.

6. How do I know if an insurance company is looking at my credit?

Some agents and companies will ask for your social security number to obtain “consumer information,” “background information,” or an “insurance bureau/credit score.” When an application for insurance is submitted, consumers should ask their agent or insurance company about whether and how credit information will be used in the underwriting and rating process.

7. Will having no credit history affect my insurance purchase?

Possibly. Sometimes an insurance company will find “no hits” or “no score” which means they cannot find a meaningful credit history for you. This lack of credit information could occur if you’re young and haven’t yet established a credit history, if you don’t believe in using credit and have always paid in cash, or if you have recently become widowed or single and all of your previous credit information was in your spouse’s name. If an insurance company finds no meaningful credit information for you, you may pay a higher rate for insurance if such a rate increase is permitted by state law. Although many companies won’t charge you their highest rate, neither will they give you their best rate. If you know that you have an established credit history, check with your agent or insurance company to make sure they are using your correct social security number, birth date, or other information to find your records.

8. What do insurance companies consider a good credit score?

A “good” score varies among companies. A good score is a number that matches the level of risk your insurance company is willing to accept for a particular premium. For one company, a 750 score may qualify you for their best (lowest) rate. For another company, the same 750 may not be high enough to qualify you for their best (lowest) rate.

9. Must an agent or insurance company tell me what my credit score is?

No. In fact, the agent or insurance company underwriter might not even know your actual credit score. Instead, the credit scoring company or model they use may just advise that your score qualifies you for a particular tier or company within the group. However, even if you know your credit score, it may not be useful to you. Since a credit score is just a snapshot of your credit information on a particular day, your score could change at any time there is a change in your credit activity or a creditor’s report to a credit bureau. In addition, insurance companies use different credit scoring models, so your score could vary from one insurer to another. For example, one company may use three scoring factors (bankruptcies, judgments, and liens) and assign certain weights/points to each. Another company may use those same three factors but assign them different weights/points and use two additional factors such as payment history and outstanding debt. Lastly, since the national credit bureaus don’t share information with one another, a credit score may change depending on which of the three national credit bureaus report the information that goes into the scoring model.

10. If I don’t know my score, and my score varies from company to company and day to day, how will I know if my credit is affecting my insurance purchases?

The FCRA requires an insurance company to tell you if they have taken an “adverse action” against you, in whole or in part, because of your credit report information. If your company tells you that you have been adversely affected, they must also tell you the name of the national credit bureau that supplied the information so that you can get a free copy of your credit report. The FCRA defines “adverse action” to include “. . . a denial or cancellation of, an increase in any charge of, or a reduction or other adverse or unfavorable change in terms of coverage or amount of, any insurance existing or applied for, in connection with the underwriting of insurance. . . .” Examples of an “adverse action” include giving the consumer a limited coverage form, not giving the consumer the best rate, not giving the consumer

a discount, or giving the consumer a surcharge. In addition, most state laws require insurance companies to provide clear and specific reasons for any refusal to issue, cancellation, or nonrenewal of an insurance policy. A reason such as “bad credit score” may not be in compliance with most state laws. Insurance companies differ in how and when they notify consumers about an adverse action. For example, notification could come either verbally or in writing from either the agent or the insurance company, and notification could come at the first policy period or at each renewal. The best way to know for sure if your credit score is affecting your acceptance with an insurer for the best policy at the best rate is to ask.

11. How can I improve my credit score if I have been adversely affected?

First, you must find out what “factors” caused your credit score to be declined. The agent or insurance company should be able to tell you the top “reason codes” (factors) that resulted in your score. In addition, you must find out what weighted number each of these factors is given to fully understand how your credit score may be improved. Insurance companies and credit scoring model developers suggest the following ways to improve your credit:

- Don't try to “quick fix” your credit overnight or you could end up hurting your score. Instead, understand that the most important factors generally are late payments, amounts owed, new credit applications, types of credit, collections, charge-offs, and negative items such as bankruptcies, liens, and judgments.
- Create a plan that will improve your credit overtime. Pay your bills on time (pay at least the minimum balance due, on time, every month). Keep credit balances low, especially on revolving debt like credit cards.
- Apply for new credit accounts sparingly.
- Keep at it. Your snapshot will improve over time if you make changes now and continue to improve. If you show good credit behavior overtime, your credit score may improve as a result.

12. What can I do if I suspect that my credit report contains inaccurate or erroneous information that is adversely affecting my credit score?

If your insurance company has taken an “adverse action” against you as a result of your credit, you're entitled to a free copy of your credit report from the credit reporting bureau they used. However, since the three national credit reporting bureaus do not share information with each other, it is a good idea to obtain a copy of your credit report from each of them because each

report may contain the same or different errors and correcting errors on one credit report may not fix the errors with the others. You may have to pay a nominal fee (probably less than \$10) for each report. Under federal law, you are entitled to a free copy of your credit report if you have been denied credit or insurance, if you are on welfare, if you are unemployed, or if you are a victim of identity theft.

If you find errors in your credit report, advise the credit bureau. In addition, you should immediately notify your agent and insurance company and ask if these errors will make a difference in your insurance purchase and whether the insurance company will defer using your credit information until the inaccurate or erroneous information is corrected. Don't wait until the matter is resolved by the credit bureau. Small errors may have little or no effect on your credit score, but significant errors could cause the insurance company to disregard the score and possibly reverse the adverse action.

The credit bureau will contact the reporting entity (bank, credit card company, collection agency, court clerk, etc.) to verify the information. The bureau must investigate and respond to you within 30 days.

If the disputed information cannot be verified, or if the reporting entity agrees that the information is incorrect, the credit bureau must remove, complete, or update the information. Also at your request, the credit bureau must send a notice of the correction to any creditor that has checked your file in the past six months.

If the reporting entity verifies that the information is indeed correct, the credit bureau will not remove the information from or correct the information on your credit report. However, the FCRA permits you to file a 100-word statement explaining your side of the story, and the reporting bureau must include your statement with your credit information each time it's sent out. Make sure your insurance company has a copy of your statement and ask if they will take it into account.

Once the errors are removed or corrected, it's a good idea to obtain a new copy of your credit report several months later to make sure the incorrect or erroneous information hasn't been reported again.

Most consumer groups suggest that you get a copy of your credit report from all three credit bureaus once a year to make sure there are no errors or to correct them before they become big problems.

The three national credit bureaus are:

- Equifax:
www.equifax.com or 1-800-685-1111

- Experian:
www.experian.com or 1-888-397-3742
- Trans Union:
www.transunion.com or 1-800-888-4213

13. Where can I go for help with credit problems?

If you can't resolve your credit problems alone or need additional assistance, there are nonprofit credit counseling organizations that may be able to assist you. In addition, nonprofit counseling programs are sometimes operated by churches, universities, military bases, credit unions, and housing authorities. You can also check with a local bank or consumer protection office to see if they have a list of reputable, low-cost financial counseling services.

Some credit repair firms promise, for a fee, to get **accurate** information deleted from your credit file. Be wary of those entities because accurate information cannot be deleted from your credit record. You have the same access to credit reporting agencies that credit repair firms do and you are entitled to dispute credit report items for free.

14. Will a less than perfect credit score haunt me forever?

The best way to find out if and when your insurance company will reevaluate and re-tier or reassign you is to ask. Some insurance companies look at your credit periodically and will place you in the appropriate company or rating tier based on your current information. If you were originally charged a higher rate because of your credit and you improve your credit over time, you may receive a lower rate the next time the company looks at your credit. Other insurance companies look at your credit only at the time you first apply for insurance. Even if you improve your credit history, the company will not take your improvement into account and you will continue in the higher-priced company or rating tier. Conversely, if you are already in the best priced company or rating tier, you would not be downgraded should your credit history deteriorate.

15. Where can I get more information?

- Ask your agent or insurance company if they have educational material about their use of credit.
- Search the Internet, but be sure the information you access deals specifically with use of credit by insurance companies.
- Contact the Federal Trade Commission for information about the FCRA or their consumer brochures on credit by calling 1-877-382-4357 toll free or visiting their Web site at www.ftc.gov.

- Contact the Office of the Commissioner of Insurance by calling our Consumer Complaint Hotline toll free at 1-800-236-8517 or visiting our Web site at oci.wi.gov

16. Final Points to Remember

- There's a good chance your current insurance company or prospective insurer is looking at your credit.
- Ask your auto and homeowner's insurance agent or company whether they are using credit information, how they are using it, and whether it is affecting your rate.
- Get a copy of your credit report from each of the three national credit bureaus and correct any errors. Notify your insurance agent and company of any errors and tell them your side of the story.
- Improve your credit history if you've had past credit problems. Ask your agent or company for the top reasons (factors) for your credit score and the weighted number each of these factors is given. If your credit score is causing you to pay higher premiums, ask if they will reevaluate you when you improve your credit.
- Shop around for insurance. Insurance rates based on credit information can vary dramatically from company to company.

If you have any further questions please contact our office.

