American
Insurance
Association

The American Insurance Association represents more than 300 property and casualty insurers, many of which provide personal auto insurance and homeowners insurance coverage to the people of Wisconsin. These companies have extensive personal lines' experience in all fifty states plus the District of Columbia. In fact, many write insurance around the world.

Although a comparatively small state, Wisconsin enjoys one of the best personal lines' insurance systems in the country. This is due to extensive private sector competition and reasonable regulation, including the balanced oversight of insurers' use of credit-based insurance scoring (CBIS).

Wisconsin's Personal Lines Insurance System, Including the Use and Regulation of CBIS, Functions Extremely Well for the Public by Every Objective Measure. [1]

Wisconsin's personal lines insurance is very affordable.

The state's average personal auto expenditure ranks it 45th in the country (with number 1 being the most expensive) according to NAIC premium data. When average premiums are considered in the context of average family incomes, Wisconsin ranks 49th.

Wisconsin's personal lines insurance is very available.

In the last two years, Wisconsin's auto residual market (the market of last resort for those who cannot qualify for coverage in the regular voluntary market) has insured virtually no cars or customers. When compared to the state's voluntary market of more than 3.6 million insured car years, this is a sure indication of a highly competitive and functional market.

Most Wisconsin drivers are insured.

Wisconsin's rate of uninsured drivers averages 20th in the country as measured over the past eight years, according to the Insurance Research Council (IRC). The state's homewoners' residual market (the Fair Access to Insurance Rates Plan) has only three-tenths of a percent (0.28%) of housing exposure.

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[1] Sources:

- Auto premium data: "NAIC 2005/2006 Auto Insurance Database Report."
- Auto residual market data: "AIPSO Facts 2008/2009."
- Uninsured motorist data, Insurance Research Council reports.
- Homeowners premium data and house years: "NAIC 2006 Dwelling Fire, Homeowners Owner-Occupied and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance."
- Homeowners residual market data: Property Insurance Plans Service Office.
- Premium to median family income ranking (both auto and homeowners): AIA analysis of U.S. Census Bureau data.
- HHI and Groups writing: AIA analysis of A.M. Best 2008 premium data in private passenger auto and homeowners lines.

Wisconsin's personal lines insurance market is extraordinarily competitive.

Metrics of competition such as the Herfindahl-Hirschman Index (HHI, a commonly accepted measure of market concentration used by anti-trust enforcers) and total groups writing indicate that the state's personal auto insurance and homeowners insurance markets are quite competitive. This is another good indication of a well functioning and beneficial market for consumers.

Insurers' Use of CBIS is Subject to Extensive Wisconsin and Federal Oversight.

Insurers are expressly permitted to use credit information under both state and federal law. When doing so, insurance companies are subject to various regulatory guidelines and mandates, including the requirement to provide adverse action notices to customers who don't qualify for the very best available rates because of their credit score.

Wisconsin has been regulating the use of credit based insurance scoring for many years; its' basic regulatory scheme centers upon a bulletin issued in 1997. The bulletin (see: http://oci.wi.gov/bulletin/61697bul.htm) was a very forward looking document at the time and remains so. In fact, many of its provisions eventually became part of the National Conference of Insurance Legislators' (NCOIL) model credit scoring law on CBIS that has been enacted by well over half the states in the country. Key components of this law include the following: insurers must provide CBIS related notices upfront at the time of application; insurers are restricted as to what credit data they may use; insurers are prohibited from using CBIS data that includes such information as income, race, or nationality; insurers may make only certain uses of "thin files," (credit records with very few accounts); they must use updated credit information under certain circumstances and they may not base certain decisions solely on credit, including the issuance and renewal of insurance.

This balanced regulation has contributed to a mutually beneficial insurance climate for consumers and insurers with the ultimate result of producing insurance that is affordable and readily available.

Prior Government and Private Studies Have Supported the Use of CBIS.

Attached as Exhibit 1 is a summary of various studies which conclusively demonstrates the acceptability of credit as a legitimate underwriting and rating factor for personal lines' insurance and which also demonstrates the extent to which other states and regulators have already examined the validity of credit based insurance scoring. Each of these studies concludes that credit based insurance scoring is highly predictive of risk.

The use of credit has added significantly to insurers' risk assessment and benefits a large majority of policyholders (59% estimated in the FTC study and higher in other studies) in the form of lower premiums and increased availability.

Claims that Current Economic Conditions Have Widely Worsened CBIS Are Utterly Rebutted by the Facts.

Long time opponents of CBIS have recently seized on current economic conditions as the latest vehicle for their attacks. Yet, as is true of their other claims such as unfair discrimination, the evidence is utterly to the contrary. At an April 2009 NAIC hearing, experts from the credit industry provided data showing that average scores have not gone down and in some cases up, due to the stability of CBIS when compared to bank lending scores and due to de-leveraging by many families.

Recent evidence from credit data further proves that the trend continues to be no over-all decline in CBIS and some actual improvement. Even for the small group of people whose scores have gone down recently, the decline is an average of a very few points, often not enough to affect the CBIS rating band that they are in.

Further, direct banning of CBIS through legislation or *de facto* by intrusive regulation, would actually harm the vast majority of policyholders who pay less as a result of CBIS, by making insurance less affordable for them because they will have to pay more. So, if the objective is affordability and availability, CBIS should be maintained with reasonable and balanced regulation such as that currently in place in Wisconsin and the majority of states and as reflected in the NCOIL model law.

Claims of Discrimination are Unfounded.

The use of credit based information scoring by insurers is sanctioned by both state and federal law and may not include consideration of race and income. No study has ever found that insurers collect and use racial or income information. And, no court has found that CBIS is per se discrimination or that it results in disparate impact. To the contrary, the studies, including the FTC's auto study, show that CBIS is in fact highly predictive and actuarially sound and there is no equally effective substitute.

Special Circumstances Are Provided for.

In response to various desires to ensure that certain individual circumstances are factored into the utilization of credit based insurance scoring it is important to note that insurers can and do take special individual circumstances into account. In fact, several states have enumerated "extraordinary life circumstances" (ELC) which allow insurers to consider individuals affected by specified circumstances. These special circumstances include suffering a catastrophic event, death of an immediate family member, divorce, temporary job loss and military deployment. Such ELCs have been formally added to the NCOIL model law on CBIS, a reform supported by us.

Communication and Education Are On-going.

Insurers have also engaged in credit communication and education outreach efforts. Copies of our educational brochure in both English and Spanish are readily available.

Strong Willingness to Work with Regulators and Legislators on Any Significant, Legitimate Issues with Regard to CBIS.

Further validating the points and the data in this testimony, the level of complaints received by most insurance regulators on the use of CBIS has been extraordinarily low—a tiny amount in the context of millions of auto and homeowners underwriting and rating actions every year. This is true, despite a federally mandated disclosure system that assures consumer awareness and encourages consumer activism, including adverse action notices. However, we consider every complaint important, as do regulators, so we want to clearly state that we favor effective complaint identification for CBIS and we reiterated our strong desire and availability to work with legislators and regulators to address any significant, legitimate issues that may arise, consistent with maintaining the benefits of CBIS for the vast majority of the public and our customers, its actuarial soundness in underwriting and rating and the competitiveness of the market that has made personal lines insurance both very available and affordable in Wisconsin.

Conclusion

Wisconsin's personal lines insurance system, including the use of CBIS, is carefully regulated, highly competitive and very beneficial for consumers by every accepted measure. This market need not, and should not, be severely disrupted by limiting or banning the use of credit based insurance scoring.

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American Insurance Association

CONCLUSIONS FROM MAJOR CREDIT-BASED INSURANCE SCORING STUDIES

- **"...87% of consumers either received a discount for credit or it had no effect on their premium"** and **"for those policies in which credit played some role in determining the final premium, those receiving a decrease outnumbered those who received an increase by 3.21 to 1."**

  Source: "Use and Impact of Credit in Personal Lines Insurance Premiums Pursuant to Ark. Code Ann. §23-67-415"; A report to the Legislative Council and the Senate and House Committees on Insurance & Commerce of the Arkansas General Assembly by the Arkansas Insurance Dept. June 2009. The Arkansas Insurance Dept. examined more than 2 million auto and over 600,000 homeowners policies. Arkansas enacted the National Conference of Insurance Legislators Model Act on Credit in 2003.

- **"Credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims."** and **"Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that many be passed on to consumers in the form of lower premiums."** Also, when scoring is used **"...more consumers (59%) would be predicted to have a decrease in their premiums than an increase (41%)."**

  Source: "Credit-based Insurance Scores: Impacts on Consumers of Automobile Insurance," A Report to Congress by the Federal Trade Commission, July 2007. The FTC examined more than two million insurance policies.

- **"A survey of Oregon insurers indicates that nearly 60 percent of personal auto policyholders...pay lower rates than they would if credit information was not used. In addition, many insurers report writing policies that they would not have written had they not had access to credit information."**

  Source: "The Use of Credit Information by Insurers," ECONorthwest, October 2006. This study was commissioned during the November 2006 elections when Oregon voters were asked to consider a statewide ballot initiative (Measure 42) that would have banned insurer use of credit. The measure was defeated with citizens voting more than 2-1 (65.6% to 34.4%) against it, rejecting "mass subsidization."

- **"These results** [impact of using credit information] **corroborate the insurance industry's contention that the majority of policyholders benefit from the use of credit scoring."**

  Source: "Report on the Use of Consumer Credit and Loss Underwriting Systems," Nevada Dept. of Business & Industry, Division of Insurance, July 2005. Insurers representing 60% of the auto and homeowners market were surveyed for this report.

- **As part of the Michigan insurance industry's successful legal efforts to stop a regulatory ban on credit, multiple companies reported in lawsuit filings that <u>a ban would produce premium increases up to 68% for both auto and homeowner policies</u>, with individual rates rising hundreds of dollars.**
  <u>Source:</u> In the case of *Insurance Institute of Mich., et. al. v Commissioner of the Office of Financial and Insurance Services*, (2005) Case #05-156-CZ, Barry County (MI) Circuit Court. There the Judge issued a clear and definitive opinion saying in part credit "clearly shows an <u>actual</u> effect on losses <u>and</u> expenses" (Judge's emphasis). The case is now on appeal (#262385).

- **"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."** Also, **"[C]redit scoring...is not unfairly discriminatory...because credit scoring is not based on race, nor is it a precise indicator of one's race."**
  <u>Source</u>: "Use of Credit Information by Insurers in Texas: The Multivariate Analysis," Supplemental Report to the 79th Legislature by Texas Department of Insurance (TDI), January 2005. The study analyzed scores and rating factors for over two million auto and homeowners insurance policies in Texas.

- **"...the lowest range of insurance scores produce indicated pure premiums 33% above average and the highest range of insurance scores produce indicated pure premiums 19% below average."**; and **"...insurance scores significantly increase the accuracy of the risk assessment process."**
  <u>Source</u>: "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity," EPIC Actuaries, LLC, June 2003. The EPIC study reviewed more than 2.7 million auto policies.

- **"The correlation between credit score and relative loss ratio is .95, which is extremely high and statistically significant. The lower a named insured's credit score, the higher the probability that the insured will incur losses on an automobile insurance policy, and the higher the expected loss on the policy."**
  <u>Source:</u> "A Statistical Analysis of the Relationship Between Credit History and Insurance Losses," University of Texas Bureau of Business Research at the McCombs School of Business, March 2003.

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