Statement of the U.S. Chamber of Commerce

ON: Drivers of Discrimination: An Examination of Unfair Premiums, Practices, and Policies in the Auto Insurance Industry

TO: U.S. House of Representatives Committee on Financial Services, Subcommittee on Housing, Community Development, and Insurance

BY: Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

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Introduction

The U.S. Chamber of Commerce ("the Chamber") believes that all financial products should undergo proper underwriting that accurately measurers the risks to the issuer. Restrictions on the types of information that can be used for underwriting could create new risks for issuers or decrease the availability of financial products they can make available. The introduction of new risks would likely have knock-on effects in the financial markets as firms are compelled to invest in more conservative assets or increase their reserves to account for changes in their liabilities. Congress should defer to the well-developed regulatory structure of the states to avoid unintended consequences for consumers, insurance providers, and financial markets.

The Chamber commends the Committee's attention to concerns that have been raised about inappropriate discrimination in the underwriting of automobile insurance. Discrimination on the basis of race is wrong under any circumstance and should have no place in our financial system. We are prepared to work with the Committee to have a transparent dialogue about the market for automobile insurance to address the Committee's concerns.

Insurance Underwriting Depends on Actuarially Reliable and Predictive Data

Broadly speaking, the Chamber believes the use of appropriate data – both in quality and quantity – is paramount for underwriting financial products. This is true for consumer financial products, such as insurance policies and loans, but the principle is equally applicable to assessing the creditworthiness of a business. The more reliable and predictive information that can be used in the assessment of risk the better – prohibiting the use of information actuarially related to insurance risk, such as credit history, may reduce the confidence of underwriters risk assessment.

Insurance companies rely on predictive data to underwrite actuarially sound policies they make available to consumers. The data set may include a wide variety of information; generally speaking, more information permits for a more precise and more confident assessment of risk. Importantly, data points cannot be analyzed in a vacuum. Oftentimes, it is their relationship with one another that provides a reliable indication of risk. For example, all other risks factors being equal, a driver located in a city might be more at risk of damage to his or her car (due to congestion, driving habits of others etc.), than a driver located in an area with a lower traffic density. However, the impact of garaging location on the driver's overall risk may be reduced if he or she only drives the car a few times per year (thus limiting the car's time on the road). Insurance companies are using data points that have been actuarially demonstrated to relate to risk – they are not arbitrary data points. This is demonstrated by the mere fact that insurance companies have historically encountered very few failures in a very competitive marketplace: they are charging policyholders sufficient premiums to satisfy future claims based on a risk assessment when the policy is issued.

Credit based insurance risk scores are an important indicator of risk for underwriting automobile insurance. According to the National Association of Insurance Commissioners, there is a correlation between certain credit characteristics and insurance risk.[1] A comprehensive study by EPIC Actuaries found that a consumer's credit-based insurance score is directly connected to that consumer's propensity for auto insurance loss.[2] And according to FICO, approximately 95% of auto insurers and 85% of homeowners insurers use credit-based insurance scores in states where it is a permissible underwriting or risk classification factor.

Importantly, insurance companies have been able to increase the availability of insurance products through advances in underwriting. This underwriting may include new models for analyzing risk, and it also necessitates appropriate data sets for undertaking such an analysis. As insurers have become increasingly sophisticated with respect to their use of rating variables, they have been able to offer insurance in the voluntary market to more applicants. According to a report from the Insurance Information Institute and the Casualty Actuarial Society, "[i]n 2002, assigned risk pools insured 827,000 consumers in the 45 states that provided data to assigned-risk manager AIPSO. According to AIPSO, by 2017 that number decreased to only 88,000 consumers — a reduction of almost 90 percent."[3]

Insurance companies must use underwriting criteria that reflects the risks of the policies they are issuing so they can pay policyholder claims and maintain solvency. Insurance companies are in the business of managing risk and prohibiting use of data that makes that more difficult could jeopardize their ability to carry out their core competency. Requirements from state insurance regulators are already designed to protect consumers from unfair discrimination and excessive rates, and to help avoid

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[1] National Association of Insurance Commissioners. Issue Brief: Use of Insurance Credit Scores in Underwriting (May 2019), available at https://www.naic.org/documents/government_relations_190507_credit_based_scores.pdf

[2] Michael J. Miller and Richard A. Smith, "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity: An Actuarial Study (June 2003). www.ask-epic.com/Publications/Relationship%20of%20 Credit%20Scores_062003.pdf

[3] Insurance Information Institute. Insurance Rating Variables: What They Are and Why They Matter (June 2019), available at https://www.iii.org/sites/default/files/docs/pdf/ratingvariables_cas-iii_wp072419.pdf

the insolvency of insurance firms. State insurance regulators are responsible for the administration of their respective insurance guarantee funds, which may be used to pay policyholder claims in the rare event of a firm's failure. Thus, it is vital to leave policymaking regarding the underwriting of insurance policies to state insurance regulators.

State-Based Regulation

The Chamber believes that the existing state-based regulatory system for underwriting insurance products is in the best interest of consumers and the financial markets. Broadly speaking, the state-based regulatory system permits for local regulators to account for different social and economic needs in their disparate markets, which may also include different risks. For example, the risk of damage to an automobile due to severe weather conditions will vary from state to state. This is just one of a myriad of differences that insurance companies and regulators must analyze when evaluating the effect of proposed rates on consumers and the insurance market as a whole.

Insurance companies must comply with the laws of every state in which it operates. States are empowered to regulate the rates charged for automobile insurance with the ostensible goal of achieving a competitive and vibrant marketplace that ultimately benefits consumers through the provision of a myriad of insurance products at affordable rates. In general, state regulators need to ensure that rates are not unfairly high, but they also need to ensure they are not too low (as discussed above). State law commonly requires that rates must not be excessive, inadequate, or unfairly discriminatory.

Insurance companies, and the policyholders and communities they serve, have been very successful under the existing regulatory system. Interfering with the risk criteria used by insurance companies could impede their ability to make investments that benefit all Americans because they may require extra reserves to account for reduced certainty in their ability to predict claims from policyholders.

Investment

Last year, the Chamber released a new report explaining how the insurance industry invests in the U.S. economy. Our report found that the insurance industry has invested approximately $6 trillion in assets that support job creation, strengthens economic infrastructure like roads and bridges, creates affordable housing, and builds new schools.[4] These investments are directly correlated to the volume of insurance the industry issues to consumers and the characteristics of those policies.

Insurance companies are focused on investing in assets that can effectively pay for future liabilities. Therefore, their investment strategies are focused on four key criteria:

1. Duration matching. Assets need to match projected liabilities for insurance companies, which means investments are typically longer-term.

2. Low credit risk. Insurance investments are focused on managing credit risk so they will not be hindered to pay out future liabilities.

3. Diversification. A diverse portfolio should provide insurance companies a stable flow of cash in a wide variety of market conditions.

4. Optimize capital redeployment. Insurance companies strive to maximize returns in their investment portfolio while properly managing risk, including by holding appropriate risk-based capital. The riskier the assets, the more capital is required to be held in reserve to offset potential losses.

Insurers are a primary source of patient capital as a function of their business model which necessitates making low-risk investment that permits them to meet policyholder claims. Insurers are among those institutional investors who are interested in receiving a return over 20-year or longer time horizons. Their limited allocation to stocks and greater emphasis on fixed income instruments support their investment time horizon as they look to provide funding for long-term capital expenditure and infrastructure projects—projects that create sustainable and tangible economic benefits to the capital markets and to communities.

Thus, by deploying their patient capital accordingly, insurance companies help counteract any shift toward increased short-term thinking. Additionally, the long-term approach that insurance companies take can empower corporate leaders to make decisions that encourage investments on projects with long-term benefits, and support their financing.

[4] U.S. Chamber of Commerce. The Role of Insurance Investments in the U.S. Economy (Winter 2019), available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/03/CCMC_InsurancePaper_v2.pdf

Infrastructure

The insurance industry contributes directly to expanding and strengthening America's economic infrastructure. This activity is primarily realized through investment in municipal bonds, which are one of the primary vehicles for financing infrastructure. The insurance industry plays a vital role in this market through its ownership of approximately 20 percent of all outstanding municipal debt – or about $740 billion. This level of investment could help rebuild up to about 1% of the total mile network in the U.S. (4 million miles) every year.

Investments by the insurance industry also strengths the social infrastructure vital for creating strong communities such as schools and affordable housing. For example, our analysis found that U.S. insurance investments in education projects through municipal bond purchases could be estimated as building about 1,000 elementary schools every year, which would support around 620,000 students and close to 45,000 teachers. Alternatively, it could provide funding for 350 high schools holding around 350,000 students and 25,000 teachers. Investments like these made by the insurance industry ensure students are able to receive their education in safe, high-quality buildings. Similarly, insurers investments can help alleviate the housing shortage facing America.

Insurers' involvement in mortgage-backed securities (MBS) and commercial and multifamily real estate helps provide homes for families of all incomes and promotes stability in the housing market. In the agency mortgage-backed securities market, insurers participate in the Government National Mortgage Association (GNMA) space, where capital has supported Federal Housing Authority (FHA), Veterans Affairs (VA), and similar affordable loan programs. This is especially important as the need for affordable housing has become a growing concern in recent years.

Corporate Debt

The insurance industry directly finances job creation and economic growth. The Chamber's report finds that U.S. insurers hold approximately 21% of all outstanding corporate debt, or about $2.5 trillion. Corporate bonds allow companies to finance various forward-looking projects as they look to grow their business. This capital can be used to fund operating expenses, invest in new projects, or simply retire outstanding debt.

While insurers make up a small share (about 5%) of total transaction volume of the most-traded corporate bonds, insurance purchases make up a significantly higher percentage (about 22%) of the purchases of the least-traded bonds. By purchasing these less frequently traded bonds, insurers are able to provide liquidity to the bond market and ensure a healthy market for corporate bond trading. Additionally, the long-term approach that insurance companies take can empower corporate leaders to make decisions that encourage investments on projects with long-term benefits, and support their financing.

These investments are only possible because insurance companies use robust underwriting for auto insurance and other policies. Prohibiting the use of credit scores for underwriting automobile insurance will undoubtedly have knock-on effects in the financial markets and inhibit the important investments that are currently being made by the insurance industry.

We appreciate the Committee taking our views regarding the underwriting of automobile insurance under consideration is it seeks to understand if unfair discrimination is occurring in the provision of these products. We believe the existing state-based regulatory regime is in the best interest of consumers and financial markets. We stand ready to work with the Committee to ensure unfair discrimination is not present in the underwriting of automobile insurance or anywhere else in our financial system.