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Credit scoring dangerous insurance trend

[JAMES DAW](#)

Texan Birny Birnbaum speaks for the poor and disadvantaged from deep in his heart, and he's opposed to letting insurers use credit histories to set their prices or decide whom to cover.

Inevitably, he argues, the use of credit scores will discriminate against the poor, the minorities and weakest members of society even though that would be prohibited by law if it were done deliberately and directly.

He tells the story of an 82-year-old widow in Dallas who was paying \$900 (U.S.) a year to insure her \$70,000 home. When Allstate Insurance introduced credit scoring, they sent her a renewal notice for \$4,500.

"In what world do they live in where that's fair?" asks the consulting economist, former state insurance regulator and now executive director of the Centre For Economic Justice in Austin.

The occult and seemingly illogical practice of mining credit data to determine who poses a greater risk of making an insurance claim is used widely for home and auto insurance in the United States.

So far in Canada, it is only used by a few of the largest insurers, and not for auto insurance. Ontario and other provinces ban its use for auto insurance. They have left homeowners unprotected.

That difference of policy confounds Birnbaum.

"It is clear both are essential insurance products," he argues. "Auto insurance is mandatory, but home insurance is essential to get a mortgage and to protect your assets. So why is credit scoring banned for auto insurance, but not even under review for home insurance?"

"Insurance is the mechanism that consumers and businesses use to protect their assets in the aftermath of a catastrophic event, a fire, an auto accident or a natural disaster.

"Insurance allows consumers and businesses to preserve and build assets, wealth and financial security. Insurance is fundamental for economic development of an individual, a community, a nation.

"Our view is that low-income consumers should have the same access to these essential financial tools as more affluent consumers, and what we find from the history of insurance red-lining (the outlawed practice of surcharging black neighbourhoods) is less access, inferior products and higher prices for low-income and minority consumers."

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Birnbaum supports the use of insurance rating factors that provide incentives for less risky behaviour and penalties for more risky behaviour. The result should be fewer accidents, claims, injuries and deaths.

But the movement to make customized use of credit records is nothing less than a revolution in the principles of insurance, and should be halted in the broad public interest, he argues.

Companies like Progressive Casualty, which no longer operates in Canada, now have billions of potential rating cells (categories), said Birnbaum. So it's impossible for them to have enough claims experience to know whether the pricing of each cell makes sense.

"Credit history is a snapshot in time of some of your credit activity," said Birnbaum. "It is not a measure of your financial responsibility." Such scores ignore whether you have savings, own health and life insurance and, in Canada, whether you have a mortgage-free home.

When people ask Birnbaum why he is opposed to credit scoring he has a long list:

- ★It is inherently unfair, because of the disproportionate impact it has on consumers in poor and minority communities.
- ★It is unfair to charge someone more after they have been forced into bankruptcy, which results about 87 per cent of the time in the United States from job loss, medical emergencies or divorce.
- ★It penalizes consumers for rational behaviour and sound financial management, such as accepting a new credit card to obtain a savings on a major purchase or as a back-up in hard times.
- ★It is an arbitrary practice and undermines basic insurance mechanisms, because the steps you might take to improve your credit score have no direct relationship to reducing your risk of an insured loss.
- ★It is contrary to public policy goals for insurance.

"If it wasn't for those things, I would have no problem with it," he said sarcastically.

The most curious situation in the United States is that exclusive agents for State Farm Mutual and Allstate Insurance who have gone before state legislatures to protest credit scoring have been dismissed, he said.

Birnbaum is hopeful that Michigan's decision to ban the use of credit scoring represents a turning point, and that studies now under way in Texas and Washington will confirm his suspicion that credit scoring is a form a race discrimination.

Many of his arguments may not apply equally to Canada, but provincial regulators should at least study what socially undesirable effects could result from the use of credit scoring.

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