How Are "Credit Scores" Used by Property and Casualty Insurers?

Short Answer

Credit scoring is a valuable underwriting and rating tool, which assists property and casualty insurers in evaluating the "risk" of loss. An insurance "credit score" is a number that is used to predict the likelihood of future insurance losses and there is a proven statistical relationship between credit scores and future insurance losses.

The Explanation

Property and casualty insurers use a systematic process to evaluate new applicants for insurance in order to best determine the likelihood of future claims. This process involves evaluating the applicant by using objective information about the risk, selecting those risks eligible for coverage, classifying risk so that the policy owners are grouped with those having similar characteristics and likelihood of loss.

The term "credit score" is the concept of considering an applicants credit history as an indication of the likelihood of future loss. There is a proven statistical relationship between credit scores and insurance losses. The actuarial firm of Tillinghast-Towers Perrin completed an independent study on credit scores that has been accepted by the National Association of Insurance Commissioners. The study reviewed both the automobile and homeowners policies of several large insurers and found that there is a clear relationship between credit score and the likelihood of insurance claims.

The use of credit scores is good news for the majority of people, since the majority of people have good credit and resulting high credit scores. These people receive better rates overall than those drivers or homeowners with a statistically higher chance of loss.

Insurance is all about risk segregation. People who smoke have higher risk characteristics in terms of life and health insurance. People who have had numerous accidents have a higher proclivity to have future accidents. Similarly, a statistical relationship exists between credit scores and insurance losses. The evolution of credit scores provides insurers with an additional objective predictive numerical score in order to provide greater certainty and objectivity to the insurance underwriting process.