

AMERICAN INSURANCE ASSOCIATION
STATEMENT ON
PROPOSED RISK CLASSIFICATION DATA CALL

* * * * *

NAIC PROPERTY & CASUALTY (C) COMMITTEE HEARING
SEPTEMBER 30, 2010

Catherine I. Paolino
Senior Counsel

As the NAIC Property and Casualty (C) Committee weighs a proposed risk classification data call, the American Insurance Association (AIA) respectfully asks you to carefully consider and balance all of the fundamental concerns outlined in these comments and urges you not to move forward with a similar data call. This testimony divides questions and problems into those that are data related and those that are administrative in nature. It also highlights some steps that some states already employ to learn more about credit-based insurance scoring.

DATA CONCERNS

In reviewing the proposed data call, insurers identified serious technical concerns in both the gathering stage at an insurance company and the analysis stage at an Insurance Department.

Importantly, if the information submitted in response to the proposed data call is inconsistent across the industry, it will be of questionable value for a regulator looking to better understand practices in his/her insurance marketplace. This would be particularly disappointing given insurers' cost and burden to provide the data. Below are several big picture issues.

Assumptions / Comparability

Where the proposed data call asks for all other factors to remain equal,¹ it seems likely that insurers could make assumptions about "the other things being equal" and arrive at different answers, especially if an insurer's rating plan contains rating factors that are interrelated.

For example, a non-member provides this illustration: assume an insurer's rating plan uses gender and age, working together so that there are six different factors.

	Gender	
	Male	Female
Age		
16-21	2.80	2.25
22-25	1.50	1.35
26+	1.00	1.00

If by assuming "other things being equal" means that every one is age 45, then the range in the factors is (1.00/1.00) or 1.00, but if one assumes that everyone is age 18, then the range would be (2.80/2.25) or 1.24.

Without at least some common assumptions provided, the inconsistency between insurer interpretations would jeopardize the validity of conclusions a regulator may draw from this data.

Storage & Reprocessing

The kinds of information stored and the manner in which rating factors work together are important topics for dialog between regulators and insurers.

¹ Consider the request in **Table III** for highest and lowest factors while holding all other factors equal.

One insurer explains that the particular information kept by an insurer and the places where the information may be stored may vary by company. For many insurers, the data and factors used to calculate the initial premium will not be stored in the system. As data and factors change (e.g. adding a youthful), the fields populated by the initial data are overlaid with the new data and the new factors. Factors, premium, insurance scores, scoring bands, territories, driver information – all these things may change throughout the tenure of the policy.

To go back to find the closest approximation for correct relativities may demand significant manual review and analysis; for some insurers this may mean recalculation by hand. The multivariate nature of their rating further complicates the process.

Another insurer explains that the computer programs that calculate the policy premiums generally are designed to calculate the total premium (rather than to isolate the impact of each individual rating variable). Thus, in order to provide the information requested in the proposed data call, many insurers will need to revise their policy rating programs to isolate and store individual rating variable information. These rating programs are extremely complex and they

how much of the 5.00 factor is due to his age being 17, vs. his gender being male, vs. his being single, vs. him being the principal operator. The factor for that company was determined as the combination of the interaction of the four attributes.

results from different sources would not be comparable because insurers may interpret the request differently

Definitions / Comparability

Without outlined standard approaches or definitions, the inconsistency between insurer interpretations would jeopardize the validity of conclusions a regulator may draw from the data. Consider this problem in the context of the definitions discussed below.

Median Value Definition⁹

While the definition of “median” relates to the middle number in a series of numbers, the proposed data call is unclear as to which figures to include and how to approach binary situations.

For example, in determining the median for a rating variable like territory it is unclear whether: (1) the high level values should be considered (assuming five values with rating factors of 0.77, 0.82, 0.86, 0.95, and 1.00 – the median value is 0.82); or the customer legal values should be considered (assuming 400 customers in the lowest rated territory, 250 in the second lowest, 200 in the third lowest, 400 in the fourth lowest, and 901 in the highest rated territory – the median value is .95).

For example, in determining the median for factors where there are only two results (like home ownership), it is unclear whether: (1) there is no median value because there is no

The extent to which the proposed data call would be applicable is unclear. For example:

Domicile – Whether the request would be limited to those insurers domiciled in a state is unclear. AIA asks regulators to consider conversations with domiciliary insurers to better understand risk classification factors, before turning to an extensive data call.

Size – If moving forward, AIA suggests that the proposed data call not be distributed to all those doing business in a state. Rather, it should be limited to the top writers on an

Timeline

As far as AIA is aware, no mention has been made of the timeframe an insurer would have to prepare a response to a data call. AIA strongly encourages adding this to the discussion as soon as possible. Given the scope and other problems, insurers have serious concerns about the amount of time and flexibility that would be provided.

Scope

The breadth of the data call and the elements considered is vast. AIA strongly urges you to narrow the scope of the request and perhaps reassessing whether further information is needed after reviewing the results of a more targeted request. If the primary purpose of the data call is to evaluate how insurers use credit-based insurance scores, please limit the request. Importantly, please evaluate whether there are more tailored approaches to getting at the questions concerning regulators. Possible alternatives are discussed in another section below.

The predictive nature of a risk factor should be the standard against which it is judged. For credit-based insurance scoring,²¹ some are concerned that focus around the testing periods, data year, calibration, and model age may mean that regulatory emphasis is moving away from whether the model remains a predictive tool. Beyond this issue, insurer practices are a matter of competitive advantage.

Alternative Approaches - Existing or Available Tools

States have used various lower cost tools that seem to address some of the objectives articulated as the (C) Committee discussed the proposed data call. Below are some examples:

To address the question of policyholder-level impact of changes in credit-based insurance scores, perhaps something could be loosely modeled after the consumer materials in **Pennsylvania**²² or **Massachusetts**.²³ Looking at hypothetical policyholders may be an easier, more direct, and less burdensome and costly way for Insurance Commissioners to supplement their understanding of cost variance resulting from certain discrete rating factors. By asking insurers to rate hypothetical policyholders with particular risk profiles (holding constant key variables), the regulator may get some of the answers sought in the more expansive proposed data call. Because it is based on a rating approach insurers go through daily (without systems or operational changes) the results may better reflect the marketplace and may avoid the actuarial and other problems discussed above. If the (C) Committee moves in the direction of hypothetical policyholders, AIA asks to be involved in the process and AIA would urge that the scope be reasonable and that the focus be narrowly defined. Factors to hold constant (with particular risk characteristics provided) would likely include commonly used variables like: credit-based insurance score, marital status, loss history, lapse in coverage, prior limits, gender, age, territory, liability limits, tickets or traffic violations or points, at-fault accidents, not-at-fault accidents, ownership of a home, vehicle year/make/model, number of cars in household. For any additional factors used, insurers would be required to submit all assumptions. While AIA

²¹ See **Additional Information Questions 8d, 18 and 19**.

²² See the assumptions provided in the Rate Comparison Chart materials by types of coverage on the Pennsylvania Insurance Department website: http://www.portal.state.pa.us/portal/server.pt/community/auto_insurance/9187

²³ See Auto Insurance Premium Comparisons on the Massachusetts Office of Consumer Affairs & Business Regulation website: http://www.mass.gov/?pageID=ocaterminal&L=4&L0=Home&L1=Consumer&L2=Insurance&L3=Automobile+Insurance&sid=Eoca&b=terminalcontent&f=doi_AutorateCompare_autoratecompare&csid=Eoca

does not think this is a perfect solution, it is listed for additional brainstorming around a possible way to assist regulators interested in looking at the data.

To address the question of the general overall impact of credit-based insurance scores, the