



HEADQUARTERS
3601 VINCENNES ROAD
INDIANAPOLIS, INDIANA 46269
TELEPHONE: (317) 875-5250
FAX: (317) 879-6408
WWW.NAMIC.ORG

WASHINGTON OFFICE
122 "C" STREET, NW
SUITE 540
WASHINGTON, D.C. 20001
TELEPHONE: (202) 628-1558
FAX: (202) 628-1601

Comment of the National Association of Mutual Insurance Companies to the Federal Trade Commission on the use of credit-based insurance scores.

These comments are in response to the FTC questions labeled “B. Credit-Based Insurance Scores and Property and Casualty Insurance” and do not address the first set of questions labeled part “A”.

Founded in 1895, the National Association of Mutual Insurance Companies (NAMIC) is a full-service national trade association with more than 1,400 member companies that underwrite 43 percent (\$196 billion) of the property/casualty insurance premium in the United States. NAMIC members account for 44 percent of the homeowners market, 38 percent of the automobile market, 39 percent of the workers’ compensation market, and 31 percent of the commercial property and liability market. NAMIC benefits member companies through advocacy, public policy and member services. Information about the association, its member companies and the property/casualty insurance industry can be found at *NAMIC Online*, www.namic.org.

Our comments to the individual questions are as follows.

1. A full understanding of credit-based scoring models requires an understanding of the risk assessment process. Each insured presents a unique risk to the insurer. In order for the insurer to determine an accurate insurance rate to be charged, there must be an accurate assessment of the risk. The more accurate the risk assessment, the more accurate and fair will be the rate charged.

No single risk factor has yet been discovered which accurately measures the totality of risk represented by each insured. The state of today’s science is that the most accurate risk assessment is achieved through a combination of risk factors. The addition of one such risk factor, credit-based insurance scores, has significantly increased the accuracy of the risk assessment process. A study published by EPIC Actuaries, LLC in June 2003 found that credit-based insurance scores were among the three most important risk factors for each of the six automobile coverages studied.

Since insurance scores are used in conjunction with other risk factors, it has been common for insurance score models to reflect only those risk factors not already included in an insurer’s rating plan. The risk factors commonly included in the score are credit-related risk factors such as number of non-insurance inquiries, number of derogatory public records, ratio of total balances to total high credit, age of oldest trade, and etc. Some insurance scores also include noncredit-related risk factors. The score, or scoring model, is typically created by testing the statistical relationship

between each risk factor and insurance losses. Those credit-related and noncredit related factors which exhibit a weak correlation with insurance losses are discarded, or given low weight. Those risk factors which exhibit the highest degree of loss predictability are given the greatest statistical weight in the scoring model. The statistical analysis technique used to measure the correlation of each risk factor with insurance losses and to determine the weight to be given to each risk factor is usually a generalized linear model or some other regression method that provides for the simultaneous, multivariate analysis of all potential risk factors to be included in the score.

Just as insurers compete with accuracy of risk assessment in their rating plans, so do they compete with the design of insurance scores. Some insurers purchase “off-the shelf” credit-related insurance scores from vendors. Some vendors assist insurers with the design of unique scores. Some insurers develop their own scores. All scoring models (i.e., the risk factors included and the weights given each factor) are proprietary and the source of great competition.

Competition, like no other force, has always been the primary driver of insurers’ quest for more accurate risk assessment, whether that risk assessment was manifested in a rating plan or an insurance score. In the long run, all consumers benefit from the forces of competition because more accurate risk assessment leads to more accurate insurance rates and greater availability of coverage choices in the marketplace.

2. It is unknown how many different credit-based insurance scoring models are in use today. Our guess is several dozen. Some scores are designed for use with personal auto insurance coverages, some are designed for homeowners insurance, and several are used for commercial property coverages.

Some vendors sell “off-the-shelf” scoring models, but also assist insurers in developing their own unique models. Some insurers develop their own scoring models.

Like all aspects of the ratemaking and underwriting processes, there are significant variations of scoring models currently in use and there is great competition associated with the design of the models.

3. There is great variation in the use of credit-based insurance scores among property/casualty insurers. There are likely a few insurers that do not use insurance scores for any purpose. Insurers who have traditionally focused on specialty, or relatively narrow, market segments may use insurance scores to objectively define those customers eligible for coverage. Insurers that tend to serve a broad spectrum of the market are likely to incorporate insurance scores into their rating process so as to create more accurate rates.

How insurers use insurance scores is a source of great variation and competition among insurers.

4. Uncertainty about the adequacy of prices is the most important factor affecting coverage availability. If an insurer is confident in the adequacy of its prices, there exists a strong economic incentive for the insurer to provide coverage whether or not it is a high-risk insured or a low-risk insured. The lowest risk in the market is unattractive to insurers if the rate is inadequate. Because credit-based insurance scores have contributed to the accuracy and adequacy of rates, there are now stronger economic incentives for insurers to provide coverage to all consumers, including high-risk insureds.

Of course, when insurance scores are introduced into a rating plan the rates for some insureds will be lower and for some insureds the rates will be higher. Such is also true for every other rate factor in the rating plan.

Someone might argue that an insured receiving the higher rate is being harmed. But the counter argument is that if insurance scores are not implemented into the rating plan, those insureds with good insurance scores are being harmed because they would be charged a rate too high for the degree of risk they represent.

Even insureds with poor insurance scores that are charged higher rates may actually be receiving coverage at more affordable rates than would be available without insurance scores. Often high risks cannot find coverage in the regular market because of inadequate rates. Those high risks are often forced to find coverage at much higher rates in the state's residual market (e.g., assigned risk plan or FAIR plan). In most cases, prices in the regular market are lower, even though increased because of a poor insurance score, than are prices in the residual market.

5. Credit-based insurance scores have tended to replace underwriting decisions concerning eligibility for coverage and placement into one of several available rating programs. Traditionally, underwriting decisions have been a mixture of an underwriter's application of objective eligibility rules and subjective judgments. Credit-based insurance scores have allowed many insurers to more fully implement a mechanical underwriting system with the result that the need for personal intervention has been reduced, the underwriting process has become virtually instantaneous and more cost-effective, and the need for subjective judgments has been eliminated.

6. Underwriting and rating decisions are entirely based on risk assessment. A study by EPIC Actuaries, LLC published in June 2003 concluded that credit-based insurance scores added significant accuracy to the risk assessment process. For each of the six automobile coverages studied, EPIC found that among the multitude of risk factors used to assess risk, credit-based insurance scores were among the three most important.

7. Historically, there has been a trend of homeowner's insureds purchasing increased amounts of coverage on the dwelling and contents, and higher deductibles. For auto insureds there has been a historical trend of purchasing higher limits of liability coverage and higher deductibles for the physical damage coverages. There are

several factors which influence the historical purchasing trends. It is impossible to isolate the impact of credit-based insurance scores.

Because credit-based insurance scores increase the accuracy of the risk assessment process and insurance pricing, auto and homeowners insurance coverages are more widely available in the regular market, thereby reducing the need for some insureds to seek coverage from the higher-rated residual markets. While the impact of credit based insurance scores cannot be isolated from all other factors affecting the insurance market, it stands to reason that any factor which encourages coverage availability will tend to reduce the need for the residual markets, as well as reduce the number of uninsureds.

It is unfair to require credit-based insurance scores, or any other risk factor, to single-handedly solve all the market's weaknesses. Risk factors, such as credit-based insurance scores, which have a positive impact on both coverage availability and accuracy in risk assessment should be encouraged.

8. Insurance scores are but one of many risk factors that determine the insurance rate for an individual insured. If all other risk factors are the same, insurers will typically charge a higher rate for an insured with a poor insurance score and a lower rate for an insured with a good insurance score. The amount of the rate differential may vary significantly from insurer to the next.

Even though the rate for an insured with a poor insurance score may be relatively higher, such higher rate is still most often lower than the price of coverage in the residual market. By making coverage more widely available in the regular market, insureds with poor credit histories benefit from increased coverage availability, and often benefit from lower rates otherwise available to them in the residual market.

To be clear, in this response we have interpreted the FTC's question as being about the impact of poor insurance scores. The question actually asks about the impact on "consumers with poor credit histories". Insurance scores are specifically developed using insurance claims data as well as elements of credit history. Studies have shown that insurance scores provide useful information to insurance underwriters, but they are not designed to classify an individual's credit history as "good" or "poor". An individual might have a "poor" credit history by some standard and still have a "good" insurance score, and vice versa.

Note also that some insurers do not use credit-based insurance scores in underwriting or rating automobile or homeowners insurance. Thus an individual's credit history, whether "good" or "poor", would have no impact on the availability or price of insurance coverage from such an insurer. As for any other product in our competitive economy, a consumer who is willing to shop is likely to find a better deal than one who is not.

9. Typically, insurers treat insureds with no credit history as though they had an average credit score. In other words, the price of coverage to an insured with no credit history

is neither increased nor decreased because of the credit history.

10. To our knowledge, no insurer knows the income, ethnicity, race, color, religion, national origin or creed of any of its insureds. As such, it is impossible for insurers to measure the impact of insurance scores on any of those groups. However, it stands to reason that if insurers are blind to those demographic factors, the application of insurance scores to those groups will be without any unfair bias.

We encourage the FTC in its study to look at the distribution of insurance scores within racial groups and within income groups. We encourage the FTC to use the distributional data to determine the probability that one can predict race, or predict income, based solely on insurance score. We believe that the FTC will find that insurers cannot reliably identify an insured's race or income from the insurance score. Geography, age, sex and marital status are important risk factors already reflected in the rating plans of most insurers. When insurers introduce insurance scores into their underwriting/rating plans they do so uniformly across all geography, age, sex and marital status groups. We therefore expect the impact of insurance scores to be approximately uniform across those groups.

Any analysis undertaken to ascertain if unfair discrimination exists in property casualty insurance must include not only the premium data but also the claims loss data. There are certain consumers who pay higher than average premiums because they incur greater than average claims costs. If the consumers who represent a greater risk didn't pay more in premiums, the consumers who represent a lesser risk would have to pay more than is warranted by their experience, which is unfair to them. Analyses that claim to show unfair discrimination based on premium data alone, while ignoring claim and loss data are misleading and effectively meaningless. NAMIC does not and could not claim that any particular protected class has more or fewer claims than average since NAMIC's members are prohibited from accessing data on the variables in question (ethnicity, race, religion, etc.).

11. As discussed in our response to Question #1, there are a variety of insurance scores being used in the market. The scores are not necessarily uniform in terms of the risk factors included, and almost certainly not uniform in the statistical weights assigned to each risk factor.

We suggest that the FTC focus on the impact of the total insurance score. If no significant differential treatment is found for the total score, then it seems irrelevant to worry about each of many risk factors, and their respective weights, that make up the total score. See also our response to question 11 which notes that analyses of the appropriateness of underwriting discrimination in insurance must include consideration of claims costs as well as of premium differentials.

12. We do not agree with the underlying assumption of this question that credit-based insurance scores have a negative impact on ECOA protected classes. Studies have shown that credit-based insurance scores add significant accuracy to the risk

assessment process, over and above the risk factors already in use. Increased accuracy in risk assessment and in pricing encourages wider availability of coverages in the regular insurance market, thereby reducing the utilization of the higher-related residual markets. Wider availability of coverage at a lower cost in the regular market benefits every insurance consumer, including those in the ECOA protected categories.

Note also that the study by EPIC Actuaries mentioned above as well as the studies performed by the Texas Department of Insurance both concluded that the variation in insurance loss costs explained by insurance scores remained high even when all other “traditional” classification factors were accounted for. Thus there are no currently available factors that would allow equally accurate risk classification without the use of insurance scores, so it is fortunate that there is no evidence that insurance scores cause any unfair discrimination in insurance.

13. As stated in our response to Question #10, to our knowledge no insurer has data in its files which would allow it to identify a member of an ECOA category. Without that information an insurer could not conduct the tests suggested by this question. We cannot speak for private vendors of credit scores as to if, or how, they may conduct such tests.

14. Most insurers market their products through insurance agents where prescreening generally does not occur. Credit-based insurance scores have increased the accuracy of the risk assessment and pricing processes, which means that insurance agents are able to make coverage available to a wider spectrum of the market that comes to them, without any prescreening. In short, you cannot prescreen customers that chooses to call an agent or walk into their door.

We are not aware as to how credit-based insurance scores may have changed the prescreening process for insurers that market their product directly to the consumers. However, it is logical to assume that because credit-based insurance scores have made pricing more accurate, direct-response insurers, like other insurers, can make coverage available to a wider spectrum of the market. To the extent that a direct response insurer has adequate rates available for a wider market, the need for prescreening is reduced.

We want to emphasize that for all insurers, direct-response and agency-produced, poor insurance scores do not make an insured less attractive to the insurer. Insurers have great economic incentive to insure those with poor credit scores if they are permitted to charge adequate rates. The decision to provide coverage is always premised on the adequacy of the rate, not the score itself.

15. Any risk factor, credit-based insurance scores or otherwise, which leads to increased accuracy in risk assessment and increased certainty in rate adequacy, provides powerful economic encouragement to an insurer to enter new lines of coverage and new states of operation. Increased accuracy in risk assessment leads to a more

competitive market that benefits all insurance consumers.

16. The overall average cost of insurance is totally independent of all risk factors used to set the price. For example, whether or not you differentiate auto insurance rates by age of driver has no impact on the overall average cost. The same is true for all other risk factors, including credit-based insurance scores.

The issue is whether including a risk factor, like an insurance score, in the rating plan leads to more accurate pricing for individual insureds. Studies have shown that credit-based insurance scoring adds significant accuracy to pricing and is among the most important of all rate factors.

It is our view that the rating plan which is fairest to all consumers is the rating plan which is the most accurate in reflecting costs. Credit-based insurance scoring has been shown to be a significant contributor to accuracy, and therefore a significant contributor to fairness for all insureds.

17. There will be a myriad of factors affecting both the population of the various residual markets and the number of uninsureds. For instance, it is a commonly held belief that a “hard-core” of drivers and homeowners exist which will always refuse to buy insurance, or will always buy the minimum required by law. We do not believe that credit-based insurance scores, or any other rate factor, should be expected to solve this problem.

While we know of no perfect way to isolate the impact of insurance scores on the various residual market populations, it stands to reason that insurance scores have had a positive impact because more accurate prices lead to wider availability of coverage in the regular market and less need for the residual market.

18. Banning or limiting the use of any underwriting or rating factor which is known to be predictive of insurance losses always, without exception, leads to decreased coverage availability and higher insurance prices. History is littered with examples of how limitations on rating by geography, age of driver, and etc. have destroyed competitive markets and drove up prices.

The first result of artificial bans or limitations on the use of known risk factors is a reduction in coverage availability. Insurers choose not to expand into new lines of coverages and new states. In extreme cases some insurers have turned in their licenses and withdrawn entirely from a state.

The second impact of artificial bans or limitations on the use of known risk factors is an increase in prices. As coverage becomes less available in the regular market, insureds are forced into the residual market with their higher rates.

A ban on the use of insurance scores is counterproductive and would harm, rather than benefit consumers.

19. Because there are a variety of insurance scoring models in use, and because all are proprietary, we cannot speak in detail about each model. However, we understand that insurance inquiries are generally not included in credit-based insurance scores. As such, credit-based insurance scores provide no disincentives for consumers to shop for insurance coverage.

20. All risk factors used in pricing insurance are reliant upon accurate information. No large database is perfectly accurate. Insurers generally communicate with their insureds concerning the various risk factors which affect the rate. This is also true for credit-based insurance scores. When an insured sees a risk factor that appears to be inaccurate, the insurer will work with the insured to verify and/or correct the information. This is as true for credit based insurance scores as it is for any other risk factor. It may be true that insurers' use of credit-based insurance scores has brought errors in credit records to the attention of consumers that might not have been otherwise discovered.

21. To the extent that an individual's credit record is incomplete, it may be impossible to compute a credit-score. These so-called "thin files" are typically treated by insurers for rating as "credit-neutral". In other words, the rate is not increased or decreased due to credit-related risk factors. Thin files represent a very small percentage of insureds.