Center for Economic Justice
Review of NCOIL Insurance Scoring Model

October 2009

The NCOIL Model Fails to Provide Meaningful Consumer Protections

The insurance industry pushes the NCOIL model throughout the states, calling the model a balanced approach that represents a compromise among various stakeholders. In fact, the NCOIL model is neither balanced nor a compromise.

The NCOIL model was the result of a negotiation between insurer trade associations and one or two of the large independent agent groups. In exchange for a liability shield from insurers, the agents group endorsed credit scoring. And then it was rubber-stamped by NCOIL members who historically have been a very friendly forum for insurers.

A recent analysis by the Consumer Federation of America documents the excessive influence of the insurance industry on NCOIL decision making and many pro-insurance industry and anti-consumer actions by NCOIL. The development and vote of the NCOIL credit scoring model in the NCOIL Property Casualty Committee illustrates how biased the NCOIL process is towards the insurance industry.

In November 2002, the NCOIL P/C Committee adopted the credit scoring model by a vote of 20-5. Those in favor of adoption were:

Rep. Jay Bradford, AR **Chairman of the Board and CEO, First Arkansas Insurance Democrat**
Rep. Rich Golick, GA **Georgia Counsel for Allstate Republican**
Rep. Timothy Osmond, IL **Insurance Agents Republican**
Rep. Ronald Crimm, KY **Insurance, Thoroughbred Associates Republican**
Rep. Shirley Bowler, LA **Republican**
Rep. Dan Flavin, LA **Licensed Real Estate Broker Republican**
Sen. Bill Bullard, Jr., MI **Republican**
Rep. Stephen Ehardt, MI **Republican**
Rep. Andrew Richner, MI **Republican**
Sen. Alan Sanborn, MI **Republican**
Sen. Cal Larson, MN **"Consultant" Republican**
Rep. George Keiser, ND **Owner Printing Service Republican**
Rep. Frank Wald, ND **Insurance and Securities Broker Republican**
Rep. Leo Fraser, NH **Claim Auditor Republican**
Sen. Neil Breslin, NY **Elected Official, Lawyer, Democrat**
Assem. Nancy Calhoun, NY **Elected Official, Republican**
Rep. David Evans, OH **Retired State Farm Insurance Underwriter Republican**
Rep. Brian Kennedy, RI **Real Estate Broker Democrat**
Rep. Mark Young, VT **Banker, Republican**
Rep. Phil Montgomery, WI **Gov't Affairs Manager Green Bay CoC Republican**

Those opposed to adoption were:

Assem. Clare Farragher, NJ Legislator, **Republican**
Assem. Alexander Grannis, NY **Legislator, Democrat**
Assem. Ivan Lafayette, NY **Legislator, Democrat**
Rep. Kathleen Keenan, VT **Democrat**
Rep. Virginia Milkey, VT **Democrat**

Representatives from only 15 states voted on the credit scoring model. 3 states alone (MI, NY and VT) accounted for 44% for the votes. 5 states (MI, NY, VT, ND, and LA) accounted for 60% of the votes. North Dakota had 8% of the votes – and 0.2% of the population – 40 times more voting weight than share of population.

Republicans were disproportionately represented – 18 out of 25 votes. Seventeen (17) Republicans voted yes and one (1) voted not. Three Democrats voted yes and four (4) voted no.

The voting members were disproportionately employed by the insurance industry – at least seven (7) were employed directly by the insurance industry, including one legislator who is employed by Allstate as their counsel in Georgia.

The bottom line is that the industry-friendly credit scoring model was a product of a process biased towards the insurance industry and unrepresentative of states and consumers.

The NCOIL model is not a compromise and does not balance the interests of consumers with those of insurers. CEJ testified before NCOIL and every one of our recommendations was ignored. Further, the NCOIL model allows insurers to continue their current practices virtually unchanged, allows insurers to hide credit scoring from the public and places an unrealistic burden on insurance regulators. The NCOIL model is "pretend" consumer protection because it includes a series of provisions that purport to provide consumer protection but, in fact, do nothing to change insurer practices.

Problems with the NCOIL Model

The NCOIL model provides no substantive protections for, or disclosure to, insurance consumers.

1. Inadequate Disclosure

There are two major problems in terms of disclosure. The requirements for when an adverse action notice is required are vague and the requirements for the disclosure contents are without substantive content. First, the definition of adverse action tracks the Fair Credit Reporting Act, which insurers have claimed is ambiguous and used to deny

adverse action notices to new business applicants who were treated adversely because of consumer credit information. The NAIC best practices paper provides a better definition of adverse action, which eliminates the ambiguity created by the Supreme Court in *GEICO.*

Second, the adverse action notice disclosure specifically allows insurers to use standard industry reason codes. These codes are meaningless to consumers. Even if the consumer could understand the terms – which is not the case for most of the reason codes – the reason provides no guidance as to what the problem in the credit report was. Attached are industry standard reason codes

2. Non-Substantive "Protection" – Prohibited Factors in Scoring Model

The NCOIL model bans the inclusion of income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the consumer as a factor in the insurance score, but is silent about factors or scores which serve as a proxy for these factors. The data are clear that permitted factors are correlated to race and income. The claim of color-blind models is a fiction. Just because income or race are not included in the models does not mean that the models are not predictive or income or race; claims are not included in the models but the models are predictive of claims. The industry has a history of using of "color-blind" factors which discriminate against low-income and minority consumers, such as age and value of the home.

3. Non-Substantive "Protection" – No Sole Use

The NCOIL prohibits the use of insurance score as the sole factor for underwriting or rating. This provides no consumer protection as every insurer uses other factors for underwriting or rating already. These sections do not alter any insurers' use of insurance scoring and allow insurance scoring to have an unlimited impact on rates – as long as some other factor was "considered." The fact remains that consumers experience higher rates because of insurance scoring and insurance scoring alone.

The NCOIL also prohibits an adverse action based solely on the absence of a credit card account. As with the other "sole use" provisions, this provides no consumer protection and addresses an industry practice used in the early 1990's for a few months.

4. Non-Substantive "Protection" – Thin Files

The NCOIL model pretends to protect consumers with thin files or no scores from adverse actions, but provides three options which allow insurers to, in fact, take adverse action against huge portions of the population. Option 1 is anything the insurer can demonstrate with statistics, which is meaningless because no insurance regulator has any independent data to verify an insurer's claims. If an insurer comes to the regulator and shows a higher loss ratio for thin files, there is no way to verify this claim. Options 2 and 3 are similarly devoid of consumer protection – treat the consumer as having a neutral

credit score or exclude the use of credit. Neutral credit score is not defined and is meaningless when an insurer has constructed the rating system around credit scoring. If an insurer raises the base rates and then offers discounts for credit scoring, what would neutral mean? The same problem – and lack of consumer protection – arises from the exclude credit score option.

5. Non-Substantive "Protection" – Inquiries and medical codes

The NCOIL model prohibits "use as a negative factor" credit inquiries not initiated by the consumer, inquiries related to insurance, collection accounts with a medical code, multiple lender inquiries for a home mortgage within 30 days unless only one is considered and multiple lender inquiries from auto industry within 30 days. These actions were already adopted by modelers prior to the NCOIL model adoption because of complaints about their use for lending credit scores. The medical code provision has limited value because it captures only a small fraction of collections dues to medical bills and provides no protection for delinquent, but not yet in collections, medical bills.

6. Non-Substantive "Protection" – Life Events

In 2009, NCOIL amended the model to change a drafting note encouraging the use of a life events exception to a provision of the model. The new provision provides no consumer protection because there are no requirements for an insurer to do anything or for a regulator to monitor insurer practices.

7. Confidential Models

The NCOIL model provides for confidentiality of the credit scoring models, based on the claim that the scoring models are trade secrets. The models are public in several states, yet insurers continue to use the models in those states. There is no evidence that public disclosure will chill insurers' use of scoring models. There is evidence that confidentiality of scoring models keeps consumers in the dark about the insurance scoring and prevents consumers from holding regulators and insurers accountable for the scoring models. TransUnion has recently withdrawn its trade secret claim and provides its scoring models to the public.

8. Reliance on Regulators to Protect Consumers

The NCOIL model requires insurers to file their scoring models but keeps the models confidential. Consequently, consumers must rely on regulators to review the models and take action against insurers for violations. Such review and action by regulators is rare and in most states, no credit scoring model has ever been challenged or disapproved. Further, the model does not require, and regulators have not taken action to, require reporting of data necessary to verify the actuarial and market performance claims made by insurers. Unlike, mortgage lending where regulators and the public can evaluate the

loan performance of lenders, insurance regulators, policy makers and the public have no independent information in insurance scoring policy debates.

Consumer Protections Missing from the NCOIL Model

Any effort to provide meaningful consumer protections must include the following provisions, all of which are missing from the proposed regulation. This list is not exhaustive.

1. The use of credit scoring is prohibited for conditioning payment plan eligibility. Payments plans are an essential tool for making insurance available to consumers by making insurance affordable to consumers. Insurers who require full policy payment up front are denying coverage to large numbers of insurers. Payment plan eligibility should be conditioned only a consumers' payment history with the insurer offering the policy. There is no reason to use credit scores for payment plan eligibility. Insurance scores, in theory, predict risk of loss and not likelihood of making a payment. Insurers stress this repeatedly in their efforts to distinguish lending credit scoring from insurance credit scoring. Further, even a lending credit score is irrelevant for insurance because the insurer is never in a position to provide coverage without payment. The proposed regulation does not address the use of credit information to condition payment plan eligibility.

2. An adverse action should be defined as any underwriting, tier placement or rating activity that results in an insurer failing to offer the most favorable terms of coverage and premium to a existing policyholder or new applicant who, if he or she had a more favorable consumer credit report, would have been eligible for the more favorable treatment. The proposed regulation fails to address insurer's abuse of the FCRA's adverse action language – the failure to provide adverse action notices to most or all new business applicants who failed to receive more favorable terms of coverage and rates because of the insurers' consideration of the consumer credit report. Insurers have mistakenly and inappropriately relied upon the "increase in any charge" language of the FCRA to argue that new customers cannot suffer an adverse action because there can be no increase in a charge for that consumer.

   For purposes of this regulation an "adverse determination" includes, but is not limited to, the following situations:

   a. An offer of insurance in an insurance company that is affiliated with an insurance company with lower rates, if the consumer does not qualify for coverage in the lower-rated insurance company because of the consumer's credit score. The lower-rated insurance company has taken an adverse action.

   b. An offer of insurance in an insurance company by an independent agent who also represents an insurance company with lower rates, if

the consumer does not qualify for coverage in the lower-rated insurance company because of the consumer's credit score. The lower-rated insurance company has taken an adverse action.

c. An offer of insurance at a premium or rate that is higher than the premium or rate the consumer would pay if the consumer had the best possible credit score, all other factors being the same. The company charging the higher premium or rate has taken an adverse action.

3. Provide meaningful information in the adverse action notice. Consumers should be provided with their credit score, the list of factors included in the credit score, the consumers' value for each of the factors and optimal value for each of the factors. The purpose of the adverse action reason disclosures is to empower the consumer to identify what information – or what lack of information – in the consumer credit report led to the adverse action and for the consumer to be able to either contest inaccurate information or change his or her credit characteristics over time.

   For example, compare the difference between a consumer being uprated and told the reason was two at-fault claims versus being told the reason was too many retail accounts. The first reason is specific and understandable to a consumer. The second reason is non-specific and does not provide the consumer with sufficient information to take action to correct a report or change credit practices.

   A meaningful consumer disclosure requirement would start with disclosure of the four most important factors, in descending order of importance, preventing a consumer from getting a more favorable credit score or credit evaluation. For purposes of adverse action reason disclosure, "important" means the greatest contribution to a less favorable score or evaluation for the consumer. The factors should be identified with sufficient specificity that a consumer can identify the factors on a standard credit report. In addition, when providing the four most important factors to the consumer, the insurer should provide both the value for that factor used by the insurer in calculating the consumer's credit score or credit evaluation and the optimal values for the particular factor. By knowing how far his or her factor values are from the optimal values, the consumer is in a better position to evaluate not only the accuracy of the credit report (including missing information), but also to determine what steps are the most appropriate for the consumer to take to improve his or her credit score.

   TransUnion has revised its reason codes to provide a decent explanation of the adverse factor and identifies the optimal value for that factor.

4. Insurance scores should be defined as numerical or categorical designations because some insurers simply develop assign credit tiers or categories instead of an actual credit score.

5. <u>The scoring models should be filed with the Division of Insurance and be public information.</u> In this way, credit scoring would be treated like any other rating factor used by insurers – the factor is part of a rate filing and the filing is public information. Allowing insurers to keep credit scoring models secret would be like allowing the Insurance Services Office to hide both the derivation of its loss costs and the loss costs themselves because ISO claimed the analytic model and output as a trade secret. No insurance regulator would permit such an action by ISO, yet the proposed regulation contemplates the same type of secrecy for credit scoring models. Further, the trade secret claim made insurers and vendors for the various credit scoring models is without merit. In some states, insurers and vendors file credit scoring models and the models are public information. Yet, the insurers and vendors file the models and use them in those states, demonstrating that public availability of the models does not put one insurer at a competitive disadvantage to other insurers. In addition, by not making the models public information, the only people who don't know what is in the models are consumers. Any insurer who has worked with or used credit scoring models – and certainly the insurers who have developed their own models – knows what credit characteristics go into the models. There will be no great revelation among insurers by making the models public information – only enlightenment of consumers.

6. <u>The relevant statistical plans should be amended to capture credit scoring information.</u> The statistical plans based on transaction-detail reporting should add two data fields – one for the raw credit score for the consumer and another for the credit score category or tier assigned to the consumer based on the raw score. The collection of statistical data that includes credit scoring information is necessary for the Commissioner to fulfill her responsibility of enforcing rate standards and is both authorized and required by the statistical plan statutes cited as authority for the proposed regulation. Further, the Commissioner should collect and analyze statistical data that includes credit scoring data elements prior to approving insurers' use of credit scoring. It is only in this manner that the Commissioner can perform an independent analysis of the statistical relationship of credit scoring to risk of loss that fully accounts for interrelationship of credit scoring with all other rating factors.

   The data reported by insurers should include information on each application, each policy issued and each claim. Application data are necessary to evaluate the impact of insurance scoring on availability and affordability of insurance in different areas. The application and policy data should include all the underwriting and rating characteristics used by the insurer, detailed geographic information, such as census tract, raw credit score and credit score category used for pricing. Claims data should be reported in sufficient detail to match claims with the policyholder underwriting and rating characteristics as well as traditional claims characteristics, such as coverage involved and cause of loss. These data are the foundation for a market analysis-oriented approach to market regulation.

7. The statistical justification for the use of credit scoring should specify that a simple loss ratio analysis is not acceptable and that a multivariate analysis that analyzes credit simultaneous and explicitly with all other known rating factors be required.

8. The development of insurance scoring models should specifically incorporate race as one of the independent variables along with the credit variables. Traditional credit reports reflect and perpetuate historical inequities based on race – see the NCLC/CEJ report as well as other articles on how subprime/high-cost loans were targeted at minority communities. In the development of lending credit scores, model developers minimize the racially discriminatory impact of credit scores by incorporating race or a proxy for race as an independent (or explanatory) variable in the analysis. This controls – in a statistical sense – for race and reduces the disparate impact of the credit scoring model on minority groups. (See article by Elizabeth Mays). This is also the approach taken by Allstate as part of the settlement in the DeHoyos lawsuit (which alleged that Allstate's insurance scoring models violated federal civil rights laws) to develop a less discriminatory model.

9. Require the use of a three-bureau report supplemented by non-traditional credit information. Consumers should not be penalized because of differences in credit information maintained by the different bureaus. Lenders have long used a three-bureau report – a credit report with merged data from the three large credit reporting agencies – to address the problems of different data in each bureau. In addition, lenders have started supplementing the traditional credit bureau information with non-traditional data which allows for scoring of consumers with little or no information in traditional reports – consumers who are disproportionately from low-income and minority communities. Non-traditional data includes rental payments and utility payments – the type of payment history that can indicate "financial responsibility."

10. Consideration in credit scoring models of the following types of credit information should be prohibited: inquiries, length of time credit has been established, type of lender, vehicle service accounts, the number of credit cards. The use of inquiries should be prohibited because the number of inquiries can be unrelated to efforts by a consumer to increase his or her credit amounts. For example, inquiries occur when a consumer sets up new telephone, cell phone or utility service. Inquires occur when a consumer gets a new credit card with a 0% teaser rate to transfer current debt. Inquiries occur when a consumer shops around for the best auto loan rate, the best insurance rate, the best mortgage refinancing rate. A statistical relationship between inquiries and risk of loss is insufficient justification for the use of inquiries because of how unrelated an inquiry can be to expanding a consumer's debt load. Length of time credit has been established should be prohibited because it is a proxy for age. Type of lender should be prohibited because it discriminates against consumers who live in neighborhood where the primary financial institution is a consumer finance company and not a bank branch. Vehicle service accounts – consumers are penalized if they have, say, a credit card for a tire store – should be

prohibited because a consumer should not be penalized for having an account with a tire store. The number of credit cards should be prohibited because the credit evaluation should focus on management of actual debt, not on the fact that a consumer has a large number of cards that were used once and never again. As the models are made available to the public, this list may grow.

11. Insurers should be required to confirm the consumer's credit score two weeks after the initial credit score. Consumers should not be penalized because credit scores can depend upon the point in the credit card cycle that the credit report is generated.

12. Insurers should be prohibited from penalizing a consumer for a collection account or delinquency report resulting from a catastrophic or life event and should be required to establish a procedure for consumers to inform the insurer of such events. There must be greater consumer protection that a prohibition against consideration of collection accounts or delinquency reports identified with a medical industry code. This is insufficient protection for consumers who are the victims of a medical catastrophe because most medically-related delinquencies or collection accounts are not coded as medical industry. Rather, a consumer will likely pay medical bills with either a credit card or other form of credit and the collection or delinquency will show up on these other types of credit. The proposed regulation should prohibit insurers from considering collection accounts or delinquency reports resulting from a catastrophic event and provide the consumer with a procedure to inform the insurer about such events. For example, something along the lines of:

EFFECT OF EXTRAORDINARY EVENTS.

(a) Notwithstanding any other law, an insurer shall, on written request from an applicant for insurance coverage or an insured, provide reasonable exceptions to the insurer's rates, rating classifications, or underwriting rules for a consumer whose credit information has been directly influenced by a catastrophic illness or injury, by the death of a spouse, child, or parent, by temporary loss of employment, by divorce, or by identity theft. In such a case, the insurer may consider only credit information not affected by the event or shall assign a neutral credit score.

(b) An insurer shall notify an applicant for insurance that of the exception for extraordinary events and create standard procedures for receiving a life event request, for consideration of the request and for adjusting premium based upon the life event. The insurer shall file these procedures with the Commissioner and the Commissioner may disapprove the procedures if not reasonable and require the insurer to revise the procedures. If the insurer does not establish procedures approved by the Commissioner, the Commissioner may prohibit the insurer from using credit information in underwriting, tier placement or rating.

(c) An insurer shall track the requests for extraordinary event exceptions, the reasons for the request and the outcome of the request in a manner specified by the Commissioner and shall report this information to the Commissioner in a manner specified by the Commisioner

(d) An insurer may require reasonable written and independently verifiable documentation of the event and the effect of the event on the person's credit before granting an exception. An insurer is not required to consider repeated events or events the insurer reconsidered previously as an extraordinary event.

(e) An insurer may also consider granting an exception to an applicant for insurance coverage or an insured for an extraordinary event not listed in this section.

13. <u>There should be a collar on the rate impact of credit scoring.</u> The Commissioner should be authorized to establish a maximum percentage differential in premiums between the rates (including consideration of rating tiers) for two consumers with, respectively, the best and the worst credit scores and with otherwise identical underwriting and rating characteristics. Credit scoring should not have greater impact on premiums than factors providing loss prevention incentives to consumers.

14. <u>Insurers should be required to validate the scoring models annually to ensure that changes in economic conditions or laws (such as the federal changes to bankruptcy laws) do not bias the scoring models.</u>

15. <u>Insurers should be required to collect and report to the Commissioner data on insurance scores and claims over time to verify the relationship between insurance scores and claims.</u> A study over time is different from the ways models are currently developed and validated; insurers and modelers look at insurance scores relative to a particular book of business at a point in time. For example, TransUnion describes the development of their model in 2003 as based on an analysis of a sample of insurer data for the period 1999 – 2001. Data should be collected to track the longer-term relationship between credit scores and claims by tracking the same applicants and policyholders over many years.