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PCI

Property Casualty Insurers
Association of America

Shaping the Future of American Insurance

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Statement of Property Casualty Insurers Association of America On House Bill 41 Before the Business and Labor Committee

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The following comments are being provided on behalf of the member companies of the Property Casualty Insurers Association of America (PCI). PCI is a national property casualty trade association comprised of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write $154 billion in annual premium, or 38 percent of the nation's property/casualty insurance. PCI members insure approximately one-third of the personal lines market in Montana.

PCI is opposed to House Bill 41, a bill intended to regulate the use of credit information by insurers. PCI members are not opposed to reasonable regulation over the use of credit information in personal lines insurance, but find this bill to be overly broad and believe it would not benefit insurance consumers, and could, in fact, result in some serious unintended consequences.

Not all insurers choose to use credit information in their underwriting or rating practices, but PCI believes that insurers should maintain the right to do so. The federal Fair Credit Reporting Act first authorized insurers to consider credit information nearly 30 years ago, and still does so today. However, over the past few years, the use of credit information in insurance has grown as the tools have been improved, and insurers have seen first hand the benefits of considering credit information. Insurance scoring (also called credit-based insurance scoring) is an objective and accurate method for assessing the likelihood of insurance losses. Insurers that consider credit information in their underwriting and pricing decisions do so for only one reason – insurance scoring allows them to rate and price business with a greater degree of accuracy and certainty. Sound underwriting and rating, in turn, allows insurers to write more business - a direct benefit for consumers.

It is important to understand how insurers use credit information and to note that there are significant differences between the credit scores used by lenders and the credit-based insurance scores used by many insurers. Although both are derived from information found on credit reports, the information is measured differently. Insurers use credit information in developing insurance scores to predict the likelihood of future insurance loss. Credit-based insurance scores provide an objective measurement of how one *manages* the risk of credit. Lending institutions, on the other hand, use credit scores to determine the availability, amount and price of credit products offered to the consumer. Lending institutions use credit to determine the likelihood of repayment. The most significant difference between insurers and lending institutions is that insurers never consider income. Insurers measure "how," not "how much." Unfortunately, some opponents of insurer use of credit have either overlooked, or ignored, this key difference.

In addition to income level, one's address, ethnicity, religion, gender, familial status, nationality, age, and marital status are also *not* considered within a credit score calculation. Further, there is no reliable evidence that points to insurance scoring resulting in higher insurance rates for any specific class of individual. Low credit scores do not correlate to a specific territory or class of individuals. On the contrary, both high and low scores are found across all income levels, and territories.

A 2003 study by EPIC Actuaries (now part of Tillinghast), the largest and most comprehensive study ever undertaken on the connection between credit history and insurance risk, found that a consumer's credit-based insurance score is unquestionably correlated to that consumer's propensity for auto insurance loss. The study was based on a countrywide sample of nearly 2.7 million automobiles. Even more significantly, the study found that insurance scores are consistently among the most important rating variables used by insurers. The EPIC researchers used a multivariate analysis technique to determine indicated risk factors. After fully accounting for all overlap and relationship with *other* risk factors, such as age/gender, territory, model year, driving record and coverage limit – credit was found to clearly be an independent and significant tool for predicting insurance loss. The propensity for loss was found to decrease as the insurance score increases. For example, after adjusting for other variables, individuals with the lowest insurance scores were found to incur 33 percent higher losses than average, while those with the highest scores incurred 19 percent lower losses than average.

Every serious and reputable actuarial study on the issue has reached the same conclusion: there is a very high correlation between insurance scores and the likelihood of filing insurance claims. Without the ability to consider credit, many insurers would be less aggressive in their marketing, and far more cautious in accepting new business. Thus, consumers would quickly have fewer choices in the marketplace.

Credit-based insurance scores allow insurers to write business that they may not have accepted in the past, and to offer lower rates to many insureds. The majority of consumers have good credit-based insurance scores and benefit accordingly – with rates refined to reduce disproportionate subsidies of higher risk individuals. Our member companies tell us that insurance scoring consistently allows them to provide discounted rates for the majority of their policyholders.

PCI believes that House Bill 41 could have serious unintended consequences for both consumers and the marketplace, and could be so difficult for companies to comply with as to be a de facto ban on the use of insurance scoring.

For example, the bill includes a definition of "adverse action" broader than that found in the Fair Credit Reporting Act, broader than that applicable to other underwriting or rating tools, and broader than that found in other state statutes. The Fair Credit Reporting Act provides that consumers must be notified when the use of credit information results in a "change" to the policy coverage or rates. However HB 41 would require insurers to send an "adverse action" notice to all consumers who receive anything other than the best rate possible. While this may not sound unreasonable, in practice it becomes a confusing process for many consumers. To illustrate: a consumer might apply for coverage based on a quote that includes consideration of an insurance score, receive appropriate disclosure that the insurer will consider credit, and then receive a policy *exactly* as quoted (or, conceivably, even at a lower premium) - yet the consumer would also receive an "adverse action" notice if the policy was not issued at the lowest possible rate.

House Bill 41 also presents a problem in that it would appear to regulate insurance scoring in underwriting and rating, but would actually work to ban consideration of credit in the rating process. Section 2 of the bill reads that an insurer may not take an adverse action based on an insurance score except as allowed in subsection 3 of that Section. Subsection 3, in turn, only permits consideration of an insurance score in the underwriting of a new business application – thus, it would appear that, despite reference to rating in the definition of "adverse action," an insurer would not be permitted to consider an insurance score as a rating factor upon renewal. Such a restriction is actually unfair to any insured whose credit history improves over time, as it appears that an insurer could offer coverage in a specific tier in the initial underwriting process, but could not later offer a lower premium (particularly if the premium was not the best available) based on an improved insurance score.

Further, the bill would prohibit any adverse action due to an absence of credit information, or due to a credit history insufficient to calculate a score. Again, based on the overly broad definition of "adverse action," this means that applicants without credit histories would be entitled to the very best rate offered – the same treatment as those consumers who have, through their own efforts, very high insurance scores. This requirement is not only unjustified from an actuarial position, it is unfair to many consumers. The standard in most other states is to allow insurers to treat those without credit records as if they had neutral records –meaning that surcharges could not be allowed unless the insurer had evidence to show higher expected loss ratios for those risks without identifiable credit histories.

Credit-based insurance scoring is an effective tool for insurers - and a fair one for consumers. To protect competition and consumer choice, it is imperative that insurers be permitted to fully price risks using nondiscriminatory and statistically valid tools available to them. PCI and our member companies are not opposed to reasonable regulation to assure the fair use of insurance scoring. We are opposed to House Bill 41 because it would unfairly restrict insurance scoring for both insurers and consumers.

PCI appreciates the opportunity to provide our comments on this bill.