Driving for Broke: The Underserved Insurance and Auto Loan Opportunity

CFSI Center for Financial Services Innovation

In the United States, there are approximately 198 million insured vehicles on the road today.[1] Among those, approximately 53 million vehicles are insured by low- to moderate-income (LMI) — often known as underserved — consumers.[2,3] In addition, 145 million vehicles — about 73% of cars on the road today — are financed and not owned outright.[4] For the underserved, access to reliable transportation is particularly critical, whether to get to a job interview, to work, or to earn income via ride-sharing apps such as Uber or Lyft.

High insurance costs and high costs of borrowing can make owning and driving a vehicle especially challenging for underserved consumers. Consequently, there is great opportunity to innovate in auto insurance and lending in order to better serve these consumers and get them on the road to improved financial health.

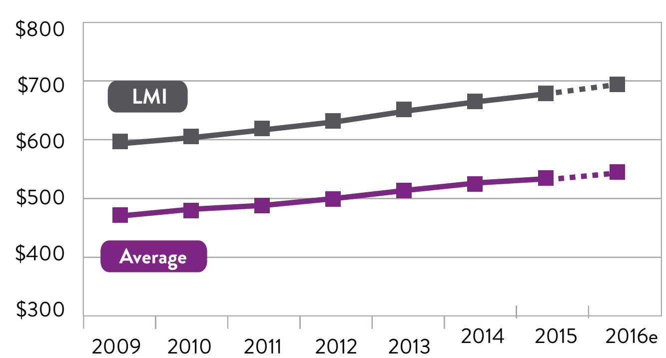
Paying a Premium

In 2015, LMI consumers spent $36.5 billion on automobile insurance premiums. On the surface, this amount may sound reasonable for 53 million vehicles. But when compared to average consumers, LMI drivers paid an average of 26.5% more for auto liability insurance on vehicles of comparable value.

Auto liability insurance is required in every state in the U.S. except for New Hampshire, so paying higher insurance costs can make it particularly difficult for underserved drivers to affordably operate their vehicles, which are often lifelines to employment and well-being.

Further complicating matters is the fact that underserved consumers often have subprime credit scores, which means they pay more for vehicle ownership with Subprime or "Buy Here Pay Here" (BHPH) Auto Loans. These borrowers spend nearly as much for their auto insurance as underserved consumers do for their auto loans. In 2015, subprime consumers spent $43.4 billion on auto loans, compared to the $36.5 billion that underserved consumers spent on auto insurance.

Average annual cost of auto liability insurance for low-to-moderate (LMI) consumers vs. average US consumers[5]



Note: Insurance premium costs differ state by state based on regulations and underwriting standards.

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[1] Insurance Information Institute, "Auto Insurance: Costs and Expenditures" 2016

[2] 53 million vehicles is derived from a combination of NAIC data and the 2015 Consumer Expenditure Study

[3] Low-income consumers include those with annual incomes <$50,000; Underserved consumers can also include those that have thin or no credit files, are un/underbanked, or experience income volatility

[4] Experian "State of Automotive Finance Market" Q4 2015 and CFSI Financially Underserved Market Size Study, Nov 2016

[5] Consumer Federation of America study. NAIC auto liability insurance pricing and NerdWallet Insurance market share.

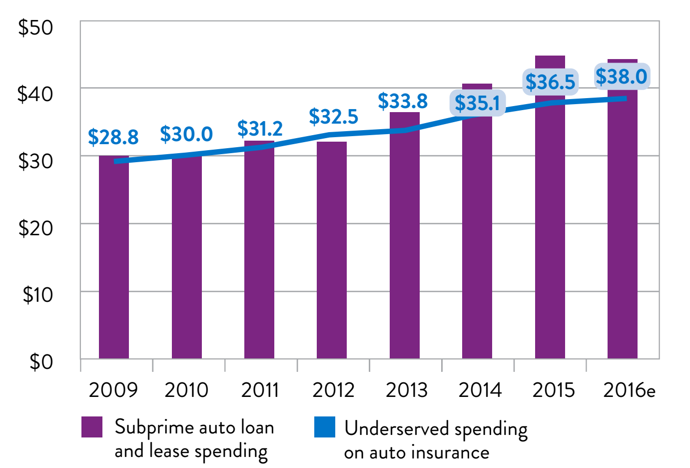
Auto Insurance: Premiums or Penalties?

A recent study from the Consumer Federation of America (CFA) found that personal driving history is not the reason low-income consumers are paying more for their auto insurance than average consumers. Instead, their higher rates are based solely on answers to economic-status related questions when applying for auto insurance.

While some auto insurers argue against the analysis that underserved consumers pay more, findings from the Consumer Federation of America's study strongly supports this assertion.

Robert Hunter, Director of Insurance at the Consumer Federation of America said, "The problem is simple but the impacts are profound: The state requires you to purchase minimum auto insurance coverage; the states will penalize you with jail time, loss of vehicle or fines if you fail to buy it; the states, responsible for policing fair prices, fail to do so by allowing pricing that makes poor good drivers pay more than rich drivers with accidents and tickets."

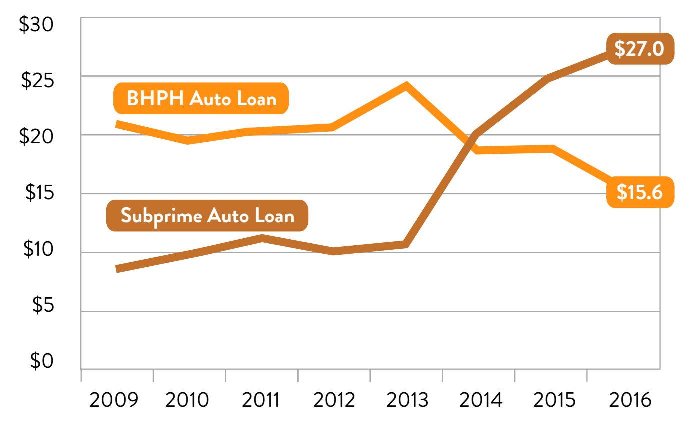
Subprime Auto Loan and Lease Spending vs. Underserved Auto Insurance Spending



California Drives Fair Insurance Pricing

One state that has seized the opportunity to create fairer pricing for underserved consumers is California. In 1988, California passed Proposition 103 which resulted in a comprehensive auto insurance system based on three mandatory factors that must have the greatest impact on rates: 1) driving record, 2) miles driven, and 3) years of experience. With these criteria in place, the California insurance market has remained competitive and profitable, with both profits and rate of returns higher than the national average for over two decades.

Underserved Auto Loan and Lease Revenue in Billions



By placing these three factors front and center in determining what a person pays for auto insurance, California has lessened the likelihood that consumers will be assigned higher rates based on income or socioeconomic status.

Auto Loans in High Gear

The opportunity to improve the financial health of underserved consumers is not limited to those who pay higher rates for auto insurance; it includes better serving consumers who spend nearly as much on Subprime Auto Loans and BHPH Loans to obtain their vehicles as underserved consumers spend on premiums to drive. In 2015 these subprime consumers spent $43.4 billion in automotive loan payments.

Average Annual Percentage Rate for New and Used Auto Loans in 2015

Auto Loan Category	VantageScore	Average APR
Super Prime	781-850	3.1%
Prime	661-780	4.6%
Nonprime	601-660	8.4%
Subprime	501-600	14.1%
Deep Subprime	300-500	17.4%
Buy Here Pay Here	Score does not impact APR	28.7%

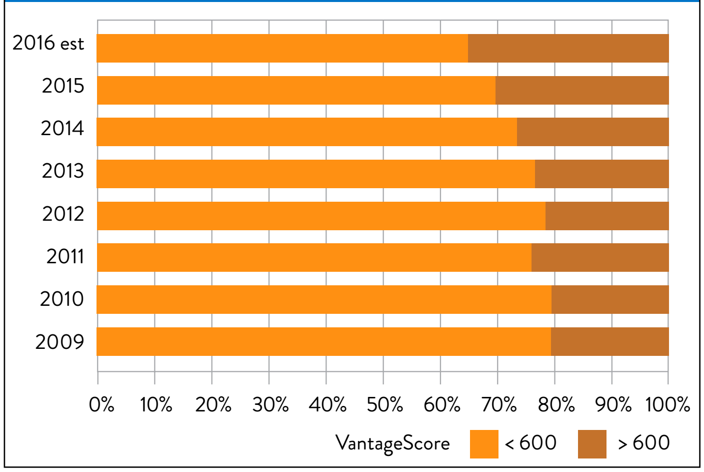
Underserved Borrowers

While overall spending on auto loans is leveling off after a burst of pent-up demand post-recession, the Subprime Auto Loan portion of the market continues to increase, growing by 22.5% in 2015, and is projected to grow an additional 9.8% in 2016. At the same time, usage of Buy Here Pay Here (BHPH) Auto Loans, which carry higher interest rates, grew by only 0.4% in 2015, and is expected to decline by 17.1% in 2016. As shown in the chart above, auto loan rates for underserved borrowers range from 6 to 14 percentage points higher for Subprime Loans than Prime Loans.[6] BHPH rates are even higher than Subprime Auto loans at an average of 29% APR. Between 2009 and 2016, underserved spending has shifted from strong usage of BHPH Loans to greater usage of Subprime Auto Loans, demonstrating the still-growing opportunity to better serve Subprime Auto Loan consumers.

The "Buy Here Pay Here" Loans Surprise

However, while Buy Here Pay Here declined in usage, and more people were approved for Subprime Auto Loans, the proportion of BHPH consumers with prime credit scores has steadily increased over the years, from 20% in 2009 to 30% in 2015.

Buy Here Pay Here (BHPH) Auto Loan Revenue by Credit Risk



This continued use of BHPH Loans by those who qualify for lower-rate loans indicates that lower credit scores or lack of a credit file are not the only factors influencing choice of auto loan products. Other barriers, such as information disparities or limited geographical access, may also impact choice, indicating opportunity for auto loan providers to better understand the needs of these borrowers. In doing so, they can address unmet demand for lower-rate auto loans for these lower-risk consumers.

Together, higher costs for insurance and loans can mean underserved consumers pay considerably more to stay on the road. This disparity in cost presents a significant opportunity to better address the needs of consumers who are underserved by higher auto insurance premiums and auto loan rates.

To learn more, read CFSI's full Underserved Market Size Study.

[6] Experian, "State of the Automotive Finance Market" Q4 2015; "CFSI 2016 Financially Underserved Market Size Study, Nov. 2016"

Innovation Around the Corner

Innovative solutions can lead to higher quality products and services in auto insurance and lending, and contribute to the financial health of consumers. Many auto innovations are already gaining traction. In auto insurance, innovators like MetroMile offer pay-per-mile insurance to help low-mileage drivers — or drivers who drive varying amounts day-to-day — save money on their overall insurance coverage and better match their coverage to their usage.

Other innovators, like Everlance, MileIQ, and TripLog, are simplifying the mileage tracking process so that drivers can capture miles traveled through a cloud-based GPS system. These innovations ensure drivers are maximizing tax benefits when driving for work, bringing down the costs of owning and driving vehicles. Meanwhile, startup CoverHound works to combat information asymmetry around insurance by allowing customers to easily compare rates online or via mobile.

Additionally, rideshare insurance is expanding across the insurance industry to provide more options to better serve the approximately 260,000 Uber and Lyft drivers participating in the 1099 economy.[7] These innovative solutions have the potential to better meet the needs of underserved consumers, and result in a more affordable means of driving a vehicle.

There are also innovations in auto financing. Companies like Neo and L2C (which was acquired by TransUnion) are using big data to move beyond credit scores and traditional data to segment thin/no-file borrowers from truly high-risk auto loan applicants. This is done by building innovative risk assessment models that can disseminate, contextualize, and learn from complex consumer data sets. Finance innovators also look to help future buyers prepare for big expenses, like automobiles. One example is BoostUp, which partners with automotive companies, such as Hyundai, to help users save for and finance vehicle purchases.

CFSI Center for Financial Services Innovation

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[7] Rideshareapps.com, "2015: The Year The Rideshare Industry Crushed The Taxi [Infographic]" 2015.