Testimony of Birny Birnbaum
On Behalf of the Center for Economic Justice and the
Consumer Federation of America

Docket No. G2007-07
Proposed 211 CMR 79.00 Private Passenger Auto Insurance Rates

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My name is Birny Birnbaum. I am Executive Director of the Center for Economic Justice, a non-profit that advocates on behalf of low-income and minority consumers on insurance, credit and utility matters. I offer my testimony on behalf of CEJ and the Consumer Federation of America. CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

I have extensive experience is the issues that are the subject of this regulation. I have formerly served as the Chief Economist and Associate Commissioner for Policy and Research at the Texas Department for Insurance where I had, among other things, responsibility for:

- Monitoring insurance markets and competition
- Reviewing property and casualty rate filings
- Developing and implementing statistical plans and data collection
- Collecting and reviewing insurer underwriting guidelines

I performed the first studies of insurance availability and redlining in Texas. Since leaving the Texas Department, I have worked in several states on auto insurance issues, including rating factor issues in California and consulting with the cities of New York, Philadelphia and Detroit on auto insurance rates.

CEJ and CFA are here today because the proposed Massachusetts auto insurance regulations are not only important to Massachusetts consumers, but have national implications for how states will address the critical issue of risk classifications. We are also here because we want to share our experience working on these issues in many other states

<u>We want to commend the Commissioner for making the issue of risk classifications a central part of the proposed regulations.</u>

Risk Classification is the Key Consumer Protection Issues

I start my comments with the observation that risk classification issues are where the action is today in auto insurance across the country. Today, risk classifications – underwriting guidelines, tier rating factors and rating factors – have greater impact on a consumer's rate that overall rate level activity by insurers. While insurers may change overall rate levels typically in a range of plus or minus 10%, the introduction of new risk classification factors can change a consumer's premium by 200%, 300% or more. We saw this when insurers introduced insurance credit scoring. Decisions about rating territories can have similar impacts on consumers.

The basis for our comments is two core public policy principals about insurance and the reason why CEJ works on insurance issues.

1. Insurance is an essential financial security tool for consumers and communities to maintain and build assets and engage in economic development. This is accomplished by the spreading of risk over many consumers, many perils, and many geographic areas. Part of this principle is that low income consumers should have the same access to this essential financial security tool as more affluent consumers. Stated differently, auto insurance should be available and affordable and universal coverage is mandated by state law requiring drivers to maintain financial responsibility.

2. The other core public policy goal of insurance is loss prevention and loss mitigation. Insurance is the most important institution for encouraging consumers to engage in less risky behavior and discouraging more risky behavior. The core function of insurance is directly related to the risk classification system's ability to provide appropriate economic incentives to consumers.

Revolution in Insurance Risk Classification

In the past ten years, there has been a revolution in auto and homeowners insurance risk classification. Insurers employ data mining to identify any characteristic or piece of data that can be used to segment the population into more profitable business. This data mining really began with the use of consumer credit reports and resulted in the development for extremely detailed risk classification schemes. Where insurers used to have 2 or 3 base rates – preferred, standard, non-standard, it is now common to find insurers with hundreds or thousands of base rates – so called tier rating.

The other important component of the change in risk classification is the focus on socio-economic characteristics of the consumer as opposed to factors related to driving experience or things under the consumer's control. The regulation identifies some of these socio-economic rating factors – education, occupation – but there are others, such as prior liability limits, prior insurance and prior insurance carrier. Taking prior liability limits as an example – two consumers who are otherwise identical and are seeking identical coverages would be treated differently because of the limits on the policy they previously purchased, with the consumer who purchased a minimum limits policy being charged more than a consumer who previously purchased increased limits. It is clear that prior liability limits is a proxy for income. And it is important to point out that prior liability limits is one of the top factors determining a consumer's premium – it is typically used as a rating tier selection factor, which I discuss in more detail below.

<u>The change in insurer risk classification undermines the core public policy goals</u>. Hyper-risk classification increases the spread of rates between desirable and less desirable consumers and the use of socio-economic factors means that this increased spread causes higher rates for those consumers least able to afford insurance. And the emphasis on socio-economic risk classification factors undermines the loss prevention role of insurance by de-emphasizing factors that provide incentives for less risky behavior and emphasizing factors outside of the consumer's control.

The Blurring of Underwriting and Rating Through "Rating Tiers"

There is another consequence of hyper risk classification – it <u>undermines the regulator's ability to maintain oversight of rates</u>. It used to be that underwriting guidelines and rating factors were fairly distinct with underwriting used to determine eligibility for coverage and slotting consumers into one of the two or three base rate categories. Most of the premium determination was done through rating factors applied to base rates.

In the late 90's insurers introduced so-called tier rating where they increased the number of base rate categories by essentially moving rating factors into the tier selection process. For example, instead of using credit scoring as a rating factor with various discounts and surcharges for different credit scores, insurers created additional rating tiers – moving from the tradition three to 30 tiers by, for example, applying ten credit score factors to the three tiers. Insurers claimed rating tiers and tier selection was underwriting and not rating and typically did not report rating tier factors and associated rating plans to regulators.

When the number of rating tiers explodes to hundreds or thousands, as many companies now employ, an insurer can effectively get a rate increase with a rate change by simply changing the rating tier eligibility – moving all consumers into the next higher rating tier.

Consequently, any meaningful rate oversight must take a comprehensive approach to risk classification by including oversight of underwriting guidelines, tier rating factors and rating factors.

I want to be clear, we are not opposed to insurer data mining to identify risk characteristics. We just want that the analysis and its results direct it towards loss prevention instead of towards new proxies for income and race.

Risk Classification in the Proposed Regulation

We suggest that the regulation address the issue of risk classification in specific ways. We applaud your proposal to prohibit certain risk classification factors that undermine the insurance system. We suggest three other things to ensure meaningful oversight of risk classifications:

1. Require filing and prior approval of all risk classification factors – underwriting guidelines, tier selection factors and rating factors. This will prevent insurers from gaming the system with pseudo-underwriting factors. It will also prevent unfair factors from being used and harming consumers before the Commissioner becomes aware of and stops the use of such factors.
2. Establish criteria for approval of risk classification factors
    a. Uniquely related to risk of loss (no spurious correlation, not a proxy for prohibited risk classifications)
    b. Promote loss prevention / consumer ability to affect premiums
    c. Promotes broader public policy goals, e.g., greenhouse gas reductions
    d. Not susceptible to fraud or mispresentation

Comments on Specific Sections of the Proposed Regulation

Purposes

Why are you doing the regulation? Presumably to improve on current situation and not simply to protect consumers from some required change. The purposes should include:

- Promote the availability and affordability of an essential financial security tool, mandated by law
- Promote loss prevention and loss mitigation

Definitions

As mentioned above, the definition of risk classifications should be inclusive of underwriting guidelines, tier placement factors and rating factors. It is unclear how underwriting guidelines in the proposed regulation differ from risk classifications or rating factors, which are defined. If the intent is prohibit denial of coverage on the basis of certain factors, the regulation should specifically state that a specific factor may not be used in whole or in part to deny or limit coverage.

Monitoring Competition

In terms of monitoring competition, the proposed revisions are quite outdated and generic. The standard for competition should include availability of insurance in all geographic areas of the state as evidence of competition. In addition, effective monitoring of the market requires the collection and publication of market performance data, including information on policies issued, policies cancelled by the consumer, policies cancelled or non-renewed by the insurer, applications denied, cost of policies and coverages and claim costs by geographic area at least as small as ZIP Code. Monitoring competition should also include the collection and publication of underwriting guidelines, tier rating factors and rating factors utilized by insurers and any variation by geographic area within the state.

Credit Scoring

I have worked on insurance scoring issues since 1991. I am convinced that insurance scoring is inherently unfair and arbitrary and undermines the core public policy goals of insurance. I will not go into the details today, but can provide voluminous research to demonstrate that insurer claims about insurance scoring are false. In particular, the claim that most consumers benefit from insurance scoring is incorrect. For example, for many years, modelers and insurers claimed that insurance scoring did not correlate to race and income. Yet, studies by the Missouri and Texas Departments of Insurance found just the opposite. And in the last year, Fair Isaac admitted that fully 20% of the population is unscorable because of thin credit files. This 20% is disproportionately low income and minority consumers and, because of the thin files, are charged more because of insurance scoring.

With regard to the recent FTC study, despite relying upon a data set hand-picked by insurers instead of an independent data set, the FTC found both that credit scoring was correlated with race and income and is a proxy for race and income. And the data included only policies actually issued. Had the data set included application data – including consumers' applications which were denied or consumers who were effectively denied coverage because of high premiums due to credit scoring. Had the study included such application data, the measured impact of insurance scoring on low income and minority consumers would have been much greater.

In terms of the regulation, we request that the Commissioner make explicit that insurance scoring is prohibited, in whole or in part for any risk classification – including underwriting, tier placement and rating for at least the one-year period set out in the regulation..

We also request that the prohibition on credit scoring be the default position instead of the current approach of making credit scoring permissible after a year. The issue of credit scoring is so important that any permission to allow its use should require specific action instead of the current approach which would allow credit scoring without any action.

Finally, we request that CEJ and CFA be able to participate in your public meetings and deliberations on credit scoring.

Advisory Organizations

If you truly want to promote competition, there should not be advisory rate filing or advisory loss costs. This is collective decision making on the components of insurance rates and is fundamentally anti-competitive. There is no need for advisory filings in a competitive market; rather, what is needed is the collection and distribution of statistical data to provide the raw material for any insurer – existing market participant or potential new market participant – to perform the core analyses expected of any insurer in the market place.

Unfair Discrimination

It is unclear what is meant by the modifier, “subject to practical limitations.” What are practical limitations and why could this provision not be used to justify virtually any practice? If this is a statutory provision, it is precisely the type of phrase that requires explication in a regulation.

Stress Certain Risk Classification Factors

We have discussed our proposals for the general approach to risk classification. We want to request that the regulation mandate miles driven as a rating factor instead of simply a discount for driving under 5,000 miles. Emphasizing miles driven is important because it provides consumers with a concrete method to reduce their premium by driving fewer miles and because it supports the broader public policy goal reducing greenhouse gas emissions.

In addition, we suggest you consider that a mandate that certain rating factors be given greater importance than others with driving record and miles driven be mandated greater weight. This will ensure that items under the consumer’s control will have greater importance than factors over which the consumer has no control.

It is important to point out that mandating the use of miles driven and giving it greater weight in determining a consumer’s premium that some other factors does not exclude the use of other factors nor does it result in unfair subsidization. Miles driven is clearly related to frequency of claims.

Moreover, miles driven as a rating factor is an important tool to allow low income consumers to economize on insurance and avoid going without insurance.

Collection and Publication of Market Performance Data

As discussed above, the collection and analysis of market performance data is essential for monitoring competition. But, the publication of these market performance data is essential for the public to monitor the market performance of insurers in the same manner that Home Mortgage Disclosure Act data is used to monitor the performance of mortgage lenders.

Consumer Information

Price comparison tools are effective only if the prices are for comparable products. This is particularly true for auto insurance where consumers have virtually no ability to determine the reasonable cost of specific coverages or provisions. A rate guide that provides average rates does not control for the difference in types and amounts of coverage. We suggest that consumer information include price comparison of a standard policy that any consumer could actually purchase.

We also believe that publication of the list of risk classification factors used by insurers is essential to empower consumers to ask the necessary questions when applying for insurance.

Uninsured Motorist Rating

The regulation is silent on uninsured motorist rating issues. We raise this because the likelihood of an uninsured or underinsured motorist claim is a function of the number of uninsured or underinsured drivers in a particular area. Consequently, consumers who purchase insurance should not be penalized with high uninsured or underinsured motorist rates because their neighbors do not purchase liability insurance. Uninsured and underinsured motorist coverage rates should be based on very broad geographic groupings to avoid unfairly penalizing consumers in lower-income areas.