THE ECONOMIC BENEFITS OF RISK-BASED PRICING

for Historically Underserved Consumers in the United States

OVERVIEW

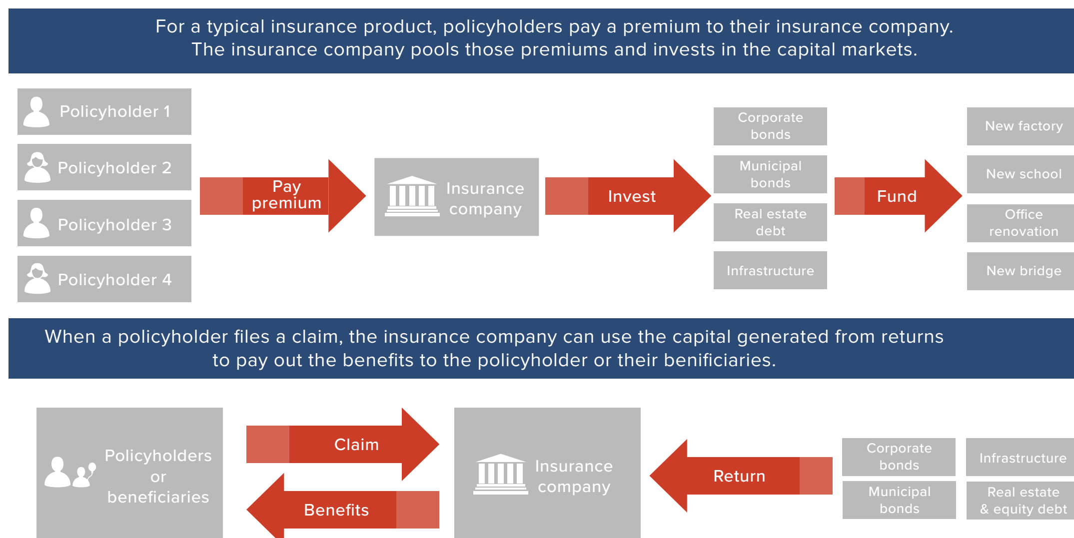
In 2021, U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) released the Economic Benefits of Risk-Based Pricing for Historically Underserved Consumers in the United States, which focuses on how risk-based pricing allows financial institutions, including insurers, to use analytics to better assess risks to offer innovative products at lower prices for consumers. Insurers provide financial protection against an individual's future unknown costs related to insurable losses on products like homeowners and automobile insurance.

KEY FINDINGS FROM THE REPORT INCLUDE:

1. Consumers are better off in the risk-based pricing system than in a uniform pricing system.
2. Credit scores, credit-based insurance scores, and other risk-based pricing factors are proven to accurately predict risk unbiasedly.
3. Minority and low-income households have realized the greatest improvements in assets and access to capital.
4. Companies are innovating and using alternative data to reduce the credit-invisible population and improve credit scores for those who currently have them.
5. Incorporating more predictive data, not less, into risk-based pricing models generates positive economic benefits.

As detailed in CCMC report titled The Role of Insurance Investments in the U.S. Economy – U.S. insurance companies finance long-term improvements in the U.S. real economy by investing policyholder premiums in anticipation of future claims. U.S. insurers deploy capital focused on longer-duration, relatively lower-volatility investments. The industries' more than $6 trillion in assets translates to the financing of economic infrastructure, affordable housing, and job creation across the United States.

By employing a risk-based pricing model insurers are able to continue to serve customers and through their investments support businesses, households, and local governments as an important source of stability to financial markets.



WHAT IS RISK-BASED PRICING AND HOW IS IT USED BY INSURERS?

- Risk-based pricing allows lenders and insurers to offer different rates or other terms to consumers based on their individual risk
- In general, insurers commonly use factors such as credit-based insurance scores (CBIS), location, driving experience, education, occupation, and property value into their risk models to predict the probability of nonpayment or insurance losses.
- Importantly, variables like CBIS, education, and occupation that, on the surface, seem unrelated to auto or homeowners insurance have been shown to strongly predict the likelihood of losses for individuals and are valid components of risk-based pricing. CBIS models utilize credit history data but include only factors shown to statistically correlate with claim costs.
- From an actuarial perspective, these factors are proven to predict risk and can improve the accuracy of risk-based pricing models so that insurers can better predict losses and offer consumers more competitively tailored rates.

HOW DOES RISK-BASED PRICING BENEFIT CONSUMERS?

- Under a risk-based pricing system, costs are lowered for the majority of consumers who are deemed low-risk, while opportunities are expanded for higher-risk consumers.
- The more accurately these models can predict risk, the more companies can offer lower rates and expand access to insurance, especially for underserved populations.

WHAT HAPPENS IF INSURERS ARE PROHIBITED FROM USING CERTAIN DATA?

- Limiting or prohibiting the use of relevant data in risk-based pricing has negative consequences; firms must rely on less information to predict risk, which reduces accuracy and, ultimately, increases costs and decreases access to competitive credit and insurance products for consumers.
- According to a 2020 study, “When insurers are prohibited from using an accurate rating variable, or the use of a variable is tempered, the average price for higher-risk policyholders decreases, and that of lower-risk policyholders increases.”[1]

For homeowners and auto insurance policies, participation in the residual market (for those who cannot get approved in the private market) has decreased substantially over time, indicating that more consumers have access to competitive products and rates.

A survey conducted by the Arkansas Department of Insurance found that, during 2016, 57.4% of automobile insurance policies that were written or renewed had reduced premiums because credit was included as a factor in the ratemaking decision and 56.6% of homeowner’s insurance policies resulted in premium reductions.

1. Powell, Lars. 2020. “Risk-Based Pricing of Property and Liability Insurance.” Journal of Insurance Regulation, 39(4)

RESOURCES

The role of insurance investments in the U.S. economy

The Economic Benefits of Risk-Based Pricing for Historically Underserved Consumers in the United States

Statement for the record regarding the March 4, 2021 hearing in the Housing & Insurance Subcommittee entitled, “Drivers of Discrimination: An Examination of Unfair Premiums, Practices, and Policies in the Auto Insurance Industry.”