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Governor, OFIS Commissioner Propose Rule to Cut Base Insurance Rates by Banning the Use of Credit Scoring

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LANSING – Governor Jennifer M. Granholm and Office of Financial and Insurance Services (OFIS) Commissioner Linda A. Watters today proposed a new state rule to reduce base rates for all insurance customers by banning the use of credit scoring in determining rates for homeowners and auto insurance sold in Michigan.

Granholm said the announcement today is the first step in her plan to address the rising cost of insurance in Michigan.

To recoup the cost of offering a credit score discount to one group of consumers, insurance companies have increased their overall base rates. Since 1999, when credit scoring began to be widely used in Michigan, average automobile insurance base rates, as reported in the OFIS Buyers Guide to Auto Insurance, increased between 45 and 90 percent, depending on location. Homeowner rates increased between 86 and 152 percent. The new insurance rule would eliminate the use of credit scoring for discounts, resulting in an expected decrease in base rates of between 10 and 45 percent.

“The use of credit scoring in Michigan has caused base rates to rise beyond what’s affordable to many Michigan citizens,” said Granholm, “especially those who do not qualify for any kind of discount. Insurance companies should be offering discounts based on the actions a consumer can take to reduce his or her insurance risk – like installing a smoke detector or buying a car alarm – not on an unrelated, unreliable credit score.”

Under the state’s Essential Insurance Act, discounts for insurance must be applied uniformly across the state to all insured persons. In addition, rates must be based on a reasonable classification under the code. Commissioner Watters said the use of credit scoring does not meet the requirements of a valid discount under the act.

“The unreliability of the data in credit reports alone violates the intention of the Insurance Code,” said Commissioner Watters. “Credit reports are fraught with errors, and consumer scores can vary from ‘high risk’ to ‘low risk’ depending on which credit reporting agency an insurer uses.”

Watters pointed out that there is no uniform, industry-wide standard mathematical model for use in insurance credit scoring, which makes it impossible for consumers to know how a given insurance company will determine their credit score. Scores are often influenced by factors beyond a consumer’s control or by factors that are traditionally associated with good financial management.

“Because the discounts are often based on factors that consumers cannot control, there is no ability for consumers to change their behaviors to achieve the discount that insurers might be offering,” Watters said. “Since consumers don’t know how their credit score is set, they can’t take action to change it.”

The Governor and OFIS Commissioner were joined by legislators from southeast Michigan who have been actively working on the issue in the Michigan House of Representatives.

“This is one of the most critical consumer protection issues facing our state,” said Rep. David Woodward (D-Royal Oak), who has sponsored legislation to ban the use of credit scoring in setting insurance premiums. “Insurance rates must be based on fair objective criteria, such as a person’s driving record, and not on some ambiguous set of conditions designed by the insurance industry.”

“Insurance credit scoring is nothing more than a subtle form of discrimination,” stressed Rep. Artina Tinsley Hardman (D-Detroit). “It is important that Michigan leads this country in ending a process that disproportionately hurts poor and minority families.”

Michigan would become the first state in recent years to completely ban the use of credit scoring in determining home and auto insurance premiums. California has banned it for setting auto insurance rates, and Maryland has banned using credit scores to determine homeowner’s insurance rates. Should the rule be approved, it would affect all personal lines of insurance.

According to a national report, more than 90 percent of automobile insurance companies use credit scores to set rates, while an increasing number of homeowners’ insurance companies are following suit.

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