Insurance Credit Scoring: The Truth Will Set Consumers Free

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The biggest reason why insurance credit scoring continues to a hot-button issue for consumers and legislators around the country is that insurers have simply not told the truth about credit scoring and its detrimental effect on insurance consumers.

Ernie Csiszar's opinion piece in the February 28, 2005 issue of *NU* assembles much of the misinformation in one place and makes the bizarre claim that insurers need to assemble grass roots support for credit scoring. How this will occur is anyone's guess since the vast majority of consumers oppose credit scoring. In 2003, the Scripps Howard Texas Poll surveyed Texans on insurance credit scoring and fully 68% of Texans supported a total ban on credit scoring.

Consumers oppose credit scoring for many reasons. First, even if we assume that credit reports are accurate and complete, which is not the case, credit scoring is inherently unfair. Fully 87% of family bankruptcies result from job loss, major medical bills and divorce. It is only in the cloistered world of insurance actuaries and executives that charging higher auto and homeowners insurance rates to some who suffered an economic or medical catastrophe is considered fair.

Second, credit scoring discriminates against poor and minority consumers. The Missouri Department of Insurance study in 2004 found race to be the single best predictor of an insurance score and that credit scores for minorities were consistently lower than scores for non-minorities. The Texas Department of Insurance study found:

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.

Seems pretty unequivocal, doesn't it? But Csiszar cites Texas Insurance Commissioner Jose Montemayor's letter to the Texas Legislature in which Montemayor concludes no bias in credit scoring. Commissioner Montemayor's explanation might be plausible if it did not contradict the actual findings of his Department's study and if he did not have a history of repeatedly changing his stance on credit scoring to justify insurer practices. Mr. Montemayor is a lame duck – and was a lame duck at the time of the letter cited by Csiszar – having asked Governor Rick Perry not to reappoint him. We suspect the reason is that Mr. Montemayor has as little credibility with the Texas Legislature as he has with Texas consumers and would face a difficult, if not impossible confirmation by the Texas

Senate. Given that Mr. Montemayor's views carry little weight with the Texas Legislature, there is certainly no reason to give them any weight outside of Texas.

Interestingly, for many years, insurers justified the use of credit scoring based on a simple correlation between credit scores and loss ratios. They still cite the 1996 Fair Isaac "study" before state legislatures. Yet, the Missouri and Texas Departments of Insurance found precisely this type of relationship – a strong correlation – between credit scores and race. For insurers, what's good for the goose is apparently no good for the gander.

Third, credit scoring is arbitrary and penalizes consumers for rational behavior. The fact is that credit reports often have errors or missing data. Not all lenders report to even one of the major credit bureaus, let alone all three. Consequently, a consumer's credit score can vary from very bad to very good based upon which bureau provided the information. I recently checked my credit reports from all three bureaus and found the information on inquiries completely different in each bureau's report.

A consumer's payment history makes up a small portion of the factors in a credit scoring model. Rather, factors concerning the type of credit, the length of credit history, inquiries, credit balance to limits, when loans were opened carry more weight than whether a consumer pays her bill on time or not. The absence of credit information hurts a score more than a late payment.

And let's not even get into errors in credit reports. Identify theft is the fastest growing financial crime and it directly affects consumers' credit scores. It seems we learn each week about a credit bureau getting hacked or a lender losing data affecting millions of consumers. For all practical purposes, an error in a credit report is irreparable for an insurance consumer. The process of finding out that credit was used, that credit score resulted in an adverse action, of obtaining the reasons for the adverse action, of obtaining a credit report and then trying to get the credit bureau and the lenders to fix the errors is not only next to impossible, but so time consuming as to make the exercise irrelevant in challenging an insurers' credit scoring determination.

Fourth, credit scoring undermines the critical role of insurance in loss prevention. Insurance has two critical purposes – to provide consumers, businesses and communities with an essential financial security tool in the event of a catastrophic event and to promote loss prevention. Insurance credit scoring undermines insurance availability and affordability and, just as important, undermines the loss prevention role of insurance. Insurance credit scoring minimizes the role of rating factors that are under a consumer's control and which provide economic incentives for less risky behavior. Instead of transparency in rating to help a consumer understand what type of behavior will be rewarded with lower premiums, credit scoring makes insurance rating an opaque process disconnected from loss prevention.

While criticizing opponents of credit scoring for pointing out that credit scoring discriminates against minorities – "playing the race card" – Csiszar has absolutely no hesitation in playing one group of consumers off against another. Csiszar throws out the

tired claims that credit scoring rewards fiscally responsible consumers and that a ban on credit scoring will cause good risks to subsidize bad. Both claims have been shown to be false for years, but that never stops insurers from engaging in class warfare.

The fact is that a credit history is not a measure of financial responsibility and that a good credit history does equate to a good credit score. A review of actual credit scoring models – which are public information – shows that the vast majority of factors in a credit scoring have nothing to do with payment history and everything to do with economic status. The fact is that a credit report contains only a small piece of a consumer's financial picture – there is no information on savings, investments, insurance or routine payments for rent and utilities. Together with the arbitrary nature of credit scoring, described above, these facts lay the fiscal responsibility myth further in the grave.

As for subsidies, insurers have lost sight of the fundamental purpose of insurance for consumers – to spread risk in a fashion that provides economic incentives for less risk behavior and economic disincentives for more risky behavior. It is not a subsidy to treat two consumers the same if they have similar risk profiles but a different number of credit cards or loans from different types of lenders. Rather, it is basic fairness.

Csiszar's arguments about credit scoring are belied by the facts about credit scoring. If consumers embrace credit scoring the way that insurers say they should, why don't we see even one insurer advertising its use of credit scoring? We see ads for safe drivers and for safe drivers, but no ads telling consumers about the great rates for good credit scores. The answer is, of course, consumers loathe credit scoring and insurers know it.

Csiszar's reaction to the Texas chapter of AARP opposing credit scoring should not be the dismissive "go figure" but some serious reflection on why a group of consumers who allegedly benefit from credit scoring demand a ban on the practice. Opponents of credit scoring, contrary to Csiszar's claims, are not opposed to risk-based pricing. We are opposed to unfair practices that discriminate against minorities and undermine the basic role of insurance in our society. If the insurers could see beyond the short term bottom line, they'd see a richer long term bottom line with the end of credit scoring. Consumers' fight against insurance credit scoring grows stronger every day.

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