You’re charging me for what?! Insurers find new ways to set car insurance rates

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Insurance companies are getting creative when it comes to determining how much you should pay for car insurance.

In addition to using traditional factors, such as your driving record and how many miles you drive each year, some insurers now look at such things as personal finances, education levels and occupations, says Robert Hunter, director of insurance at the nonprofit Consumer Federation of America.

The use of such non-traditional factors began in the 1990s, when insurers started making credit-risk assessments, Hunter says.

“Driving records are becoming less important,” Hunter says. “Credit scoring was the first of what I call non-driving characteristics. They have added education and occupation. All of these factors tend to hurt the poor.”

According to the federation, the use of this data to set insurance rates tends to penalize people who already are struggling to make ends meet, along with minority consumers. A 2006 University of California, Los Angeles, study that focused on L.A. found that car insurance rates can vary widely, with higher costs in poor and minority neighborhoods than elsewhere.

Doug Heller, a consumer advocate at the nonprofit Consumer Watchdog group, says the insurance industry continues to find new ways to “slice and dice” policyholder information to generate profit.

“There is no question that auto insurers are adding new schemes to charge customers in ways that have nothing to do with their driving record, and we are seeing it across the country, with an emphasis on type of employment, educational attainment levels, whether you own or rent your home,” Heller says.

Michael Barry, a spokesman for the industry-backed Insurance Information Institute, says that only a few companies have begun using education and occupation data to set car insurance premiums. Even so, Hunter estimates as many as one-third of the car insurance premiums in the U.S. are figured using occupation and education data in conjunction with other factors.

Insurers deny wrongdoing

Insurers maintain they're doing nothing wrong by expanding the factors they use to determine car insurance rates. They say the information they use is legitimate, as long as they can show a correlation between the statistics they gather and the likelihood that drivers will file car insurance claims.

Karl Newman, president of the Seattle-based NW Insurance Council, says some critics overlook the fact that selling insurance is a business.

"These companies have to bring in enough revenue to pay their claims, to pay their employees, to keep the lights on and to be in a position to expand, just like any other business," Newman says.

Jack Hungelmann, author of "Insurance For Dummies," says the various factors that insurance companies use to predict car insurance claims are scientific. It may seem unfair to penalize people for their lack of education, their jobs or their handling of personal finances when setting insurance rates, but it makes perfect sense from a business standpoint.

"It is justified, even though everyone doesn't always agree with the morality of it," Hungelmann says. "Many people) feel it is discriminatory, and yet there is such a strong correlation between scoring and claims that it can't be denied."

The credit debate

Hunter says the debate over using non-traditional factors began with the practice of using credit information to set car insurance premiums. Critics say the use of financial information means your insurance bill could increase because you have credit problems, even if you've never filed an insurance claim. Hunter says it punishes people who've experienced financial hardships as a result of the lingering recession, through no fault of their own.

The Insurance Information Institute says actuarial studies have shown that how you manage finances is a good predictor of whether you'll file an insurance claim. Barry says all of the factors that are taken into consideration when setting insurance rates must be approved by state insurance regulators.

According to the United Policyholders consumer group, only a few states stop insurers from using credit information: California, Massachusetts and Hawaii prohibit it for car insurance and Maryland and Hawaii for homeowner's insurance. Insurers must notify you concerning the use of your credit information. The federal Fair Credit Reporting Act's Adverse Action Notification provision requires users of credit reports to notify consumers if the information leads to decisions that result in such things as higher insurance premiums or the denial of loans.

Find out how you're rated

Although most insurance companies rely on insurance scores, they're reluctant to reveal their formulas for setting car insurance rates, says Newman, the NW Insurance Council president.

“Each company has its own secret sauce,” he says. “It is proprietary information.”
Amy Bach, executive director of United Policyholders, says you should feel free to ask insurers how you’re rated on credit and other factors, but “they may or may not tell you.”
“The recipe for the rate they are charging you is considered a trade secret,” she says, “and insurers tend to keep it close to their chests to retain a competitive advantage.”
If you’re determined to find out more about what criteria are used, you should contact your state insurance department and ask to see your insurer’s records, Bach says. Even after you’ve seen them, it may be difficult to figure out exactly how prices are set; insurers may not disclose the weight they give to each factor when calculating the risk that your car insurance policy represents.
If you think your car insurance premium is too high, you can ask for a re-evaluation, but Bach says there’s no practical process for appealing your insurer’s decision. Because insurers are highly competitive, you may get a better price from another carrier, though.
“All you can do is shop and compare and try to find the best coverage for the best price, regardless of how you may be rated,” Bach says.