Consumer Perspectives on Insurance Credit Scoring And New Risk Classifications

Casualty Actuarial Society
Ratemaking and Product Management Seminar

March 2012

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The Center for Economic Justice

CEJ is a non-profit consumer advocacy organization dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. Most of work is before administrative agencies on insurance, financial services and utility issues.

On the Web: www.cej-online.org

Overview

1. Insurance Credit Scoring (CS) Is Inherently Unfair
2. CS Is Unfairly Discriminatory in a Regulatory Sense
3. CS Has A Disparate Impact on Low-Income and Minority Consumers
4. CS Undermines the Core Public Policy Goals of Insurance
5. CS Is Not Needed / Claims of Consumer Benefits of CS are Refuted by Objective, Independent Data
6. Modernization of Risk Classification Regulation Needed to Address New World of Massive Databases and Tools for Data Mining and Predictive Analytics

Insurance Credit Scoring is Inherently Unfair

- Penalizes Victims of Medical, Economic Catastrophes
- Penalizes Consumers for Abusive Lending Practices / Broader Economic Conditions
- Arbitrary and Illogical Results – Unrelated to How Well a Consumer "Manages" Her finances

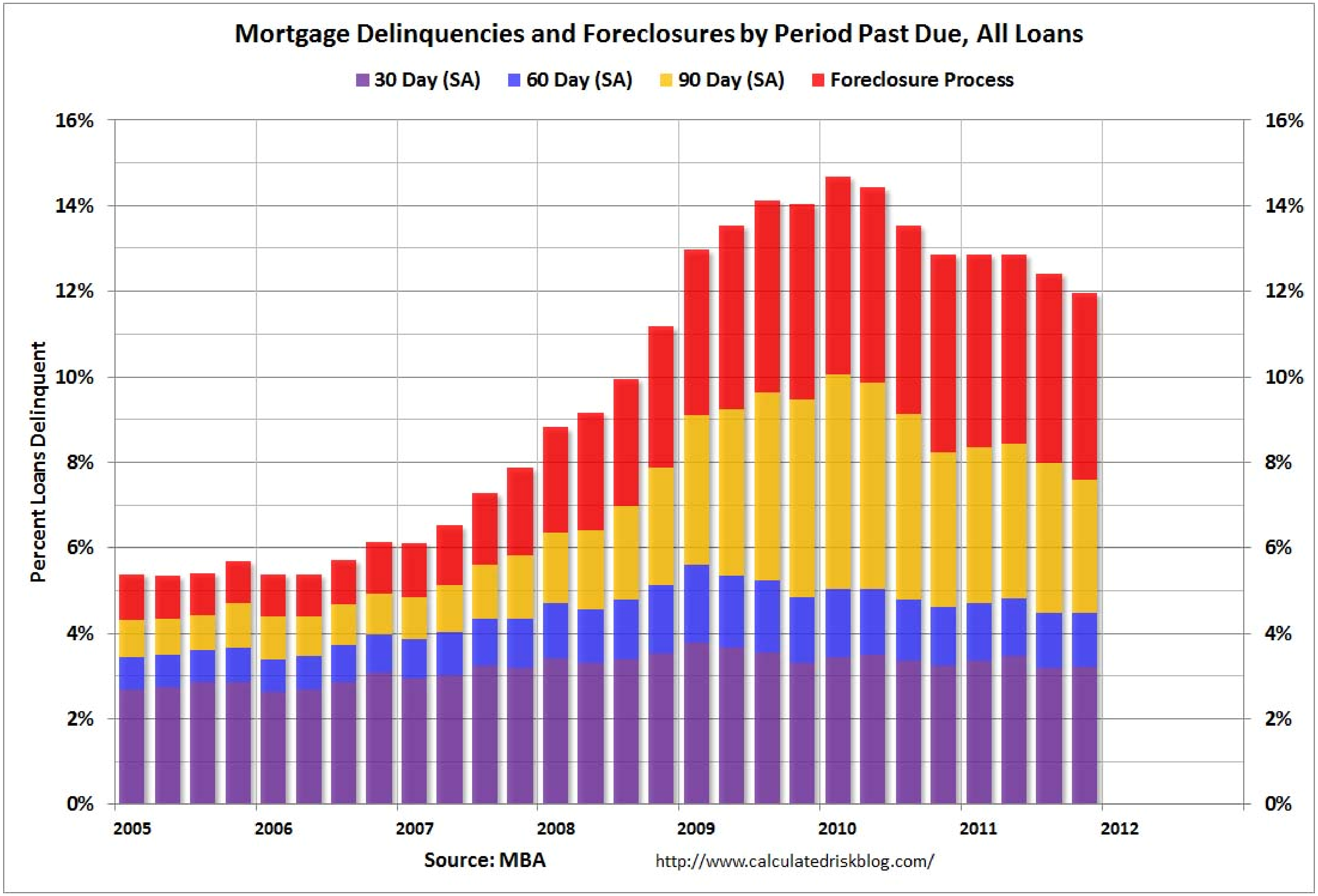
Consumers Hammered By Financial Crisis and Recession

- Reckless and Abusive Lending
- High Unemployment
- Wage Cuts
- Credit Limit Reductions
- Increases in Loan and Credit Card Fees
- Increasing Medical Costs

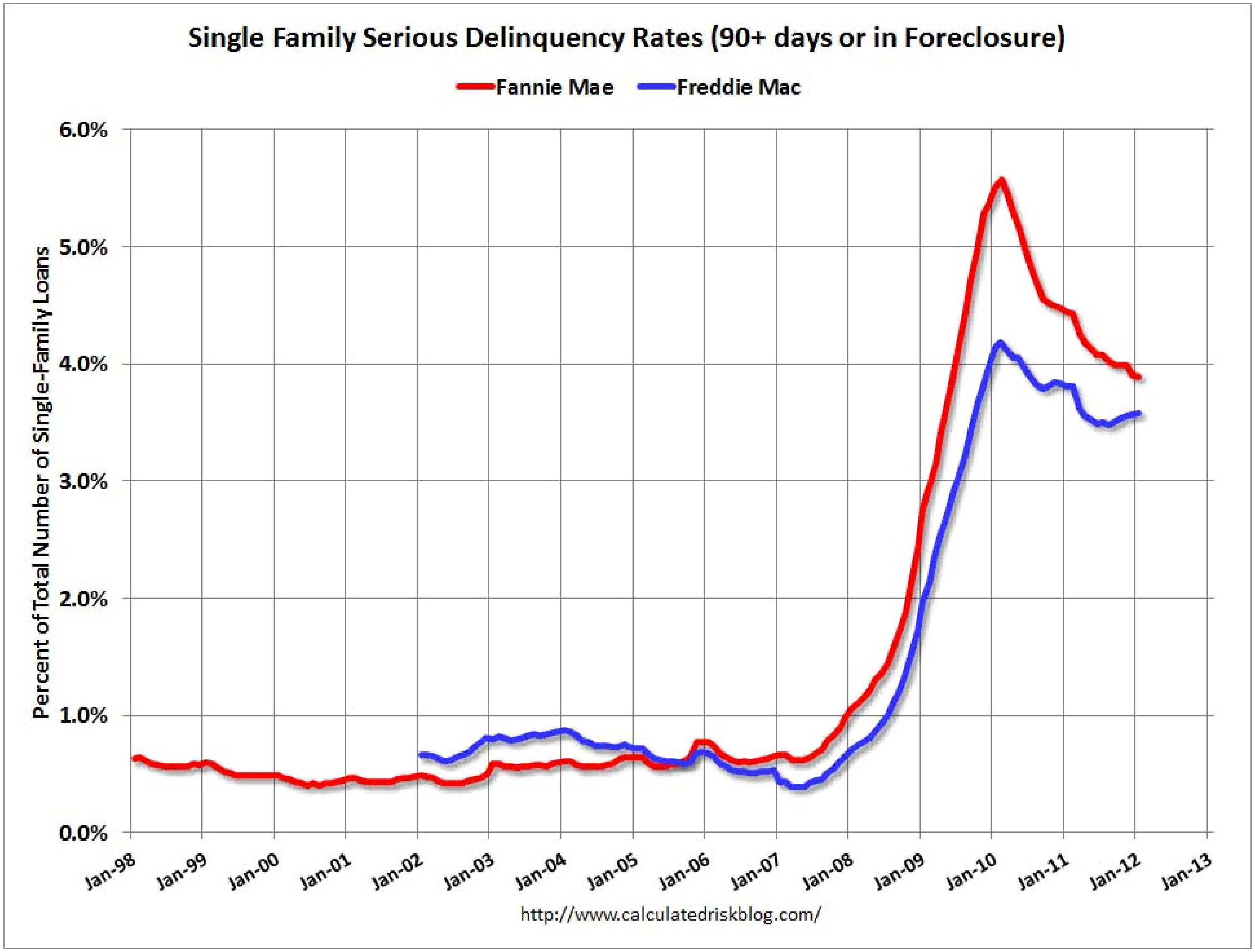
Record or Near-Record Highs in

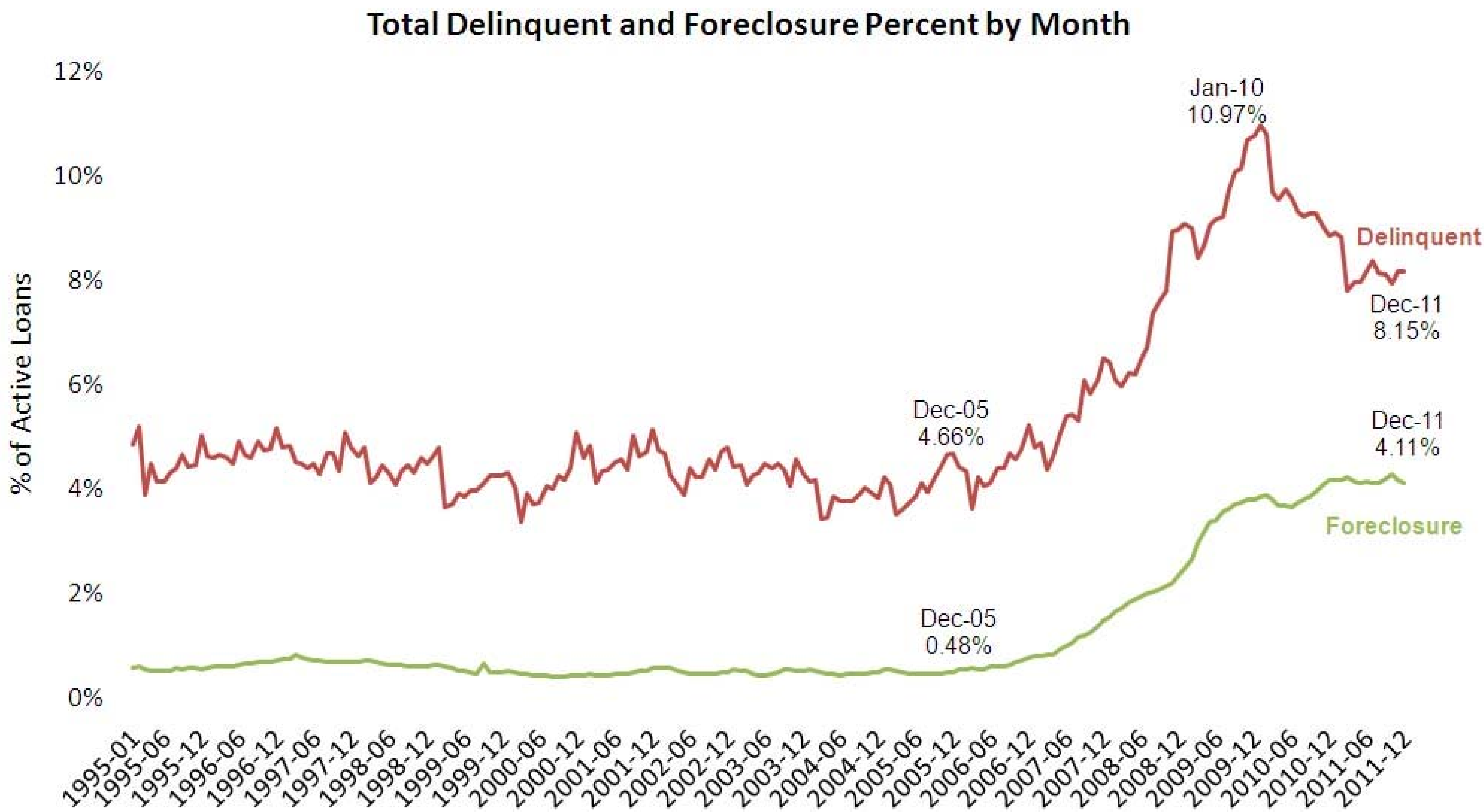
- Delinquencies
- Foreclosures
- Bankruptcies

Following Charts from www.calculatedriskblog.com



Mortgage Delinquencies and Foreclosures by Period Past Due, All Loans
30 Day (SA)
60 Day (SA)
90 Day (SA)
Foreclosure Process
Percent Loans Delinquent
16%
14%
12%
10%
8%
6%
4%
2%
0%
2005
2006
2007
2008
2009
2010
2011
2012
Source: MBA
http://www.calculatedriskblog.com/


Single Family Serious Delinquency Rates (90+ days or in Foreclosure)
Fannie Mae
Freddie Mac
Percent of Total Number of Single-Family Loans
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09
Jan-10
Jan-11
Jan-12
Jan-13
http://www.calculatedriskblog.com/



Total Delinquent and Foreclosure Percent by Month
12%
10%
8%
6%
4%
2%
0%
% of Active Loans
Jan-10
10.97%
Delinquent
Dec-11
8.15%
Dec-05
4.66%
Dec-11
4.11%
Foreclosure
Dec-05
0.48%
1995-01
1995-06
1995-12
1996-06
1996-12
1997-06
1997-12
1998-06
1998-12
1999-06
1999-12
2000-06
2000-12
2001-06
2001-12
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2005-06
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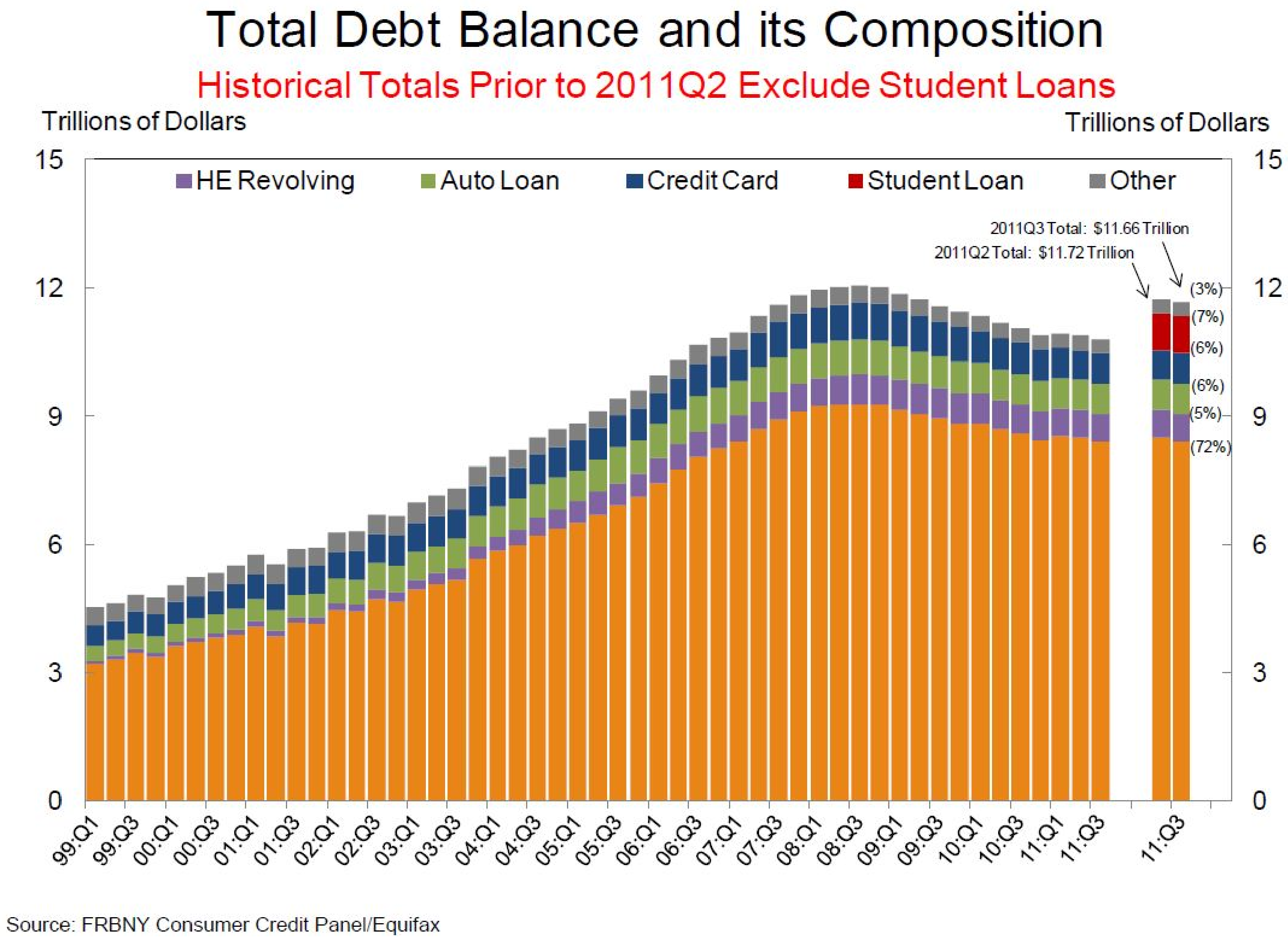
2010-12
2011-06
2011-12


Total Debt Balance and its Composition
Historical Totals Prior to 2011Q2 Exclude Student Loans
Trillions of Dollars
Trillions of Dollars
HE Revolving
Auto Loan
Credit Card
Student Loan
Other
2011Q3 Total: $11.66 Trillion
2011Q2 Total: $11.72 Trillion
(3%)
(7%)
(6%)
(6%)
(5%)
(72%)
15
12
9
6
3
0
99:Q1
99:Q3
00:Q1
00:Q3
01:Q1
01:Q3
02:Q1
02:Q3
03:Q1
03:Q3
04:Q1
04:Q3
05:Q1
05:Q3
06:Q1
06:Q3
07:Q1
07:Q3
08:Q1
08:Q3
09:Q1
09:Q3
10:Q1
10:Q3
11:Q1
11:Q3
11:Q3
Source: FRBNY Consumer Credit Panel/Equifax

Causes of Bankruptcies

Harvard Study of Bankruptcies in 2001:

- 87% of Bankruptcies Caused by Job Loss, Medical Bills or Divorce

- 46.2% from Medical Problems

Harvard Study of Bankruptcies in 2007:

- 62.1% of Bankruptcies Caused by Medical Problems

- 75% of These Were Families With Health Insurance.

Insurance Credit Scoring Is Not Objective

- Differences across credit bureaus
- Differences within a credit bureau due to lender choices
- Changes in definitions of credit report items – bankruptcy law change
- Public policy initiatives changing credit scores – moratorium on foreclosures
- Timing of report – balance to limits varies by time of the month
- Decisions of lenders – not reporting limits, changing limits

Insurance Credit Scoring Is Subject to Manipulation

- Invitations/Solicitations for Manipulation
- Piggy-Back on another consumer
- Shift balances from one car to multiple cards

Penalizes Consumer for Rational Behavior

- Shop around for best rates
- Cancel a card when lender acts unfairly
- Get a card to get 10% first visit discount

Insurance Credit Scoring Is Unfairly Discriminatory in a Regulatory Sense

- Discriminates On The Basis Of Race -- Credit Reports Reflect and Perpetuate Historical Inequities.

- Violates Actuarial Principles – Not An Objective Risk Classification And Subject To Manipulation.

- “Life Event” Exceptions Departs from Actuarial Objectivity

Correlation to Race and Income – The Missouri DOI Study

- The insurance credit-scoring system produces significantly worse scores for residents of high-minority ZIP Codes.
- The insurance credit-scoring systems produce significantly worse scores for residents of low-income ZIP Code.
- The relationship between minority concentration in a ZIP Code and credit scores remained after eliminating a broad array of socioeconomic variables, such as income, educational attainment, marital status and unemployment rates, as possible causes. **Indeed, minority concentration proved to be the single most reliable predictor of credit scores.**

Correlation to Race and Income – The Texas DOI Study

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.

The Flawed Federal Trade Commission Study

- Failed to obtain a comprehensive and independent data set for analysis.

- One FTC Commissioner voted against issuing the study out of concern for quality of study.

- FTC has since changed approach for homeowners’ analysis.

- Even with limited data, FTC found racial impact.

Credit Scoring Reflects / Perpetuates Historical Inequities

"Segregation therefore racialized and intensified the consequences of the American housing bubble. Hispanic and black home owners, not to mention entire Hispanic and black neighborhoods, bore the brunt of the foreclosure crisis. This outcome was not simply a result of neutral market forces but was structured on the basis of race and ethnicity through the social fact of residential segregation."

Rugh and Massey, *Racial Segregation and the American Foreclosure Crisis*, American Sociological Review, Vol 75, No 5

Undermines the Core Public Policy Goals of Insurance

- Undermines the goal of universal coverage by worsening the availability and affordability of insurance for those consumers with the least means to purchase insurance; and

- Undermines the loss mitigation role of insurance by

  - Placing great emphasis on a rating factor which has no ability to promote loss mitigation by policyholder; and

  - Encouraging consumers to spend time manipulating credit scores instead of true loss mitigation activities.

Insurance Scoring Is Not Needed

- States Which Ban Insurance Credit Scoring, including California and Massachusetts Have Thriving Markets.
- Insurers Entered The Massachusetts Auto Market After Partial Deregulation, Even Though Insurance Credit Scoring Is Banned.
- Insurance Credit Scoring Not Needed to Avoid Adverse Selection.
- Insurance Credit Scoring Not Needed With Modern Risk Classification.

Claims of Consumer Benefits of Insurance Scoring Are Refuted by Objective, Independent Data

"Allows Insurers to Write More Business"

Fact: Uninsured Motorist Rate Has Increased Countrywide While Uninsured Motorist Rate Has Declined in CA and MA where Insurance Credit Scoring is Banned

Fact: Auto Residual Market Has Declined More in CA than Countrywide

Fact: Creditor-Placed (Force-Placed) Insurance Has Skyrocketed in Past 5 Years

No Objective Evidence to Support This Claim

Industry Claim: "Insurance Credit Scores Reflect Personal Responsibility"

Blaming the Victim Claim is Factually Incorrect

- Actual Causes of Financial Distress Typically Beyond Control of Consumers
- Traditional Credit Reports Missing Information on Financial Responsibility, Let Alone Personal Responsibility
- Recent Actions by Credit Scoring Modelers to Utilize Non-Traditional Credit Information Documents Disparate Impact of Traditional Credit Information on Low-Income and Minority Consumers.

Needed: Modernize Regulation of Risk Classifications

Brave New World of Risk Classifications:

- Massive Commercial Databases with Consumer Information
- Inexpensive Data Mining and Predictive Analytics Tools
- Questionable New Risk Classifications
    - Education
    - Occupation
    - Prior Liability Limits
    - Prior Insurance
    - Social Media Use
    - Micro-Location

Modernize Regulation of Risk Classifications

1. Correlation to Risk of Loss Necessary, but Not Sufficient
2. Consider Impact on Incentives for Loss Mitigation as well as Adverse Selection
3. Prior Approval of Risk Classifications to Ensure Public Policy Discussion