Comments of the Center for Economic Justice to the Federal Insurance Office

Definitions, Metrics and Data for Monitoring Availability and Affordability of Personal Auto Insurance in Traditionally Underserved Communities

June 9, 2014

The Center for Economic Justice (CEJ) submits these comments in response to the Federal Insurance Office's (FIO) request for comments on the following issues:

1. A reasonable and meaningful definition of affordability of personal auto insurance;

2. The appropriate metrics to use in order to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable personal auto insurance; and

3. The data source(s) FIO should use to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable auto insurance.

CEJ Experience on the FIO Inquiry

CEJ has extensive experience regarding availability and affordability of personal auto insurance. Birny Birnbaum of CEJ has performed availability analyses of personal auto insurance for the Texas Office of Public Insurance Counsel and the Texas Department of Insurance. While Associate Commissioner for Policy and Research at the Texas Department of Insurance, Mr. Birnbaum developed a data collection program for monitoring market performance of insurers in Texas auto insurance markets. Mr. Birnbaum authored availability studies of Texas auto insurance markets for CEJ in 1997. Since 1997, Mr. Birnbaum has performed a variety of insurance market studies for public agencies and for CEJ. He has been active as a consumer representative at the NAIC over the years on issues of insurance availability and affordability, credit scoring and other risk classifications and data collection for market surveillance.

Context for Recommendations

While FIO's questions focus on affordability, the analysis of affordability is not meaningful without related analyses of availability. While insurers licensed to write in a specific state may sell insurance anywhere in the state, the fact is that many insurers focus on non-LMI markets, while so-called "non-standard" insurers focus on LMI markets.

As a preface to specific responses to FIO's questions, CEJ submits that there is a clear need for FIO to take significant action to fulfill its Congressional mandate and monitor the availability and affordability of personal auto insurance. In addition to FIO's statutory mandate to monitor the availability and affordability of insurance in traditionally underserved areas, the need for FIO action is evidenced by the following:

1. ***Auto use and, consequently, auto insurance, is essential for economic participation by low-income and minority ("LMI") consumers.*** As referenced in the FIO request for comments, there is great need for LMI consumers to utilize automobiles to obtain and maintain jobs.

2. ***Required by law and loan contracts.*** As referenced in the FIO request for comments, the vast majority of states required the purchase of liability insurance to fulfill financial responsibility requirements. Many states have significantly increases enforcement of financial responsibility laws in recent years with insured vehicle databases and insurance matching tools in addition to increasing penalties for driving without insurance. In addition, auto lenders require borrowers to maintain physical damage coverage on vehicles serving as collateral on loans.

3. ***History of insurer redlining and unfair discrimination against LMI consumers.*** Numerous studies over the past 30 years have documented redlining by insurers – unfairly discriminating against LMI consumers because of where they live or other factors. For example, CEJ's 1997 studies documented massive disparities in insurer market share in high-minority ZIP codes compared to low-minority population ZIP Codes.[1] Numerous studies have documented that credit scoring, generally, and insurance credit scoring, specifically, disfavors consumers in LMI communities.[2] The Missouri Department of Insurance study of insurance credit scoring found the single most predictive factor of an insurance score was race.[3] Studies of agent location have also documented discrimination against LMI communities.[4]

4. ***Approved insurer pricing practices that cause LMI consumers to pay more for the same coverage than non-LMI consumers.*** While some risk classification is essential to avoid adverse selection and to provide economic incentives for less risk behavior by consumers, states have allowed a number of pricing practices that disfavor LMI consumers and thwart public policy purposes for risk classification. For example, most states allow insurers to utilize small geographic rating territories for uninsured motorists with the result that consumers living in LMI communities are forced to pay more for UM coverage simply because more of the neighbors cannot afford insurance than consumers in non-LMI communities. States have allowed ultra-refined, very small geographic rating territories which reflect and perpetuate historic housing discrimination. Most states permit the use of insurance credit scoring and socio-economic risk classifications

[1] http://cej-online.org/redlining.php
[2] See, for example, CEJ's studies and testimony on insurance credit scoring, http://cej-online.org/creditscoringmainpage.htm. See NCLC Webinar, "Credit Scores and Credit Reports: Problematic Uses and How They Worsen the Racial Economic Gap" http://www.nclc.org/credit-scores-and-credit-reports-problematic-uses-and-how-they-worsen-the-racial-economic-gap/event-details.html.
[3] See, Brent Kabler, Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri, Missouri Department of Insurance – Statistics Section, January 2004.
[4] See "Homeowners Insurance Availability and Agent Location" by Jay Schultz in *Insurance Redlining: Disinvestment, Reinvestment and the Evolving Role of Financial Institutions,* edited by Gregory D. Squires.

which disfavor LMI communities. The Consumer Federation of America has documented the impacts of these socio-economic risk classifications on LMI consumers.

5. ***Insurers' use of big data and data mining for marketing and pricing.*** The historic redlining and pricing discrimination against LMI communities will become dwarfed by the impact of insurers' new use of big data, data mining and predictive analytics. Insurers have already introduced price optimization, which tailors the price of insurance to a consumer's price elasticity of demand. Such pricing tools are unrelated to risk of loss, do nothing to provide economic incentives for less risky behavior and strongly disfavor LMI communities. The next phase is the use of a variety of information from data brokers that insurers will use for marketing, pricing and other purposes. Insurers may already have dynamic pricing tools in place so a consumer using her mobile phone to shop for auto insurance is directed to specific insurers, shopping sites or price levels based on real-time evaluation of information collected and sold by data brokers.[5]

6. ***Absence of existing data collection to answer basic questions about availability and affordability of personal auto insurance / uselessness of aggregate averages***. The FIO request for comments documents the absence of necessary data to evaluate affordability and availability issues in LMI communities.

> "Studies have used various metrics to measure availability and affordability of personal auto insurance. These include:
> 1. The market share of the top ten writers of personal auto insurance;
> 2. The market share of the residual market;
> 3. The average auto insurance premium;
> 4. The loss ratio; and
> 5. An affordability index calculated by dividing the average auto insurance premium by median household income.
> These metrics may be calculated only for the auto insurance coverage mandated by most states (*e.g.*, bodily injury and property damage) or all auto insurance coverage (*e.g.*, bodily injury, property damage, uninsured/underinsured motorist, collision, and comprehensive)."

[5] See for example, "Weblining and Other Racial Justice Concerns in the Era of Big Data" at http://www.nclc.org/weblining-and-other-racial-justice-concerns-in-the-era-of-big-data/event-details.html. See also the White House Report on Big Data, which states, "Unfortunately, "perfect personalization" also leaves room for subtle and not-so-subtle forms of discrimination in pricing, services and opportunities." at p 7. http://www.whitehouse.gov/sites/default/files/docs/big_data_privacy_report_may_1_2014.pdf. See also the Federal Trade Commission Report on Data Brokers, which recommends action to prevent data obtained from data brokers from being used for unlawful discriminatory purposes at p ix and 55. http://www.ftc.gov/system/files/documents/reports/data-brokers-call-transparency-accountability-report-federal-trade-commission-may-2014/140527databrokerreport.pdf.

The insurance industry assault on any effort to monitor the availability and affordability of insurance in LMI communities utilizes state-wide or nation-wide averages to support their claim that auto insurance prices have not grown rapidly, that average prices show auto insurance is affordable and that "competition" (meaning little or no substantive regulation of prices or data collection for monitoring the market performance of insurers) promotes availability and affordability.[6]

The industry reports have literally nothing to say about availability and affordability of auto insurance in LMI communities. To illustrate, imagine if the discussion about the affordability of flood insurance from the NFIP was limited to state or nationwide average premium charges. By the insurance industry's logic, flood insurance was affordable – on average. But the fact was that legislators and regulators in coastal states argued that *specific communities with their states* were facing unaffordable flood insurance prices. If Congress has accepted the same arguments for flood insurance as the insurance industry has offered for auto insurance, Congress would never have mandated a study of affordability of flood insurance and the National Academy of Sciences would not have sought policy-specific data for carrying out that analysis.

An example of how new pricing tools worsens affordability in LMI communities when average price remains the same is insurance credit scoring. Insurers argue that by allowing them to price "more accurately", insurers will be willing to write business they would otherwise refused. Putting aside the fact that there is zero evidence to support this claim, it is instructive to examine insurance scoring exacerbates affordability issues for LMI consumers. Insurance credit scoring is used by insurers in addition to other risk classifications and its use means that the most favored consumers will get a larger discount and the least favored consumers will get higher surcharges – and in the case of insurance scoring, prices will go up significantly for those with poor insurance credit scores. The average price of insurance remains the same (since insurance scoring has no claim reduction impact), so the range of prices has now expanded – a lower low and a higher high. The consumers most impacted by the higher high are disproportionately LMI consumers who already faced affordability issues and now face greater affordability issues.

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[6] The NAIC Property Casualty and Market Regulation Committees adopted, last month adopted "Compendium of Reports on the Pricing of Personal Auto Insurance" as part of the their committee charges to "to review issues relating to low-income households and the auto insurance marketplace and to make recommendations as appropriate." The report features industry submissions featuring the industry arguments, described above, while failing to include the research documenting the problems with insurance availability and affordability for LMI consumers or any actual data or analysis of availability or affordability in LMI communities. http://www.naic.org/committees_c.htm.

7. ***State regulators historic failure and lack of interest in monitoring availability and affordability issues in their states.*** The lack of any useful data collection efforts at the NAIC and in all but a few states regarding auto insurance availability and affordability demonstrates state regulators' (with a few exceptions) general lack of interest in the issues raised by FIO. The recent report adopted by the NAIC Property Casualty and Market Regulation Committees puts an exclamation mark on this disinterest. The recent report provides no insight into availability and affordability issues for LMI auto insurance consumers.

Recommendations for Definitions

Definitions, metrics and data are need for both affordability and availability of personal auto insurance.

Affordability

The best metric of affordability is auto insurance costs as a percentage of disposable income. The question is where to set that percentage. We suggest that the notice's example is a useful one – does not preclude a person or family from the purchase of other necessities. With that definition, the metric will vary by income levels – from a very small percentage at very low incomes to somewhat higher at low incomes.

In terms of the numerator, simply measuring premium cost is insufficient as a measure of auto insurance costs. In many low-income markets, so-called "non-standard" insurers target low-income consumers and utilize high-cost premium finance to enable the consumer to pay on a monthly basis instead of the entire premium up front. Similarly, some assigned risk (residual market) mechanisms provide for monthly payments with a monthly fee, similar to the approach used in standard and preferred auto insurance markets.

Central to evaluating affordability is the issue of when and what portion of the total premium and financing charge a consumer must pay in addition to the total amount paid. For example, there are clear availability and affordability differences between a consumer facing a $1,200 premium and

a. being offered the option of monthly payments with a $4 per month additional charge;
b. being forced to utilize premium finance at 18% or higher interest rates; or
c. being forced to pay the entire premium up front without any financing or monthly pay option.

Availability

We suggest that a useful definition for availability is similar numbers and types of insurers marketing and offering comparable products, services and risk-adjusted prices (for normalized products) in LMI communities and non-LMI communities. An additional definition could be the presence or absence of marketing and sales practices that either recognize (or attempt to assist) or penalize common characteristics of LMI consumers.

Recommendations for Metrics

Affordability

The following metrics are based on analyses defining LMI markets by minority population and income at the smallest geographic area for which socio-economic characteristics of the geographic areas exist. ZIP Codes are generally too large a geographic area and census blocks and tracts are smaller.

Additional affordability metrics would be based on multi-variate analysis to identify and quantify statistically significant differences by smallest geographic area / socio-economic characteristics of the smallest geographic area:

- Quote prices and quote prices plus monthly pay options/premium finance charges for policies normalized for different coverages;
- Premiums and premiums plus monthly pay options/premium finance charges for policies issued normalized for coverage differences;
- Applicant use of captive agent, independent agent, insurer web site, aggregator/leads web site, mobile phones;
- availability and use of monthly pay and premium finance;
- cancellations for non-pay and other reasons;
- policyholder tenure;
- uninsured motorists; and
- claims made, paid and denied for comparable damage

Availability

Availability metrics would also be developed utilizing multi-variate analysis to identify and quantify statistically significant differences by smallest geographic area / socio-economic characteristics of the smallest geographic area for:

- Number and type of insurers actively marketing as measured by number of quotes offered, amount of price quote for normalized coverage;
- Availability of monthly pay and premium finance;
- Big data marketing and other marketing differences;
- Impact of socio-economic risk classifications;
- Location of agents / use of minority agents and service representatives

Recommendations for Data

In general, transaction data are necessary to monitor the availability and affordability of auto insurance. Summary data have a number of drawbacks of which the most damaging is the limited analysis options compared to granular data. With transaction data, FIO can analyze multiple characteristics or factors at the same time as well as utilize data mining by combining the transaction insurance data with other consumer data – in the same way that insurers utilize big data and data mining for predictive analytics. In addition to meaningful analysis of availability and affordability issues not possible with summary data, collection of transaction data from insurers has additional benefits:

- Monitoring of market outcomes in an era of big data and lack of regulatory oversight into insurers pricing practices.
- Promote more efficient and effective market regulation by state regulators by enabling insurance regulators to perform more sophisticated and more centralized market analysis, leading to more uniform market analyses across states.
- Development of more useful market performance data to promote greater competition in auto insurance markets. Competition among insurers does not equate to competitive markets if consumers have little or no ability to exert market power.

Attached please find Birny Birnbaum's recent presentation to state insurance market regulators on the benefits of transaction data collection versus summary data collection.

In addition to transaction data from auto insurers on quotes, policies and claims, FIO should collect additional information from insurers regarding the data sources utilized for marketing, pricing and claims settlement and list of risk classifications utilized.

FIO should collect data from states to assist in the monitoring auto insurance markets including:

- Prices and financing options available in states' residual markets. Residual market prices and financing options can then be compared to prices and financing costs offered by insurers in LMI communities; and
- Number of registered vehicles, uninsured motorist tracking activities and outcomes, penalties for driving without insurance and data on application of these penalties, including for example, the number and location of consumers fined, imprisoned, denied non-economic benefits because of "no pay, no play" laws or otherwise penalized in LMI and non-LMI communities.