Consumer Federation of America

The Use of Credit Scores by Auto Insurers: Adverse Impacts on Low- and Moderate-Income Drivers

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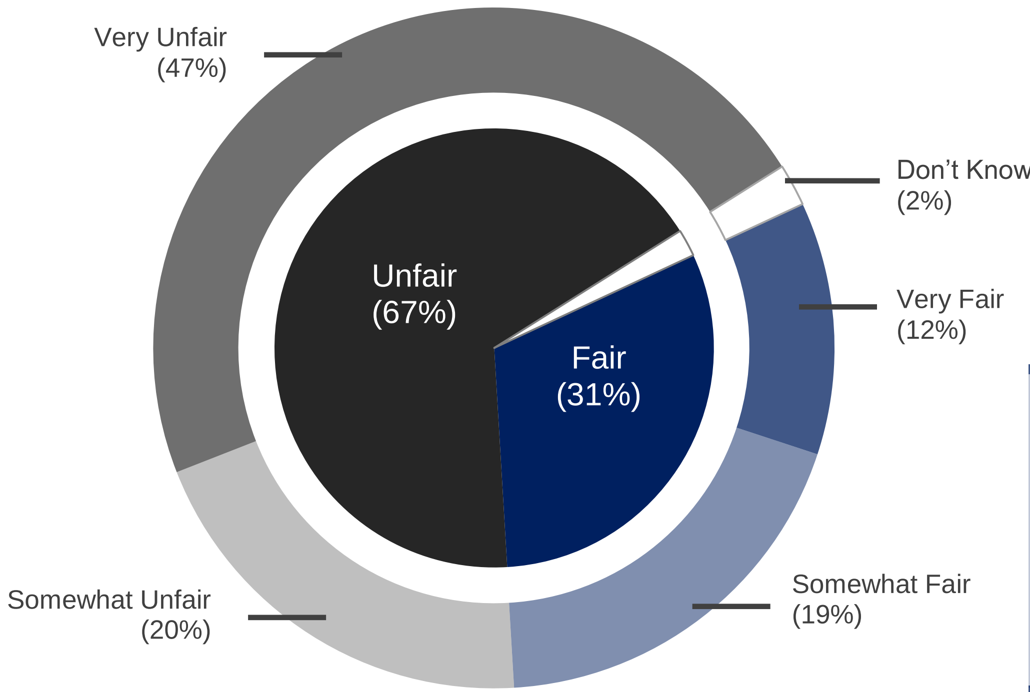
The use of credit scores by auto insurers to price policies has been a controversial issue over the past decade. Insurers argue that credit scores are correlated with claims frequency – the lower the credit score, the more frequent the claims – can serve as a useful factor in their pricing of auto insurance policies. Critics of this practice respond that correlation is not causation and that insurer use of these scores discriminates against low- and moderate-income drivers who, because of economic circumstance, are more likely to have lower credit scores than those with higher incomes.[1]

Consumer Views of Auto Insurer Use of Credit Scores

In part because auto insurance has been regulated at the state level, there has been no vigorous national debate about this issue, although three states – California, Massachusetts, and Hawaii – have prohibited insurer use of credit scores in setting auto (and home) insurance prices. However, when Americans are asked whether they think it is fair for auto insurers to use credit scores in their 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 in 2012 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 31 percent agreed while 67 percent disagreed, with 47 percent of the total sample strongly disagreeing (see Figure 1).[3]

Figure 1. Two-Thirds of the Public Believe that Using Credit Score to Determine Auto Insurance Rates is Unfair



Source: 2012 Survey conducted by ORC International

Question: "How fair do you think it is for insurers to use each of the following factors in deciding on an auto insurance price for a driver?

But does the use by insurers of credit scores in auto insurance policies result in disparate treatment of low- and moderate-income drivers? There are two key aspects of this question. First, do low- and moderate-income drivers tend to have lower credit scores? And second, what is the impact of insurer use of these scores on actual prices? Assuming all other factors are equal, are drivers with low scores charged substantially higher premiums than those with high scores? This paper summarizes old research on the first question and contributes new data on the second.

Relation between Family Income and Credit Scores

Several state insurance departments have conducted or commissioned studies of credit scores, as has the Federal Trade Commission. All of these studies have used different datasets. Yet, all have found a positive relationship between household income and these scores – as income declines, scores tend to decline.[4] A Missouri study of scores by ZIP Codes from 1991 to 2001 found that credit scores appear to be positively and significantly correlated with family income.[5] A 2003 Washington State study uncovered a "statistically significant association between credit scores and income," with lower incomes being correlated with lower scores.[6] Research by the Texas Insurance Department submitted to the state legislature in 2004 learned that "in general, average and median credit scores tend to get better as income rises."[7] And research by the Federal Trade Commission published in 2007 found that as income increases, scores tend to increase.[8] Thus, it is not surprising that a Florida Insurance study of 2001 reported that insurance agents with offices in low-income areas "unanimously condemned the use of credit scores because of the negative impact on lower-income customers."[9]

This research confirms common sense. The single most important factor in determining the credit scores of most Americans is whether they make consumer and mortgage loan payments on time. Yet, lower-income drivers are much more likely to have difficulty making these on-time payments because they have less discretionary income, less income security, and lower levels of saving. (This likelihood is not risky to insurers because, if premiums are not paid, there is no insurance coverage.) The result, as much research and reporting have revealed, is that low- and moderate-income families who make prudent financial decisions tend to face far more severe financial challenges than do higher-income families.

Relation between Credit Scores and Auto Insurance Prices

But to what extent do auto insurers tend to charge higher prices to low- and moderate-income drivers just because they have lower credit scores? This is not an easy topic to research because the auto insurer websites providing price quotes to drivers search for the actual credit scores of those making inquiries, making it very difficult to extensively compare the relationship of credit scores to premiums. To be able to make these and other comparisons, CFA purchased data on prices supplied by major insurers to Quadrant Information Services, an independent data services company that aggregates insurance premiums.

Specifically, CFA acquired data on all 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). This woman lived in a moderate-income ZIP code (c. $30,000 median income) in ten major cities – Hartford, Baltimore, Atlanta, Louisville, Chicago, Houston, Denver, Phoenix, Oakland, and Seattle. The data included premiums from all State Farm and Allstate companies that offered price quotes in these sample ZIP codes, and they differentiated ten levels of credit score – excellent, very good, good, average, fair, fair to below fair, below fair, below fair to poor, poor, and worst.

Figure 2. Driver characteristics held constant in analysis

About the Driver:

30 year old single female
Licensed 14 years
No lapse in coverage
No accidents, moving violations, or license suspensions
High school diploma
Employed in clerical profession
Tenant for 10 years
No affinity group discounts
Good credit rating

About Her Vehicle:

2000 Honda Civic EX
Drives to work 10 miles one way, 5 days/week
10,000 total miles annually

About Her Coverage:

Minimum liability coverage required by state

Excluding the Oakland prices because California disallows insurer use of credit scores in setting rates, computing the average price charged to this woman with different levels of credit score revealed an average difference of about 100 percent in price between the top and bottom levels -- $563 vs. $1277. These differences are somewhat greater for State Farm policies than for those of Allstate though the State Farm prices also tend to be lower.

How drivers in each of the ten cities may be affected is revealed by the following two tables. (Oakland is included for purposes of comparison.) In general, different companies of the same insurer sell to drivers they consider to have different risk-profiles. One would think that those drivers with fair or poor credit scores would most likely be sold policies from companies charging the highest prices.

Table 1. Allstate Annual Premiums by Credit Score Rating and City

City	Poor	Average	Excellent	Poor / Excellent
Atlanta (30311)				
F&C	$827	$583	$466	77%
Indemnity	1,295	1,295	1,295	0%
Baltimore (21215)				
Indemnity	1,399	1,122	1,001	40%
P&C	2,834	1,840	1,613	76%
Chicago (60620)				
F&C	511	511	511	0%
Indemnity	1,312	1,159	1,079	22%
Denver (80219)				
F&C	948	757	618	53%
Indemnity	1,052	914	872	21%
Hartford (06106)				
F&C	1,295	979	692	87%
Indemnity	2,096	2,096	2,096	0%
Houston (77088)				
County Mutual	1,299	1,182	1,094	19%
F&C	995	807	556	79%
Louisville (40217)				
Indemnity	1,714	1,535	1,474	16%
P&C	2,104	1,406	919	129%
Oakland (94606)				
Indemnity	526	526	526	0%
Phoenix (85032)				
F&C	652	529	456	43%
Indemnity	837	723	686	22%
Seattle (98108)				
F&C	1,440	1,014	715	101%
Indemnity	1,119	957	916	22%
Average (Excluding Oakland)	**$1,318**	**$1,078**	**$948**	**39%**

Source: Analysis of data provided by Quadrant Information Services

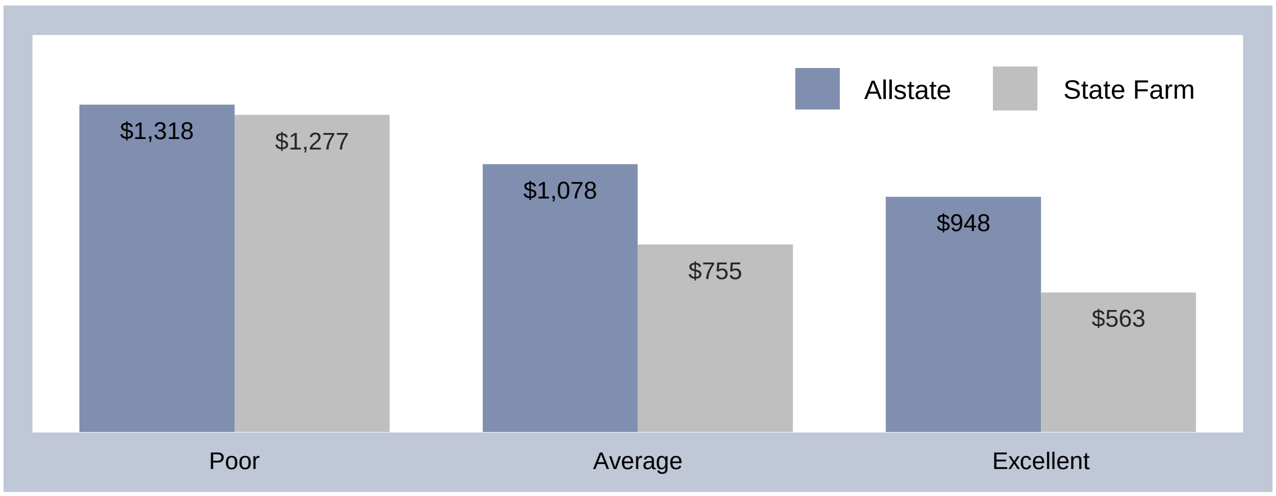
Table 2. State Farm Annual Premiums by Credit Score Rating and City

City	Poor	Average	Excellent	Poor / Excellent
Atlanta (30311)				
F&C	$998	$613	$462	116%
Mutual Auto	856	526	397	116%
Baltimore (21215)				
F&C	3,909	2,099	1,467	166%
Mutual Auto	2,788	1,485	1,030	171%
Chicago (60620)				
F&C	847	508	381	122%
Mutual Auto	761	455	341	123%
Denver (80219)				
F&C	855	557	440	94%
Mutual Auto	765	496	391	96%
Hartford (06106)				
F&C	1,570	994	779	102%
Mutual Auto	1,208	741	567	113%
Houston (77088)				
County Mutual	1,285	802	623	106%
F&C	1,033	635	485	113%
Mutual Auto	939	579	445	111%
Louisville (40217)				
F&C	1,452	867	647	124%
Mutual Auto	1,069	630	466	129%
Oakland (94606)				
Mutual Auto	658	658	658	0%
Phoenix (85032)				
F&C	920	547	408	125%
Mutual Auto	825	489	364	127%
Seattle (98108)				
F&C	1,175	714	540	118%
Mutual Auto	1,013	609	457	122%
Average (Excluding Oakland)	**$1,277**	**$755**	**$563**	**127%**

Source: Analysis of data provided by Quadrant Information Services

The two tables above reveal significant differences in prices related to credit scores in nine cities. Excluding the Oakland prices because California disallows insurer use of credit scores in setting rates, computing the average price charged to this driver with different levels of credit score revealed an average difference of 39 percent for an Allstate policy between the top and bottom credit score levels - $948 and $1,318. Likewise, this driver would pay an average difference of 127 percent for a State Farm policy between the top and bottom credit score levels - $563 and $1,277. These differences are somewhat greater for State Farm policies than for those of Allstate though the State Farm prices also tend to be lower.

Figure 3. Average Annual Premium (Excluding Oakland) by Company and Credit Score Rating



Source: Analysis of data provided by Quadrant Information Services

Though the differences are not as large as State Farm's, the prices are also higher. For an average credit rating, 13 of the 19 Allstate prices exceed $900 a year.

The analysis also suggests that the prohibitively high prices quoted in Baltimore, $3,046 to this driver if she had only an "average" credit score and $5,695 if she had a "worst" score may indicate a lack of interest in serving lower-income drivers. And in all nine cities, this driver would be charged substantially more by Allstate if she had the lowest than the highest credit rating.

Conclusion and Recommendations

These data on the relation of insurer credit scores to prices, in addition to the earlier research establishing a strong association of income and credit score, clearly show disparate treatment of low- and moderate-income drivers by major auto insurers. Again, the poor are being asked to pay more, at base, because they are poor. States should consider following the lead of California, Massachusetts, and Hawaii in banning insurer use of credit scores in their pricing. Just as importantly, all state insurance departments should make a much stronger commitment to understanding and mitigating high, discriminatory costs of auto insurance charged lower-income drivers.

Endnotes

[1]Regarding the use of correlation by insurers, the American Academy of Actuaries "Risk Classification of Principles Statement" requires that there be the "existence of a plausible relationship between the characteristics of the class and the hazard insured against."

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

[3] ORC International, Auto Insurance Omnibus (June 7-10, 2012).

[4] A 1999 Virginia State Corporation Commission's Bureau of Insurance report assessing the relationship between scores and income, according to the Federal Trade Commission, report "left unclear the relationship between scores and race and income."

[5] Missouri Department of Insurance, Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri (January 2004).

[6] State of Washington, Office of the Insurance Commissioner, A Report to the Legislature: Effect of Credit Scoring on Auto Insurance Underwriting and Pricing (2003).

[7] Texas Department of Insurance, Report to the 79th Legislature: Use of Credit Information by Insurers in Texas (December 30, 2004), p. 16.

[8] Federal Trade Commission Report to Congress, Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance (July 2007).

[9] Florida Department of Financial Services, Task Force on the Use of Credit Reports in Underwriting Automobile and Homeowners Insurance (January 23, 2002), p. 10.