

Testimony of Neil Alldredge
On Behalf of the National Association of Mutual Insurance Companies
Joint NAIC C/D Committee Hearing on Credit-Based Insurance Scores
April 30, 2009

Good afternoon Director McRaith and Commissioner Holland, I'm Neil Alldredge, Vice President – State & Policy Affairs for the National Association of Mutual Insurance Companies (NAMIC). NAMIC represents 1,300 member companies that underwrite over 40 percent of the insurance market in the United States.

Before I begin, I will note that NAMIC has submitted several documents for the record. In particular, I draw your attention to our Issue Analysis public policy paper that examines the issue of disparate impact, unfair discrimination and the use of insurance scoring. We have also submitted an Issue Brief titled: *Credit-Based Insurance Scoring, Separating Facts from Fallacies*. This policy briefing does a good job (in 4 pages) summarizing most of the points you have heard today.

Introduction

Credit-based insurance scores have been used by insurance company underwriters and actuaries for nearly two decades to more accurately assess risk and price coverage for automobile and homeowners' insurance policies.

The use of insurance scores encourages competition and enables insurers to offer coverage to more consumers at a fairer price. Furthermore, consumers benefit from insurance scoring because it keeps the insurance marketplace competitive, resulting in lower prices, better service, and more product choices.

Insurance scores provide an objective, fair, and consistent tool that insurers use with other information to better predict the likelihood of future claims and the cost of those claims. During the late 1990s, lawmakers and regulators in several states began enacting laws and regulations that established procedures for insurers to follow in using an individual's credit information. In 2002, the National Conference of Insurance Legislators (NCOIL) created a "Model Act Regarding Use of Credit Information in Personal Insurance," which became the basis for additional legislation in other states. Today, 47 states have laws or regulations pertaining to credit-based insurance scoring.

In spite of an apparent consensus on this issue, some public officials and advocacy groups have continued to press for further restrictions on the use of insurance scores, or to prohibit the practice entirely. We believe this course of action is not warranted and would be harmful to the vast majority of policyholders.

Studies

The focus of my testimony today is to review the various studies conducted on insurance scoring. To date, 17 industry, state or federal agency studies have been conducted. Typically these studies have examined the correlation between credit-based insurance scores and the propensity for insured losses and/or the impact credit-based insurance scores have on low-income or minority populations. It is certainly the most studied rating and underwriting variable currently used by insurers.

These studies all share some common findings, primarily that credit-based insurance scores are predictive of loss, that the majority of consumers benefit from the practice and that credit-based insurance scores are not a proxy for race or income.

The focus of our testimony today is on the two most comprehensive studies conducted to date, the Texas Department of Insurance study of 2005 and the study conducted by the Federal Trade Commission released in 2007. I will also review the survey conducted by the Arkansas Department of Insurance.

Texas

The Texas Department of Insurance (TDI) released the main body of the report in December 2004, and issued a supplemental report in January 2005. The TDI study was based on data obtained from six leading insurers for approximately 2 million policies. Of these, approximately 1.2 million were for personal auto insurance and 800,000 were for homeowners insurance. The personal auto policies covered roughly 2.5 million vehicles.

The TDI study was unusual both because of the size of its database, and because it included individual information on race and ethnicity. That information was missing from other studies because insurers do not collect information concerning the race or ethnicity of their policyholders. The TDI, however, was able to draw on the resources of the Texas Department of Public Safety and the Texas Office of the Secretary of State. Based on data supplied by those agencies, the TDI was able to classify individual policyholders as white, black, Asian, and Hispanic.

The December report concluded that “there appears to be a strong relationship between credit scores and claims experience on an aggregate basis,” but cautioned that “credit scores, to some extent, may be reflective of other risk characteristics associated with claims.” The report explained that the department would need to perform a multivariate analysis to determine whether credit scoring enables an insurer to predict losses more accurately than it could by relying solely on more traditional underwriting variables. The report also found that some minority populations were over-represented in the lower score categories but that no unfair discrimination was detected.

A month later, the department released its supplemental report containing the multivariate analysis. It found that “for both personal auto liability and homeowners, credit score was related to claim experience even after considering other commonly used rating variables. This means that credit score provides insurers with additional predictive information

distinct from other rating variables. By using credit score, insurers can better classify and rate risks based on differences in claim experience.”

This finding so surprised then Texas Insurance Commissioner Jose Montemayor that he felt obliged to acknowledge, in a letter to Governor Rick Perry, that his “initial suspicions were that while there may be a correlation to risk, credit scoring’s value in pricing and underwriting risk was superficial, supported by the strength of other risk variables.” The study, however, “did not support those initial suspicions.” Moreover, credit scoring “is not unfairly discriminatory as defined in current law because credit scoring is not based on race, nor is it a precise indicator of one’s race.” A copy of the letter from Commissioner Montemayor is included in this testimony.

Federal Trade Commission

When the federal Fair Credit Reporting Act with reauthorized in 2003 there was language inserted directing the Federal Trade Commission (FTC) to study the impact insurance scores had on the availability and affordability of insurance. The authorizing statute also directed the FTC to examine whether insurance scores had a disparate impact on protected classes. The study was made public in early 2007.

The FTC found that 59 percent of consumers benefitted from the use of credit-based insurance scores and that scores were correlated to and predictive of loss.

The FTC stated that credit-based insurance scoring provides benefits to consumers, including rates that are more accurate, effectively reducing subsidies which also allow insurers to offer insurance to higher risk drivers who otherwise may not be able to obtain coverage. The FTC also said that credit-based insurance scoring may reduce the cost of granting and pricing insurance with the cost savings passed along to consumers in the form of lower premiums.

The FTC found that “credit-based insurance scores appear to have little effect as a ‘proxy’ for membership in racial and ethnic groups in decisions related to insurance.” The study noted that there was a range of credit-based insurance scores and losses within every group studied and that insurance scores are predictive *within* racial groups. In other words, every racial group has individuals with low scores and high scores and within those groups insurance scores are predictive of loss.

Arkansas

In 2005, the Arkansas Department of Insurance began an annual survey of the effect of the state’s insurance scoring law, which is based on the NCOIL model, on insurance consumers. The 2007 survey concluded that of 3,026,092 personal lines policies written or renewed in that year, 32 percent of customers received a discount, 9 percent received an increase, and the remaining 59 percent of consumers saw a neutral impact due to insurer use of insurance scores. In other words, 91 percent of personal lines customers either received a discount for credit or it had no impact on premium. For policies where credit played some role in determining the final premium, those receiving a decrease outnumbered those receiving an increase by a ratio of 3.44 to 1. These results were

virtually identical to findings of the 2005 and 2006 survey. All the surveys are available on the Arkansas Department of Insurance website.

Conclusion

Several other studies have been conducted by different state insurance departments over the last 10 years (Virginia, Washington and Alaska, for example), all these studies have two clear findings – that credit-based insurance scores are predictive of loss and that the vast majority of consumers benefit from the tool. There have been no academic studies that include insurance loss or rate information that have found that credit-based insurance scores are either predictive of, or a proxy for, race or income.

We also believe a common sense examination of insurance markets is revealing. It would stand to reason that if credit-based insurance scores have a negative effect on availability or affordability that residual market mechanisms and consumer complaints would be skyrocketing. Neither phenomenon is occurring. In nearly every state in the country the personal lines markets are competitive, vibrant and healthy. Consumers have choices and all the serious research indicates that a vast majority benefit from the use of this valuable tool.