Statement

Insurance Association of Connecticut

Insurance and Real Estate Committee

February 14, 2013

HB 5510, An Act Prohibiting The Use Of Credit Histories As A Factor In Underwriting Or Rating Private Passenger Motor Vehicle Insurance Policies

The Insurance Association of Connecticut opposes HB 5510, An Act Prohibiting The Use Of Credit Histories As A Factor In Underwriting Or Rating Private Passenger Motor Vehicle Insurance Policies. HB 5510 would prohibit insurers from using credit history information in relation to the underwriting or rating of private passenger automobile insurance.

Insurers must be allowed flexibility in the underwriting and rating process in order that they may accurately predict the risk. Credit history information has been used by insurers for years. The correlation between credit history and loss experience is accepted as a proven tool of objective empirical validity. People with a personal history of poor credit management are more likely to have losses attributable to poor risk management.

There is no evidence of abuse in the use of this underwriting tool. Underwriting criteria are submitted to the Insurance Department. The Commissioner has the authority to disapprove the use of criteria found to be unfair or improper. Market conduct examinations and the Connecticut Unfair Insurance Practices Act also provide a sufficient regulatory oversight.

A “credit score” results from an objective, statistical analysis of credit report information, which identifies the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial positions.

The credit scoring model is developed by companies who analyze hundreds of thousands of records and establish predictive credit characteristics. Weights are assigned to the characteristics. The claimant’s total credit score ranks the individual’s credit history by their expected loss ratio and claim frequency. The higher the score, the lower the insurance risk.

The credit scoring model does <u>not</u> consider any information on income, net worth, address, race, gender, age, nationality or marital status. In fact, it has been consistently shown that credit scores have no relationship to income.

Connecticut has established numerous consumer protections in its regulation of the use of credit information (C.G.S. 38a-686(b)(6)). Credit scoring can only be used for new business or, upon renewal, if requested by the insured or if premiums are reduced through such use; certain credit characteristics, such as the number of credit inquiries by a consumer or the consumer’s total line of credit, cannot be used; credit scoring programs may not penalize an applicant for having no credit history. Connecticut law also requires insurers to consider whether the applicant has experienced an “extraordinary life circumstance” which has adversely affected the applicant’s credit history (C.G.S. 38a-686(b)(6)(D)). If so, reasonable exceptions to rating and underwriting rules must be extended to the applicant.

Under Connecticut statutes (C.G.S. 38a-687(b)(6)(E)), if an applicant is denied coverage or some other adverse action is taken based on credit information, the insurer must inform the applicant of the basis of that decision and that the applicant is entitled to a free copy of the credit report from the reporting company. Credit information is extremely accurate – the Association of Credit Bureaus reports less than one percent of all credit report challenges are proven to be errors.

For over two years, the National Association of Insurance Commissioners conducted a study of the use of credit history in insurance underwriting and published a report on that study in 1997. The NAIC found no credible evidence of unfair discriminatory impact in the use of such information, and no credible evidence to challenge insurer's claims that such information serves as an accurate predictor of the likelihood of future losses.

In 1999, the Virginia Bureau of Insurance issued a report, entitled "Use of Credit Reports in Underwriting," which stated:

- "Based on the Bureau's review of the characteristics used in the [scoring] models, the Bureau concluded that none of the characteristics appear to be unfairly discriminatory."
- "Based on the Bureau's findings, there appears to be concrete data indicating that a correlation exists between credit scores and losses."

In 2003, the University of Texas released a study it conducted on the use of credit information ("A Statistical Analysis of the Relationship Between Credit History and Insurance Losses"). The study, which was funded by the state legislature, concluded that there was a "significant relationship" between an individual's credit score and incurred losses, and that the "credit score did yield new information not contained in the existing underwriting variables." The study's conclusion stated "The lower a named insured's credit score, the higher the probability that the insured will incur losses on an automobile insurance policy . . ."

In 2005, the Texas Department of Insurance issued a report, "Use of Credit Information By Insurers in Texas", which stated that:

> ". . . credit score provides insurers with additional predictive information distinct from other rating variables. By using credit score, insurers can better classify and rate risks based on differences in claim experience."

The Texas study also showed that the average loss per vehicle for people with the worst scores is double that of people with the best scores, and drivers with the best scores are involved in about 40% fewer accidents than those with the worst scores.

A 2006 study prepared by the Insurance Department in Arkansas found that "89.2% of consumers whose premium involved a credit component either received a lower premium or their premium was unaffected."

The Federal Trade Commission issued a report to Congress ("Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance", July 2007). Included in the report's findings are the following:

- "Credit-based insurance scores are effective predictors of risk under automobile policies . . . The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer." (p. 3)
- "Use of credit-based insurance scores may result in benefits for consumers. For example, scores permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would not be able to determine an appropriate premium." (p. 3)

A recent industry survey found that use of credit histories has helped insurers write more policies. Insurers were able to accept some applicants because the credit score results offset other information.

Credit history information is a legitimate tool, among others, which may be used by insurers in underwriting automobile insurance throughout the country. There is a proven link between credit history and risk of loss, which permits the insurer to accurately, objectively and consistently judge the risk presented.

Connecticut consumers are benefiting from a highly competitive auto insurance marketplace. Insurers are competing for business in the state on the basis of price, product and service. More insurers are coming in to engage in that market. Coverage is readily available in the standard market, as evidenced by the fact that the state's assigned risk pool has been markedly reduced in size (there are less than 200 insureds currently in the pool, versus a high of almost 200,000 drivers in 1988). In recent years, overall rate changes for automobile insurance have been minimal.

The IAC urges rejection of HB 5510.