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JANUARY 28, 2002

FINANCE

Insurance: A New Way to Squeeze the Weak?

Insurers' use of credit scores to set premiums is spurring outrage--and legal and legislative action

Heather Lowe, a 32-year-old secretary in Bellingham, Wash., reeled when she opened her auto insurance bill in November. Farmer's Bureau was raising her annual premiums by 46%, to \$1,665, a blow for the divorced mother of two. She had paid all her previous premiums on time. True, she had had an accident some years before, but the company didn't raise her rates then. Why now? Her agent was no help. Then she got suspicious. The renewal notice showed Farmer's had checked her credit. Investigating, she traced the credit problem to her ex-husband's bankruptcy. Her name was still on a joint mortgage and some credit cards. But that didn't answer the basic question: What did her credit rating have to do with the odds she would wreck her car? Unable to pay the higher rate, Lowe let her insurance lapse temporarily. "What happens to people like me who are not at fault and don't have a bad driving record?" she sighs.

An increasing number of Americans are getting similar jolts from their home and auto insurers. State laws generally require companies to cover anyone who represents an acceptable risk, and premiums must reflect the statistical odds that they'll file claims based on such criteria as age, place of residence, and driving record. But over the past three years--a period when premiums and profits were under pressure--U.S. insurers have quietly ramped up the use of a controversial new risk criterion: credit history. According to a July, 2001, study by Conning & Co., a Hartford industry research firm, 92% now use it as a factor in calculating premiums on home and auto insurance.

The practice has already inspired a major backlash. Mounting consumer complaints have aroused state regulators' suspicions that it's a creative new form of redlining: illegal discrimination against low-income, elderly, and minority customers whose credit record may be less than pristine. Using credit scoring "is discriminatory," says Washington State Insurance Commissioner Mike Kreidler. "You can pay two times as much for your insurance as your next-door neighbor because of your credit score." More than 20 states are investigating the practice. In San Antonio, six people filed a class action in federal court alleging that Allstate Insurance Co. uses credit criteria to discriminate against minority customers. Allstate denies the allegations.

The controversy revives ugly memories. For decades, insurers routinely drew a metaphorical red line around poor or minority neighborhoods, refusing to insure residents' homes or cars. The practice was supposed to be outlawed by the Fair Housing Act of 1968, but redlining never completely went away. In 1997, Nationwide Insurance, Allstate ([ALL](#)), and State Farm Insurance settled a redlining complaint with the Housing & Urban Development Dept. by agreeing to fund minority-homeownership programs. Consumer advocates say they have to be eternally vigilant because insurers always try to avoid covering those they see as less desirable customers. "Redlining has its own momentum," says Al Scudieri, a former FBI agent who investigates redlining for a Tampa law firm.

Major property and casualty insurers--including Allstate, Progressive Casualty Insurance, and State Farm--insist that credit data are a meaningful adjunct to conventional underwriting procedures, and they are used to reward the financially responsible of all income levels, not to discriminate. (GEICO Corp. wouldn't comment. State Farm uses credit scores to assess whether to insure someone, not to set rates.) "There's a powerful correlation between credit history and potential losses from policyholders," says Dean K. Lamb, research director at Allstate, which has used credit scoring for pricing since 1999. "What we're trying to measure is not how much money a person has but how they manage it."

Allstate and some other insurers say credit scoring lowers some customers' rates. Progressive says in a statement that 63% of its U.S. policyholders "have a lower rate because of our use of credit, in conjunction with other factors." But regulators in some states, including Texas, where State Insurance Commissioner Jose Montemayor has ordered investigations of Allstate and Farmer's Bureau, think financial criteria could be behind last year's sharp rise--as much as 18% by some estimates--in homeowners' and auto insurance premiums nationwide. "We want to determine the extent to which credit scoring may be responsible for some of these staggering rate increases," says Montemayor. Rates in Texas have risen over 30%. Lowe's experience backs that up. After Farmer's November shocker, she shopped around and was given a quote for comparable coverage that didn't involve credit scoring for only \$1,020 from a local company, Columbia Agencies Inc. She expects to have enough saved to start coverage at the end of January. A Farmer's spokeswoman says factors other than credit may have boosted Lowe's rates.

Insurance industry executives concede that credit-scoring is a lightning rod for critics. "We expect to see legislative and regulatory proposals in at least 25 states that will ban or restrict the use of credit scores for underwriting and rating purposes," says Sam Sorich, vice-president of the National Association of Independent Insurers, a lobbying group. He and others say they'll fight such legislation because credit scoring is not only legal under the Federal Fair Credit Reporting Act of 1970 but its validity as a predictor of claims has been well documented. The practice really caught on in 1999 after several studies, from the Virginia Bureau of Insurance and the credit scoring agency Fair, Isaac & Co., among others, lent support to the notion that poor credit scores correlated with higher claims. With premiums under pressure, insurers were looking for ways to cut claims and justify higher rates. "The use of credit reports was the magic potion that would help them squeeze those extra profits," says Wayne D. Holdredge, a principal

at financial-services consultants Tillinghast-Towers Perrin.

Yet even some industry insiders have misgivings. Insurance sales agents complain that they're losing loyal customers. And the National Association of Professional Allstate Agents has condemned credit scoring as discriminatory. "Every day, hundreds, if not thousands, of people are affected negatively by their credit score," fumes Bill Murphy, an independent agent in Austin, Tex.

Allstate agent Raymond Gonzalez says he couldn't defend a 25% hike the company imposed in May on his customer, Jose C. DeHoyos, based on his credit record. The 65-year-old Hispanic-American from Somerset, Tex., has filed only one claim in 26 years as an Allstate customer--for hailstorm damage to his car five years ago. He's now the lead plaintiff in the San Antonio class action. DeHoyos' attorney, Christa L. Collins, says the only blemishes on his credit history are two late payments, totaling \$131, to a hospital and a gas station. Says Allstate spokesman Michael Trevino: "It could be a perfect credit report in his mind because he might have always paid on time, but there are other variables, like number of credit accounts and outstanding balances relative to credit limits that are considered in our score."

Insurance regulators say what makes them particularly suspicious is insurers' refusal to explain how they use credit histories, which are notoriously inaccurate and hard to interpret. Back in 1980, Aetna Inc.--which sold its property and casualty business in 1996--admitted past discrimination with ads showing a man eating crow. Given the groundswell against credit scoring, other insurers may soon see the same dish on the menu.

By Brian Grow in Atlanta and Pallavi Gogoi in Chicago

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1920-40

Insurers routinely discriminate against minority clients

1968

Presidential panel on Insurance in Riot-Affected Areas documents impact of redlining for the first time

1980

Aetna admits past racial discrimination with ads showing man eating crow

1988

Amendment to Fair Housing Act of 1968 and new HUD regulations prohibit redlining for homeowners' insurance

1992

American Family Insurance sued for racial discrimination

1997

Nationwide Insurance fined \$10 million in Texas for redlining

1999

Use of credit records as insurance-eligibility criteria starts to become widespread

2002

More than 20 states are investigating insurance credit-scoring

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