



Testimony of  
Chet Wiermanski, Group Vice President, Analytical Services, TransUnion LLC  
On The Use of Credit-Based Insurance Scores

Before The  
National Association of Insurance Commissioners  
Property and Casualty Insurance (C) Committee  
Market Regulation and Consumer Affairs (D) Committee

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Director McRaith, Commissioner Holland and distinguished committee members, thank you for providing TransUnion with the opportunity to speak with you today at this important hearing on credit-based insurance scores. We appreciate your leadership on the insurance scoring issue, this open forum, and your objectivity surrounding the often studied, but frequently misunderstood topic of credit-based insurance scores. I hope to shed some light on two of your objectives for this hearing: to understand the development of credit-based insurance scores and the trending of these scores in light of the current economic recession.

By way of background, TransUnion is a global leader in credit and information management and one of three global consumer credit reporting companies (CRAs). Headquartered in Chicago, TransUnion provides objective credit reports and credit-based insurance scores to insurers. As such, we do not determine rates or premiums, nor do we accept or reject applicants or policyholders. Our credit-based TransUnion Insurance Risk Scores (TUIRS) are used by insurers across the country. The security and accuracy of our information are our highest priorities.

TransUnion Insurance Risk Scores are developed to be completely transparent at all levels of the policy cycle. Thus, agents and consumers have a clear understanding of the credit characteristics impacting each score and how scores may potentially be improved. With each TUIRS adverse action reason code message, we provide an explanation detailing why the score is less than ideal. All characteristics and algorithms used to create TUIRS are available upon request, providing a clearer understanding of all the credit elements that impact a consumer's insurance score.

TransUnion Insurance Risk Scores are based exclusively on objective, factual, accurate credit report information, including consumer accounts such as credit cards, retail store cards, mortgages, and auto loans. Also included in our scores is public record information, including bankruptcies, liens and judgments, and collection accounts. Additionally, TUIRS takes into consideration consumer initiated inquiries associated with their request for new credit accounts. Multiple consumer generated credit inquiries associated with the shopping for a mortgage or auto loan are deduplicated to minimize the impact on their score. All of this factual credit information is received from tens of thousands of financial institutions, retailers, and court houses on a monthly basis. I should also note what is not included in the credit report and or in the calculation of a consumer's TUIRS: medical history and records, consumer buying habits, checking and savings information, income, or any prohibited basis characteristics identified by the Comptroller of the Currency, which includes information regarding marital status, race, age, religion, family status, color, receipt of public assistance, disability, gender or national origin.

It is important to note that while the term credit score is often used interchangeably by many for credit and insurance decisioning, credit-based insurance scores and credit risk scores are not synonymous. Credit-based risk scores are designed to predict the likelihood that an individual will satisfactorily repay their credit obligations, while insurance scores are designed to predict claims loss ratio. TransUnion Insurance Risk Scores were developed to meet the needs of our insurance customers who seek a transparent, objective, and accurate predictor of consumer insurance risk. TUIRS was developed from a pool of insurance policies collected directly from many different insurance companies. Approximately 1.1 million consumers were analyzed, accounting for about \$741 million in premiums, with claim amounts totaling \$539 million from 127,000 claims. The average loss ratio was 73% and the average premium was \$650. Claims frequency totaled .11 per consumer and the average claim was \$4200.

When developing the TransUnion Insurance Risk Score, TransUnion looked at approximately 2000 predictor candidate credit characteristics derived from consumer credit reports obtained one year prior to establishing each consumer's loss ratio. Using logistic regression we selected the credit characteristics that best predicted consumer loss ratios and based upon statistical analysis assigned the appropriate weights to each characteristic value to optimize the model's ability to estimate a consumer's loss ratio. Thus, our insurance scoring models are highly interpretable, multidimensional, consistent and objective.

TUIRS contains over seventy unique credit characteristics. Some of the credit characteristics used in TUIRS include the number of collections within five years, percentage of all accounts with balances greater than 50% of limit, months since oldest bankcard account has been opened, average balance of financial installment accounts, number of previous bankruptcies, and ratio of total balance to credit limit for all credit accounts. What is important to note is that each credit characteristic is highly correlated to loss ratio, and this correlation has been studied and verified by our customers, independent actuaries, state departments of insurance and federal regulators.

TransUnion continues to study our models and their performance in light of changes in the economic landscape. Thus, for this hearing, I will provide our perspective on two major questions, including, the trend and volatility of credit-based insurance risk scores and how actions taken by lenders to minimize their risk exposure are impacting credit-based insurance risk scores.

To better understand how recent economic conditions and changes in lending practices affect credit-based insurance scores, TransUnion analyzed a random sample of approximately 28 million consumers from each of the twelve most recent quarterly archived credit files. Each of the different consumers sampled was scored by all three TransUnion developed credit-based insurance risk models. In addition to appending a score from each TransUnion developed credit-based insurance risk model, thousands of credit characteristics were also appended to the approximately 340 million unique consumer credit reports in this analysis.

Between the fourth quarter of 2005 and the fourth quarter of 2008 the national average TransUnion Insurance Risk Score for each of the three proprietary TransUnion developed insurance models exhibited a very small fluctuation. As an example, during this time period the

national average TransUnion Auto Insurance Risk Score, which ranges on a scale of 150 to 950, shifted from a low of 840.7 in the first quarter of 2006 to a high of 843.7 in the first quarter of 2008. The most recent national average TransUnion Auto Insurance Risk Score, as reflected of the fourth quarter of 2008, is 842.7. The national average scores for TransUnion's Property and combined Auto/Property Insurance Risk Scores showed similar fluctuations.

In general, the national average TransUnion Insurance Risk Scores exhibit far less fluctuation than the national average for credit risk scores. Credit risk scores are generally more volatile because they tend to rely more upon various forms of revolving credit utilization, recent new account openings and recent delinquency, than TransUnion Insurance Risk Scores. Although different aspects of utilization, account openings, and delinquency are contained within TransUnion's Insurance Risk Scores, these credit characteristics are defined differently and are not weighted as heavily as TransUnion's credit risk scores. Generally speaking TransUnion's Insurance Risk Scores, when compared to TransUnion's credit risk scores, tend to place more emphasis on credit characteristics that demonstrate a consumer's depth of credit history as reflected by the number and type of accounts maintained over time and a longer term view towards account delinquency.

A recent concern regarding credit-based scoring systems, in particular insurance risk models, is that proactive actions taken by lenders to reduce potential losses by lowering revolving credit limits may artificially lower a consumer's insurance score, which penalizes consumers in the form of higher premiums and less favorable terms to the consumer. Based upon TransUnion's analysis it appears that from an insurance risk score perspective, the action of lowering revolving credit limits has not played a significant role in the small fluctuations observed in the national average for TransUnion Insurance Risk Scores. This is attributed to the manner in which credit utilization credit characteristics are designed and weighted within TransUnion's Insurance Risk Scores. For example, revolving credit utilization credit characteristics are included in credit risk models, but they are not included in the calculation of TransUnion Insurance Risk Scores. Based upon empirical evidence uncovered when developing TransUnion's Insurance Risk Scores, only a relatively few credit utilization characteristics, of the dozens tested, were highly correlated to insurance loss ratio and subsequently included within the models. In addition, a majority of the credit characteristics calculate credit utilization as a function of a consumer's revolving credit limits combined with original installment loan amounts.

This different approach dilutes the potential impact associated with the lowering of revolving credit limits.

As you continue to review the subject of insurance scores in this hearing and beyond, we ask you to consider a few points:

- Credit-based TransUnion Insurance Risk Scores are completely transparent.
- TransUnion Insurance Risk scores do not use any variables that unfairly discriminate against classes of consumers.
- A number of valid studies show a high correlation between credit data and future insurance losses, and that credit data are highly predictive of such losses.
- Analysis of credit-based TransUnion Insurance Risk Scores shows that they are not volatile; rather, scores are stable.

Once again, thank you for the opportunity to speak with you regarding the topic of credit and insurance, and I stand open for any questions you may have.