Consumer Federation of America

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Joint Interim Study on Personal Credit and Car Premiums

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My name is Tom Feltner and I am the director of financial services at CFA, a national organization of more than 250 nonprofit consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education. I would like to thank the chair and members of the committee for the opportunity to present Consumer Federation of America's research concerning auto insurance pricing and particularly the relationship between the premiums charged to customers and their personal credit history.

CFA has researched auto insurance issues and advocated for fairness in the insurance market for over 20 years. We believe that when auto insurance is fairly priced, lower-income people can safely and affordably purchase, maintain and insure a car, which is generally a prerequisite to getting the best job for which they are qualified. Drawing on our research, we have urged state lawmakers and Insurance Commissioners around the country to protect consumers from the unfair use of certain auto insurance rating factors such as credit score, education, occupation and other factors that are unrelated to a driver's performance behind the wheel.

These non-driving factors often strongly influence how auto insurance is priced and result in higher prices charged to lower-income drivers regardless of their driving record and controlling for all other factors. In Oklahoma, as with every other state except New Hampshire, drivers are required to maintain auto insurance, and they face stiff penalties in the state for driving uninsured. Our research shows that most Americans believe it is right to require drivers to carry auto insurance, but we also believe that when the government orders its citizens to purchase a product in the marketplace, the government has a special responsibility to prevent unfair pricing and needs to take extra steps to ensure that the mandated product is affordable to lower- and moderate-income residents.

My testimony will focus on why we believe that auto insurance affordability is one of the most important economic development challenges faced by lower-wealth people. As part of this discussion, I would like to share the findings of CFA research that shows how drivers, particularly lower-income drivers are priced largely on socio-economic factors outside of their control rather than how they drive. These findings demonstrate the urgent need for reforms such as the prohibition on the use of credit score and other factors to set auto insurance rates.

Low-wealth people need access to a car and affordable auto insurance

For most Americans, access to the best job for which one is qualified requires ownership of a car. As a result, car ownership among low- and moderate-income (LMI) households is high. According to a 2001 government survey, 65 percent of low-income households – or those making less than approximately $20,000 per year – and 86 percent of moderate-income households – or those making less than approximately $40,000 a year – own a car.

Without insurance, drivers face severe penalties that do little to reduce the rate of uninsured motorists. In Oklahoma, drivers face high fines of up to $250, jail time, removal of their license plate, seizure of their car, and suspension of their license and registration. While the impacts of recent changes to the penalties in Oklahoma are not yet clear, the state has historically had among the largest percentages of uninsured drivers. CFA's research has shown that severe penalties have little impact on reducing the rate of uninsured motorists. Instead, our research suggests that there is a much stronger relationship between state poverty rates and the percentage of drivers without insurance. [1]

Non-driving factors used to set insurance prices, such as credit score

Earlier I noted that Americans agree drivers should be required to carry coverage, but when they are asked whether they think it is fair for auto insurers to use credit scores or other economic and personal characteristics in the pricing of auto insurance policies, a large majority say no.

In a 2009 survey commissioned by the Iowa Insurance Department that asked state residents whether people with poor credit scores should pay higher auto insurances rates, only 12 percent agreed while 65 percent disagreed.[2] When the Consumer Federation of America (CFA) commissioned a national survey earlier this year that asked a representative sample of more than 1,000 adult Americans whether they thought it was fair for insurers to use credit scores in setting auto insurance rates, only 38 percent agreed while 60 percent thought it unfair. Similarly, around two-thirds consider it unfair to use other personal characteristics, such as occupation, level of education, home ownership status, marital status when setting auto insurance premiums. On the other hand, more than 80% think it is fair to base premiums on accidents caused and moving violations.[3]

The use of credit score drives up rates in Oklahoma regardless of driver history

The use of credit scores by auto insurers to price policies has been a controversial issue over the past decade. Insurers argue that credit scores are correlated with claims frequency – the lower the credit score, the more frequent the claims – and can serve as a useful factor in their pricing of auto insurance policies. We reject this assumption since, even if there were a correlation between credit scores and claims, there is no plausible explanation as to why this is the case and having an explanation is central to classifying risk in a fair and responsible manner. However, we do see a strong relationship between credit score and income, suggesting that, when used to set insurance rates, it results in higher prices for lower-income people.[4]

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[1] Brobeck, Stephen, Michael Best, and Thomas Feltner. *Uninsured Drivers: A Societal Dilemma in Need of a Solution*. Washington, DC: Consumer Federation of America, March 2014. http://www.consumerfed.org/pdfs/140310_uninsureddriversasocialdilemma_cfa.pdf.

[2] St. Ambrose University, Use of Credit Scores by the Insurance Industry: Iowa Consumers' Perspective (2009), p. 20.

[3] ORC International, Auto Insurance Factors (June 9-12, 2016).

[4] Brobeck, Stephen, J. Robert Hunter, and Thomas Feltner. "The Use of Credit Scores by Auto Insurers: Adverse Impacts on Low- and Moderate-Income Drivers." Consumer Federation of America, December 2013. http://www.consumerfed.org/pdfs/useofcreditscoresbyautoinsurers_dec2013_cfa.pdf.

The severity of the rate hikes associated with credit scoring is staggering. For example, in 2013 CFA acquired data on insurance prices charged by the two largest auto insurers – State Farm and Allstate – for a 30-year old single woman with a good driving record (no accidents or moving violations) for the minimum required liability coverage (no collision or comprehensive coverage).

In nine U.S. cities tested as part of this study, Allstate Indemnity charged a driver with an excellent credit score $948 for coverage. A driver with the exact same, clean driving record but a poor credit score was charged on average $1,318 – $370 more or a 39 percent increase. State Farm Mutual Auto charged a driver with an excellent credit score $563, on average and a driver with a poor credit score $1,277 – more than double.

We have also seen new independent research that will be published in the coming weeks that places Oklahoma at the bottom when it comes to credit scoring fairness, and we will forward it to the committee as soon as the news outlet publishes its data. It shows that Oklahomans face some of the steepest credit-score penalties in the nation, with people having average scores paying 39% more than those with excellent scores and drivers with poor credit scores pay 200% more, even if they have a clean driving record.

Put differently, insurance companies have come to give a low credit score more weight than causing an accident or a conviction for drunk driving. While everyone in this room, and every one of your constituents can explain why someone caught drunk driving is a higher risk and should pay more for liability insurance, no one has ever explained why your credit history makes you a more dangerous driver.

Use of Credit Score Unfairly Targets Lower-Income Drivers and Drivers of Color with Higher Premiums

Even if we put aside all the well-documented problems with inaccuracies in credit scores, what we know about credit scores is that they tend to reflect economic challenges and socio-economic characteristics of individuals that have nothing to do with their ability to safely drive a vehicle. Auto insurance credit scoring benefits bad drivers with good credit, but studies have shown that its use punishes lower income drivers and people of color. For example:

- A 2007 Missouri Department of Insurance study found that minority and low-income individuals were significantly more likely to have worse credit scores than wealthier individuals and non-minorities. The average gap between minorities and non-minorities with poor scores was 28.9 percentage points. The gap between individuals whose family income was below the statewide median versus those with family incomes above the median was 29.2 percentage points.

- A 2005 Texas Department of Insurance study revealed: "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."

There have been other efforts over the years to research credit scoring as it relates to auto insurance, but generally the research has failed to meet important methodological standards, usually relying on data selected by the insurance companies without the kind of controls we would need to lend credence to the reports. For example, a 2007 Federal Trade Commission study often cited by insurance industry proponents of auto insurance credit scoring was deeply flawed. For that study, the FTC did not require insurers to submit data, but, instead, the Commission only reviewed data that was hand-picked by the insurance industry. Pamela Jones Harbour, an FTC Commissioner at the time who refused to endorse the report, made clear that her dissent was driven by the data collection methodology: the "data collection and analysis fell short of the FTC's gold standard for rigor and completeness...better alternatives were available and should have been utilized." She wrote that "had this report been based on the real insurance marketplace--using actual, verifiable data on individual policyholders, from a broad cross-section of insurance companies--reliable answers might have emerged."   But, as Commissioner Harbour explained, the use of voluntary data fatally compromised the report:

> [T]his report relies solely on two sources of information: data the insurance industry was willing to turn over voluntarily, and data that were publicly available. The data from the insurance industry came from a study of credit-based insurance scores that the industry sponsored. Not all of the firms that contributed to the study agreed to have their data forwarded to the Commission. Staff ultimately used a subset of the industry's data that came from five insurance companies.[] As the Smith letter cited in footnote 9 of the majority's statement confirms, these industry participants never provided the Commission with written verification of the accuracy, authenticity, or representativeness of the data.[] Moreover, records were stripped of identifying data, such that individual records could not be linked to specific companies. The data cannot be independently verified to determine whether any bias was introduced during the selection process. [footnotes removed]

Another study, released by the Arkansas Department of Insurance is also too flawed to use. The report is a tabulation of a survey asking insurers how many policies got a rate increase due to credit scoring, how many a rate decrease, and how many rates stayed the same after credit scoring. But the data were collected without instructions as to how the companies should calculate an increase or decrease or over what time period, which makes it impossible to say that the data submitted by any one company measures the same thing captured by any other company's data. Because individual company submissions were non-public, we cannot evaluate or validate the findings. This is important because some companies implement credit scoring by first raising everyone's base rate and then reducing the rates to high credit score drivers and not discounting lower credit score customers. So, for the Arkansas report some insurers may have reported that 100% of customers saw reductions or no change from the base rates, even though huge numbers of lower and average credit score customers actually paid more than they would have without the actuarially unjustified base rate increase. Because the companies were allowed to respond however they wanted and because the data aren't public, there's no way to meaningfully assess the credit-scoring problem with this report.

Even if we were to accept the Arkansas study's conclusion that large majorities got discounts under the credit scoring system, it would necessarily mean that the group of customers with lower credit scores paid huge surcharges, even if they had a perfect driving record. This is because insurance pricing is a zero-sum game. If 80% of the drivers got a 10% discount, then, in order to meet the rate needs of the insurance company, the remaining fifth of the customers - the lower credit score customers - would pay a 40% surcharge, irrespective of their driving history. Since we know that credit-scoring has a correlation with income and race, we would conclude that, if the Arkansas finding were accurate, credit-scoring imposes an extremely severe penalty on those least able to afford it.

While we believe that this study from Arkansas is too flawed to be instructive, it allows us to ask an important question: however insurance companies distribute the credit score penalty, is it fair to punish good drivers for reasons not associated with their driving but with economic conditions over which the consumer often has no control?

The fact is, the insurance industry has cherry-picked data to keep consumer protection efforts at bay, but they cannot answer the basic question: what does my credit score have to do with my risk of causing an accident? And although there is no meaningful, causal relationship between credit score and driving, insurance companies are allowed to place a premium on that information and punish good drivers simply because they lost a job, faced a huge medical bill, fell a bit deeper into debt, or confronted any of the other situations that can lower a credit score. This means that good drivers in Oklahoma with lower credit scores are forced to subsidize the rates of bad drivers with higher credit scores. And it is also a major reason why Oklahoma has such a high uninsured motorist rate; credit scoring makes auto insurance unaffordable for many lower-income Oklahomans.

The use of other socio-economic factors amplifies the problem for lower-income drivers

The unfair use of non-driving rating factors is not limited to credit score. In previous reports, CFA collected premium quotes from individual companies' websites to assess the impact of various rating factors on the price of auto insurance. Using this method, previous research found, for example, that several major insurers charge significantly higher premiums to drivers with only a high school diploma than to those drivers with higher levels of education, such as a master's degree.[5]

These are unfair when used individually, but have a sizable, harmful impact on affordability when used together along with other socio-economic factors, as they often are for many low-wealth people.

In June 2016, CFA released a report that calculated the impact of five personal and economic characteristics other than credit score on premiums and found that lower- and moderate-income drivers pay substantially more for basic auto insurance than upper-income drivers even when everything else (such as their address, driving record, type of car, etc) is held constant.

In Oklahoma City, for example, GEICO charged $666 per year to a married, male, manufacturing executive with a Master's degree who owned his home and had been insured with the same company for three years, but if he was an unmarried factory worker with a high school diploma, who rented his house and did not have insurance because he didn't have a car for a few months, GEICO charged him $1108, or $450 more per year. Similarly, Farmers Insurance raised rates from $692 for the higher socio-economic status driver to $1,404 for the lower socio-economic status driver.

When we tested a similar scenario with Progressive, we found that a lower-income female Oklahoman with a perfect driver record paid $1,064 per year, while the upper-income driver who caused an accident resulting in bodily injury *and* was convicted of speeding 20 mph over the speed limit both within the past 12 months paid 6 percent less than her prefect driving counterpart.

Auto insurance premiums should signal to drivers that if they drive safely they will pay less. But right now, in Oklahoma, if you want to lower your auto insurance premium by hundreds of dollars, insurance companies are saying loud and clear that you should go back to college, get married, get a new job and fix errors on your credit report or pay off your outstanding medical debts. Those may be great ideas, but your ability to afford auto insurance and comply with state law should not depend on them.

[5] Brobeck, Stephen. "Use of Education, Occupation, and Other Non-Driving Factors Inflate Premiums for Low- and Moderate-Income Drivers." Washington, DC: Consumer Federation of America, September 24, 2012. http://consumerfed.org/pdfs/PR.AutoInsuranceRateFactorRelease.9.24.12.pdf.

Conclusions

These findings raise important questions as to whether state-mandated auto insurance is priced fairly and affordably in Oklahoma. Both the use of credit scores and other personal and economic characteristics in the pricing of insurance leads to an unnecessary burden on low- and moderate-income Oklahomans who are trying to comply with the mandatory insurance law. High insurance premiums act to deny these residents economic opportunity and the ability to insure a car that is so critical to getting to the best job for which they are qualified and also help explain why so many low-wealth Oklahomans drive without insurance.

Thank you for the opportunity to share CFA's research and perspective on this critical matter.