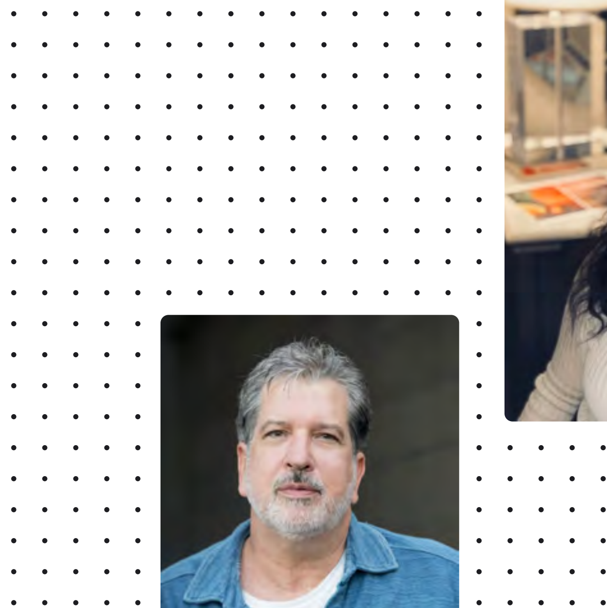
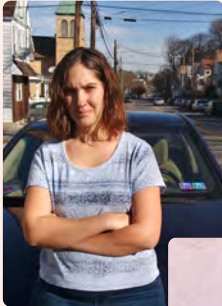
Credit scores and car insurance: How unfair pricing practices discriminate against millions of drivers



Root Inc

Contents



I. A flawed, discriminatory pricing model impacts the everyday lives of Americans 2

II. When a necessity perpetuates a cycle of inequality 7

III. The industry's lack of transparency keeps drivers in the dark 13

IV. Conclusion 16

I.

A flawed, discriminatory pricing model impacts the everyday lives of Americans

“If I could pay less for car insurance, I could put that money toward my business,” Shawna says. “And if [my business] grows, I could put more money back toward my health.”

Unfair insurance pricing disproportionately impacts historically underserved communities, forcing people to make impossible decisions about what they can afford.

The first time 27-year-old Shawna decided to skip a necessary dose of insulin to stretch her dwindling supply of the expensive medicine, she knew it wouldn’t be the last time she’d risk her health to make ends meet. A diabetic since age four, Shawna has spent her entire adult life struggling to balance the crippling costs of a chronic condition with everyday expenses.

Often, that’s meant racking up credit card debt to offset medical expenses. As a self-employed small business owner, Shawna has found it nearly impossible to afford both health and car insurance, the latter of which she needs for her business. She is well aware of the vicious cycle this creates.

Shawna is far from alone in navigating the harsh realities of car insurance pricing. A recent survey of 1,003 U.S. adults conducted by Root Insurance revealed that more than one-third (35%) of Americans cannot afford to purchase essential items because of the expense of their premiums.

This is especially true for people of color, younger drivers and those with lower credit scores. The economic hardships caused by COVID-19 have made it even harder for people to make ends meet. In fact, 35% of Americans say they can no longer afford to pay for car insurance because of the pandemic.

Those with poor credit likely face an even harder time than others. And today, "those with poor credit" is a category composed of millions of Americans.

Unaffordable medical expenses, student loans, the youthful mismanagement of money, financial fallout from un- or under-employment, and so many other factors put countless people in an impossible cycle of financial hardship dictated by their credit scores. The burden—and in many cases, unfairness, of this cycle—demands attention and action, especially now, when America's future is shifting economically and socially.

When focusing on those who get behind the wheel every day—the majority of whom are mandated by law to maintain car insurance—this burden often materializes through the outdated premium-pricing practices still upheld by most insurers. By using credit scores to determine monthly rates, insurers maintain a system where those with low credit are likely to pay more, regardless of their driving behavior.

According to the late Jerome Williams, Rutgers University Distinguished Professor, Prudential Chair in Business, and Research Director of The Center for Urban Entrepreneurship & Economic Development, the common practice of including credit scores in premium pricing is inherently flawed.

> "You're making an assumption that everybody that has a low credit score is less likely to pay the bill," Williams says. "That's not fair. Sometimes people have low credit scores for valid reasons, but they still pay their bills."

He equates the practice to redlining, a form of lending discrimination that is illegal.

Take the last housing crisis as an example. Studies show that those with higher FICO® Scores in 2007 fell into serious delinquency on their mortgage payments at almost four times the rate they had in 2005. Comparatively, homeowners who had low FICO® Scores in 2007 were only twice as likely to have fallen into serious delinquency as they were in 2005.

Douglas Heller, an insurance expert and consultant for the Consumer Federation of America, also points back to that period as an example of why credit-based pricing doesn't make sense.

> "When the financial crisis of 2008 happened and credit scores dropped, accidents weren't up," Heller says. "Accidents actually were down. If credit really was related to risk in this sense, we should've seen accidents go up."

Williams, who has spent decades researching bias and discrimination in the consumer marketplace, says the systemic unfairness of auto insurance creates an unlevel playing field, especially for people of color.

According to the Federal Reserve, Black and Hispanic Americans have lower credit scores when compared to white and Asian Americans. They are also more likely to be categorized as risky by insurers, according to the Federal Trade Commission (FTC).

> “It’s like in football,” Williams says. “You have to go 10 yards to get a first down, but for the team that’s African American, you’re going to have to go 20 yards to get a first down. That’s not a level playing field in my estimation.”

Most Americans agree with him. According to Root’s consumer survey, 77% of U.S. adults believe that when insurance companies use credit scores to determine insurance premiums, it introduces bias and discrimination into their pricing.

77%

of Americans agree that auto insurance is a burden for many.

In a newly published study, Barbara Kiviat, a Stanford University sociologist who has long studied the impact of credit-based pricing decisions in car insurance, finds that nearly half of Americans say that using credit scores in insurance pricing is “somewhat” or “very” unfair. Nearly 75% say the same about using race or ethnicity as a factor. As Kiviat cites in her 2019 research, an FTC report has shown that minorities had significantly lower credit-based insurance scores than did white individuals.

Pricing discrimination has also been challenged in court. To date, several auto lenders have paid tens of millions of dollars to settle claims that they improperly overcharged minorities.

(Source: 2020 Root survey)

Daniela, a 24-year-old mother in Washington, D.C. with significant medical and student loan debts, feels the constant strain of this unjust pricing.

> “It’s just life things like rent, food and gas—and yes, car insurance” that are hard to keep up [with], Daniela says. A poor credit score has worked against her since she was 18, when she got her first credit card without understanding the risks.

A poor credit score also haunts 31-year-old Andrew, a self-described driving fanatic. Andrew has multiple advanced driving certifications under his belt and a near-perfect driving record.

“My idea of fun is trying to achieve a perfect braking sequence every time I come up to a stop sign,” he says. “You shouldn’t feel any jolt at all from the braking. Just a smooth, easy stop.”

But Andrew is also the father of three young children and has recently faced immense financial hardships. Those challenges—combined with poor credit from years of medical bills—make legally getting behind the wheel harder and harder.

“I overdrafted my checking account buying $8 worth of Burger King to feed my kids,” he says.

The path to good credit is complex for anyone, and consumer risk assessment is equally complicated. For many industries, a fairer alternative to using credit scores isn’t immediately apparent.

For the car insurance industry, though, logical alternatives do exist—namely, assessing driving performance. The question is whether insurers are willing to change their longstanding practices, and whether policy and regulation will be created to hold them accountable.

II.

When a necessity perpetuates a cycle of inequality

In the modern marketplace, the inequity of credit score-based premiums affects millions of people who need car insurance in order to work.

Auto insurance is an essential fact of life for more than 75% of American adults, who rely on a car to drive themselves to work, and for more than 90% of those in the market for car insurance, who say a car is integral to daily tasks.

However, while the need for insurance has been largely standardized for these millions of Americans, the costs associated with it are not.

"There are very few places in America where you can be fully employed or earn as much as you're capable of earning without a car," says insurance expert Heller. "Having access to a vehicle is foundational to financial security, so there is an obligation to make sure [car insurance] is priced fairly."

In 2020, Root Insurance became the first car insurance company to commit to dropping credit scores from its pricing model entirely.

> "Ultimately, a person's credit score isn't a good measure of their driving behavior," says Root Insurance CEO Alex Timm. "Root is focused on how a person drives, not on factors that could potentially introduce unfair bias to our prices."

Mike Kreidler, insurance commissioner for the state of Washington, also proposed legislation in 2020 to end the practice of using credit score in determining rates, especially in light of the outsized impact it was having on residents of his state during the pandemic.

"Most people expect to see their insurance rates increase if they cause an accident, get convicted of drunk driving, or file a claim after damage to their home," Kreidler recently argued in *The Seattle Times*.

> "But what does losing your job or opting for no-interest financing for furniture or a car have to do with how you drive or take care of your property?" Kreidler asks.

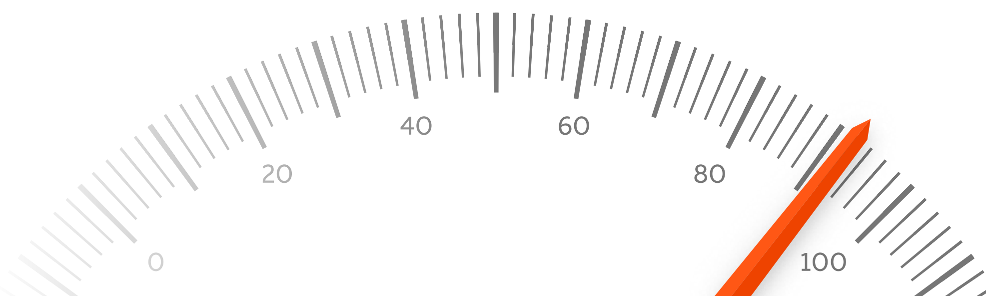
Unfortunately, several insurance associations have been quick to reject his stance.

Modern credit scoring first emerged in the late-1950s with the intention of standardizing an impartial system for assessing an individual's financial risk potential. The model used today, known as the FICO® Score, was introduced in 1989 and has since become a common assessment tool used by decision-makers—ranging from lenders to insurers to employers—when determining a stranger's trustworthiness.

Many insurers use what's called credit-based insurer scores (CBIS) in their pricing. CBIS use information derived from a person's credit history to determine the likelihood that a driver will file an insurance claim or cause an accident. While insurers often try to distinguish between the CBIS and traditional credit score, Heller says it is "irrelevant—a distinction without a difference."

More than 90% of those in the market for car insurance say a car is essential to their everyday lives.

(Source: 2020 Root survey)



How does credit score impact insurance by state?

Poor credit scores can impact drivers differently, depending on where they live.

STATE	VERY POOR (300–579)	DIFFERENCE	EXCEPTIONAL (800–850)
Alabama	$1,528.79	**168% or $958**	$570.48
Alaska	$1,034.61	**91% or $494**	$540.88
Arizona	$1,336.51	**138% or $774**	$562.74
Arkansas	$1,374.78	**108% or $715**	$659.69
California	$907.70	**0% or $0**	$907.70
Colorado	$1,660.15	**127% or $928**	$731.88
Connecticut	$1,384.88	**101% or $695**	$689.81
Delaware	$1,755.06	**122% or $964**	$791.04
District of Columbia	$1,645.84	**140% or $959**	$686.83
Florida	$1,989.38	**120% or $1086**	$903.16
Georgia	$1,381.14	**98% or $684**	$697.61
Hawaii	$540.59	**0% or $0**	$540.59
Idaho	$971.21	**118% or $525**	$446.18
Illinois	$1,160.44	**114% or $619**	$541.39
Indiana	$1,043.20	**101% or $525**	$518.06
Iowa	$827.44	**85% or $381**	$446.58
Kansas	$1,333.49	**104% or $680**	$653.77
Kentucky	$2,296.13	**179% or $1473**	$823.17
Louisiana	$2,150.15	**113% or $1139**	$1,010.93
Maine	$755.98	**86% or $349**	$406.74
Maryland	$1,177.89	**94% or $571**	$606.60
Massachusetts	$638.38	**0% or $0**	$638.38
Michigan	$3,420.33	**198% or $2272**	$1,148.55
Minnesota	$1,326.54	**140% or $774**	$552.18
Mississippi	$1,423.70	**113% or $754**	$669.89

(Source: The Zebra)

How does credit score impact insurance by state? *(continued)*

STATE	VERY POOR (300–579)	DIFFERENCE	EXCEPTIONAL (800–850)
Missouri	$1,640.86	**173% or $1040**	$600.50
Montana	$1,268.85	**116% or $682**	$586.93
Nebraska	$1,143.58	**103% or $580**	$563.90
Nevada	$2,353.06	**199% or $1567**	$786.20
New Hampshire	$983.16	**105% or $504**	$478.86
New Jersey	$1,568.09	**117% or $847**	$721.18
New Mexico	$1,198.89	**101% or $601**	$597.56
New York	$1,695.69	**123% or $935**	$760.64
North Carolina	$713.36	**59% or $265**	$448.59
North Dakota	$1,239.66	**118% or $671**	$568.84
Ohio	$967.03	**118% or $523**	$443.75
Oklahoma	$1,316.40	**88% or $615**	$701.49
Oregon	$1,336.03	**117% or $721**	$614.86
Pennsylvania	$1,305.37	**114% or $696**	$609.33
Rhode Island	$1,985.02	**122% or $1090**	$894.62
South Carolina	$1,420.65	**133% or $811**	$609.48
South Dakota	$1,241.46	**110% or $652**	$589.94
Tennessee	$1,499.47	**146% or $889**	$610.58
Texas	$1,549.86	**87% or $720**	$829.76
Utah	$1,256.99	**149% or $752**	$505.38
Vermont	$1,139.91	**144% or $672**	$467.73
Virginia	$818.51	**94% or $396**	$422.35
Washington	$1,149.85	**125% or $638**	$511.52
West Virginia	$1,254.92	**100% or $628**	$626.72
Wisconsin	$973.47	**109% or $507**	$466.76
Wyoming	$986.79	**59% or $367**	$619.71

(Source: The Zebra)

From the beginning, credit scoring was meant to be a more effective alternative to the widely discriminatory practice of assessing risk through the subjective judging of a person's character. More than 90% of auto insurers use credit scores to help determine premiums, claiming the practice is objective and fair.

Yet, for roughly 230 million licensed drivers in America today, research suggests this practice is not fair or effective.

These scores influence how much a driver pays based on who they are, not how they drive. In Kiviat's research, respondents who thought using credit scores in car insurance pricing was fair took the scores "as signals of people's inherent qualities—marks not simply of what people do but of who they are."

However, people who thought using credit scores was not fair pointed to different reasoning. They tended to say that credit scores were not logically associated with driving behavior—an important distinction.

For tens of millions of Americans, the cost of unfair insurance pricing takes a high toll on their everyday lives and economic well-being. The difference in average car insurance premiums between drivers with the lowest and highest credit scores is more than $1,500 annually, according to The Zebra.

Vicki Bogan, who studies financial economics and behavioral and household finance, says, "Someone might be thinking, 'OK, my credit score isn't very good, so I know I'm going to pay more for my auto loan.

> "But, it probably doesn't occur to people that they may pay more for their car insurance because of their credit score. These are hidden consumer costs."

Student debt

44,000,000

44 million Americans have student loans, and roughly one-third of students report amassing credit card debt during school.

(Sources: EducationData.org and EVERFI)

Medical debt

79,000,000

79 million Americans have medical debt. Similarly, roughly one-third of credit card holders are in debt because of medical bills.

(Sources: The Commonwealth Fund and CompareCards)

> "Many households are already financially fragile," Bogan says. "Often, once someone gets into a downward spiral due to a significant financial issue or hit, it's hard for them to recover from that."

The $288 billion auto insurance industry is meant to protect consumers, not trap them in a cycle of worsening economic hardship.

To fulfill this mission, credit scores must be dropped from pricing to correct the unfair and inequitable model that's widely employed by insurers today.

> "There have been times when [my family and I] couldn't drive because we couldn't afford car insurance," says 33-year-old Valerie. "Car insurance is a necessity, yet credit scores are impacting payments. It's literally like a poor tax on the most vulnerable people of society, the people who need the most help. It's a barrier that just isn't fair."

III.

The industry's lack of transparency keeps drivers in the dark

Most Americans are completely unaware that credit scores are a factor in auto insurance pricing.

Roughly 4 out of 10 Americans don't know how their credit score is determined. For many consumers, their first foray into credit happens without a sound grasp of how the system works or the long-term implications of a low score.

It's no surprise, then, that the majority of survey respondents reported being completely unaware that credit scores are a factor in auto insurance pricing. Among those that are aware, very few believe it's a fair practice.

"Virtually every insurance company in America is using your credit history when they're determining how much to charge you—and sometimes even [when they're choosing] which affiliated company they're going to place you with in their group of insurance companies," Heller says. "But most people have no idea that their credit history will impact their insurance rates. Because, why would they know that?"

Heller says that in his experience, some insurance companies charge consumers with poor credit rates that are "staggeringly" higher than the rates of those with good credit.

Two-thirds (66%) of the general population are unaware that credit score is a factor in auto insurance calculations.

74% with lower credit are not aware that credit score is a factor

72% with lower incomes are not aware that credit score is a factor

70% of Hispanic/Latinx people are not aware that credit score is a factor

82% expect driving record to be the most important factor in pricing

63% expect years of experience to be the most important factor

47% expect driving distance/frequency to be the most important factor

6% think credit score should be considered important in pricing rates

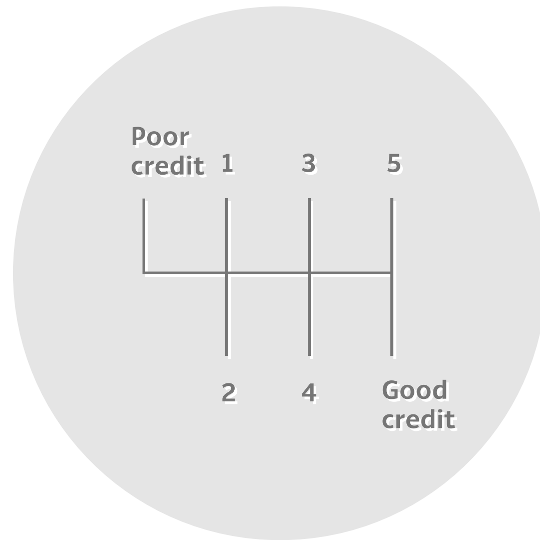
(Source: 2020 Root survey)

Those with poor or average credit are 2.2 times more likely than those with a good credit score to say they have a difficult time applying for and purchasing car insurance (21% versus 9%, respectively). (Source: 2020 Root survey)

Those statistics come as no surprise to economic expert Bogan.

"Financial literacy is a big issue in this country," she says. "So, it is not surprising that many consumers are unaware of this practice. Compounding this issue is the lack of transparency. Because of the lack of transparency, it is difficult to fault consumers for not knowing."

While most consumers are aware that credit scores are important in certain situations, car insurance proves to be a less obvious use.



To further illustrate the inequity of the practice, imagine what would happen if a similar standard was applied to another important consumer market. Take, for instance, higher education.

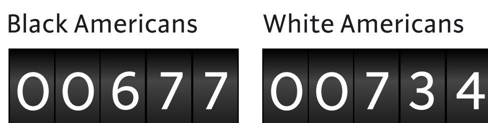
> What if a university said, 'Okay, if you have a low credit score, you have to pay higher tuition?'" asks Williams.

Opposition to a biased practice such as this would be swift. Yet, this unfairness persists in the auto insurance industry.

"Americans who are financially stressed, who historically had less access to financial services, who are self-employed, who have had to use a lot of credit to support their business or their entrepreneurship—these people get punished when they buy auto insurance, even if they have a perfect driving record," says Heller.

> “One thing we know for sure is that because of the legacy of discrimination in financial services markets, many Black, Brown and Indigenous Americans have, on average, lower credit scores, and, as a result, higher insurance rates,” Heller adds.

Black Americans have an average credit score of 677 compared to 734 for white Americans, according to FICO credit score data.



(Source: Shift Credit Card Processing)

> “The industry is putting one over on us because nobody stands up to say, ‘Enough is enough,’” says 66-year-old Peggy. “A credit score has absolutely nothing to do with how you drive.”

IV.

Conclusion

For the economy, communities, and individuals, dropping credit score creates clear advantages—even in an imperfect industry.

Research shows that differential treatments in the marketplace come at a steep societal and economic price. The lived experiences of neighbors, community members, and fellow drivers proves just how profound that price is.

For consumers, upward mobility is hindered—especially for people of color. Even for companies and industries—whether implicit or not—these practices can limit the profitability of goods and services in the long term. While removing credit scores from auto insurance pricing models is not a wholesale solution, it is a critical and significant step toward increased equity.

“Insurance companies have tied our premiums to our credit because it serves their interests, not because it serves consumers or public safety,” says Heller.

But, he adds that the economic argument for removing credit scores from pricing models is strong: “If you eliminate the use of credit, you're eliminating a barrier to the market. In the long run, getting rid of credit will bring more good drivers into the pool, spreading the risk wider and creating savings for everybody.”

While data has become a ubiquitous part of doing business—and something many consumers appreciate because it helps enable more customized goods and services—the perceived fairness of data’s applications often comes down to how much control a consumer had over the situation that gave rise to the data, according to Kiviat’s research.

> “Respondents pointed out that medical bills can lead to lower credit scores, spiking rents can drive people to move, ex-spouses can delay childcare payments, freezing winters can make utility bills unaffordable, and so on,” Kiviat says.

All of which can play into a cycle of insurmountable financial hardship.

This is an issue of such magnitude that engaging in a collective effort to remove credit scores from pricing models will help lay the foundation for a better future. Fairly priced car insurance stands to offer greater opportunity to those for whom a car and insurance affordability are significant factors in their own welfare.

"It really is kind of like the American dream," says Pedro, a young professional in D.C.

He says his parents weren't very open with him about finances, and his lack of knowledge resulted in him amassing a lot of credit card debt at a young age—something he's been working to correct ever since. But Pedro says it hasn't been easy because of the impact credit scores have on major aspects of our lives.

"Someone could be an awful driver but have a smaller payment because of their credit score, and not enough consumers like me know this is going on," he says.

The auto insurance industry has an obligation to meaningfully fight discrimination on behalf of its customers and for the benefit of its business. It can no longer ignore the systemic issues associated with the use of credit scoring.

"We're at a pivotal point where things are going to be different," says Williams. "Companies that continue to exploit and treat consumers unfairly will eventually see consumers start to exit and voice their concerns. It's going to hurt the company, and sometimes it will hurt the company so much that it's tough to turn it around."

More than 90% of car insurance companies currently use credit scores to determine premiums, and only three states prohibit the practice.

"Removing credit scores from insurance pricing is a big change but not an impossible hurdle for our industry," says Alex Timm. "In fact, we'll be able to price risk better without this false metric as a crutch."

The status quo must be uprooted to bring fairness, transparency, and modernity to the insurance industry, making room for more effective and accurate measures of risk.

Visit dropthescore.com to learn more about why we're dropping credit score from our pricing models and how we're leading the industry in reducing bias.