



May 15, 2009

The Honorable Michael McRaith
Illinois Director of Insurance
Illinois Division of Insurance
320 W. Washington
Springfield, IL 62767

Dear Director McRaith:

As follow-up to the National Association of Insurance Commissioners (NAIC) hearing on insurer use of credit on April 30, 2009, below please find additional information and clarifications on several areas of the testimony and discussion.

Causation

One of the most common questions regarding insurers' use of credit relates to the relationship between a person's credit history and their propensity to incur future loss. At the outset, it is important to remember that insurers are under no legal obligation to explain why a particular rating factor works beyond simply demonstrating its actuarial value and its compliance with law.

Theories have been proffered as to why credit is so accurate, including that consumers who are fastidious in managing their finances are likely to manage other aspects of their lives in a similar fashion. A 2007 article in the *Journal of Risk and Insurance* by University of Texas professors Patrick Brockett and Linda Golden entitled, *Biological and Psychobehavioral Correlates of Credit Scores and Automobile Insurance Losses: Toward an Explication of Why Credit Scoring Works*, is the most comprehensive exploration of this issue. The study finds strong similarities between the psychological profile of financial risk takers and risky drivers. The Federal Trade Commission reviewed several other theories as to correlation in its 2007 study of the use of insurance scoring in automobile insurance, but ultimately concluded that the information available did "not allow the agency to draw any broad or definitive explanations why there is a relationship between credit-based insurance scores and risk." (FTC Study, p. 30.)

A ban on the use of credit information at renewal would also result in several negative effects on certain consumers. In the worst case scenario, because most consumers generally enjoy increasing scores as they grow older, it would mean that consumers with improving insurance scores are denied the discount afforded by that improvement for the remainder of their insurance policy. And, given that consumers generally do not shop around for insurance coverage as much as they do for other goods, they would likely remain ignorant of the fact that they are being denied cheaper insurance and therefore unable to take remedial steps (such as shopping around).

Also, to the extent consumers actually do shop around, a prohibition on the use of credit at renewal hinders the ability of an insured's current carrier from competing on a level playing field with competitors who are otherwise free to consider credit information in providing a quote. How consumers benefit from impeding the ability of their current insurer to provide competitive rates against other carriers with access to additional actuarial data is unclear.

Redistribution of Premium

The use of insurance scoring provides for a more equitable distribution of the cost of risk among policyholders and encourages competition. The more rating factors that insurers are allowed to use, the more accurate a risk profile insurers are able to develop for both their policyholders, both on an aggregate and individual policyholder level. Insurance scoring, as with other rating factors, allows carriers to more equitably distribute the cost of their risk among existing policyholders. As a result, those that represent greater risk are charged more and those that represent less risk are charged less. It bears repeating that a 2003 study by EPIC Actuaries (now part of Tillinghast) found that individuals with the lowest insurance scores were found to incur 33 percent higher losses than average, while those with the highest scores incurred 19 percent lower losses than average. It makes sense that riskier consumers should pay more than less riskier consumers. There is also evidence that availability and competition have been enhanced by insurance scoring.

No hits/Thin Files

The NCOIL model specially addresses those consumers who either lack any credit history (no hits) or lack sufficient information to generate a score (thin files). In either instance, insurers are to: (1) treat the consumer as if the applicant or insured had neutral credit information; (2) exclude the use of credit information as a factor and use only other underwriting criteria; or (3) treat the consumer as otherwise approved by the insurance commissioner. This provision is directed at those consumers who do not have, for whatever reason, enough credit history to calculate an insurance score. In particular, elderly consumers who never felt comfortable using credit are protected from being adversely impacted by that discomfort.

Insurance Scoring and Potential Discriminatory Impact

During the fact-finding hearing, the issue of credit-based insurance scoring and potential discriminatory impact was raised. Insurers do not collect or use information on race, color, religion or national origin.

For additional analysis on this subject, we refer to information submitted by NAMIC and AIA.

Insurance Scoring and Model Adjustment

During the fact-finding hearing, a question was presented concerning whether insurance score models are changed, evaluated, or updated. While each model developer has its own proprietary methodology, as a general proposition, the models are updated both as required to meet statutory and/or regulatory

requirements in each state and regularly to ensure continuing predictive value. These legal and regulatory requirements, as well as market-place competition, all work to ensure that models and their methodologies are dynamic to meet the regulatory and market demands.

Comparisons to Financial Institutions

At various points in the hearing, it was suggested that the regulatory scheme governing lending institutions and their use of credit report information could be applied to the use of such information in the rating and underwriting of insurance. While ultimately this is a public policy decision, it is important to note both the similarities and the differences between how lenders and how insurers use such information, and what impact the imposition of such requirements would have on insurers and their customers.

First, allow us to suggest the similarities. Congress directed the Federal Reserve Board (Federal Reserve)

Rather they use scores as a factor when estimating the number or total cost of insurance claims that prospective customers (customers renewing their policies) are likely to file.” (FTC Report, page 2)

Unlike insurers, lenders issuing mortgages are require

