The NAIC and Insurance Credit Scoring: Missing in Action

Birny Birnbaum
Center for Economic Justice

NAIC Consumer Liaison Meeting, June 2003

Last March, I came before you and asked the NAIC to make 2003 the year that the NAIC truly makes the case for state insurance regulation.

Today, I come before you to report that on the issue of insurance credit scoring, the NAIC has failed to make that case.

I want to be clear – I am not crticizing the activities of individual regulators in his or her state – rather, I'm talking about the inaction of the NAIC as an organization.

We have provided several documents to you today:

- This outline of my talk.
- A letter from several consumer representatives describing one of the many aspects of credit scoring that makes it an unfair process.
- A short paper describing the major problems with credit scoring and responding to the arguments offered by industry
- A detailed review and critique of the University of Texas Bureau of Business Research study on the correlation of credit scoring and loss ratios.

Before I proceed, Mila Kofman is going to briefly discuss the letter before you, which explains how consumers who are victimes of health insurer fraud issues are further penalized with higher auto and homeowners insurance rates because of credit scoring.

NAIC Activity on Credit Scoring

1996 White Paper: Concern, but No Action

Since 1996: Generally Unfettered Used by Insurers for Underwriting

Recent Years: Credit Scoring Working Group Hearings

November 2002 NCOIL Model

2003 Legislatures: NCOIL Model pushed by industry

2002: NAIC – No Model Law

"Consumer Protection" from Options Paper and Brochure

First Time that NAIC has deferred to NCOIL on major issue

2003 Legislative Session on Credit Scoring: NAIC Missing in Action

No NAIC model, No regulatory response to industry claims

A recent article in the industry trade press describes the situation:

“As state legislative sessions wind up throughout the country, the industry is breathing something of a sigh of relief as the rash of legislative activity proposed to regulate the practice using credit scores in the underwriting of personal lines policies has not put too many onerous prohibitions on it."

"Leaving the model law field to NCOIL, the National Association of Insurance Commissioners is still pondering whether or not to proceed with such a study under the auspices of the American Academy
of Actuaries."

2003 Charge: Appoint a working group to review and discuss the use of credit scores and credit history in the insurance underwriting and rating process, including the assessment of the impact of credit scoring on certain populations and whether credit scoring methodology should be more standardized.

June 2003 Credit Scoring WG Meeting Cancelled: “The working group is not in a position to provide a formal recommendation about whether a disproportional or disparate impact study should be conducted. The working group will continue to discuss this issue as additional information and analysis becomes available.”

CEJ no longer wants the NAIC to pursue such a study. It is not necessary because the data are clear to anyone who cares to look and because we no longer have confidence of the NAIC’s commitment to consumer protection on this issue

UT Study: Analysis of Correlation

- Correlation Analysis: Methodology dismissed in 1996 as "counterproductive and misleading." [Page 5]

- No multivariate analysis. [Page 6-7]

UT Study: Credit is a Proxy for Other Factors

- Credit scores in the standard/preferred market much higher than those in non-standard market. [Page 11]

- Taken from period before credit used – expect average scores to be the same

- Shows conclusively that insurers already using some underwriting factors that were correlated to credit.

- Credit is a proxy for other factors already used by insurers – documents the concern of regulators in 1996.

UT Study: Credit Scores Correlated to Race and Income

- CEJ has done several studies of Texas auto insurance market showing likelihood of being denied coverage in standard market and be placed in non-standard market is 3 to 4 times higher if you live in a poor and minority community than if you live in a white community. [Page 12]

Credit Scores' Disproportionate Impact on Poor Consumers: Other Evidence

Survey of Consumer Finances:

- Credit characteristics weighted heavily in scoring models highly related to income.
- Survey of Consumer Finances: Low income 10 times more likely to have payment 60 days overdue than high-income families.
- Survey of Consumer Finances: Low income 15 times more likely to have high debt to income ratio – ratio of over 40%

What's in a Credit History and What's Not

- Financial Institutions in Poor and Minority Communities – Check Cashing, Rent to Own, Payday Lenders, Subprime Lenders

Agent Example: Before credit scoring, 66% of predominantly Hispanic community qualified for preferred tier. After credit scoring, 1%.

Bottom Line: Industry has gotten its model in most states, NAIC has complied with industry wishes on credit scoring

Consumer Protection: Don't know what's scarier – NAIC activities so weak that a brochure and options paper rise to level of consumer protection or that some regulators actually believe the documents are consumer protection.

At a time when the NAIC is trying to make the case for state insurance regulation, you succeeded in making yourselves irrelevant on one of the most critical consumer protection issues in the past decade.

With your inaction on credit scoring, the NAIC has once again, done more to make the case for federal regulation.

The current approach of NAIC leadership to promote insurer self-regulation at every turn is contrary to consumer protection and will not generate support for state insurance regulation.