Insurance Credit Scoring:
Regulatory Oversight and Market Surveillance

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Insurance Regulatory Examiners Society
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The Center for Economic Justice

CEJ is a non-profit organization advocating on behalf of consumers on insurance, credit and utility issues.

Birny Birnbaum has been active on insurance credit scoring issues for over 20 years as regulator, expert witness, consultant to state insurance departments and consumer advocate.

Regulatory Oversight of Insurance Credit Scoring: Examining Company Practices

1. Map Out Insurer's Process of Using Consumer Credit Information

2. Identify and Review Key Procedures and Disclosures

3. Collect Data to Review Outcomes and Compliance

Map Out Processes

New Business vs. Renewal Business

- Provide Initial Disclosures / Obtain Permission to Use Credit History
- Obtain Credit History, Pull Selected Data
- Evaluate Credit History Data – Scoring Model, Scoring Rules
- Utilize Credit Scores in UW, Rating
- Provide Additional Disclosures / Notices
- Respond to Consumer Inquiries
- Timeline for Process
- State-Specific Requirements

Initial Disclosures / Obtain Permission

Review Initial Disclosure for Compliance with State Law and Fair Credit Reporting Act

Does Disclosure Indicate That Consumer Has Right to Decline Permission to Use Credit History, to Decline Giving SSN?

Review Procedures for Consumer Declining to Give Permission: How Treated?

Consistent With Procedures Set Out in Rate and Rule Manual

Verify "Neutral" Treatment

Follow the Data

What CRA is Source of Credit History Data? Review Agreement and Responsibilities of CRA and Insurer and Third Party Modeler

Identify How Data Are Used?

- Third Party Scoring Model vs. Insurer Model
- Credit Data Only or Credit Plus Additional Data
- Review Model – Confirm Model Used is Model Filed with Department
- Multiple scoring models – which one applied?
- Follow Model Output to Premium Calculation – Score, Ranking
- UW, Rating Tiers, Rating Factors
- How Many Times is Credit Data Used?
- Review Rules for Determination of Adverse Action

Review Model(s) Used -- Basics

Meet All Filing Requirements

What Factors Used in Model? Any Prohibited Factors?

Is Filed Model the Model Actually Used

Adverse Action Notice

Review Rules / Procedures for Determining Adverse Action and Providing Notice

Review Notice

- Contain Required Information?
- Test Contacts Indicated in Notice
- Indicate questions about credit history directed to CRA?
- Indicate questions about credit score directed to insurer?
- Indicate adverse action? Plain language?
- Neutral score – how determined?
- Include Reasons Why Score Not Better? Plain language?

Testing Consumer Disclosures

Are Disclosures Misleading?

Consumer Testing: Focus Groups

Consumer Testing: Surveys of Applicants

Life Events

Section 6. Extraordinary Life Circumstances

A. Notwithstanding any other law or regulation, an insurer that uses credit information shall, on written request from an applicant for insurance coverage or an insured, provide reasonable exceptions to the insurer's rates, rating classifications, company or tier placement, or underwriting rules or guidelines for a consumer who has experienced and whose credit information has been directly influenced by any of the following events:

1. Catastrophic event, as declared by the federal or state government

2. Serious illness or injury, or serious illness or injury to an immediate family member

3. Death of a spouse, child, or parent

4. Divorce or involuntary interruption of legally-owed alimony or support payments

5. Identity theft

6. Temporary loss of employment for a period of 3 months or more, if it results from involuntary termination

7. Military deployment overseas

8. Other events, as determined by the insurer

B. If an applicant or insured submits a request for an exception as set forth in Section 6(A), an insurer may, in its sole discretion, but is not mandated to:

1. Require the consumer to provide reasonable written and independently verifiable documentation of the event.

2. Require the consumer to demonstrate that the event had direct and meaningful impact on the consumer's credit information.

3. Require such request be made no more than 60 days from the date of the application for insurance or the policy renewal.
4. Grant an exception despite the consumer not providing the initial request for an exception in writing.

5. Grant an exception where the consumer asks for consideration of repeated events or the insurer has considered this event previously.

D. The insurer shall provide notice to consumers that reasonable exceptions are available and information about how the consumer may inquire further.

Life Events

Review Procedures and Practice

- How disclosed? Consistently? Written procedures?
- How applied? Consistently? Written procedures?
- Obtain Data on All Requests for Life Events and All Resolutions, Examine by Geographic Location and By Agent

Uses of Model

Are Credit Scores Used for Inappropriate Purposes?

- Not Used Directly or Indirectly to Condition Payment Plan Eligibility

Consumer Inquiries – How Handled

Review Procedures Policies for Responding to Consumer Inquiries and Complaints

Review Explanations Offered. Are Consumer Given Runaround?

Obtain All Inquiries / Complaint and Responses

State-Specific Requirements

- Discounts Only
- Limits on Rate Impact
- Periodic Re-Scoring
- Limitations on Use: New Business vs. Renewal
- Prohibited Factors
- Additional Disclosures

Michigan SB 300

The insurer or a third party on behalf of the insurer does not use income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the insured or insurance applicant in calculating an insurance score.

The insurer does not take an adverse action against a consumer solely because he or she does not have a credit card account, without consideration of any other applicable factor independent of credit information.

The insurer or a third party on behalf of the insurer does not consider an absence of credit information or an inability to calculate an insurance score in the rating of personal insurance unless any resulting rate differential is reasonably justified by differences in losses, expenses, or both, or the insured or insurance applicant is treated as having the most favorable insurance score available.

The insurer or a third party on the insurer's behalf uses a credit report issued within 90 days before the date an insurance score based on that credit report is first applied to the insured.

The insurer does not use the following as a negative factor in any insurance score or in reviewing credit information:

(*i*) credit inquiries not initiated by the consumer or requested by the consumer for his or her own credit information.

(*ii*) credit inquiries relating to insurance coverage, if so identified on an insured's or insurance applicant's credit report.

(*iii*) multiple lender inquiries, if coded by the consumer reporting agency on the credit report as being from the home mortgage industry and made within 45 days of one another, unless only 1 inquiry is considered.

(iv) multiple lender inquiries, if coded by the consumer reporting agency on the credit report as being from the automobile lending industry and made within 45 days of one another, unless only 1 inquiry is considered.

(v) the number, if under 3, of credit or charge card accounts opened by a consumer in the immediately preceding 12 months.

(*vi*) an action commenced by or against the consumer under the bankruptcy code, 11 usc 101 to 1330, if the date of the order for relief or the date of adjudication, as applicable, in that action is more than 10 years before the date of the credit report.

(*vii*) collection accounts with a medical industry code, if so identified on the consumer's credit report.

The insurer or a third party on behalf of the insurer does not calculate an insurance score by differentiating on whether an insured's or insurance applicant's accounts are maintained at a state or nationally chartered bank or a state or federally chartered savings and loan association, savings bank, or credit union.

Review of Model Advanced

- How was model developed?
- Old Model, Still Relevant After Financial Collapse
- What Validation Done on Model?
- Current Validation
- Used in manner consistent with actuarial data?
- What are dependent variables?

Was credit history data mined to produce models predicting outcomes other than claims:

- Propensity to purchase higher limits, other products
- Price Elasticity of Demand

Discriminatory Impacts

Market Outcome Data

Credit Scores for All Applicants in Recent Time Frame (or prospectively if necessary to obtain information on Application Not Resulting in Policy)

Critical to Obtain Info on All Applications – Policies Issued, No Policy Issued

Proxy for Prohibited Factors?

Consumer Perspectives on Insurance Credit Scoring

NCLC / Suffolk University Law School
Symposium on Credit Scoring & Credit Reporting

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The Center for Economic Justice

CEJ is a non-profit consumer advocacy organization dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. Most of work is before administrative agencies on insurance, financial services and utility issues.

On the Web: www.cej-online.org

Overview

1. Insurance Credit Scoring (CS) Is Inherently Unfair

2. CS Has A Disparate Impact on Low-Income and Minority Consumers

3. CS Undermines the Core Public Policy Goals of Insurance

4. CS Is Not Needed / Insurer Claims of Consumer Benefits of CS are Refuted by Objective, Independent Data

5. 2007 FTC Study Massively Flawed

Insurance Scoring Has Wide Impact on Consumers

Used by insurers writing the vast majority of personal auto and residential property insurance markets.

200 million vehicles insured

75 million residential properties insured – plus millions more renters.

Over $250 Billion in Annual Premiums

Insurance Credit Scoring is Inherently Unfair

- Penalizes Victims of Medical, Economic Catastrophes
- Penalizes Consumers for Abusive Lending Practices / Broader Economic Conditions
- Arbitrary and Illogical Results – Unrelated to How Well a Consumer "Manages" Her Finances

Consumers Hammered By Financial Crisis and Recession

- Reckless and Abusive Lending
- High Unemployment
- Wage Cuts
- Credit Limit Reductions
- Increases in Loan and Credit Card Fees
- Increasing Medical Costs

Record or Near-Record Highs in

- Delinquencies
- Foreclosures
- Bankruptcies

Are Insurance Scores Predictive of Future Claims?

Despite huge increases in characteristics purportedly associated with insurance claims – delinquencies, foreclosures – in the aftermath of the financial market collapse and Great Recession, insurance claims decreased – even in the states with the highest delinquency and foreclosure rates.

"Rank Ordering" – makes no sense as a rationale for insurance scoring.

Causes of Bankruptcies

Harvard Study of Bankruptcies in 2001:

- 87% of Bankruptcies Caused by Job Loss, Medical Bills or Divorce
- 46.2% from Medical Problems

Harvard Study of Bankruptcies in 2007:

- 62.1% of Bankruptcies Caused by Medical Problems
- 75% of These Were Families With Health Insurance.

Insurance Credit Scoring Is Not Objective

- Differences across credit bureaus
- Differences within a credit bureau due to lender choices
- Changes in definitions of credit report items – bankruptcy law change
- Public policy initiatives changing credit scores – moratorium on foreclosures
- Timing of report – balance to limits varies by time of the month
- Decisions of lenders – not reporting limits, changing limits
- 17% not scorable – no hits, thin files – these consumers treated negatively

Insurance Credit Scoring Is Subject to Manipulation

- Invitations/Solicitations for Manipulation
- Piggy-Back on another consumer
- Shift balances from one car to multiple cards

Penalizes Consumer for Rational Behavior

- Shop around for best rates
- Cancel a card when lender acts unfairly
- Get a card to get 10% first visit discount

Correlation to Race and Income – The Missouri DOI Study

- The insurance credit-scoring system produces significantly worse scores for residents of high-minority ZIP Codes.

- The insurance credit-scoring systems produce significantly worse scores for residents of low-income ZIP Code.

- The relationship between minority concentration in a ZIP Code and credit scores remained after eliminating a broad array of socioeconomic variables, such as income, educational attainment, marital status and unemployment rates, as possible causes. **Indeed, minority concentration proved to be the single most reliable predictor of credit scores.**

Correlation to Race and Income – The Texas DOI Study

The individual policyholder data shows a consistent pattern of differences in credit scores among the different racial/ethnic groups. The average credit scores for Whites and Asians are better than those for Blacks and Hispanics. In addition, Blacks and Hispanics tend to be over-represented in the worse credit score categories and under-represented in the better credit score categories.

Credit Scoring Reflects / Perpetuates Historical Inequities

"Segregation therefore racialized and intensified the consequences of the American housing bubble. Hispanic and black home owners, not to mention entire Hispanic and black neighborhoods, bore the brunt of the foreclosure crisis. This outcome was not simply a result of neutral market forces but was structured on the basis of race and ethnicity through the social fact of residential segregation."

Rugh and Massey, *Racial Segregation and the American Foreclosure Crisis*, American Sociological Review, Vol 75, No 5

Undermines the Core Public Policy Goals of Insurance

- Undermines the goal of universal coverage by worsening the availability and affordability of insurance for those consumers with the least means to purchase insurance; and

- Undermines the loss mitigation role of insurance by

  - Placing great emphasis on a rating factor which has no ability to promote loss mitigation by policyholder; and

  - Encouraging consumers to spend time manipulating credit scores instead of true loss mitigation activities.

Insurance Scoring Is Not Needed

- States Which Ban Insurance Credit Scoring, including California and Massachusetts Have Thriving Markets.

- Insurers Entered The Massachusetts Auto Market After Partial Deregulation, Even Though Insurance Credit Scoring Is Banned.

- Insurance Credit Scoring Not Needed to Avoid Adverse Selection.

- Insurance Credit Scoring Not Needed With Modern Risk Classification.

Claims of Consumer Benefits of Insurance Scoring Are Refuted by Objective, Independent Data

"Allows Insurers to Write More Business"

Fact: Uninsured Motorist Rate Has Increased Countrywide While Uninsured Motorist Rate Has Declined in CA and MA where Insurance Credit Scoring is Banned

Fact: Auto Residual Market Has Declined More in CA than Countrywide

Fact: Creditor-Placed (Force-Placed) Insurance Has Skyrocketed in Past 5 Years

No Objective Evidence to Support This Claim

Industry Claim: “Insurance Credit Scores Reflect Personal Responsibility”

Blaming the Victim Claim is Factually Incorrect

- Actual Causes of Financial Distress Typically Beyond Control of Consumers
- Traditional Credit Reports Missing Information on Financial Responsibility, Let Alone Personal Responsibility
- Recent Actions by Credit Scoring Modelers to Utilize Non-Traditional Credit Information Documents Disparate Impact of Traditional Credit Information on Low-Income and Minority Consumers.

FTC 2007 Study

The FTC analysis of insurance scoring is deeply flawed and the report is unresponsive to its Congressional mandate. The report's harm to consumers in the debate over insurance scoring has been immense.   The problems with the report include:

1. Data for the study selected by industry. The insurance industry effectively controlled the study by dictating the data that would be used in the study. There was no way to determine if the data were reliable.

   FTC did not know whether the policyholders included had or had not been insurance scored. FTC re-weighted the data to address underrepresentation in low-income and minority communities.

2. No substantive analysis of the impact of insurance scoring on the availability and affordability of insurance products as requested by Congress. Because of its reliance on industry-selected data, the FTC performed no analysis of how consumers actually fared from insurers' use of credit scoring. No information on average credit scores or average premiums for **applicants.**

3. Regurgitating insurer claims about credit scoring despite evidence that contradicts these claims. The FTC ignored evidence indicating that the correlation between insurance scores and claims was a spurious correlation – that insurance scoring was a proxy for some other factor actually related to claims.

4. The failure to analyze the "blaming-the-victim" strategy used by insurers to justify insurance scoring -- the bogus claim that people who manage their finances well are likely to manage their risks well and that's why credit scoring works. The fact is that, by the credit modelers own admission, almost 20% of the population is unscorable with traditional credit reports because of little or no information in the files. These folks are disproportionately low income and minority consumers who get charged higher rates through no fault of their own. And even a cursory examination of actual scoring models reveals that most of the factors determining an insurance score have nothing to do with whether a consumer pays her bill on time, but with factors related to socio-economic status. Yet, the FTC report dutifully repeats this desperate rationalization for insurance scoring with no critical analysis.

5. The failure to examine any alternatives to insurance scoring that are predictive of claims but are not based on any consumer credit information. The FTC ignored research indicating that insurers could eliminate the use of credit information but obtain the same ability to predict claims with advanced modeling and data mining of traditional rating factors. Consequently, the FTC ignored an obvious alternative to insurance scoring that could reduce the impact on low income and minority consumers.

FTC 2007 Auto Study

African-Americans and Hispanics are Disproportionately Represented in Bad Insurance Score Ranges – But Scoring is Not a Proxy for Race

What does it mean for something to be a proxy?

Insurers Claim Credit Scoring Allows Insurers to Rate More Accurately and Thereby Allows Them to Write More Business – We Agree, Despite All Evidence to the Contrary

"Use of credit-based insurance scores may result in benefits for consumers. For example, scores permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would otherwise not be able to determine an appropriate premium. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums. However, little hard data was submitted or available to quantify the magnitude of these benefits to consumers."

If insurance scoring resulted in insurers writing more business, what would we expect to see in states allowing insurance scoring? Fewer uninsured drivers and fewer drivers denied coverage in the voluntary market and subsequently insured in the residual market.

"Figure 7 shows that the state-run program share fell during the second half of the 1990s, as score were being introduced, and then leveled off after 2000. The pattern is nearly identical in states that allowed the use of scores and states that did not."

Did the FTC conclude that these results were inconsistent with industry claims about insurance scoring causing insurers to write more business?

"Therefore, Figure 7 is probably best interpreted as meaning that scores at least did not interfere with the smooth functioning of automobile insurance markets."

What about uninsured motorist rates?

“Figure 6 also shows the number of uninsured motorist claims filed compared to the number of property damage claims filed was basically unchanged in states where scores were allowed and decreased somewhat in states where they were not.”

Did the FTC conclude that these results were inconsistent with industry claims about insurance scoring causing insurers to write more business?

“These results, however, should be treated with caution.”

Indeed.