United Policyholders
Empowering the Insured

Credit Scoring in Insurance: An Unfair Practice

For the past 20 years, insurance companies have been using your credit history to decide whether or not to offer you an auto or homeowners insurance policy, which of their policies they will make available to you and how much they will charge you. Insurers call this practice credit-based insurance scoring. You have not heard of this? That is not surprising because insurers go out of their way to keep this information under the radar. Consumer advocates, including United Policyholders, the Center for Economic Justice, and Consumers Union have long fought this unfair industry practice.

How does your credit score impact your insurance?

With some insurance companies, a consumer with the worst credit score – everything else equal – can pay two, three or four times as much as a consumer with the best credit score. But even though your credit history is likely to have more impact on your premium than any other factor – your driving record or the condition of your home – insurers don't advertise their use of credit information. Instead, you will see commercials claiming responsible drivers save money – even though a driver with a clean record can pay more than a driver with an accident or violation because of credit history.

Consumers should be aware of how important credit history is for insurance. In most states, insurers can do pretty much what they want with your credit information because most insurers today will only quote you a very high premium if you refuse to allow the insurer to obtain your credit history. And once you have a policy with an insurer, the insurer can check your credit history whenever it wants to.

Are insurers completely free to access and use your credit history?

A few states prohibit insurers from using consumer credit information – California, Massachusetts and Hawaii for auto insurance and Maryland and Hawaii for homeowners insurance. In other states, state or federal law requires the insurance company to provide you some important notifications – the most important of which is the federal Fair Credit Reporting Act (FCRA) Adverse Action Notification. The FCRA requires any user of a credit report to notify the consumer if the use of that report resulted in an adverse action, which, in the case of insurance, would be denial of coverage or a higher premium than a consumer with an average insurance credit score. These adverse action notices come with your policy or policy renewal information, but may be hard to identify because insurers don't like to use the word "adverse!"

If you get an adverse action notice, it should list up to four reasons why your insurance score was not better. Unfortunately, in most states, the "reason codes" are difficult to understand. But they are a starting point. Federal law requires the credit bureaus (Experian, Equifax and Transunion) to each provide you one free credit report a year. If you get an adverse action notice, you also have a right to a free credit report from the credit bureau used by your insurance company.

How can you find out what your credit score is and how your insurer is using it?

A consumer can get one free credit report annually from each of the three big credit bureaus. Beware – most sites that promise a free credit report are not free because they require you to purchase something. The site www.annualcreditreport.com is the official site sponsored by the credit bureaus to comply with the FCRA requirement. It is useful to obtain and compare credit reports from the three bureaus to see what information is missing or incorrect in any one report – particularly the report form the bureau used by your insurance company.

Another web site – www.creditkarma.com – will provide a free credit report and free credit scores. One of the credit scores is an insurance score. It is interesting and useful to see how credit scores differ for lending and insurance. However, the insurance score on the Credit Karma site is based on a Transunion model and Transunion credit data – it is likely not the credit score calculated and used by your insurance company.

A recent change to the FCRA now requires insurers to provide consumers with the insurance credit score if the insurer took an adverse action. As with the reason codes, having the score may not be very helpful unless insurers show consumers how the score affected the insurance premium. In any event, consumers should ask the insurer what insurance credit score was used in the premium calculation, where that score fits in to the range of all consumers' scores (what percentile) and what score is needed to get a better (lower) premium.

Credit report errors are common, and can be hard to correct

Your insurance credit score can be hurt by errors in your credit report – incorrect information and missing information. It is important to check your credit report from the credit bureau used by your insurance company because the information in your credit reports can be very different across the three big credit bureaus. Incorrect information – an indication of a missed payment that was really not missed or an indication of a bankruptcy that you did not have – can lower your insurance score and raise your premium.

To give you an idea how different insurance companies use consumer credit information, the web site www.helpinsure.com created by the Texas Department of Insurance may be helpful. This web site allows consumers to compare auto and homeowners rates (for Texas) across insurance companies for specific customer profiles. By changing the profile from good credit to bad credit, a consumer can see generally how much impact on premium the insurance credit score has for individual insurance companies. Although the site is based on Texas auto and homeowners insurance rates, insurers who rely heavily on consumer credit information in one state tend to do so in all other states where use of credit information is permitted.

Despite the claims by insurers that “credit-based insurance scores reward responsible consumers,” missing information can also hurt your insurance score because your score is based on things like how many times you have had your credit report checked (“hard inquiries”), what type of credit you have, your balance in relation to the credit limit, how long you have used credit and how many credit cards you have – all regardless of whether you pay your bills on time.

Why is credit scoring unfair?

Insurance credit scoring is unfair for a number of reasons. It penalizes consumers who are victims of medical or economic catastrophes. Almost 90% of bankruptcies results from job loss, medical expenses or divorce. Given the high cost of health care – even for those with insurance – and the very high and long-lasting unemployment of the Great Recession, it is unfair for insurers to charge consumers higher premiums simply because the consumers have been the victims of a job loss or a dread medical condition.

Insurance credit scoring is unfair because it penalizes consumers for rational behavior. For example, if you shop around for insurance, each insurance company will check your credit and increase the number of inquiries on your credit report which hurts your score. If you like to use one credit card for rewards, you get a worse credit score than if you spread the charges over two or three cards because the debt to card limit ratio on the one card is high. If you open a card account at a department store or home improvement store to take advantage of the 10% discount on first time purchases, your score will drop because of the additional inquiry and credit line.

Insurance credit scoring penalizes low-income and minority communities – not because low-income or minority consumers are poor money managers – because the negative factors used in the insurance scoring models are biased against low-income and minority consumers and because the absence of credit information hurts a score as much or more than the presence of negative information. Just as low-income and minority consumers were often the target of predatory lending practices, insurance credit scoring reflects and perpetuates historical inequities.

What can you do about a high insurance premium caused by insurance credit scores?

If you have credit report problems because of unemployment, medical costs, divorce or some other major "life event," ask the insurance company if they will make an exception for the life event and use a better insurance score to determine your premium. Many states' laws require insurers to consider life events, but there are no standards for such consideration. Contact the insurance company or agent and ask them to consider your life event.

Look over the reasons on the adverse action notice along with a copy of the credit report to see if there are any errors or missing items. Again, the insurers make it hard for consumers because the credit report a consumer gets from the credit bureau is not the same credit report actually used by the insurance company!

Seek out insurance companies that give discounts for positive actions such as pay-by-the-mile auto insurance which gives you the power to drive less and pay less for your insurance.

Complain in writing to your elected officials and insurance department about insurers' use of credit information. The insurers have gotten their way in most states by claiming that insurance scores are "accurate predictors of future claims" and banning insurance scoring would cause "good risks" to subsidize "bad risks" and cause rates to rise for many customers. This definition of "fair" may work for an insurance company actuary, but not in the real world. Insurers have won most legislative battles with big political contributions and big threats (to raise rates for many consumers). Tell your elected officials to look after consumers and not contributors and that insurers will not raise rates for those consumers they think are the best policyholders.

For more info on credit scoring, check out the web sites of the Center for Economic Justice and the National Association of Insurance Commissioners.