THE ECONOMIC BENEFITS OF RISK-BASED PRICING

for Historically Underserved Consumers in the United States

Risk-based pricing allows financial companies to use analytics to better assess risks to offer innovative products at lower prices for consumers. The benefits of risk-based pricing are far reaching, and a recent report from the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) goes into further detail as well as provides policy recommendations. Download a copy of the full report at www.centerforcapitalmarkets.com/resource/rbp.

KEY FINDINGS

1. Consumers are better off in the risk-based pricing system than in a uniform pricing system. In the risk-based pricing system, firms offer consumers individual rates based on their risk profile. Two major benefits of this system are the following: (1) consumers, over time, pay less in the risk-based pricing system than in the uniform pricing system; and (2) unlike in the uniform pricing system, consumers have incentives to improve their financial health (e.g., by paying bills on time, by paying down debt) and, by extension, reduce their risk to enjoy lower-priced financial products in the risk-based pricing system.

2. Credit scores, credit-based insurance scores, and other risk-based pricing factors are proven to accurately predict risk unbiasedly. Credit scores predict the probability of default, while credit-based insurance scores, and other factors such as occupation and education, predict insurance losses. The accuracy and reliability of these variables have been validated repeatedly. Importantly, race, ethnicity, religion, or any other unrelated personal information are not included in risk-based pricing models.

3. Minority and low-income households have realized the greatest improvements in assets and access to capital. Black and Hispanic households and low-income households had the highest growth rates over the past 30 years across six measures of assets and capital: homeownership, auto ownership, mortgage and line-of-credit loans, auto loans, installment loans, and credit cards. For homeowners and auto insurance policies, participation in the residual market (for those who cannot get approved in the private market) has decreased substantially over time, indicating that more consumers have access to competitive products and rates.

4. Companies are innovating and using alternative data to reduce the credit-invisible population and improve credit scores for those who currently have them. At the end of 2018, 60.4 million American adults were unlikely to be able to access credit, including 26.5 million credit-invisible Americans. Alternative data, such as mobile phone bills, cashflow data, and telematics, help companies better determine consumers' risk profiles when traditional information is lacking. Alternative data produces more scorable consumers and can improve rates for those who have traditional credit scores. Companies are using this data to increase access to credit and insurance.

5. Incorporating more predictive data, not less, into risk-based pricing models generates positive economic benefits. Consumers have access to more financial products and better rates when alternative data is used in risk-based pricing. According to the Organisation for Economic Co-operation and Development, "in the aggregate, lending is increased, leading to greater economic growth, rising productivity and greater stocks of capital. Average interest rates drop. Poverty and income inequality are alleviated."

POLICY RECOMMENDATIONS

- **Support the use of more data in risk-based pricing models.** The more predictive data that is included in risk-based pricing models, the more accurately companies can predict risk. Importantly, consumers benefit from improved accuracy through increased access to financial products and better rates. Supporting the use of more data includes two components: (1) policymakers should not restrict the use of predictive data currently used in modeling; and (2) policymakers should support the use of alternative data in risk-based pricing models. Additionally, regulators should provide clear guidance on the permissible uses of alternative data to reduce uncertainty, thus encouraging wider use of alternative data.

- **Support policies that improve the financial health of all Americans.** In risk-based pricing, consumers' credit scores improve as their financial health improves. With higher credit scores, consumers enjoy increased access to credit at lower costs. Policymakers should support policies that help Americans improve their financial health, which, in turn, will increase economic opportunities for these individuals.

- **Support additional research.** The use of additional data helps Americans improve their credit scores. However, little research exists on the barriers preventing or discouraging companies from incorporating alternative data into their risk-based pricing models. Government agencies should examine the regulatory and market conditions causing these barriers in order to encourage wider adoption of alternative data in risk-based pricing. For example, the Government Accountability Office (GAO) could conduct a study on the barriers related to reporting of payment data to credit bureaus by large telecom providers.