Consumer Perspectives on Insurance Credit Scoring

NCLC / Suffolk University Law School
Symposium on Credit Scoring & Credit Reporting

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The Center for Economic Justice

CEJ is a non-profit consumer advocacy organization dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. Most of work is before administrative agencies on insurance, financial services and utility issues.

On the Web: www.cej-online.org

Overview

1. Insurance Credit Scoring (CS) Is Inherently Unfair

2. CS Has A Disparate Impact on Low-Income and Minority Consumers

3. CS Undermines the Core Public Policy Goals of Insurance

4. CS Is Not Needed / Insurer Claims of Consumer Benefits of CS are Refuted by Objective, Independent Data

5. 2007 FTC Study Massively Flawed

Insurance Scoring Has Wide Impact on Consumers

Used by insurers writing the vast majority of personal auto and residential property insurance markets.

200 million vehicles insured

75 million residential properties insured – plus millions more renters.

Over $250 Billion in Annual Premiums

Insurance Credit Scoring is Inherently Unfair

- Penalizes Victims of Medical, Economic Catastrophes
- Penalizes Consumers for Abusive Lending Practices / Broader Economic Conditions
- Arbitrary and Illogical Results – Unrelated to How Well a Consumer "Manages" Her Finances

Consumers Hammered By Financial Crisis and Recession

- Reckless and Abusive Lending
- High Unemployment
- Wage Cuts
- Credit Limit Reductions
- Increases in Loan and Credit Card Fees
- Increasing Medical Costs

Record or Near-Record Highs in

- Delinquencies
- Foreclosures
- Bankruptcies

Are Insurance Scores Predictive of Future Claims?

Despite huge increases in characteristics purportedly associated with insurance claims – delinquencies, foreclosures – in the aftermath of the financial market collapse and Great Recession, insurance claims decreased – even in the states with the highest delinquency and foreclosure rates.

"Rank Ordering" – makes no sense as a rationale for insurance scoring.

Causes of Bankruptcies

Harvard Study of Bankruptcies in 2001:

- 87% of Bankruptcies Caused by Job Loss, Medical Bills or Divorce
- 46.2% from Medical Problems

Harvard Study of Bankruptcies in 2007:

- 62.1% of Bankruptcies Caused by Medical Problems
- 75% of These Were Families With Health Insurance.

Insurance Credit Scoring Is Not Objective

- Differences across credit bureaus
- Differences within a credit bureau due to lender choices
- Changes in definitions of credit report items – bankruptcy law change
- Public policy initiatives changing credit scores – moratorium on foreclosures
- Timing of report – balance to limits varies by time of the month
- Decisions of lenders – not reporting limits, changing limits
- 17% not scorable – no hits, thin files – these consumers treated negatively

Insurance Credit Scoring Is Subject to Manipulation

- Invitations/Solicitations for Manipulation
- Piggy-Back on another consumer
- Shift balances from one car to multiple cards

Penalizes Consumer for Rational Behavior

- Shop around for best rates
- Cancel a card when lender acts unfairly
- Get a card to get 10% first visit discount

Correlation to Race and Income – The Missouri DOI Study

- The insurance credit-scoring system produces significantly worse scores for residents of high-minority ZIP Codes.

- The insurance credit-scoring systems produce significantly worse scores for residents of low-income ZIP Code.

- The relationship between minority concentration in a ZIP Code and credit scores remained after eliminating a broad array of socioeconomic variables, such as income, educational attainment, marital status and unemployment rates, as possible causes. **Indeed, minority concentration proved to be the single most reliable predictor of credit scores.**

Correlation to Race and Income – The Texas DOI Study

The individual policyholder data shows a consistent pattern of differences in credit scores among the different racial/ethnic groups. The average credit scores for Whites and Asians are better than those for Blacks and Hispanics. In addition, Blacks and Hispanics tend to be over-represented in the worse credit score categories and under-represented in the better credit score categories.

Credit Scoring Reflects / Perpetuates Historical Inequities

"Segregation therefore racialized and intensified the consequences of the American housing bubble. Hispanic and black home owners, not to mention entire Hispanic and black neighborhoods, bore the brunt of the foreclosure crisis. This outcome was not simply a result of neutral market forces but was structured on the basis of race and ethnicity through the social fact of residential segregation."

Rugh and Massey, *Racial Segregation and the American Foreclosure Crisis*, American Sociological Review, Vol 75, No 5

Undermines the Core Public Policy Goals of Insurance

- Undermines the goal of universal coverage by worsening the availability and affordability of insurance for those consumers with the least means to purchase insurance; and

- Undermines the loss mitigation role of insurance by

  - Placing great emphasis on a rating factor which has no ability to promote loss mitigation by policyholder; and

  - Encouraging consumers to spend time manipulating credit scores instead of true loss mitigation activities.

Insurance Scoring Is Not Needed

- States Which Ban Insurance Credit Scoring, including California and Massachusetts Have Thriving Markets.

- Insurers Entered The Massachusetts Auto Market After Partial Deregulation, Even Though Insurance Credit Scoring Is Banned.

- Insurance Credit Scoring Not Needed to Avoid Adverse Selection.

- Insurance Credit Scoring Not Needed With Modern Risk Classification.

Claims of Consumer Benefits of Insurance Scoring Are Refuted by Objective, Independent Data

"Allows Insurers to Write More Business"

Fact: Uninsured Motorist Rate Has Increased Countrywide While Uninsured Motorist Rate Has Declined in CA and MA where Insurance Credit Scoring is Banned

Fact: Auto Residual Market Has Declined More in CA than Countrywide

Fact: Creditor-Placed (Force-Placed) Insurance Has Skyrocketed in Past 5 Years

No Objective Evidence to Support This Claim

Industry Claim: "Insurance Credit Scores Reflect Personal Responsibility"

Blaming the Victim Claim is Factually Incorrect

- Actual Causes of Financial Distress Typically Beyond Control of Consumers

- Traditional Credit Reports Missing Information on Financial Responsibility, Let Alone Personal Responsibility

- Recent Actions by Credit Scoring Modelers to Utilize Non-Traditional Credit Information Documents Disparate Impact of Traditional Credit Information on Low-Income and Minority Consumers.

FTC 2007 Study

The FTC analysis of insurance scoring is deeply flawed and the report is unresponsive to its Congressional mandate. The report's harm to consumers in the debate over insurance scoring has been immense. The problems with the report include:

1. Data for the study selected by industry. The insurance industry effectively controlled the study by dictating the data that would be used in the study. There was no way to determine if the data were reliable.

   FTC did not know whether the policyholders included had or had not been insurance scored. FTC re-weighted the data to address underrepresentation in low-income and minority communities.

2. No substantive analysis of the impact of insurance scoring on the availability and affordability of insurance products as requested by Congress. Because of its reliance on industry-selected data, the FTC performed no analysis of how consumers actually fared from insurers' use of credit scoring. No information on average credit scores or average premiums for **applicants.**

3. Regurgitating insurer claims about credit scoring despite evidence that contradicts these claims. The FTC ignored evidence indicating that the correlation between insurance scores and claims was a spurious correlation – that insurance scoring was a proxy for some other factor actually related to claims.

4. The failure to analyze the "blaming-the-victim" strategy used by insurers to justify insurance scoring -- the bogus claim that people who manage their finances well are likely to manage their risks well and that's why credit scoring works. The fact is that, by the credit modelers own admission, almost 20% of the population is unscorable with traditional credit reports because of little or no information in the files. These folks are disproportionately low income and minority consumers who get charged higher rates through no fault of their own. And even a cursory examination of actual scoring models reveals that most of the factors determining an insurance score have nothing to do with whether a consumer pays her bill on time, but with factors related to socio-economic status. Yet, the FTC report dutifully repeats this desperate rationalization for insurance scoring with no critical analysis.

5. The failure to examine any alternatives to insurance scoring that are predictive of claims but are not based on any consumer credit information. The FTC ignored research indicating that insurers could eliminate the use of credit information but obtain the same ability to predict claims with advanced modeling and data mining of traditional rating factors. Consequently, the FTC ignored an obvious alternative to insurance scoring that could reduce the impact on low income and minority consumers.

FTC 2007 Auto Study

African-Americans and Hispanics are Disproportionately Represented in Bad Insurance Score Ranges – But Scoring is Not a Proxy for Race

What does it mean for something to be a proxy?

Insurers Claim Credit Scoring Allows Insurers to Rate More Accurately and Thereby Allows Them to Write More Business – We Agree, Despite All Evidence to the Contrary

"Use of credit-based insurance scores may result in benefits for consumers. For example, scores permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would otherwise not be able to determine an appropriate premium. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums. However, little hard data was submitted or available to quantify the magnitude of these benefits to consumers."

If insurance scoring resulted in insurers writing more business, what would we expect to see in states allowing insurance scoring? Fewer uninsured drivers and fewer drivers denied coverage in the voluntary market and subsequently insured in the residual market.

“Figure 7 shows that the state-run program share fell during the second half of the 1990s, as score were being introduced, and then leveled off after 2000. The pattern is nearly identical in states that allowed the use of scores and states that did not.”

Did the FTC conclude that these results were inconsistent with industry claims about insurance scoring causing insurers to write more business?

“Therefore, Figure 7 is probably best interpreted as meaning that scores at least did not interfere with the smooth functioning of automobile insurance markets.”

What about uninsured motorist rates?

“Figure 6 also shows the number of uninsured motorist claims filed compared to the number of property damage claims filed was basically unchanged in states where scores were allowed and decreased somewhat in states where they were not.”

Did the FTC conclude that these results were inconsistent with industry claims about insurance scoring causing insurers to write more business?

“These results, however, should be treated with caution.”

Indeed.