

EXAM 6 – CANADA, FALL 2017

3. (2.5 points)

A British Columbia property and casualty insurance company is considering reviewing its factors for the credit-based insurance scores for homeowners insurance. The company believes that recent improvements in economic conditions reduce the need to segregate by credit-based insurance scores because “most policyholders are now in a good economic situation”. The company plans to review the consent to use credit information for rating that it has obtained from all policyholders.

a. (1 point)

Fully discuss the appropriateness of using credit-based insurance scores for risk differentiation.

b. (1 point)

Fully discuss the need to review the credit score consent forms for all policyholders, citing an outcome from a landmark decision.

c. (0.5 point)

Discuss the need to review credit-based insurance scores after a change in economic conditions.

EXAM 6C FALL 2017 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 3	
TOTAL POINT VALUE: 2.5	LEARNING OBJECTIVE(S): A2, A3
SAMPLE ANSWERS	
Part a: 1 point	
<u>Sample 1</u> Credit score has been shown to be a predictor of risk level and insurers are saying that they are able to write more risks with the use of credit-based insurance score. Even if the credit scores at the aggregate level are on the rise and high for most policyholders, the relative risks difference between two credit score might still be there, as would be revealed by differential analysis. As such, appropriate to use credit-based insurance score.	
<u>Sample 2</u> It is appropriate as it helps segment risk based on similar expected loss costs. This will not lead to overall increase in premium but rather a better distribution among risks and thus, avoid subsidization between low and high risks.	
<u>Sample 3</u> Credit-based is statistically significant to the expected losses, it is easy to obtain and verify and also will not be manipulated by insured. Therefore, it's appropriate to use for risk differentiation.	
<u>Sample 4</u> It is appropriate as it has been proven to be a good predictor of losses and it is generally accepted by public. However, insurer must have an informed and clear consent from their insureds and credit-based insurance scores must be approved by regulators.	
<u>Sample 5</u> It could be seen as an invasion of privacy at some extent. Credit-based insurance scores also tend to be discriminatory to certain segments of the population (low-income, young, ethnic groups). Moreover, the causality could be hard to see from an insured point of view. In this sense, using credit scores for risk differentiation becomes an ethical issue.	
Part b: 1 point	
<u>Sample 1</u> BC Credit case has shown the importance for companies to obtain clear and explicit consent form from their policyholders. Even though it is already in use, it would be good to review all consent forms to ensure they are updated with the intended use of credit and that the consent is clear and explicit.	

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Sample 2

If the company finds that its consent form is deficient, it will likely be required to follow the result of the PIPEDA report. It will need to update its current consent form, inform all current policyholders of the new consent form and obtain consent. The insurer will not have to obtain consent from all historical policyholders, as this would put strain on the company and broker network.

Sample 3

There is no need to review the consent as long as consent were obtained in accordance with PIPEDA and IBC code of conduct. From Hughes vs Economical case, consent must explain explicitly how the credit score will be used.

Part c: 0.5 point

Sample 1

Just like any rating variable, a change in economic condition that will cause distributional shift in credit scores will be caught by the pricing actuary who will adjust accordingly the rates. Credit score is not used to set overall premium, just to redistribute it fairly according to expected losses. The overall premium will not be impacted.

Sample 2

This is necessary because it is a premium trend, as mix of business have changed, it would be good to remain competitive and analyze the loss cost relationship with the new distribution of credit-based score portfolio, in order to not be adversely selected.

Sample 3

Since the distribution of credit score may have change, we need to review relativities to ensure there are still in line with expected losses. If the relation between the different credit score groups have changed, then the relativities need to be reviewed.

Sample 4

Will need to review because:

- 1- Average score will be different = need to offset
- 2- Potentially greater differentiation of credit score between policyholder. Need to re-evaluate the credit score algorithm and factors to see if still make sense.

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EXAMINER'S REPORT
<p>Candidates were expected to discuss on the usage of credit-based insurance scores and landmark decision related to it.</p>
<p>Part a</p> <p>Candidates were expected to discuss the appropriateness of using credit scoring for ratemaking.</p> <p>A common error included :</p> <ul style="list-style-type: none">• Not providing enough detail for full marks, for example:<ul style="list-style-type: none">○ Credit scores identifies between risks and effectively estimates loss cost differences
<p>Part b</p> <p>Candidates were expected to discuss the need to review credit score consent forms and support their argument through citation of an outcome from a landmark case (Hughes v. Economical, PIPEDA, or BC Credit Case).</p> <p>A common error included :</p> <ul style="list-style-type: none">• Explaining the landmark case without answering to the question. To obtain full credit, candidates should explain the link between this case and the landmark case. For example, the following would receive partial credit:<ul style="list-style-type: none">○ BC Credit Case, a couple brought a suit against an insurer stating that their credit score was used to determine their premium without consent. Insurer claimed consent was given using standard form. Court ruled that standard form was not sufficient and consent must be informed; must review all policy consent forms retroactively. Supreme Court overturned this; reviewing all forms would be too demanding, but consent forms must be reviewed going forward and informed consent given. <p>If a sentence such as “Thus, it is needed to review the consent forms for all policyholders to ensure that the consent is clear and explicit” were added, this would then have received full credit.</p>
<p>Part c</p> <p>The candidates were expected to discuss the need to review credit-based insurance scores following a change in economic conditions.</p> <p>Common errors include:</p> <ul style="list-style-type: none">• Explaining the impact on the overall premium without answering to the question, for example:<ul style="list-style-type: none">○ It should be reviewed after a change in economic conditions so changes can be off-balanced to maintain your average target level of premium.• Explaining the impact on credit scores instead of credit-based insurance scores, for example:

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- After a change in economic conditions, policyholders may be affected by the economy as well as their credit scores. Thus, we need to review credit score to keep information accurate and up-to-date.