

Personal Lines Dilemma: The Controversy of Credit Scoring

by Jerry Tuttle, CPCU, FCAS, FCIA

Editor's note: The following article addresses the very current issue of credit scoring. Author Jerry Tuttle, FCAS, FCIA, CPCU, ARM, AIM, ARe, is senior vice president and senior pricing actuary at St. Paul Reinsurance Company in New York City. Jerry has contributed to a number of textbooks as a reviewer including CPCU 5, ARe 141, and ARe 142, and he currently serves on the CPCU Society's Personal Lines Section Committee. He recently wrote an award-winning actuarial short story Proof, which may be found at <http://users.aol.com/fcas/proof.html>. Our thanks to Jerry for contributing this article.



The following is a summary of the panel session on credit scoring at the CPCU Society's 2000 Annual Meeting and Seminars in San Antonio, TX.

Lamont Boyd, CPCU, of Fair, Isaac & Company

explained that his firm has been doing statistical modeling since 1956 for various industries, including mortgage lending and consumer credit. In insurance, consumer credit information has been a traditional underwriting tool since the 1970s. Credit management is generally within the individual's control (exceptions are poor health or divorce), and bad credit management intuitively correlates with poor insurance claims experience.

A credit bureau report for an individual includes trade lines (dates, types of credit accounts and amounts, and account activity), credit inquiries, and public record items (judgments, liens, and collections). Fair, Isaac uses only credit inquiries initiated by the consumer, not inquiries that are marketing solicitations. Some 20 to 30 credit bureau data items have predictive value for insurance. Fair, Isaac selects the data items, assigns statistical weights to them, produces a model predicting loss ratio as a function of credit score, and tests the model for statistical validity. The resulting numerical credit scores, which range from 300 to 900, show a clear relationship between low credit score and high loss ratio, and vice versa.

Boyd emphasized that the following items are not considered in credit scoring: income, net worth, gender, marital status, religion, age, and location. He quoted an AIA study that shows that average credit scores do not vary significantly by size of income.

Fair, Isaac has 300 insurance company clients. Each company's data is validated sepa-

rately, and some companies use custom-built models. The benefits of credit scoring are providing greater objectivity, consistency, and accuracy in the underwriting process and providing an underwriting characteristic that is under the individual's control.

Clyde "Clint" Gillespie, CPCU, of AAA Mid-Atlantic Insurance, discussed some of the more practical issues of using credit scoring from the insurer viewpoint. According to a recent survey of the top 100 homeowners and auto insurers in Virginia, 60 percent of insurers use credit reports to underwrite new homeowners business and 24 percent use it to write new auto business. Of those insurers using credit reports, when there is little or no credit history, a few insurers will underwrite as if the report were adverse, a majority will underwrite as if the report were good, and a large percentage will make an individual decision. Also, a large percentage of insurers will refuse to accept new business solely due to an adverse credit report.

Gillespie explained that Virginia has special requirements regarding notifying an insured if non-renewal is based on a credit report, providing the insured with the name and address of the credit bureau, and suspending non-renewal while the insured questions the accuracy of the credit report.

Gillespie emphasized that the insurance industry needs to educate the public about credit scoring. The public seems to accept its use in mortgages and car loans, but does not understand its use in predicting insurance claims. He strongly suggested that insurers avoid the trap of using credit scoring as the sole deciding factor in underwriting, and that insurers continue their traditional underwriting.

Randolph Rohrbaugh, acting deputy insurance commissioner in Pennsylvania, says that

Continued on page 2

Personal Lines Dilemma: The Controversy of Credit Scoring

Continued from page 1

his state has spent considerable time researching credit scoring with Fair, Isaac, insurers, and other state insurance departments, and that the Pennsylvania department wants to react on an educated level. In recent years Pennsylvania has had stable rates, numerous new insurers, and medical cost containment, so the department is concerned about anything that may disrupt the marketplace.

Pennsylvania has surveyed its top 65 auto insurers and found that 28 admit to using credit in underwriting, but Rohrbaugh feels this is low. Of the 28, 19 use it as a tool to select among preferred, standard, or nonstandard rates, and 12 of the 19 do not disclose to the insured that they use credit. Rohrbaugh is concerned why insurers fail to disclose this, and he suggests that credit scoring is hard to explain and that companies may not fully understand credit scoring themselves.

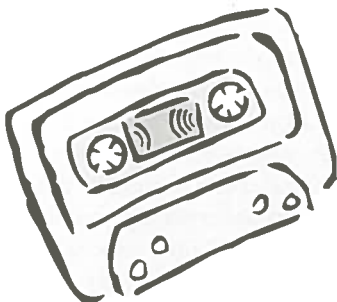
Rohrbaugh is concerned about the black box nature of the credit scoring models, and he proposes that the models be given to the actuarial profession to examine publicly. He doesn't doubt that there are correlations between credit and claims experience, but he questions whether credit scoring double counts characteristics that the existing classification system is already measuring. For example, low credit scores may correlate with age or territory, for which insurers already price. He also quoted a statistic that 70 percent of the data in credit

reports is inaccurate, so he asks how insurers can make credible underwriting decisions.

Rohrbaugh concluded by challenging insurers to open up the black box, examine the social issues including lack of disclosure, educate the consumer, and in general take responsibility for how they use credit scoring.

There was lively discussion from the audience. One question was whether the credit scoring model had been validated by an independent third party. Boyd replied that the Tillinghast actuarial firm had verified it, but an audience member responded that Tillinghast had not performed a multivariate analysis that would address the double counting issue. Another question was whether credit scoring had been applied to commercial insurance, and the reply was no. An insurance agent explained that it is extremely awkward to write a new insured and then have to tell him he is not accepted due to a bad credit report. An audience member suggested another example of possible double counting of credit scoring with rating is for insureds with monthly policies who have both higher frequency and higher company expenses than annual insureds, and who may also have worse credit scores. ■

Order Your 2000 Annual Meeting and Seminars Tapes Today!



Call The Sound of Knowledge at (858) 483-4300 for complete details or visit the online store at www.tsok.net. All audio tapes are \$20 unless otherwise specified. Videotapes are \$39 each. Shipping and handling additional.

Tapes from the 1998 and 1999 Annual Meetings and Seminars are still available. Visit www.tsok.net for a complete listing.

Road Rage and Aggressive Driving

by Clyde "Clint" Gillespie, CPCU



Clint Gillespie, CPCU, LUTCF, is state manager for product and pricing in three states for AAA Mid-Atlantic Insurance Group. His insurance career began with State Farm Insurance in California. For the past 20 plus years, he has held positions in marketing, underwriting, claims, product development, and agent licensing. He is the founder and chairman for the CPCU Society's Personal Lines Section, and is past secretary of the CPCU Society's Philadelphia Chapter.

Editor's note: The following article is Part I of a two-part series about road rage and aggressive driving. Incidents of violent driving have been on the rise for several years. According to the American Automobile Association, they have been increasing by 7 percent per year since 1990. An Australian study estimates that about half of all traffic accidents in Australia may be due to road rage. A study in the U.K. indicates that, of Britain's some 2.8 million company car drivers, about 83 percent have been victims of some form of road rage during their working life. In Part II of this series, we'll examine what each state is doing to deal with this issue. Is your company taking any steps to address this problem? Let us hear from you. E-mail the editor at dbak8@allstate.com.

In 1999, The AAA Foundation for Traffic Safety commissioned a study on "Controlling Road Rage." In this article I will share with you some of the information from that study. If you would like to review the study in its entirety you can go to the web site www.aaafoundation.org.

Many of us have misconceptions regarding road rage and aggressive driving and believe they are one in the same, which they are not. Many acts of aggressive driving, however, do become acts of road rage. The National Highway Traffic Safety Administration provides us with the following definitions:

Road Rage: "An incident in which an angry or impatient motorist or passenger intentionally injures or kills another motorist, passenger, or pedestrian or attempts or threatens to injure or kill another motorist, passenger, or pedestrian. Road rage is uncontrolled anger that results in violence or threatened violence on the road and it is criminal behavior."

Aggressive Driving: Does not rise to the level of criminal behavior but includes tailgating, abrupt lane changes, and speeding, alone or in combination. These potentially dangerous behaviors are traffic offenses, but are not criminal behavior.

We are all subjected to acts of aggressive driving and, unfortunately, capable of crossing a very fine line from remaining a responsible driver to becoming another road rage statistic. To better understand the situation we need to look at the profiles of aggressive drivers and road rage participants. An aggressive driver has been defined as a person who drives at speeds "far" in excess of the norm, which causes them to:

- Follow too close.
- Run stop signs and red lights.
- Change lanes frequently and abruptly without signals.

- Pass on the shoulder or unpaved portions of the roadway.
- Leer at and/or threaten verbally (or through gestures), motorists who are thoughtless enough to be in front of them.
- They are anyone who operates a motor vehicle in an offensive, hostile, or belligerent manner, creating an unsafe environment for the motoring public.
- They use the anonymity of their automobile to take their frustrations out on anybody at any time.
- They are mostly young males.
- They tend to have "aggressive" cars—high-powered sports cars and/or sport utility vehicles.
- They are high-risk drivers. They speed, drink and drive and drive, unbelted.
- They think their agenda is more important than everyone else's.

In examining the profile of those involved in road rage you will find they are:

- young and old
- male and female
- rich and poor
- well dressed and poorly dressed
- white, black, Hispanic, and Asian
- any driver has the potential for violence

The last bullet point goes to the core of the problem in that it can be "any driver" which includes us. In the Executive Summary of the study, I find the following paragraphs to be very interesting:

A supplemental survey on road rage characteristics asked U.S. law enforcement personnel about actual road rage incidents. Most respondents

Continued on page 4

Road Rage and Aggressive Driving

Continued from page 3



say road rage is a problem in their area. Although based on a small sample, there appears to be a slightly higher incidence of road rage incidents during the Friday afternoon peak travel times, during fair weather, under moderately congested conditions, and in urban areas. Incidence does not appear to be influenced by proximity to holidays. However, alcohol and/or drugs were found to be associated with one-quarter of incidents.

Enforcement and education are the most commonly used interventions to prevent aggressive driving and road rage. Legislation is another avenue, but so far the enactment of statutes has been impeded by existing laws that address this issue and by concerns about ambiguous wording. Results suggest that enforcement efforts should be accompanied by public information campaigns. Cooperative programs were found to be effective for distributing resources and creating invisible patrol boundaries. Interagency liaisons also offer economies of scale to smaller jurisdictions that have smaller advertising budgets. Intelligent transportation systems also show promise for deterring aggressive driving and road rage, mainly through the use of intersection cameras.

What Can Be Done?

The report listed only two insurance companies, Allstate and State Farm, as having launched education programs. The CPCU Society and your Personal Lines Section, however, have been conducting a seminar throughout the country. These seminars have been given at regional levels to insurance associations, individual CPCU Society chapters, and various other organizations. To this date, we have given more than 15 presentations with two more scheduled for the first part of April. If you are interested in having a presentation made on road rage you can contact John Kelly, CPCU, the CPCU Society's continuing education coordinating manager, at (800) 932-2728, ext. 2773, or e-mail me at www.cgille6345@aol.com.

The only solution to controlling road rage and aggressive driving is a combination of the following:

- education
- increased enforcement
- self-help methods
- increased penalties for offenders
- improved reporting system via cellular phones
- intelligent transportation systems and photo enforcement

In our next issue, we'll examine various states and their programs. ■

Bricks to Clicks

by Dale M. Halon, CPCU, CIC

Editor's note: Dale M. Halon, CPCU, CIC, invites us to a very informative seminar at the 2001 Annual Meeting and Seminars—Bricks to Clicks: The Underwriting Process Meets the Internet. Dale is associate vice president of DoubleClick, Inc. where he is responsible for marketing, direct sales, and consultation to insurance companies for focused customer acquisition programs. He has addressed numerous industry groups on predictive models, databases, and underwriting tools and marketing data. He has published articles in insurance trade publications regarding predictive modeling, and the use of consumer credit in insurance and multi-channel marketing.

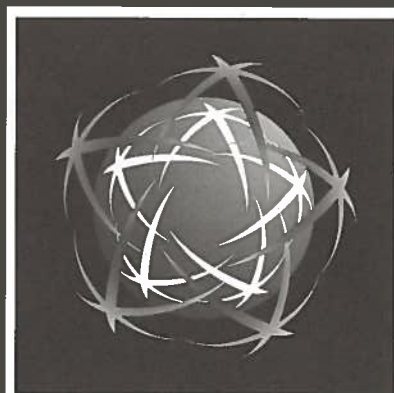
Bricks to Clicks: The Underwriting Process Meets the Internet is the topic being sponsored at the CPCU Society's 2001 Annual Meeting and Seminars developed by the Personal Lines Section and the Information Technology Section. Be sure to catch this timely and engaging discussion at October's Annual Meeting and Seminars.

Many personal lines insurance companies have added the Internet as an option for their prospective customers in addition to their established channel of direct telephone and/or agency-assisted sales. While Internet technology allows for quick decision making and communication that can be documented easily, it is at arms length. Insurers no longer know their customers on a personal basis. In this new environment, insurers have yet to find the right balance between obtaining accurate underwriting information and adequately pricing and analyzing the risk. What are the customer's expectations and the insurer's expect-

tations? How will the underwriting process be affected? What are the pricing and information need ramifications? CPCUs will have the advantage of hearing from industry professionals who have assumed a leadership role in these efforts.

The presenters we have lined up to address this topic are industry professionals from leading insurers and those closest to dealing with this new underwriting concern. These industry experts will share their perspectives on underwriting in the marketing process, pricing considerations, the effect on the underwriting process, and the different ways to use external information.

If you plan to be in Seattle on Monday afternoon, October 22, you will have a lot to gain from the insights being shared at the seminar. If you had not planned on attending the Annual Meeting and Seminars, this may be the reason to include it in your plans. We look forward to seeing you there. ■



CPCU 2001
Business Without Boundaries
CPCU Society Annual Meeting & Seminars • October 21 - 23 • Seattle

**Watch for details
on the CPCU Society's
57th Annual Meeting
and Seminars
on our web site at
www.cpcusociety.org.**

From the Insurance Research Council

Editor's note: The following IRC information is a reprint from a press release issued by the American Institute for CPCU and the Insurance Institute of America. The Insurance Research Council (IRC) is a division of the American Institute for CPCU and the Insurance Institute of America. The Institutes are independent, nonprofit organizations dedicated to providing educational programs, professional certification, and research for the property and casualty insurance business. The IRC provides timely and reliable research to all parties involved in public policy issues affecting insurance companies and their customers. The excerpts we have chosen for this issue of *Personally Speaking* involve a couple of timely issues: cell phone usage and seat belt usage. We would be interested in your thoughts regarding these and other topics. E-mail the editor at dbak8@allstate.com.

Americans Believe Cellular Phones Distract Drivers, Yet they Use Them Anyway



Ninety-one percent of American households believe that use of cellular phones while driving distracts drivers and increases the likelihood of accidents.

Eighty-nine percent of cellular phone owners agree that using cellular phones while driving distracts drivers and increases the likelihood of accidents. Despite this belief, overall self-reported cell phone use while driving has actually increased in the last three years, largely a result of cellular phone ownership nearly doubling since 1997.

Sixty-nine percent of the public favors laws to ban cellular phone use while driving, but only a third (35 percent) think it is likely that people would obey a ban.

Reported Seat Belt Use Is Up



The following findings are contained in IRC's new study, *Characteristics of Auto Accidents: An Analysis of Auto Injury Claims*. This study examines the nature and key

characteristics of motor vehicle accidents and claimants based on a 1997 survey of 80,009 closed auto insurance claim files.

Reported use of seat belts or child restraints among bodily injury auto accident claimants has nearly doubled in the past decade from 43 percent in 1987 to 87 percent in 1997. The study found that usage is highest among women and older adults and lowest among children seven to 16 years old. Not surprisingly, accident victims who reported wearing seat belts were much less likely to be seriously injured, disabled, or killed in an accident than those not wearing seat belts.

By vehicle type, reported usage is highest among occupants of passenger cars and SUVs and lowest among occupants of pickup trucks. This is of concern because pickup trucks, like SUVs, have a greater propensity than other vehicles to roll over in an accident. The study reveals that rollover accidents occurring in pickup trucks result in higher disability and fatality rates, perhaps in part because of lower seat belt usage among these occupants.

The study also suggests that SUVs might not be the best choice of vehicle for teen drivers, since these inexperienced drivers tend to overcorrect when turning, resulting in an even greater likelihood of rolling the vehicle. The data shows that teenage SUV drivers (age 20 or younger) are more likely than older SUV drivers to roll over the vehicle. This, coupled with the fact that teens are less likely than older drivers to buckle up, can mean a greater risk of injury for these drivers. ■

What are your opinions? Are there additional measures insurers should take? E-mail the editor at dbak8@allstate.com.

A Word About the Personal Lines Section

Editor's note: Thanks to the Personal Lines Section Membership Committee for the following notice.

The Personal Lines Section is one of the special interest sections of the CPCU Society devoted to providing its members with useful information relating to current developments in the personal lines insurance arena. Led by a group of dedicated CPCUs appointed by the Society president, the Personal Lines Section Committee is focused on bringing attention to issues that are of interest to personal lines practitioners.

Examples of recent work produced by the section committee includes the publication of a newsletter containing articles of interest such as insurance bureau scoring as a risk evaluating tool; customer loyalty vs. insurance distribution systems; data drive underwriting, and more.

The section develops educational seminars presented at the CPCU Society's Annual Meeting and Seminars. At the 2000 Annual Meeting and Seminars in San Antonio, the section presented an interesting session on the use of insurance bureau scoring that was well attended. A session entitled "Bricks to Clicks: The Underwriting Process Meets the Internet" will be presented at the 2001 Annual Meeting and Seminars in Seattle, WA. On a smaller

scale, a seminar dealing with road rage and aggressive drivers has been presented at multiple locations around the country.

The Personal Lines Section provides great networking opportunities for its members to interact with other CPCUs who work in or have a special interest in personal lines insurance. These opportunities to connect with other personal lines professionals can prove to be valuable in today's ever-changing marketplace.

Joining the Personal Lines Section is easy and inexpensive. All you need to do is complete a section membership application and enclose a check for \$30. First-year section membership is waived for all new designees who wish to join. An application for section membership can be obtained by calling the CPCU Society's Member Resource Center at (800) 932-2728, select option 4. For more information, please contact section chairman, Clyde "Clint" Gillespie, at cgille6345@aol.com or call him at (215) 864-7671.

If you are already a member, please share this information with your fellow CPCUs. ■

Laughton Receives Award for Academic Excellence from IIA

The Insurance Institute of America (IIA) presented an Award for Academic Excellence in the Associate in Personal Insurance (API) program to Patricia F. Laughton, CPCU, insurance education coordinator for RR&T Insurance Services. Morehead

persons who earn the highest grade averages for the national essay examinations in this Institute program. The CPCU Society's Personal Lines Section sponsored the award, which was presented at a national awards ceremony in San Antonio, TX, on October 24.

From the Editor

by Diane G. Baker, CPCU, ARP



With this issue, I would like to introduce myself as your editor for *Personally Speaking*.

I am very pleased to have the opportunity to work for you in this capacity . . . and I stress "work for you." It is my hope that

Personally Speaking will serve as a platform for interesting and timely communication that you can use. In that regard, I would like to hear from you. What issues in our personal lines business "keep you up at night"? What topics or questions would you like to see your newsletter address?

In this current issue you will find a variety of topics ranging from "road rage" to the latest at the Insurance Research Council to the "dilemma of credit scoring." There is an informative article from our Membership Committee that fills you in on what our section is about. For the future? Again, I solicit

your input and articles. If you have an article you would like to submit, please forward it to me. If you have an idea, but prefer not to write an article, simply send in the idea. Our newsletter's success depends upon knowing your interests. Please write, call, fax, or e-mail me at the address shown below.

Another request: We are attempting to update our directory of members. If you are a member of the Personal Lines Section and are willing to receive information by e-mail, will you please e-mail your address to rsimon@allstate.com?

Thanks in advance for your support in making *Personally Speaking* a success. ■

Diane G. Baker, CPCU, ARP
Allstate Insurance Company
2775 Sanders Road, E1N
Northbrook, IL 60062-6127
E-mail: dbak8@allstate.com
Phone: (847) 402-7998
Fax: (847) 402-9695

Diane G. Baker, CPCU, ARP, is an assistant vice president of risk management at Allstate Insurance Company in Northbrook, Illinois. A graduate of UNC-Chapel Hill, she earned her CPCU in 1989. She is a past member of the CPCU Society's Underwriting Section and past editor of Underwriting Trends.

Personally Speaking is published by and for the members of the CPCU Society's Personal Lines Section.

Editor

Diane G. Baker, CPCU, ARP
Allstate Insurance Company
2775 Sanders Road, E1N
Northbrook, IL 60062-6127
E-mail: dbak8@allstate.com
Phone: (847) 402-7998
Fax: (847) 402-9695

Section Chairman

Clint Gillespie, CPCU
AAA Mid-Atlantic Insurance Co.
100 West Road, Suite 304
Towson, MD 21204
E-mail: cgille6345@aol.com

Sections Manager

John Kelly, CPCU, ARM, AAI
CPCU Society

Managing Editor

Michele A. Laps
CPCU Society

Production Editor

Joan Satchell
CPCU Society

CPCU Society

Kahler Hall
720 Providence Road
PO Box 3009
Malvern, PA 19355-0709
(800) 932-2728
www.cpcusociety.org

Statements of fact and opinion are the responsibility of the authors alone and do not imply an opinion on the part of officers, individual members, or staff of the CPCU Society.

© 2001 CPCU Society



Printed on Recycled Paper

Personally Speaking



720 Providence Road
PO Box 3009
Malvern, PA 19355-0709

Personal Lines
Section Quarterly

Vol. 3 No. 1
March 2001