Insurance Institute of Michigan

June 16, 2011

The Honorable Members of the House Insurance Committee
House of Representatives
Lansing, MI 48909

On behalf of the members of the Insurance Institute of Michigan (IIM), we express our strong support for House Bills 4593-96 which adopt the National Conference of Insurance Legislators (NCOIL) model legislation governing the use of credit-based insurance scoring in the rating of home and automobile insurance.

Nearly every single state in the country permits the use of credit-based insurance scoring by existing statute or regulation. Of those states, 27 have adopted specific provisions modeled after the NCOIL model legislation, as is proposed in the bills being considered by the House Insurance Committee.

We have also enclosed an extensive list of studies on the use of credit-based insurance scoring including a 2007 U.S. Federal Trade Commission Report to Congress which found that insurance scores are in fact predictive of insurance risk and that the scores have little effect as a "proxy" for membership in racial and ethnic groups.

The use of credit-based insurance scoring has been permitted in Michigan since the mid-1990s. Its use was reaffirmed in the 2010 Michigan Supreme Court case, *Insurance Institute of Michigan,et al v Commissioner of Financial and Insurance Regulation* (docket #137407).

The adoption of House Bills 4593-96 will provide Michigan with a consistent and stable regulatory environment, which is important in encouraging insurers to compete for business in Michigan. That is good for both consumers and insurers.

In light of the above, **IIM would respectfully request that you support House Bills 4593-96.**

Thank you in advance for your attention to this matter. Please let us know if you have any questions or comments.

Sincerely,

Peter A. Kuhnmuench
Executive Director

Dyck E. Van Koevering
General Counsel

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Insurance Institute
of Michigan

Insurance Institute of Michigan Position
Regulation of Credit Scoring Discounts
Senate Bill 300
House Bills 4593-96
As of May 12, 2011

The Insurance Institute of Michigan (IIM) supports legislation designed to regulate the use of credit-based insurance scoring consistent with the model legislation adopted by the National Conference of Insurance Legislators (NCOIL).

In Michigan, two-thirds of home and auto insurance policyholders have a lower premium because of good credit-based insurance discounts offered by insurance companies. Insurance companies use credit information because it makes pricing more accurate. Combined with more familiar factors, such as years of driving experience, previous accidents, type of car or home, where you live or drive, and whether you have an alarm system, credit-based insurance scores allow insurance companies to differentiate between lower and higher insurance risks.

IIM supports legislation that is based on a national model developed by the National Conference of Insurance Legislators. It would:

- Require insurance companies to disclose to consumers that credit information will be considered when determining insurance premiums;
- Allow policyholders to request a review of their insurance score at the time of their annual renewal;
- Require insurance companies to re-rate a person who has successfully challenged an error in their credit history; and
- Prohibit insurance companies from using the following as negative factors in insurance scores: credit inquiries not initiated by the consumer, credit inquiries related to insurance coverage, collection accounts with medical codes, and multiple mortgage and automobile lending inquiries.
- Require an adverse action notice with reason codes providing consumer with information on how to improve their scores.

In July of 2007 after years of extensive research, the Federal Trade Commission (FTC) found that use of credit-based insurance scores leads to more accurate underwriting of auto insurance policies in that there is a correlation between insurance scores and the likelihood of filing an insurance claim.

The FTC report, *Credit Based Insurance Scores: Impacts on Consumers of Automobile Insurance*, also states that credit-based insurance scores cannot easily be used as a proxy for race and ethnic origin. In other words, credit-based insurance scoring predicted risk for members of minority groups in much the same way that it predicted risk for members of non-minority groups.

The use of credit-based insurance scoring discounts makes pricing more fair. People less likely to file a claim in the future pay less and those more likely to have a loss pay more.

Credit-based insurance scoring provides a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. Information such as a person's age, income, ethnic group, religion, gender or marital status is not factored into credit-based insurance scores.

According to a 2008 *Detroit Free Press* editorial, "Banning credit scores would raise rates for some and lower them for others, but it won't solve the larger problem of affordability and equity in insurance. In truth, this change would hurt as many as it helps – in and out of Michigan's great cities and across all economic lines. As many urban policy holders now enjoy good-credit discounts, amounting to 3% to 40%, as do rural and out-state residents."

Using credit-based insurance scores as criteria for rating is within the scope of Michigan insurance laws and the Fair Credit Reporting Act. Senate Bill 300 and House Bills 4593-96 would continue to allow insurance companies to offer discounts while addressing concerns raised by consumers.

For more information, contact Peter Kuhnmuench or Dyck Van Koevering at 517/371-2880

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Insurance Institute
of Michigan

Credit-Based Insurance Scoring Studies

2009 St. Ambrose University, Iowa

St. Ambrose University studied Iowa consumers' perspective of the use of credit-based insurance scores by the insurance industry. The report concluded that while Iowans believe that the use of credit based insurance scores to set rates is unfair, that perception is incorrect. The university study also found that there is no evidence within the study to suggest that the minority population of Iowa is disproportionately subjected to adverse actions based on the use of credit-based insurance scoring.

2007 U.S. Federal Trade Commission Report to Congress

This study found that credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims. The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer. Thus, on average, higher-risk consumers will pay higher premiums and lower-risk consumers will pay lower premiums. Credit-based insurance scores appear to have little effect as a "proxy" for membership in racial and ethnic groups in decisions related to insurance. The relationship between scores and claims risk remains strong when controls for race, ethnicity, and neighborhood income are included in statistical models of risk.

2004-5 Texas Department of Insurance

Found that by using credit scoring, insurers can better classify and rate risk based on differences in claim experience. This study analyzed random sample of claim records totaling 2 million vehicle years and more than 600,000 house years for homeowners insurance. The major findings of this study are: 1) there is a strong correlation between credit scoring and risk; 2) certain age, income and race groups tended to have worse credit scores, though not all minorities have bad credit scores; and 3) credit scoring significantly improves pricing accuracy when combined with other rating variables in predicting risk.

Compiled by the
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1996 Tillinghast-Towers Perrin

Found a 99 percent probability of a relationship between insurance scores and the likelihood of an individual filing an insurance claim. Tillinghast reviewed loss ratios relative to insurance scores for both auto and homeowners insurance. In eight of nine samples, the probability that a statistically significant correlation exists exceeded 99 percent.

*A loss ratio is the percentage of each premium dollar an insurer spends on claims.

Insurance Institute of Michigan

Myths v Reality

Credit-based insurance scoring

The use of credit-based insurance scoring has garnered attention here in Michigan and country-wide. This widely misunderstood rating factor is one of the most effective predictors of risk used by insurance carriers. It allows people with more risk to pay more for insurance and people with less risk to pay less. In fact, **two-thirds** of Michigan residents pay less for insurance because of the use of credit-based insurance scoring.

Myth: "A person's credit score has nothing to do with how they drive, yet it raises the average driver's premium by 30 percent."

Reality: Michigan's insurance laws are the strictest in the nation. Insurance companies cannot use a person's credit-based insurance score to deny them insurance or raise their premium. It can only be used to provide a discount. In fact, two-thirds of all Michigan consumers currently receive lower rates because of the use of credit-based insurance scoring. If the practice is banned in Michigan, many policyholders with good scores will see their rates go up, while riskier drivers will pay less!

Myth: "Credit-based insurance scoring is the practice of using an insurance policyholder's level of education, occupation and record of paying household bills in determining rates."

Reality: Education level and occupation is not a part of credit-based insurance scoring discounts. A credit-based insurance score is derived from computer models, using information from a consumer credit report. They are not the same as a person's FICO (credit) score.

Credit-based insurance scores are used in combination with other rating factors -- a person's driving record, type of car they drive, how much they drive or the type of house they have -- to determine the policyholder's insurance risk.

Myth: "Credit-based insurance does not affect the amount of premiums collected by insurance companies; it affects whom those premiums are collected from based on factors unrelated to driving."

Reality: Michigan policyholders have been receiving discounts for credit-based insurance scores since the early 1990s. Independent studies have proven a strong connection between certain factors in an individual credit history and the likelihood of an individual filing a claim. People who use credit wisely are generally responsible in other areas of their lives. Research indicates that people with better credit-based insurance scores have fewer losses and less expensive claims.

Myth: "Credit-based insurance scoring is not a good predictor of claims."

Reality: Study after study has shown that credit-based insurance scoring is an effective predictor of risk. The most recent was a 2007 study by the Federal Trade Commission. Prior to that, studies that have found credit-based insurance scoring to be an accurate predictor of risk include: Texas Department of Insurance (2005), EPIC Actuaries (2003), University of Texas McCombs School of Business (2003), 2000 Casualty Actuarial Society Paper by James E. Monaghan, ACAS, MAAA (2000) and Tillighast-Towers Perrin (1996).

Insurance Institute of Michigan

Fact Sheet

Credit-Based Insurance Scoring

Overview

More than two-thirds of Michigan policyholders receive lower insurance rates because of the use of credit-based insurance scores.

Facts to Know

- The use of credit scoring was authorized by the Michigan Legislature in 1996 (Public Act 514).
- Insurance carriers use credit-based insurance scoring to more accurately price their products. Independent studies have proven a strong connection between credit history and the likelihood of an individual filing a claim. People who use credit wisely are generally responsible in other areas of their lives. Research has found that people with better insurance credit scores have fewer losses and less expensive claims.
- Credit-based insurance scoring allows people who are less likely to file a claim to pay lower premiums and those individuals with high risk of filing a claim to pay more.
- Twenty-seven states have adopted the National Conference of Insurance Legislators' (NCOIL) model credit-scoring bill.
- Studies finding that credit-based insurance scores are not discriminatory: St Ambrose University (2009); United States Federal Trade Commission (2007), Texas (2005); EPIC Actuaries (2003); and Virginia Bureau of Insurance (1999).
- Education level has no impact on a person's credit-based insurance score.
- The Consumer Data Industry Association reports that less than 1 percent of all credit report challenges result in a change once the inquiry has been fully investigated. Studies have found that credit reports are more reliable than motor vehicle records.

Q & A ABOUT THE USE OF INSURANCE CREDIT SCORE DISCOUNTS IN MICHIGAN

What does a person's credit have to do with home and auto insurance?

Independent studies have proven a strong connection between certain factors in an individual's credit history and the likelihood of an individual filing a claim. People who use credit wisely are generally responsible in other areas of their lives. Research indicates that people with better credit-based insurance scores have fewer losses and less expensive claims.

What is a credit-based insurance score discount?

Credit-based insurance scores are different from "credit scores" used by lenders. Insurance companies develop credit-based insurance scores from certain credit history information contained in credit bureau reports and use the information when making rating decisions. A credit-based insurance score provides a numeric assessment of an individual's insurance risk. It reflects credit payment patterns, outstanding debt, length of credit history, types of credit and number of new applications for credit. Insurance companies consider only those items from credit reports that are relevant to insurance loss potential. Unlike a lender, an insurance company is not assessing a customer's income and debt, they are evaluating how customers manage their finances and credit granted to them.

Why do insurance companies use credit history in rating decision making?

To make fair and objective underwriting decisions, insurance companies need to have as much information as possible. Items in a person's credit history provide a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. Information such as a person's age, income, ethnic group, religion, gender or marital status is not factored into credit-based insurance scores.

Why don't insurance companies just look at driving records or claims history?

Driving records alone are not the best predictors of insurance risk. Most people think that insurance companies can obtain all the information they need from state motor vehicle departments. However, a study by the Insurance Research Council (IRC) indicated that one in five traffic violations may not appear on a Motor Vehicle Record (MVR). Credit information is generally more accurate and compliments driving history to work to the advantage of most policyholders.

How does the use of credit-based insurance score discount benefit insurance consumers?

The use of credit-based insurance scores actually allows insurance companies to offer lower rates by providing discounts to consumers who have proven to responsibly manage their finances. Two-thirds of policyholders have a significantly lower premium because of good credit.

What would happen if insurance companies could no longer provide a discount based on credit information?

If credit information is no longer used as a factor for discounts, many consumers who have a lower potential for loss would pay more for insurance.

Do all insurance companies use credit-based insurance scoring in their rate making?

Most insurance companies do use credit-based insurance scoring. However, consumers can access a list of insurance companies that do and don't use insurance credit scoring at the Michigan Office of Financial and Insurance Regulation website, *www.michigan.gov/ofir*.

Can a consumer be denied insurance based on their credit-based insurance score?

In Michigan, state law prohibits consumers from being refused insurance based on their credit-based insurance score. Insurance companies here may, however, offer a discount for good insurance credit.

How is a consumer's privacy protected?

Access to specific credit information is very limited. Most insurance companies only see the score, not the information that went into developing it. All companies must follow the federal Fair Credit Reporting Act and state laws that apply to the use of credit information. These measures ensure there is confidentiality, accuracy and a legitimate need for the information.

Aren't credit reports notoriously inaccurate?

The Consumer Data Industry Association reports that less than 1 percent of all credit report challenges result in a change once the inquiry has been fully investigated. Studies have found that credit reports are more reliable than motor vehicle records.

How can consumers find out about their credit-based insurance score discount?

The use of credit information is not secret. Every existing and potential policyholder deserves to know how a company uses credit information. Policyholders can ask their agent for an explanation of their credit-based insurance score. If you don't feel your agent or company is telling you what you need to know, shop around for another agent or company that will.

What can consumers do to improve their credit-based insurance score?

Consumers can improve their credit-based insurance scores over time by using credit responsibly. Make sure you pay bills on time, keep balances low and apply for and open new credit accounts only as needed.

It is also a good idea to periodically obtain a copy of your credit reports from the three major credit bureaus to check for any inaccuracies. These are available free once a year by visiting, *www.annualcreditreport.com* or calling 1-877-322-8228.

Can consumers ask to have their credit score recalculated if they improve their credit score?

Yes. At the request of the policyholder, a company will rescore at least once annually.

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IN OUR OPINION

Insurance rates need major repair

■ **Ruling on credit scoring could shift pricing, but legislators must do more to address affordability**

The Michigan Supreme Court will likely decide whether Michigan insurance companies have the right to use credit histories to help determine a customer's coverage rates. Either way, the decision will do little, if anything, to ease the problem of unaffordable urban insurance rates. Legislators, not judges, must drive the solutions.

Banning credit scores would raise rates for some and lower them for others, but it won't solve the larger problem of affordability and equity in insurance. In truth, this change would hurt as many as it helps — in and out of Michigan's great cities and across all economic lines. As many urban policy holders now enjoy good-credit discounts, amounting to 3% to 40%, as do rural and out-state residents.

Real problems demand real solutions. Michigan's unaffordable insurance rates are driving people out of Detroit and other large cities. They are practically forcing thousands of motorists to commit fraud to secure coverage or go, illegally, without it. Some drivers in Detroit, the nation's poorest big city according to statistics released this week, pay $4,000 a year or more for auto insurance.

The problems of affordability and access are so severe that legislators must make difficult choices, such as allowing drivers the option to lower rates by buying less medical coverage, as they can in other states, and having fee schedules for auto insurance companies paying for medical treatments and services, similar to the worker's compensation system. Other steps include authorizing the insurance commissioner to order refunds and requiring more public scrutiny of the Michigan Catastrophic Claims Association.

No one welcomes changes to Michigan's exemplary unlimited no-fault system, but having some protection is better than having none. Now, 17% of all Michigan drivers are on the road without insurance, up from 11% in 1989. In Detroit, the share may be as high as 50%. That's unacceptable.

Peter Kuhnmuench, executive director of the Insurance Institute of Michigan, said the trade group plans to appeal the recent Court of Appeals ruling that would prohibit Michigan insurance companies from using customers' credit scores to help determine premiums. Numerous studies show a direct correlation between credit scores and risk, and the Court of Appeals decision would increase rates for roughly two-thirds of policy holders, he said.

Whether or not that's true, it's hard to see how eliminating the use of credit scores would do anything but shift, rather than reduce, overall insurance costs for urban and low-income policy holders.

Whatever the courts ultimately decide, legislators must continue to work on finding real ways to lower insurance costs and reduce disparities.

The Detroit News www.detnews.com

December 1, 2009 http://detnews.com/article/20091201/OPINION01/912010315

Editorial: Dems ignore best way to cut auto insurance costs

THE DETROIT NEWS

State House and Senate Democrats proposed auto insurance reforms would likely require all Michigan drivers to share in the very high cost of coverage now paid in urban areas, especially Detroit. They are not the best way to reduce insurance rates.

The plan would give state regulators more authority to control insurance premium rates and limit the criteria they can use for setting rates, which is expected to drive up costs outside of major cities. This would penalize drivers who don't deserve it, but it wouldn't get at the biggest cost determiner: Our no-fault system includes the richest medical benefits in the country.

The push for this legislation also has to be questioned -- considering the other major issues lawmakers have before them -- when the Senate already has rejected similar measures in the past.

The proposals stem from a report by Michigan Insurance Consumer Advocate Melvin "Butch" Hollowell, who says Michiganians pay some of the nation's highest auto insurance premiums and that the state gives insurers a "blank check" to raise rates at will.

Hollowell and his boss, Gov. Jennifer Granholm, also claim it's unfair to include the vehicle owner's level of education, occupation and credit score among the criteria upon which auto insurance premiums are based.

But insurers have an actuarial basis for using credit scoring and the other factors Hollowell and Granholm criticize. And it's important to remember they're among an amalgam of criteria that include theft, crash and lawsuit rates where a vehicle owner drives most of the time.

Michigan's average auto insurance premium of $1,067.74 is 12th highest in the country, according to the most recent ranking by the National Association of Insurance Commissioners.

That's not so bad considering that our laws require auto insurers to cover all reasonable charges for lifetime medical care to accident victims, as well as three years worth of lost wages. Other states allow as little as $50,000 in personal-injury protection.

The Insurance Institute of Michigan, an insurance trade association, says requiring less personal injury coverage would do more to lower rates than the Democrats' proposals. That lower-cost option would be especially helpful in Detroit or other urban areas where high crash and theft rates make auto ownership riskier, driving up the cost of insurance. Premiums would drop 15 to 45 percent, depending on levels of optional coverage.

Other industry suggestions include workers compensation-like limits on medical charges for accident injury care and a state authority to combat insurance theft and fraud.

If lawmakers consider a rewrite of the state's auto insurance laws to be crucial, these ideas deserve consideration.

hollandsentinel.com

Our view - Setting insurance rates isn't state's job

The Holland Sentinel

Posted Dec 05, 2009 @ 04:35 PM

Holland, MI —

Some Democratic leaders in Michigan are proposing changes in the state's auto insurance regulations that they say would help reduce premiums. But imposing changes that limit the ability of insurers to match price with risk would end up hurting low-risk drivers and could drive some companies out of the state. Michigan can't really reduce auto insurance rates unless it acts to reduce insurers' liabilities.

Michigan has some of the highest auto insurance rates in the country, in part because the state mandates some expensive benefits. Last week, Democratic legislators and the state insurance consumer advocate proposed a series of bills they say would reduce rates. Among other provisions, the legislation would require prior approval of rate increases by the state, ban the use of occupation, education and credit scores as criteria for setting rates, and mandate that companies offer low-cost policies for low-income drivers.

We are concerned with any rules that bar insurers from considering factors that have a sound actuarial basis. Arbitrarily excluding some criteria, such as occupation or zip code, simply shifts costs to customers who actually have lower risks and who deserve lower rates. (The one factor that we question is the use of credit scores, since layoffs can send them plummeting without causing any real change in a customer's driving risk; we would favor excluding sudden job loss or bankruptcy from medical bills from rate-setting criteria.) And while we favor the concept of low-cost options in a state that makes auto insurance mandatory (though anywhere from a fifth to a third of Michigan drivers skirt the law), it's unclear if the $600 charge proposed by Democrats would cover the cost of even a basic policy. The liability of insurers wouldn't go away — again, other drivers would bear a greater cost.

One market-oriented move that legislators could take to control costs would be to reduce insurance benefit mandates. Michigan is the only state to require insurers to provide unlimited lifetime medical benefits to accident victims. Insurance companies estimate that allowing drivers to opt out of that requirement could cut premiums 15 percent or more.

Reasonable regulation to ensure that insurance premiums are assessed fairly is important. However, we are suspicious of any effort by politicians to try to set prices arbitrarily, whether it's out of legitimate concern for consumers or an effort to curry political favor. One way or another, someone has to pay the cost of insurance — there's no way around that, no matter how badly the politicians wish it.