RISK-BASED PRICING OF PROPERTY AND LIABILITY INSURANCE

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IMPORTANCE The use of several insurance rating factors – including credit-based insurance scores (CBIS), education, and occupation – improves the accuracy of insurance prices, yet it is frequently a controversial topic in some states and at the federal level. Arguments provided for and against these variables are inconsistent and demonstrate a lack of objective information in civil discourse.

OBJECTIVES The primary objective of this article is to provide a thorough explanation of how and why these variables are used, and how they affect consumers. I also address several common criticisms of rating variables with logic, statutory language, and empirical evidence.

FINDINGS The use of CBIS, occupation, and education as insurance rating variables has been studied by regulators, policymakers, and academics. Evidence consistently shows that these factors are correlated with losses and they make insurance rates more accurate.
The most common arguments used against these rating factors are incorrect, irrelevant, or both. Critics argue that these variables 1) have no causal relation to losses (incorrect and irrelevant), 2) that they do not provide incentives for loss control (incorrect), and 3) that they are used as proxies for prohibited factors (incorrect). Read the paper for details! The high level of competition observed in insurance markets protects consumers from excessive prices.

CONCLUSION & RELEVANCE Accurate insurance prices are optimal for policyholders, insurance companies, and society, because accurate prices result in an efficient level of risk-taking. Accurate prices also distribute the cost of risk equitably, such that riskier insureds pay more than safer insureds. Studies show that inaccurate rates increase losses, which makes insurance more expensive and increases property damage, injuries, and deaths. Therefore, I recommend allowing these variables in ratemaking.