United States House of Representatives
Committee on Financial Services
2128 Rayburn House Office Building
Washington, D.C. 20515

February 28, 2020

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: March 4, 2020, HCDI Subcommittee hearing entitled, "Drivers of Discrimination: An Examination of Unfair Premiums, Practices and Policies in the Auto Insurance Industry"

The Subcommittee on Housing, Community Development and Insurance will hold a hearing entitled, "Drivers of Discrimination: An Examination of Unfair Premiums, Practices and Policies in the Auto Insurance Industry" at 2:00 p.m. on Wednesday, March 4, 2020, in room 2128 of the Rayburn House Office Building. This hearing will have one panel with five witnesses:

- **Douglas Heller**, Insurance Expert, Consumer Federation of America
- **Elizabeth Kelleher Dwyer**, Superintendent of Insurance, the State of Rhode Island, *on behalf of* the National Association of Insurance Commissioners
- **Eric Poe**, CPA and Chief Operating Officer, CURE Auto Insurance
- **Sonja Larkin-Thorne,** Consumer Advocate (retired)
- **Erin Collins,** Vice President- State Affairs, National Association of Mutual Insurance Companies

Overview

In every state except New Hampshire and Virginia, drivers are required to purchase auto insurance,[1] making auto insurance coverage a necessity for the vast majority of U.S. drivers. Like other insurance products, auto insurance premiums are generally priced based on an insurance company's estimate of what it will pay out in claims through the use of complex algorithms that include consideration of factors that are intended to provide a more individualized risk-based premium. Auto insurance premiums, for example, are based in part on driving related factors such as an individual consumer's driving record.[2] But the use of such factors can raise questions about fairness; for example, racial profiling and other policing tactics that disproportionately target lower income and minority communities could artificially increase traffic violations for certain

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[1] Insurance Information Institute, "Background on Compulsory Auto/Uninsured Motorists," Jan. 14, 2020.

[2] *See, e.g.* Insurance Information Institute, "What determines the price of an auto insurance policy?"

consumers.[3] Auto insurance premiums also often utilize several non-driving related factors such as a consumer's credit history, homeownership status, professional occupation, and educational attainment.[4] The use of these non-driving related factors also raises questions about fairness because it does not have an obvious correlation to losses covered in an auto insurance policy, and because these factors can sometimes serve as proxies for socioeconomic status and race.

The Role of the Federal Government in Auto Insurance

Under the McCarran-Ferguson Act, the insurance industry is regulated primarily at the state level.[5] The National Association of Insurance Commissioners (NAIC) helps to coordinate regulation across states. The Dodd-Frank Wall Street Reform and Consumer Protection Act established the Federal Insurance Office (FIO) within the Department of the Treasury, which has the authority to "monitor the extent to which traditionally underserved communities and consumers have access to affordable non-health insurance products," but does not have authority to issue regulations or preempt state laws beyond those that are not in compliance with international standards.[6]

Research on Discrimination in Auto Insurance Pricing

Building on studies showing discrimination in automobile finance and purchasing, researchers have found evidence of disparate impact in auto insurance rates.[7] According to a 2015 study conducted by the Consumer Federation of America (CFA), "on average, a good driver in a predominately African American community will pay considerably more for state-mandated auto insurance coverage than a similarly situated driver in a predominately white community."[8] Even in upper middle-income, predominately African American communities, the 2015 CFA study found that auto insurance premiums were on average 194 percent higher than the average premium charged to similarly situated drivers in an upper middle-income, predominately white community.[9] A 1997 analysis by the Center for Economic Justice found that "drivers in poor and minority communities were disproportionately rejected by standard insurers and forced into the higher cost non-standard" insurance plans.[10] A 2017 joint study by ProPublica and Consumer Reports found that people living in predominantly minority zip codes in California, Illinois, Missouri, and Texas were paying more for their auto insurance than individuals in white zip codes.[11] A 2017 study by CFA also found that "female motorists with perfect driving records often pay significantly more

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[3] Stanford Computational Policy Lab, "A large-scale analysis of racial disparities in police stops across the United States," March 13, 2019.

[4] *See, e.g.*, Insurance Information Institute, "What determines the price of an auto insurance policy?"

[5] 15 U.S.C. §§ 1011-1015

[6] Congressional Research Service, "The Dodd Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions," Aug. 17, 2010.

[7] Ian Ayres, Fair Driving: Gender and Race Discrimination in Retail Auto Negotiations, 104 Harv. L. Rev. 817 (1991); Further Evidence of Discrimination in New Auto Negotiations and Estimates of Its Cause, 94 Mich. L. Rev. 109 (1995).

[8] CFA, "High Price of Mandatory Auto Insurance in Predominantly African American Communities," Nov. 2015.

[9] *Id*.

[10] Center for Economic Justice, "Auto Insurance Redlining in Texas: Availability Worsens," Apr. 1997.

[11] Jeff Larson et. al., ProPublica; Dina Haner et. al., Consumer Reports, "How We Examined Racial Discrimination in Auto Insurance Prices," Apr. 2017.

for auto insurance than male drivers with identical driving records and other characteristics the insurers use to price auto insurance."[12]

Examining the "Drivers of Discrimination"
Auto insurance rates are heavily influenced by aspects of a consumer's driving record, with drivers with a history of speeding tickets or driving under the influence paying higher premiums.[13] This can raise questions about fairness in pricing due to evidence of police bias that can artificially increase traffic violations for people of color and those in lower income communities.[14] Other driving related factors can also raise questions about fairness despite their apparent correlation to risk of losses that an auto insurance company will have to cover, such as incidents of theft and vandalism in a consumer's neighborhood, the safety features included in a consumer's car, and where a consumer parks their car. For example, these factors could serve as proxies for income if a consumer is not able to afford to move to a neighborhood with lower rates of theft and vandalism, or afford a car with better safety features, or afford a home with a covered garage. Increasingly, insurance companies have been experimenting with "driver behavior profiling," wherein drivers can earn a discount on their premiums by using smartphone applications that track their driving habits and allow them to demonstrate that they are a safe driver.[15] However, addition to the privacy concerns raised by this practice, differences in road conditions from neighborhood to neighborhood may exacerbate rather than alleviate disparities.

Auto insurance rates can also be significantly influenced by non-driving related factors such as an individual's gender, age, professional occupation, homeownership status, educational attainment, and credit score.[16] Insurance companies have argued that the data shows a legitimate correlation between these factors and the risk of losses they must cover, and that state regulators would not allow for the use of these factors if they couldn't prove a legitimate correlation.[17] However, a 2015 CFA study found that the use of these factors can have a disparate impact against people of color and lower income consumers in spite of their individual driving records.[18]

Auto insurers' estimates of losses are based on their estimates of claims that will be filed, not estimates of all losses that could be covered if claims were filed. To the extent that consumers choose not to file a claim with their insurance company and instead pay for damages out of their own pocket, auto insurance companies do not have access to this information and these losses are not accounted for in their estimates of expected losses. For example, if higher income, higher wealth individuals are more likely to pay out of pocket for damages instead of filing a claim with

[12] CFA, "Most Large Auto Insurers Charge 40 and 60-Year-Old Women Higher Rates Than Men, Often More than $100 Per Year," Oct. 12, 2017.

[13] Insurance Information Institute, "What determines the price of auto insurance policy?"

[14] Stanford Computational Policy Lab, "A large-scale analysis of racial disparities in policestops across the United States," March 13, 2019.

[15] Ferreira et. al, National Institute of Health, "Driver behavior profiling: An investigation with different smartphone sensors and machine learning," Apr. 10, 2017.

[16] *See, e.g*., Consumer Reports, "The Truth About Car Insurance," Jul. 30, 2015.

[17] See, e.g. NAMIC, Statement for the Record for Financial Services Committee's Subcommittee on Oversight and Investigations hearing entitled, "Examining Discrimination in the Automobile Loan and Insurance Industries," May 1, 2019.

[18] CFA, "High Price of Mandatory Auto Insurance in Predominantly African American Communities," Nov. 2015.

an insurance company, insurance companies' estimates of losses associated with higher income, higher wealth individuals could similarly be lower than lower income, lower wealth individuals.

Credit-Based Insurance Scores

The use of credit histories in auto insurance pricing has been debated for years. Many auto insurance companies use credit-based insurance scores to calculate an individual's rate. A credit-based insurance score is calculated using information contained in a consumer report, such as past delinquencies, consumer debt ratios, and the length of credit.[19] According to Consumer Reports, credit-based insurance scores are by far the biggest cost driver for consumers despite being a non-driving related factor.[20] In 2003, Congress considered legislation that would prohibit the use of credit scores in setting insurance rates, but instead opted to include language in a broader overhaul of the Fair Credit Reporting Act directing the Federal Trade Commission (FTC) along with the Department of Housing and Urban Development's Office of Fair Housing to conduct a study on the issue.[21] Although the FTC found that credit-based insurance scores had some proxy effect for racial and ethnic groups that resulted in higher premiums for African American and Latino consumers, it concluded that the relationship between scores and claims risk remains strong even when controlling for race, ethnicity, and neighborhood income.[22] The National Fair Housing Alliance has criticized this study for using data "handpicked by the industry."[23] A 2016 study by Georgetown University researchers looked specifically at the question of whether credit-based insurance scores serve as a proxy for income, and concluded that an "insurance score does not act as a proxy for income in a standard actuarial model of auto claim risk."[24] However, advocates and others have continued to question the fairness of using this non-driving related factor that has an outsized impact on a consumer's auto insurance rate.[25]

In 1988, California voters approved Proposition 103, which banned the use of credit scores in auto insurance underwriting. According to CFA, data suggests that Prop 103 has helped save consumers money without undermining a healthy auto insurance market in California.[26] Massachusetts and Hawaii also prohibit the use of credit scores in setting auto insurance rates.[27]

Consumer Reports also identified a practice called "price optimization," wherein insurance companies charge consumers the highest possible price by using data like credit scores to

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[19] FTC, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," July 2007.

[20] Consumer Reports, "The Secret Behind Your Rates," 2015

[21] *Id.*

[22] *Id.*

[23] NFHA, Testimony before the House Financial Services Committee's Subcommittee on Oversight and Investigations entitled, "The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance," May 21, 2008.

[24] Morris, Schwartz, and Teitelbaum, "Do Credit-Based Insurance Scores Proxy for Income In Predicting Auto Claim Risk?," June 15, 2016.

[25] See, e.g. Propublica and Consumer Reports, "How we examined Racial Discrimination in Auto Insurance Prices," Apr. 5, 2017.

[27] American Property and Casualty Insurance Association, "Insurance Scoring Saves Consumers Money," 2019

[27] American Property and Casualty Insurance Association, "Insurance Scoring Saves Consumers Money," 2019

determine the likelihood they'll shop around for a cheaper alternative.[28] Several states, including California, Ohio, Florida, Vermont, Maryland, and Washington, have enacted an outright ban on the practice of price optimization, while a dozen additional states have issued guidance to limit the practice.[29]

State Regulation of Auto Insurance Discrimination
Consistent with the McCarran-Ferguson Act, there is no federal law that prohibits discrimination in the auto insurance industry, but virtually every state has a statutory provision that stipulates that "rates shall not be excessive, inadequate, or unfairly discriminatory."[30] Further, model legislation promulgated by the National Conference of Insurance Legislators (NCOIL) now prohibits pricing on the basis of gender, address, zip code, religion, marital status, nationality and ethnic group.[31] However, states are not required to adopt this model law and the extent to which discrimination is specifically prohibited on the basis of certain factors or individual characteristics varies. According to one 2014 review of state insurance antidiscrimination laws, these protections vary significantly from state to state, and many states do not have laws restricting pricing on the basis of race, national origin, or religion.[32] It is also unclear the extent to which there is any consistency across states in terms of determining what counts as "unfairly discriminatory" and what standards are used by state regulators to make such a determination. While state regulators should have access to scoring models for the purposes of oversight and enforcement of state laws, including anti-discrimination laws, some have raised concerns that as insurance company algorithms have become more and more complex, state regulators are not well-equipped to adequately monitor and enforce anti-discrimination laws.[33]

Legislative Proposals

- **H.R.1756, the "Preventing Credit Score Discrimination in Auto Insurance Act" (Tlaib).** This bill would prohibit the use of a credit report, a credit score, or other consumer credit information in determining auto insurance coverage or rates.
- **Discussion Draft, "the FAIR Study Act" (Tlaib).** This bill would require the Director of FIO to annually publish a report that evaluates the presence or absence of disparate impact in auto insurance pricing based on certain categories of individuals.

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[28] Consumer Reports, "The Truth About Car Insurance," Sep. 2015.
[29] National Association of Professional All State Agents, State Regulation of Price Optimization
[30] APCIA, "Strong State Regulation of Insurance Prohibits Discrimination."
[31] See NCOIL, Model Act Regarding Use of Credit Information in Personal Insurance, (readopted November 2015).
[32] Ronen Avraham, Kyle D. Logue, Daniel Schwarz, "Understanding Insurance Antidiscrimination Laws," University of Minnesota Law School, 2014.
[33] See "Consumer Reports, "The Truth About Car Insurance," July 30, 2015. (The report termed the process of rate-setting as, "shrouded in secrecy and rife with inequity.").