Consumers Union

MEASURE 42
Myths & Facts

Myth: Most consumers get “discounts” when insurance companies use credit data to make decisions about insurance policies.

Fact: When credit scoring is used, even those receiving so-called “discounts” can pay more. For example, when Farmers Insurance Company began using credit scoring to rate and underwrite policies in Ohio, the company reported that 94 percent of its policyholders received a discount.

But in reality, 50 percent or fewer actually received a reduction in discounts. That’s because when Farmers started using credit scoring it also raised the base rates for 49.2% of its customers. Approximately 50.8 percent of its customers had their base rates decreased. After the base rates were raised, policyholders receiving a 40% credit scoring “discount” were still paying 20.3% more in premiums after credit scoring was used. A policyholder had to qualify for a minimum of a 60% credit score “discount” before actually paying less than they did before the insurer began to use credit scoring. This scenario is fairly typical of what happens when insurers using credit scoring. For many consumers with good credit, the discount is illusory.

Those who don’t qualify for the discount are heavily penalized, especially those who are disproportionately impacted by using credit scoring in insurance. In Ohio, after Farmers raised the base rate to provide a credit scoring “discount,” 8.8% of the policyholders experienced a 100.5% increase in their rates; 13.7 % had a 50.4% rate increase, and; 26.7% had their rates rise by 20.3%. Ironically, this later group experienced a significant rate increase while receiving a 40% credit scoring so-called “discount.”

Myth: Most Oregonians will pay higher rates for insurance if Measure 42 passes.

Fact: Experience in other states suggests that the benefit of credit scoring discounts is overstated, so insurance industry predictions about how rates will go up under Measure 42 are equally suspect. There is no independent analysis to support the insurance industry’s assertion that most policyholders will see premiums go up under Measure 42.

Insurance companies are already required by law to look at other rating factors that relate to risk. If the use of credit scoring in insurance is banned, insurance companies will have to rely on other important factors in setting fair rates. If Measure 42 passes, automobile insurers, for example, may choose to assign more weight to other typical factors such as one’s driving history, years of driving experience, the number of miles driven per year, and one’s claims history. Under such a system, Measure 42 would put all drivers on a level playing field. Experienced drivers with great driving records and no accidents would be the biggest winners, and bad drivers would be the losers, regardless of credit history.

In addition, competition in the marketplace will prompt insurers to minimize any potential premium hikes so they can retain their existing customers and gain additional market share.

Myth: People with low credit scores have more accidents so insurance companies are justified in charging them more.

Fact: There is no proven connection between credit status and getting into a car accident, having a home fire, or experiencing some other kind of loss. Likewise, insurers have not been able to show that individuals with low credit scores have claims that are more expensive (or severe) than people with high credit scores. A January 2005 study by the Texas Department of Insurance found that for automobile insurance, there was "very little or no statistical evidence that credit score was related to the amount of the claim or claim severity."

Insurers claim that there is a statistical correlation between low credit scores and a higher probability of filing a claim. But claims filing propensity becomes relevant only if it is preceded by an accident triggering a claim. At best, insurers have shown a statistical correlation – not a causal link -- between a lower credit score and an increased possibility that IF someone with a low credit score has an accident, they are more likely to use the insurance policy they paid for. This does not prove that individuals with low credit scores are worse drivers, or that they have significantly more accidents than everyone else.

Myth: If Measure 42 passed, Oregonians with good credit history will subsidize individuals with bad credit. That's not fair.

Fact: On the contrary, the current system penalizes experienced, good drivers who pay their premiums on time and have no history of claims, but happen to have lower credit scores. It's unfair that bad drivers are rewarded with lower premiums simply because they have a better credit score. Those bad drivers have no incentive to change their driving habits which is bad for everyone. When good drivers pay more than bad drivers, just because of their credit history, good drivers are subsidizing bad drivers. Bad drivers should pay their fair share.

Myth: Using credit based data for insurance purposes is justifiable because it is widely used to determine risk in other contexts such as banking and housing.

Fact: Using an individual's debt repayment history for credit purposes is more easily defended as a legitimate business use of credit data. Using credit data to predict insurance loss is far less compelling since it involves using credit data for a non-credit purpose. Insurers are not considering the information for debt repayment purposes since premiums are generally paid for in advance. The remedy for an insurer if an insured does not pay premiums that are due is to discontinue coverage. A lender, or a landlord, on the other hand, places much greater reliance on credit information to protect against the risk of non-repayment inherent in a credit transaction.

Myth: Credit-based insurance scores are an objective and fair way to measure subjective factors related to insurance risk.

Fact: Scores have no consistent effect on premiums. Because scoring methods vary from company to company, consumers cannot predict whether certain behavior will result in favorable or unfavorable treatment by an insurance company.

Under Oregon law, insurance companies scoring models are secret. Consumers have no legal right to examine the scoring models insurance companies use to rate their policies. By preventing an independent, public review of the models they use, insurance companies deprive consumers of vital information to help consumers gauge what they can do differently to increase their insurance scores, as responsible drivers or homeowners.

Consumer Reports examination of credit models used by large U.S. auto insurers in Florida, Michigan and Texas found numerous inconsistencies. Scoring systems can penalize consumers for reasonable credit usage. Opening three new accounts in the last year, including one credit card in the last four months, and then making two or more loan inquiries can increase your insurance score—and boost your premium.

Myth: A consumer's financial difficulties may indicate a tendency toward greater risk taking behavior and increases the odds that a person with a low credit score will be involved in an accident or file a claim.

Fact: A study conducted in 2000 by James Monaghan, a research strategist at Metropolitan Property and Casualty Insurance Company, which reviewed these longstanding inferences, says that links between responsible financial management and future expected losses are "unsupported."

Insurance scoring can punish people who are not experiencing financial difficulties. For example, only 40 percent of Fair Isaac's Assist insurance score is based on payment history. The other 60 percent weighs balances and credit limits, the age of your earliest account, whether you shopped for loans, and the types of loans you have.

Progressive's A24 credit scoring model looks at 12 items on credit records and will penalize you for opening one new credit card in the previous four months or having a credit card balance higher than 40 percent of your limit, neither actions are indicative of grave financial problems.

Myth: Credit scores are a reliable indicator of a consumer's creditworthiness.

Fact: Credit based data, upon which insurance companies rely for credit and insurance scores, are notoriously inaccurate and can lead to depressed credit scores. In 2002, the Consumer Federation of America and the National Credit Reporting Association analyzed the credit scores of more than 500,000 consumers, and reviewed the files of more than 1,700 individuals maintained by the three major credit reporting repositories. They concluded that "tens of millions of consumers are at risk of being penalized for incorrect information in their credit reports, in the form of increased costs or decreased access to credit and vital services."

In 2004, U.S. PIRG found that one in four credit reports contained errors serious enough to cause consumers to be denied credit, housing or even a job.

Consumer credit files upon which insurance scores are calculated may contain a multitude of potential errors or omissions leading to less favorable credit and insurance scores. For example:

- Credit scoring models are not designed to include good money management traits and not all types of good money management behavior is reported to the credit bureaus;

- Credit scoring models are also not designed to account for individuals who manage their finances well, but operate without credit;

- The credit score may be inaccurate because of errors in a consumer's file, identity theft, or fraud against the consumer;

- A credit card issuer's report may be distorted if it fails to provide a consumer's credit limit in its report to the three national bureaus. For example, in one case a consumer's credit score was reduced by 66 points solely because her credit-card issuer did not report her credit limits.

There are many reasons why someone may have a low credit score through no fault of their own, but still be an excellent driver or a responsible homeowner. Yet when credit data is used to make decisions about their insurance premiums, these consumers will be penalized.

Myth: Insurance companies can tell the difference between accurate and inaccurate information that influences my credit or insurance score.

Fact: Insurers have no way of knowing which of their customer's credit files include inaccurate or erroneous information. The high percentage of errors in credit reports undermines the assumption insurers make to justify the use of credit information, i.e., that good credit scores are evidence that an individual is a good money manager.

In Oregon, an insurance company can consider credit data information that is the subject of dispute by the consumer, as long as that data is not corrected in a credit file. For individuals whose credit files contain erroneous data that is difficult to correct, or where a creditor causes a long delay in reporting the correction, inflated insurance premiums can create a longstanding and unfair obstacle to obtaining vital insurance.