Testimony of

American Property Casualty Insurance Association (APCIA)
before the
Senate Finance Committee

Senate Bill 552-Motor Vehicle Insurance Use of Credit History Rating Policy

February 17, 2021

<u>Letter of Opposition</u>

The American Property Casualty Insurance Association (APCIA) is a national trade organization representing nearly 60 percent of the U.S. property casualty insurance market. APCIA appreciates the opportunity to provide written opposition to Senate Bill 552 which would ban the use of credit history in rating a private passenger auto policy. Senate Bill 552 prohibit a private passenger motor vehicle insurer from using an applicant's or insured's credit history to rate a risk in any matter.

APCIA and the property casualty insurance industry recognize that today, there is greater scrutiny of racial and social equity, justice, and inclusion issues. The industry is committed to creating a more diverse and inclusive workforce, providing fair treatment to all customers, and helping provide our unique expertise in risk mitigation, risk management and loss prevention to make insurance more affordable in low income, minority and traditionally underserved communities. APCIA is aligned with the National Association of Insurance Commissioners (NAIC) and National Council of Insurance Legislators on the need to have hard conversations together about how to directly tackle concerns related to fairness and preventing unlawful discrimination to determine if there are improvements that could both strengthen competitive markets and address inequities while preserving the risk-based foundation of insurance. Last year the NAIC announced the formation of a special committee focused on Race & Diversity. The committee is charged with the following: 1) Conduct research and analyze the level of diversity and inclusion within the insurance sector; 2) Engage with a broad group of stakeholders on issues related to race, diversity, and inclusion in the insurance sector; 3) Determine whether current practices exist in the insurance sector that potentially disadvantage minorities; 4) Make recommendations to the Executive Committee and membership by year-end regarding steps: (a) both insurance regulators and the insurance industry can take to increase diversity and inclusion; (b) that should be taken to address practices that potentially disadvantage minorities; and (c) to ensure ongoing engagement of the NAIC on these issues through charges to existing committees, task forces and working groups.

Use of Credit in Maryland

Maryland laws provide very specific criteria and restrictions in the use of credit in rating Maryland private passenger auto policies. Section § 27-501(e-2) of the Maryland Insurance Article provides the guidelines for the use of credit. An insurer may not refuse to underwrite, cancel, refuse to renew, or increase the renewal premium based, in whole or part, on the credit history of an application. An insurer may use credit to rate a **new policy** but 1) may only use credit history going back five years; 2) advise the applicant that credit is used and if requested identify the portion of premium based on credit; 3) may not use the lack of credit or number of credit inquiries as a factor in rating; 4) must review an insured's credit history every two years or by request; and if there is an improvement adjust the premium to reflect the improvement.

Maryland laws provide very specific criteria in regulating underwriting practices of private passenger auto insurers. Section § 27-501(a)(1) of the Maryland Insurance Article prohibits unfair discrimination in underwriting by making clear that an insurer or insurance producer may not cancel or refuse to underwrite or renew a risk or class of risk based wholly or partly on race, color, creed, sex, or blindness of an applicant or policyholder or for any arbitrary, capricious or unfairly discriminatory reason. Further, this Section states that an insurer or insurance producer may not cancel or refuse to underwrite or renew a risk or class of risk except by the application of standards that are reasonably related to the insurer's economic and business purpose. In addition, Maryland only permits the use of credit for underwriting private passenger auto but does not permit it for the use of homeowner's insurance.

Insurers Use of Credit

It is important to understand how insurers use credit information and to note that there are significant differences between the credit scores used by lenders and the credit-based insurance scores used by many insurers. Although both are derived from information found on credit reports, the information is measured differently. Insurers use credit information in developing insurance scores to predict the likelihood of future insurance loss. Credit-based insurance scores provide an objective measurement of how one manages the risk of credit. Lending institutions, on the other hand, use credit scores to determine the availability, amount and price of credit products offered to the consumer. Lending institutions use credit to determine the likelihood of repayment. The most significant difference between insurers and lending institutions is that insurers never consider income.

In addition to income level, one's address, ethnicity, religion, gender, familial status, nationality, age education, occupation and marital status are also not considered within a credit score calculation. Further, there is no reliable evidence that points to insurance scoring resulting in higher insurance rates for any specific class of individual. Low credit scores do not correlate to a specific territory or class of individuals. On the contrary, both high and low scores are found across all income levels, and territories.

Every serious and reputable actuarial study on the issue, including a study released in 2007 by the Federal Trade Commission[1], has reached the same conclusion: there is a very high correlation between insurance scores and the likelihood of insurance claims. A number of states have reached the same conclusion is in conducting their own studies. The Virginia Bureau of Insurance[2] concluded in 1999 that "[i]n every case where insurers have proposed to use credit scoring as a rating factor…the use of credit scoring has been found to be statistically correlated to losses." More recently, the Vermont Department of Financial Regulation stated, in a 2016 report, that "[c]redit-based insurance scores are a predictor of claims risk that appears to provide a financial benefit to many Vermont policy holders.[3]

Credit-based insurance scores allow insurers to write business that they may not have accepted in the past, and to offer lower rates to many insureds. The majority of consumers have good credit-based

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[1] [1]https://www.ftc.gov/news-events/press-releases/2007/07/ftc-releases-report-effects-credit-based-insurance-scores
[2] Available upon request.
[3] https://legislature.vermont.gov/assets/Legislative-Reports/Credit-based-Insurance-Scoring-Report-12-15-16.pdf

insurance scores and benefit accordingly – with rates refined to reduce disproportionate subsidies of higher risk individuals. An annual survey released by the Arkansas Insurance Department between 2005 and 2017[4] consistently found approximately 50 percent of consumers in that state save money due to insurers' use of credit information while only 20 percent pay more because of that same use. The remaining 30 percent are otherwise unaffected. To put it another way, policies decreasing in premium due to insurance scoring outnumbered policies increasing in premium by a factor of 3 to 1.

Greater access to information allows insurers to "grant and price coverage more efficiently, producing cost savings that could result in lower premiums," and permits insurers to "evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they otherwise would not be able to determine an appropriate premium."[5] An indicator of the competitiveness is the market share of Maryland Automobile Insurance Fund, (MAIF) who is the writer of auto insurance of last resort. MAIF's market share has dropped from 4.69% of the total written premium for private passenger auto in 2005 to 1.40% in 2019.[6] The fact that MAIF's market share has decreased while other writers have increased would indicate that insurers are willing to accept more risk because they can better evaluate risk using various risk factors. Thus, more and more Marylanders are no longer being insured through MAIF.

Further demonstrating the value of the use of credit, APCIA has been analyzing data demonstrating that credit-based insurance scores correlate to specific risky driving behavior. For example, consumers with higher credit scores are less likely to brake hard or excessively accelerate -- risky driving behavior associated with higher loss costs.

Contrary to the claim that credit-based insurance scores do not predict risky behavior but instead unfairly discriminate against groups, when our analysis is complete, this data could provide a real-world demonstration that certain driving behavior is in fact captured by credit. Prohibiting the consideration of these factors, as Senate Bill 552 would, creates inequity by leading to pricing that is not risk-based.

We understand the desire of legislators to address social inequities, but undermining risk-based pricing by prohibiting the use of certain actuarially justified rating factors could actually exacerbate those inequities. If credit information is eliminated from consideration, it is highly probably that auto insurers will come to rely even more heavily on other factors like driving history as recorded in motor vehicle records (MVRs).

MVRs are notoriously incomplete, In fact, it is these very deficiencies with MVRs that lead to, in part, the widespread use of credit-based insurance scores. Overreliance on MVRs can be especially harmful for minorities who are more likely to be the subject of traffic law enforcement actions, as shown by multiple studies, including the Stanford Open Policing Project[7].

Placing greater weight on a consumer's prior driving history by eliminating the use of other factors more predictive of risk not only harms the very consumers the proposed legislation seeks to protect,

[4] https://insurance.arkansas.gov/uploads/resource/documents/2017credit.pdf
[5] Id. Federal Trade Commission, July 24, 2007
[6] "Id. The Maryland Insurance Administration's 2006 Report on the Effect of Competitive Rating in the Marketplace" & '2019 NAIC Annual Statement data calculated by APCIA using the S&P Global Market Intelligence database.
[7] https://openpolicing.stanford.edu/

but also undermines the fairness and solvency purposes of state regulations that require rates to reflect the risk of future losses. Although helpful, over-reliance on motor vehicle records or prior accidents diminishes insurers ability to accurately predict future claims experience.

Impact of COVID-19 Pandemic on Average Credit Scores

Despite widespread expectations that the economic slowdown brought about by the pandemic would lead to a cratering in average credit scores, in fact, just as during the Great Recession, average credit scores are about the same if not improving in some states.

Why is this? A number of reasons. A wide range of financial services institutions, such as banks, credit card companies, insurance companies, home finance companies and auto lenders, are granting leniency around payments due to COVID-19. And, under the federal CARES Act, if an account is up-to-date and a consumer enters into a debt-relief program with a debtor, the creditor must continue to report the account as current.[8] This means there will be no negative impact on that consumer's credit history.

In addition, consumers in general are changing their behavior as a result of the changed economic circumstances. They are becoming more conservative in their spending habits and paying down debt, which is stabilizing if not improving credit score.

That is why it would be particularly unfortunate to ban the use of credit-based insurance scores at this time. As a 2019 report from the Maryland Insurance Administration points out, "the use of credit results in a premium decrease for substantially more policyholders than those that experience a premium increase due to credit," **a percentage the report pegs at 75%.** [9]

If either of these bills were to pass, it could possibly result in an increase in premium for a substantial number of policyholders at precisely the wrong time to do it, in the middle of a pandemic when so many are dealing with economic uncertainty.

What Happens When a State Bans Credit?

It's important to note that only three states prohibit consideration in the underwriting and/or rating of auto insurance: California; Hawaii and Massachusetts. However, because those restrictions were put in place before insurers began using credit on a widespread basis, they do not provide a good case study of the impact of a ban on insurance. Maryland, however, adopted a ban on the use of credit in homeowners insurance in 2002. What was the impact of Maryland's ban? Homeowners' insurance rates went up. In fact, they went up at a faster rate than the rest of the country (53% to 36%) between 2002 and 2007, and they went up faster than they did in neighboring states and at least one company left the market.

Summary

[8] https://www.transunion.com/legal/covid-19-data-furnishers

[9] https://pilot-insurance.maryland.gov/Consumer/Appeals%20and%20Grievances%20Reports/Private-Passenger-Motor-Vehicle-Ins-Rating-Factors-Report.pdf

Restrictions on the use of underwriting factors such as credit could harm the marketplace, thereby negatively impacting a state's economy. Such limits create unfair subsidies among consumers, stifle competition, limit innovation, and force insurers to be more cautious about writing new business or expanding into new markets. As a direct result, consumers enjoy less choice, less availability, and higher average costs. This not only increases the uncertainty risk premium, but insurers are further forced to rely on a decreasing number of legitimate predictive factors, factors that are not necessarily proportionately distributed among different groups. Individual consumers who fare poorly with a small range of very limited factors may have vastly fewer and affordable insurance coverage options without the use of a multiplicity of factors.

For these reasons, APCIA asks the Committee to provide unfavorable report on Senate Bill 552
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Respectfully submitted,

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