Hearing before the House Financial Services Subcommittee on Oversight and Investigations

“The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

Testimony of Charles Neeson, Westfield Group on behalf of Property Casualty Insurers Association of America

May 21, 2008

Chairman Watt and Members of the Subcommittee:

Thank you for the opportunity to comment on H.R. 5633, legislation that seeks to prohibit the use of information in credit reports for issuing or setting premiums for motor vehicle or property insurance. My name is Charles Neeson and I appear before you today as both a Senior Executive with Westfield Insurance and as a representative of the Property Casualty Insurers Association of America (PCI), of which Westfield is a member. 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. I am a member of the American Academy of Actuaries and an Associate in the Casualty Actuarial Society.

An insurance company's ability to more accurately predict losses is a critical component of properly underwriting risks. When insurers are able to properly underwrite risks, consumers benefit with lower rates and more choices. Because credit-based insurance scoring is an objective and accurate method for assessing the likelihood of insurance loss, we strongly oppose passage of H.R. 5633 or H.R. 6062.

Insurance is an incredibly competitive business, and one way for an insurance company to distinguish itself from its competitors is to develop better ways of gauging risk to more accurately price an insurance policy. By analyzing historical policyholder information such as loss and claims data, insurers have found that certain personal attributes correlate with the level of risk that an individual represents.

For example, insurance companies have found that gender and age, regardless of race or ethnicity, correlate to future loss. Loss data indicates that young males are more likely to incur losses than older males, or even young females. Additionally, historical data reflects a high correlation between the type of automobile driven and the number of losses incurred. Individuals who drive high-performance vehicles are approximately 36 percent more likely to be involved in automobile accidents than those who drive standard automobiles.

Likewise, historical data reflects a strong correlation between the timeliness with which an individual pays his bills and the average number of homeowner insurance losses that individual will incur. Individuals who are delinquent in paying their bills two or more times within the last two years are approximately 80 percent more likely to file an insurance claim than those who pay their bills on time.

It is precisely this type of information that forms the basis for credit-based insurance scores, alternatively referred to as insurance scores. Westfield Group began using insurance scores in 2000 as a part of an effort to improve the pricing of our automobile and homeowners' insurance products. In analyzing the relationship between credit information and our loss data, we found a strong correlation. Used in conjunction with more traditional rating factors such as vehicle performance, age, gender and territory, credit-based insurance scoring allowed Westfield to more accurately price our products and improve our competitive position. Today, approximately 75 percent of our policyholders pay less because of the use of insurance scores, while only eight percent pay more. In other words, without the use of credit-based insurance scores, three-quarters of our policyholders would be paying more for their insurance than they are now.

Outside of Westfield's own experience with credit-based insurance scoring, an annual survey published by the Arkansas Insurance Department shows that insurance scoring either benefits or has no effect on the vast majority of consumers in Arkansas. The latest survey shows that 90.2 percent of automobile insurance policyholders and 90.8 percent of homeowners insurance policyholders either received a discount or were otherwise unaffected by the use of credit.

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.”

In July 2007, the Federal Trade Commission (FTC) issued a report to Congress on insurers’ use of credit-based insurance scores entitled, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance.” In its report, the FTC concludes that insurance companies which use credit-based insurance scores are more likely to price automobile insurance more closely to the risk of loss that consumers pose, resulting, on average, in higher-risk consumers paying higher premiums and lower-risk consumers paying lower premiums. Additionally, the FTC concludes that credit-based insurance scores permit insurance companies to evaluate risk with greater accuracy. Finally, the report finds that credit-based insurance scores do predict risk within different racial, ethnic and income groups and that the “use of credit-based insurance scores do not act solely as a proxy for membership in these groups.”

The use of credit-based insurance scoring is subject to extensive regulation by the States. The National Conference of Insurance Legislators (NCOIL) promulgated model legislation regarding its use, and most States have either enacted the model or adopted restrictions similar to those contained in the model. One of the main provisions of the model is that an insurance score cannot be the sole reason for denying, canceling or non-renewing an insurance policy. The model also contains numerous other important consumer protections, such as prohibiting the use of credit information related to medical collection accounts.

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. Without the ability to consider credit, many insurers would be less aggressive in their marketing, and far more cautious in accepting new business. Consider:

- The FTC study noted that the majority of consumers have good insurance scores and that “[c]redit-based insurance scores may benefit consumers overall.”

- In a cover letter to a study of credit-based insurance scores issued by the Texas Department of Insurance, former Commissioner Jose Montemayor declared, “Credit scoring, if continued, is not unfairly discriminatory as defined in current law, because credit scoring is not based on race, nor is it a precise indicator of one’s race.” With respect to the impact of a ban on the use of credit information, Mr. Montemayor commented, “Be advised, however, that banning credit scoring overnight, by rule or law, creates pricing and availability disruptions in a market … Premiums would go up for a large number of policyholders if the collar on credit scoring (or any other risk variable for that matter) is set too narrow, because it would force an immediate price shock that would be unrelated to a change in risk.”

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. And while it is a common criticism of insurance scoring that the exact reason for that correlation is unknown, there are also numerous other rating factors for which causality is unknown. For example, even though there is no definitive explanation for why married individuals represent less of a loss of risk than single individuals, marital status is a widely-accepted and widely-utilized rating factor.

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 such as credit-based insurance scores.

Thank you for allowing me to come and testify before you today. I would be happy to address any questions you may have on this subject.