The Credit Crisis and Insurance Scoring:
A Moratorium Needed to Protect Consumers

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According to the Wall Street Journal, mortgage defaults have doubled from 2005 to almost 1.5 million in 2007. Over that period, homes lost to foreclosure and short sales also doubled to almost 1 million. The WSJ reports that the lost homes are projected to increase by another 50% in 2008 to an additional 1.5 million. The WSJ also reports, the percentage of home loans, by total value, on which payments are delinquent by 30 days or more has almost doubled since the beginning of 2006.

And the mortgage crisis has rippled through into auto loans and credit cards with higher incidence of late payments and defaults. In some states and metropolitan areas, the situation is dire, with almost 5% of homes in foreclosure. This is devastating not only to those homeowners, but to neighborhoods where property values are dropping and home equity is no longer available for financial cushion.

We are witnessing some of the worst financial conditions for consumers in history.

Did this come about by reckless borrowing by consumers? In some cases, yes. But the vast majority of consumers in financial distress are in that position because of reckless and abusive lending practices by lenders and a dramatic decline in real estate markets and home values in many parts of the country.

The impact on credit scores, generally, and insurance scores, in particular, is obviously dramatic. Foreclosures, delinquencies, bankruptcies have all increased dramatically – lowering insurance scores. Debt load has increased, lowering insurance scores. Reliance on non-traditional lenders has increased, lowering insurance scores.

When insurance scores go down, insurers get increased premium as consumers are placed in higher-cost rating tiers. The increase in premiums to insurers typically comes without a rate filing because the consumer is simply moved to a higher-cost rating tier.

Another revelation from the subprime market – FICO scores did not accurately predict the problems with subprime loans. FICO has revised its lending credit scores. Yet, there has been no recalibration of insurance scores. Scores that were devised in period of low foreclosures and better financial conditions are being inappropriately used in a radically different financial climate.

We have also seen the introduction of non-traditional lending credit scores after the revelation that 20-25% of the population was unscoreable with traditional credit scores because that portion of the population – largely low-income and minority – simply did not have enough information in the credit report. New credit scoring tools are utilizing non-traditional credit information like rent and utility payments. But, again, there has been no analogous movement or change in insurance scores.

Despite the radical increase in foreclosures, delinquencies, bankruptcies, debt and the associated decline in insurance scores – personal lines claims have not been increasing at the same pace. Since 2003 clam frequencies for property damage, collision and comprehensive coverages have all decreased, according to industry Fast Track data.

The bottom line is that many consumers are being penalized with higher auto and homeowners insurance premiums because of insurance scoring – because of lenders' reckless and abusive lending decisions and not because of any irresponsible behavior by the consumers.

And the practice is moving to health insurance with the development of medical credit scores. Surely, state insurance regulators want to weigh in on this practice before it becomes entrenched.

Even today, lenders' business decisions continue to penalize consumers. Primary lenders has tightened lending guidelines and redlined hundreds of communities around the country where home values have declined or may decline. Lenders holding second mortgages are preventing workout refinancing deals for consumers, thereby denying consumers an opportunity to keep their homes. Just as it was lenders' business decisions that created problems for some many consumers, it is now lenders' business decisions denying consumers opportunities to address the problem. Bad as this is for so many consumers on the mortgage loan side, it is cruel to pile on with higher auto and homeowners insurance premiums because of insurance scoring.

There is clearly a crisis for many consumers who are at risk of losing their homes and face associated financial pressures. Just as Congress and the states are taking action to help victimized consumers, states should do their part and, at a minimum, place a 3-year ban on insurers' use of consumer credit information.

I would like to close by putting our request in a broader context of the NAIC's history with insurance scoring.

The NAIC has never developed a model law regarding the use of insurance scores. As a result, the NCOIL model has been largely adopted in about half the states. The NCOIL model provides no substantive consumer protections – it is an example of pretend consumer protections. But, by deferring to NCOIL on this critical issue, the NAIC has allowed the NCOIL model to define insuance scoring regulatory oversight in many states and has enhanced NCOIL's profile because of the success of the NCOIL model.

The NAIC has deferred to insurers on evaluation of the impact of insurance scoring on consumers. Instead of collecting data and performing a rigorous analysis, the NAIC has allowed insurers to make any claims they want to state legislators without any corroboration by state regulations.

The NAIC has deferred to the federal government – the FTC – to study the impact of insurance scoring on low income and minority consumers. The result was a study based on data hand-picked by the industry and a report that regurgitated unsubstantiated insurer claims about insurance scoring.

The NAIC has deferred to the courts – the Supreme Court, in particular – on adverse actions and ratemaking using insurance scoring. Instead of a model law which sets out a clear standard for when a consumer is harmed by insurance scoring, the states are now stuck with a terrible Supreme Court decision which includes an unenforceable standard for "neutral" credit scores.

And now, Representative Gutierrez has introduced legislation in Congress which prohibits insurers' use of consumer credit information if the Federal Trade Commission finds the insurance scoring results in unfair discrimination or serves as a proxy for race. So now, we have a proposal to establish the FTC – a federal agency – as organization that decides what is or is not unfair discrimination in insurance. You will excuse me if I ask, isn't that the role of state insurance regulators? By continuing to defer to everyone else on insurance scoring, the NAIC and state insurance regulators are failing to protect consumers and missing the opportunity to make the case for state-based regulation.

We respectfully ask the NAIC to stop deferring to everyone else on insurance scoring and start taking action to protect insurance consumers.

1. Quickly develop a model law prohibiting insurers' use of consumer credit information for personal lines underwriting, risk classification and rating for three years and push the moratorium in individual states. The need for consumer protection is great and immediate.

2. Develop a market analysis data collection program that includes, among other things, the data necessary to do an independent analysis of insurance scoring and its impact on insurance availability and affordability. Such data and analysis would have to include information on applications as well as policies issues. I'll talk more about this during the presentation on market analysis data collection.

3. During the three-year moratorium on insurance scoring, study the practice to determine whether a permanent ban is appropriate or, if not, develop a model law that provides substantive consumer protections.

Crisis often brings opportunity. This crisis brings an opportunity for the NAIC to finally and forcefully address consumer protections in insurance scoring.