

Responding to the Regulation of the Use of Credit Scoring

CAS 2003 Ratemaking
Seminar
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MAAA

Discussion Items

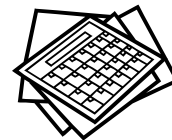
- Increased focus on credit
- Regulatory issues
- Addressing the Issues – past, present, and future(?)



Increased Focus on Credit

What Happened in 2002?

- Active legislative sessions – action considered in 26-30 states
- Hearings – GA, MI, FL
- Task Forces – FL, OR
- Regulatory restrictions



Potential for Increased Attention in 2003

- Additional legislative activity
- Increased regulatory attention
- Judicial attention
- Studies being released



Increased Regulatory/Judicial Attention

- One year ago – credit was an issue in about 30 states
- Now, at least 40 states have addressed credit somehow
- Dehoyos et al vs. Allstate – Alleged that Allstate used credit to mask their intentional racial discrimination

Studies Being Released

- Jan, 2003 – OIC in WA found that, although the data was not credible, credit scores seemed to discriminate on basis of race and age
- Feb, 2003 – AK DOI concluded that, although the study technique was not perfect, credit scores seemed to discriminate on basis of race and age
- Mar, 2003 – UT-Austin professor found that credit is predictive, even on a multivariate basis



Regulatory Issues

Regulatory Issues

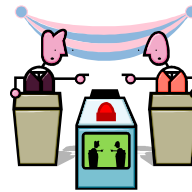
- Correlation with current rating factors
- Secrecy
- Inaccuracy of credit reports
- Causality
- Disparate impact on protected classes
- Unintended disparate impact



Addressing the Issues

Past Responses

- Statistical
- Trade secret
- “Passing the buck”
- Rhetorical



Currently

Improving!



Potential Future Approaches

- More open communication
- More substantive responses
- More statistical proof
- Increased public presence



Correlation With Current Rating Factors

- Opponents argued that the impact of credit was not real, but just duplicating other information
- Many companies analyzed internally, but there was nothing in the public domain
- Monaghan – began to address with two way tables
- UT-Austin study – true industry multivariate study that concludes that credit has strong predictive power
- Future – companies may need to continue to justify independently to regulators and the public (WA)

Secrecy



- Regulators
 - Lacked of information to regulate
 - Company vs. model vendor tennis match
- Agents
 - Often given limited information
 - Difficult position of needing to deliver bad news but not really be able to explain why
- Consumers
 - Difficult to understand how credit impacts insurance
 - More difficult to understand what is driving the score

Secrecy

- Regulators
 - Give them the information needed
 - Recognize need for confidentiality
- Agents
 - Give them the information needed
 - Be sensitive to privacy laws and regulations
- Consumers
 - Communicate before, during, and after sale
 - More helpful information on score drivers
 - Increase public awareness of importance of credit management

Inaccuracy of Credit Reports

- Have pointed to inaccuracy of other items (MVR's)
- Significant vs. insignificant errors
- May need to set up internal processes by which incorrect information can be ignored even before it is corrected on the credit report

Causality

- Is it required?
- Other current factors may not seem intuitive
 - Good student discount
 - Multi-line discount
- Potential reasons
 - Personal responsibility
 - Propensity to file and/or inflate claims

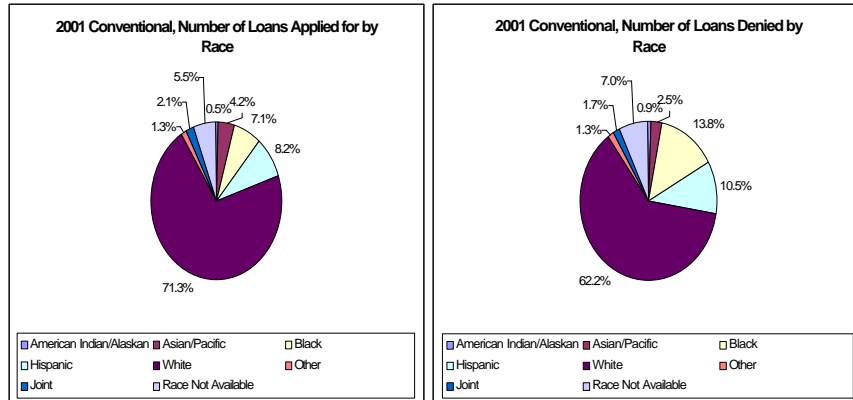
Disparate Impact on Protected Classes - Responses

- Race and income are not a part of the model, so there is no disparate impact
- We are using an objective variable, so there is not an issue
- By knowing a person's credit score, we do not know their race or their income
- AIA study, Virginia study

Disparate Impact – Why the Responses May Not Be Enough

- WA Study
- AK Study
- Dehoyos vs. Allstate
- Anecdotal evidence
- Public perception

Public Perception



Source: Federal Financial Institutions Examination Council – HMDA Aggregate Reports

Disparate Impact

- Research study to help answer the question
- Consequence of doing nothing may be the loss of the use of credit in some areas
- Caution – where does it end?

Unintended Disparate Impact

- Life-changing events
 - Loss of employment
 - Medical catastrophe
 - Divorce
- May need some type of underwriting exception for these types of events

What the Future May Look Like

- Credit will survive in some form
- That form could potentially take on 51 different shapes
- Important for insurers to be proactive in forming what those shapes look like

