Insurance Risk Scores for Life Insurance in the COVID-19 Era and Beyond

Offer greater access to financial security in an increasingly digital world

A NEW FRONTIER FOR LIFE INSURANCE

Credit-based insurance risk scores ("insurance risk scores" going forward) have been successfully used to more accurately assess risk and price coverage for personal automobile and property insurance policies for more than two decades. The life insurance industry, in contrast, has only recently begun to deploy them for life insurance underwriting.

Insurance risk scores provide significant advantages in an increasingly digital-forward industry, and most life insurance providers also realize these scores enable more accurate premium pricing. However, there may be concerns as to the relevance of relying on credit information to underwrite customers, especially as the COVID-19 pandemic ravages the United States economy.

INSURANCE RISK SCORES INCREASE OBJECTIVITY

The good news is that insurance risk scores *increase* objectivity in insurance decision-making. TransUnion data shows that basing underwriting decisions on these insurance risk scores helps properly identify high- and low-risk customers and does not use or contain any information regarding income, race or ethnicity.[1] The data also shows that scores have been very stable over the course of the pandemic, indicating that they're a valuable metric over the long term, even during economic downturns.[1]

All in all, consumers gain greater access, more financial protection and an improved customer experience when life insurance companies use insurance risk scores as part of their underwriting process – all things every provider should strive to deliver, especially in the COVID-19 era.

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BACKGROUND: INSURANCE RISK SCORES ARE NOT THE SAME AS TRADITIONAL CREDIT SCORES

Those unfamiliar with insurance risk scores might think of them as just another version of the traditional credit score we're all familiar with. But that's not the case. Both scores are similar in that they predict future risk, but they differ in why and how they are created.

So, before we look at stability in insurance risk scores, let's first compare traditional credit scores and insurance risk scores.

TRADITIONAL CREDIT SCORES:	INSURANCE RISK SCORES:
• Predict credit delinquencies of financial transactions, such as for credit cards or mortgages • Are used as the primary tool in credit underwriting decisions, among other potential variables • Are subject to the Fair Credit Reporting Act (FCRA)	• Predict insurance losses • Are used to make insurance underwriting decisions, among other variables (such as age and medical history) • Are likewise subject to FCRA and consider unique state regulations regarding use of credit in insurance

ACCELERATED, NO-TOUCH UNDERWRITING IS NOW CRITICAL FOR SUCCESS

Traditional life insurance underwriting can be a long, drawn-out process, and it often requires a physical visit to the customer's home for a medical exam. Even in ordinary times, this process has formed a barrier for many insurance shoppers who prefer a frictionless digital experience and may balk at the invasive nature of an in-person examination. And during the COVID-19 pandemic, stay-at-home orders and preferences for social distancing make the traditional process even less appealing – at a time when, as we'll see, more people want access to the financial security that life insurance offers.

Insurance risk scores can help providers overcome these difficulties. Customers can apply for life insurance through online or digital channels. Insurance risk scores help providers triage shoppers as they make their way through the underwriting process. While some customers will still need to arrange a medical exam, many will not; this reduces insurer costs and makes shoppers more likely to complete their applications and obtain the coverage they want.

The upshot? An accelerated underwriting process, powered by insurance risk scores, brings an improved life insurance process to more customers via both traditional channels and the digital channels that have been gaining importance during the COVID-19 crisis.

STABILITY IN TROUBLED TIMES

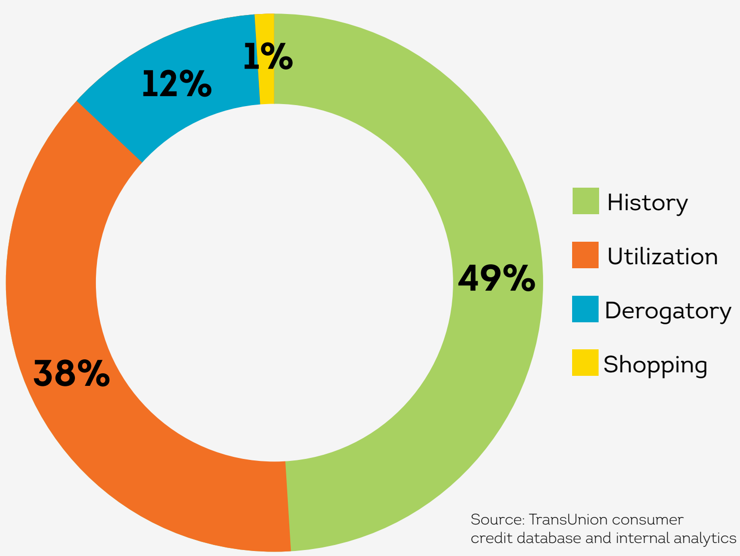
But as the COVID-19 crisis continues, leaving many potential customers in tenuous economic circumstances, insurance providers may worry about the stability of using insurance risk scores.

For example, if someone lost their job in the hospitality industry due to 2020's huge drop in travel, that shouldn't make it harder for them to buy life insurance, should it?

Rest easy: That's not how insurance risk scores work in practice. Remember, while insurance risk scores draw on credit data, they aren't making the same financial predictions that a traditional credit score does.

To understand this better, let's take a look at the four main contributors to the predictive power of TransUnion TrueRisk® Life Score, as seen in Figure 1:

- First, and most powerful, is historical information, shown in green at 49%. This represents factors like how many accounts a consumer has over time and their tenure.
- Second, at 38% and shown in orange, is utilization, which is the ratio of a consumer's balance to their limit.
- Third, at 12% and shown in blue, is derogatory information. This includes delinquencies or delinquent activity, such as bankruptcies and poor payment histories.
- Last, shown in yellow at 1%, is shopping information based on credit inquiries. More simply, it's the instances where a consumer has applied for new credit.



As you can see, when it comes to insurance risk scoring, the ability to make timely payments isn't necessarily the most important risk factor. In fact, preliminary TransUnion analysis has shown that as the COVID-19 pandemic has played out in 2020, the other factors have played an important role in keeping these scores stable and predictive.[1]

Figure 1. **The four main contributors to the predictive power of TrueRisk Life.**

TrueRisk Life was built with more priority given to longer-term attributes and performance, which means the score will be more stable over time and less impacted by recent derogatory and shopping behaviors than typical scores.

THE CARES ACT AND CREDIT REPORTING

Moreover, the Coronavirus Aid, Relief and Economic Security (CARES) Act has affected how certain kinds of financial distress can be reflected in the credit reporting data that goes into these insurance risk scores.

The CARES Act has no direct impact on credit-reporting agencies like TransUnion. Instead, it focuses on data furnishers – creditors, lenders and utilities, as examples – and how they should handle consumers affected by COVID-19-related financial distress.

Under the CARES Act, how data furnishers report accounts to credit reporting agencies depends upon whether the consumer was current or already delinquent when the accommodation was made. The data furnisher shall:

- Report as "current" if the account was current before the accommodation
- Not advance the "delinquent" status if the account was delinquent before the accommodation
- Report as "current" if the borrower brought the account to current from delinquent

Note that the CARES Act requirement applies only to agreements made between January 31, 2020, and the later of either 120 days after March 27, 2020, or 120 days after the national emergency ends. (For more details, see the TransUnion COVID-19 Resources for Data Furnishers.)

ANALYZING DATA-FURNISHER REPORTING DATA

As such, lenders across multiple industries have begun reporting payment accommodations through a variety of forbearance and payment codes. A payment accommodation is a term used to classify any type of forbearance or payment suspension to borrowers to provide temporary loan relief due to COVID-19.

As of December 27, 2020, 12.7 million US consumers have at least one non-student loan COVID-19 payment accommodation on file,[2] which is down from a peak of 21 million consumers on June 28, 2020 (student loan payment accommodations are excluded, as a significant portion are not consumer initiated).

As shown in Figure 2, new accommodation reporting outpaced accommodation removal through the end of May 2020. Since then, the count of accommodation removals has been greater than newly reported accommodations. As of December 27, 2020, 78% of all reported accommodations since March have been removed.

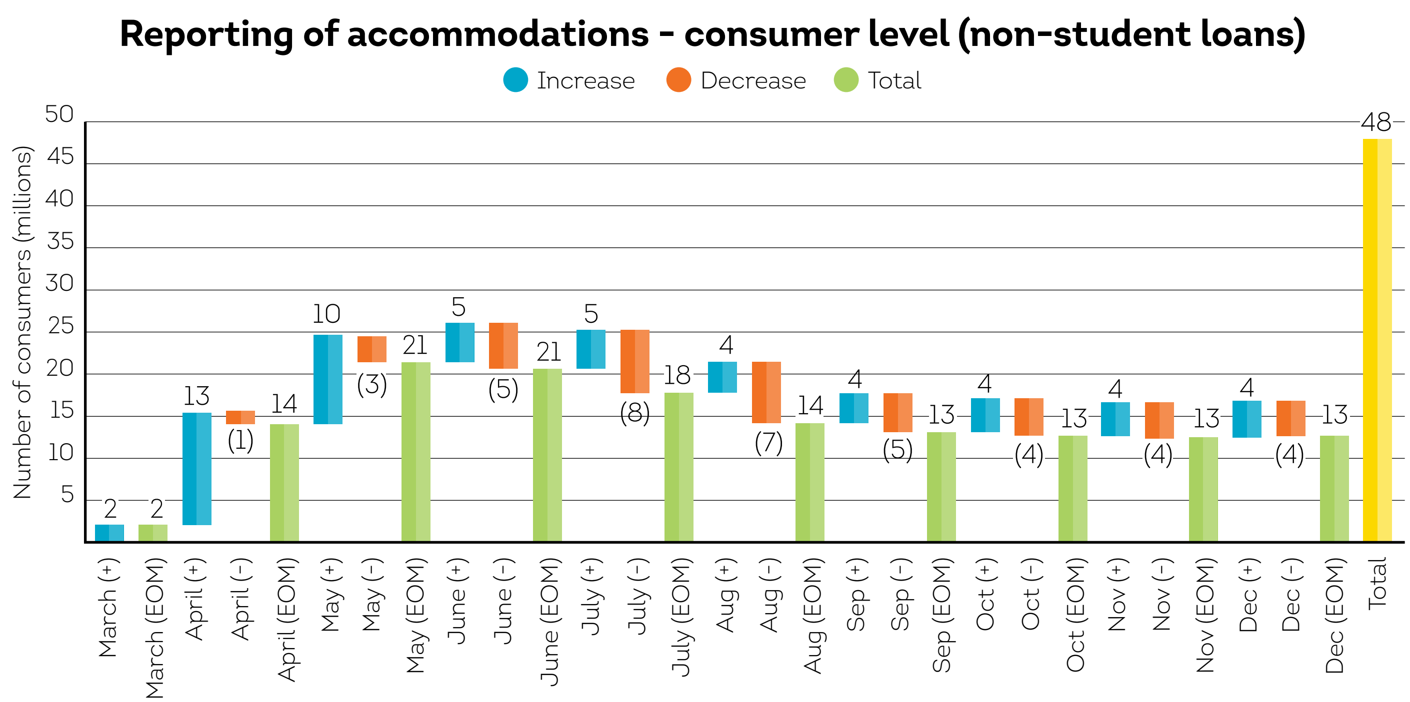


Figure 2. Reporting of accommodations – consumer level (excluding student loans).

A STEADY METRIC

As a result of how the model was developed, the median TrueRisk Life Score has not changed over the course of 2020. That means that life insurance providers can still accurately segment customers' risk profiles despite the economic disruption represented by the COVID-19 pandemic.

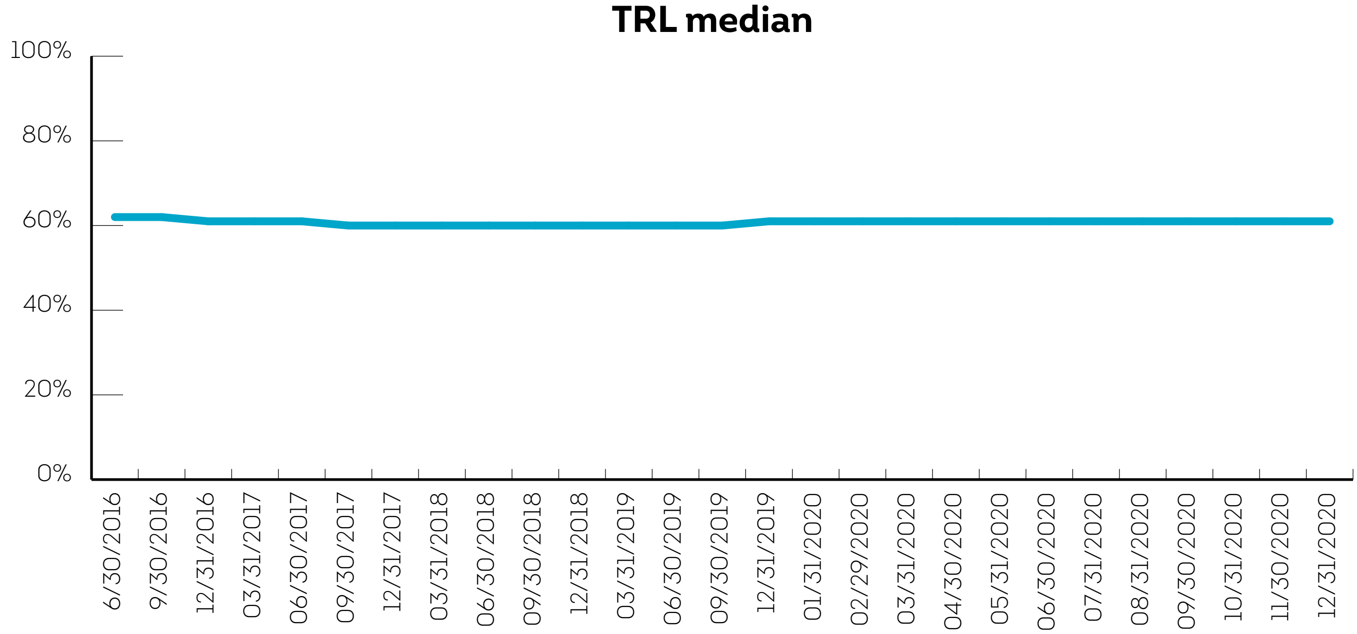


Figure 3. **Median TrueRisk Life Insurance Score (2016–2020).**

TransUnion has also been able to leverage data around insurance risk score inquiries to make an intriguing discovery: ***The population of those seeking quotes for life insurance has a lower risk than the population as a whole, perhaps because those proactive enough to seek the protection of life insurance are generally more responsible in their conduct.***[3]

Figure 4 shows the distribution of scores for life insurance applicants. The median score has been very consistent since the start of the pandemic, but you will also notice that the median score is significantly lower (indicating lower risk) than for the total population shown in Figure 3.

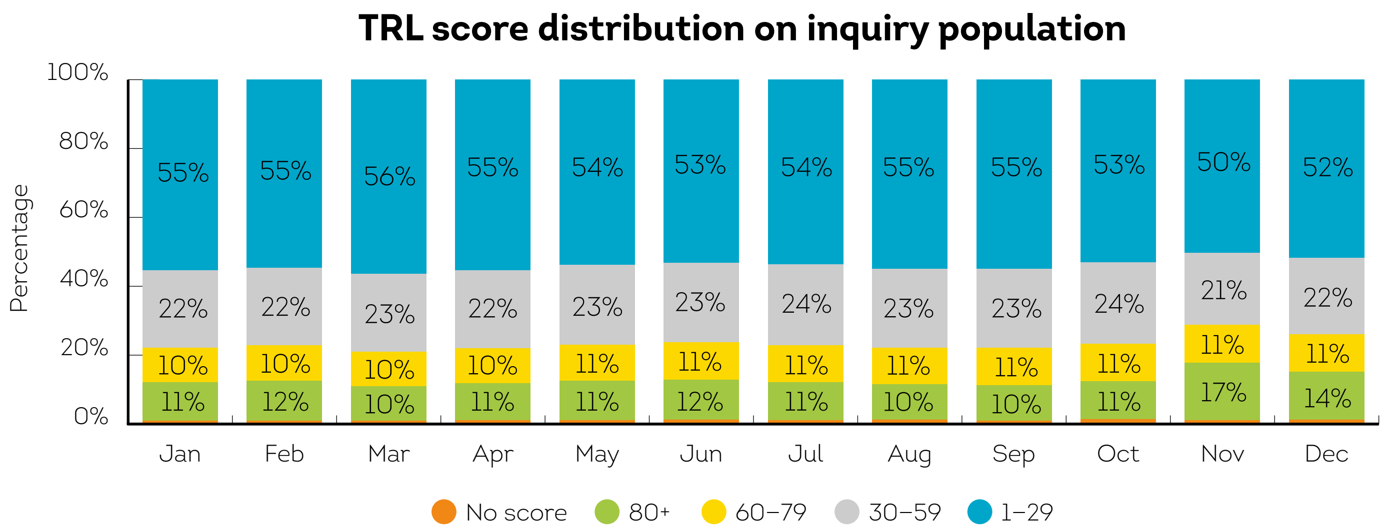


Figure 4. **Median TrueRisk Life Insurance Score (life insurance applicants, 2020).**

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TransUnion also looked at the age distribution of applicants before and after the start of the pandemic to determine if there has been a shift in the age of life insurance applicants. Surprisingly, the age profile of applicants has stayed fairly consistent. In January, 74% of applicants were 49 or younger. In October, the profile was almost exactly the same, with 75% of applicants being 49 or younger. So while more people have become aware of the need for life insurance and are shopping for it, the age of those applicants has not changed.

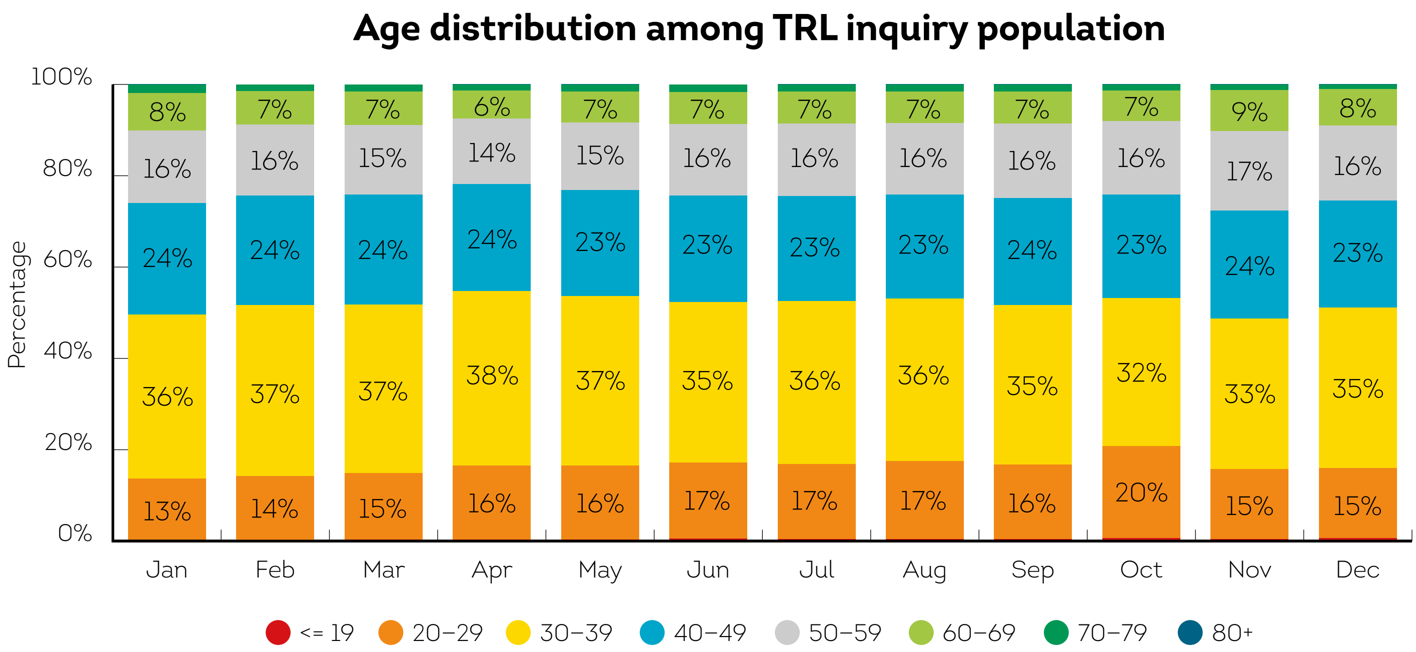

Figure 5. Age profile of TrueRisk Life Insurance Score inquiries, 2020.

AN OBJECTIVE TOOL

Insurance risk scores provide insurers with a tool to improve the objectivity of their underwriting even during the COVID-19 pandemic. Furthermore, there have been several extensive external studies that have been completed in the last two decades that speak to the subject matter contained herein.

For instance, researchers from the Federal Reserve Board[4] completed an extensive study in 2010 that provided definitive results and stated, “The results of our analyses provide little or no evidence of disparate impact by race or ethnicity or by gender.” The study also stated, “Additionally, we are unable to identify any credit characteristics whose omission from the model appears to be the result of correlations with these demographic groups.”

Additionally, in July 2007, the Federal Trade Commission (FTC) released a study[5] that reached conclusions virtually identical to those of an earlier Texas Department of Insurance report.[6] The FTC report found that credit-based insurance scores appear to have little effect as a proxy for membership in racial and ethnic groups in decisions related to insurance. In fact, it found when credit-based insurance scoring is used, 59% of consumers pay less for insurance.

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TRANSUNION: COMMITTED TO HELPING THE INDUSTRY AND CONSUMERS

Unlike other more traditional life insurance underwriting reports that may contain limited information on certain applicants, insurance risk scores are available for the vast majority of the population. They can enable life insurers to offer more products and better coverage to more consumers and to progress in their digital transformation of customer outreach, risk assessment and policy fulfillment processes. In turn, consumers can benefit from this, because their application experiences are easier, faster and more user friendly, ultimately delivering easier access to greater financial protection.

COVID-19 has not shaken the stability of these insurance risk scores, proving their resilience to volatile economic conditions. That's crucial, because digitization has become ever more important to the industry during the pandemic and will remain so afterwards. TransUnion continues to monitor score trends with the aim of helping insurers and consumers weather the storm and emerge stronger than before. We call this **Information for Good®**.

HOW TO LEARN MORE

If you have questions about TransUnion insurance risk scores, please visit **transunion.com/industry/insurance/life-insurance** or email **inssupt@transunion.com**.

NOTE: This analysis was conducted exclusively for validating the stability of our insurance risk scores, not for evaluating individuals' risks.

CITATIONS

[1] 2020 TransUnion internal analysis.

[2] The CARES Act suspended payments on federally held student loans through September 30, 2020, and an executive order directed the Department of Education to extend the suspension until December 31, 2020. [Source: *Information for Student Loan Borrowers*. Consumer Financial Protection Bureau. https://www.consumerfinance.gov/coronavirus/student-loans.]

[3] TransUnion Median TrueRisk Life Insurance Score, 2020.

[4] Robert Avery, Kenneth Brevoort and Glenn Canner. "Does Credit Scoring Produce a Disparate Impact? Board of Governors of the Federal Reserve System." October 12, 2010. Federal Reserve Board, Washington, D.C. https://www.federalreserve.gov/pubs/feds/2010/201058/201058pap.pdf.

[5] "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance." Federal Trade Commission, July 2007. https://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf.

[6] "Use of Credit Information by Insurers in Texas." Texas Department of Insurance, January 2005. https://www.tdi.texas.gov/reports/documents/credit05sup.pdf.

