FICO Credit-Based Insurance Scores

Insurance is a Risk Management Tool. Personal insurance is a financial arrangement that allows an individual with financial assets to protect those assets in a cost effective way by spreading the risk of loss to

greater tendency to have more frequent or more costly losses. Insurers compete with each other to more accurately match an individual's risk profile to her pool contribution. If an insurer charges too little, and the premiums are insufficient to pay for the losses in the pool, the insurer will have to increase the premiums it charges to current and future policyholders. This could start an irreversible process of adverse selection, which drives lower-risk policyholders to another pool, which drives up the losses of the policyholders left in the pool, and the cycle continues until the insurer goes out of business.

Selecting Risks Requires Making Accurate Predictions. Selecting the lowest-risk

FICO Credit-Based Insurance Scores. FICO credit-based insurance score models are built for the sole purpose of predicting insurance losses. There are no assumptions built into FICO credit-based insurance scoring models other than mathematical assumptions. There are no policy decisions, no judgments, and no attempts to anticipate or direct the results of the model. Single factors have no specific weight assigned to them, except as they relate in combination with other factors in the models. A FICO credit-based insurance scoring model is a complex mathematical algorithm that is built solely to predict the likelihood of insurance losses. It is an analysis of millions of insurance loss results from past empirical data, using hundreds of credit characteristics as inputs to the model, and looking for correlations between the two. The analysis finds patterns among the factors that have a statistically significant correlation to insurance losses and builds those patterns into rules. There is no attempt made to determine why the model works, or why credit characteristics predict insurance losses.

The Correlation vs. Causation Debate. It is beyond debate that

Proxy. Critics of credit-based insurance scores say that the scores, which are built with depersonalized credit data, are unfairly discriminatory because they are a proxy for other factors that are illegal to use for underwriting or rating purposes.
By definition, a factor is a proxy for a second factor if the first factor is used as a substitute for the second factor with the intent to circumvent a prohibition against the use of the second factor and achieve the result that would be expected if the second factor had been used directly. The use of a "proxy" is illegal because it is a method of overt

age and race, since young drivers living in urban areas have more accidents than the general population. There is ample evidence that credit-based insurance scores provide further predictive lift; otherwise, insurance companies would not use the scores.

Disparate Impact. Critics have said that even if credit-based insurance scores are not overtly discriminatory, their use creates an illegal disparate impact on protected classes of individuals. This concept that a company's business practices—employment, lending, or insurance underwriting—could be illegally discriminatory, even though the policies were not discriminatory on their face, was developed by the U.S. Supreme Court as the "effects test". This doctrine is explained in the FTC's Commentary to Regulation B, which implements the Equal Credit Opportunity Act (section 202.6, 6(a)2) as it pertains to the granting of credit:

> The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under Title VII of the Civil Rights Act of 1964 . . . and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 . . . Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4-5; and in the House Report that accompanied H.R. 6516, No. 94-210, p.5. The Act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate

laws reflect the social policy of those states, and these are the rules by which FICO credit-based insurance scoring models are built. The models are built with depersonalized