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Testimony of Birny Birnbaum
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Before the

Minnesota Senate Commerce Committee

"Auto Insurance Rates and Coverage Regulation"

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Chair Metzen, Ranking Member Gazelka, Vice Chair Jensen and Members of the Committee, my name is Birny Birnbaum. Thank you for the opportunity to speak to you today on auto insurance affordability issues. I serve as the economic adviser and director of the Center for Economic Justice (CEJ), a non-profit consumer organization that seeks to ensure fair access and fair treatment to credit, insurance and utility services, with an emphasis on representing low-income consumers. I also serve as a designated consumer representative at the National Association of Insurance Commissioners (NAIC) as well as a member of the Federal Advisory Committee on Insurance (FACI), which advises the Director of the Federal Insurance Office. I chair the FACI subcommittee on insurance availability and affordability. I have been recognized as an expert by numerous courts as expert on insurance rates.

I've worked for the past 25 years on insurance affordability issues as an insurance regulator and consultant to public agencies and consumer organizations. From 1991 through 1996, I worked as the Chief Economist of the Texas Office of Public Insurance Counsel – a state agency dedicated to representing insurance consumers – and then as Chief Economist and Associate Commissioner for Policy and Research at the Texas Department of Insurance. In those roles, I performed analyses of auto, homeowners, title and credit insurance markets. I was responsible for the review and approval of rate filings. I performed the first redlining studies of auto insurance and was responsible for establishing the collection of data by the TDI to enable the Department to meaningfully monitor insurance markets.

The data collection for auto and home insurance included zip code level data reporting by insurers. Analysis of the auto data showed initially that consumers in low-income and high minority population zip codes were many times more likely to be denied coverage by standard and preferred insurers and end up in the high-cost assigned risk plan. Subsequent analyses showed that nearly all the largest auto insurers had very little presence in low-income and minority communities – market shares in these communities a fraction of their statewide market share.

For a while, these zip code data by company were public and after two reports by the CEJ in 1996 and 1997, the Texas Insurance Commissioner took action against one insurer, who agreed to place agents in minority communities and write more business in these communities.

At this point, the insurance industry sued to keep this zip code data confidential, claiming trade secret. After a four year legal battle, the industry prevailed and the public no longer has access to data to monitor the market performance of insurers or data to hold regulators accountable for their monitoring of insurance markets.

I provide this history for two reasons. First, this is an area in which I have extensive experience and technical expertise. Second, there is a long history of insurers working hard to prevent meaningful analysis of the market impacts of their pricing practices.

I'd like to make five major points today

1. There has been a revolution in insurance pricing, marketing and claims settlement resulting from insurers' use of Big Data -- massive databases of non-insurance, personal consumer information

2. Insurers' use of big data has huge implications for fairness and affordability of auto insurance and for regulators' ability to protect consumers from unfair practices
3. It is important to look at auto insurance affordability issues and such study should be done in an objective manner that does not assume the answer or change the question.
4. Data needed for a meaningful analysis of auto insurance affordability are available from the normal business records of insurers.
5. States-insurance regulators and legislators need to step up or risk ceding further authority to the Federal Insurance Office.

Big Data Defined

Insurers' use of Big Data has transformed the way they do marketing, pricing and claims settlement. Big Data means:

- Massive databases of information about (millions) of individual consumers
- Associated data mining and predictive analytics applied to those data
- Scoring models produced from these analytics.

Insurers use the massive databases of non-insurance, personal information about millions of consumers to steer and segment consumers with little or no transparency or oversight and, in most cases, skirting the protections for consumers required by the Fair Credit Reporting Act.

Insurers use a variety of non-insurance databases and related scoring models with little disclosure to regulators, let alone to consumers, of their use of these data and models with no accountability regarding the accuracy/completeness of the data, the objectivity / fairness of the models or the market outcomes of the use of these data and models, including unfair discrimination against low-income and minority consumers.

In a series of reports on big data, the Federal Trade Commission and the White House have examined the potential benefits and harms to consumers from Big Data. For example, the White House report stated:

Algorithms, Alternative Scoring and the Specter of Discrimination The business models and big data strategies now being built around the collection and use of consumer data, particularly among the "third-party" data services companies, raise important questions about how to ensure transparency and accountability in these practices. Powerful algorithms can unlock value in the vast troves of information available to businesses, and can help empower consumers, but also raise the potential of encoding discrimination in automated decisions. Fueled by greater access to data and powerful analytics, there are now a host of products that "score" individuals beyond the scope of traditional credit scores, which are regulated by law. These products attempt to statistically characterize everything from a consumer's ability to pay to whether, on the basis of their social media posts, they are a "social influencer" or "socially influenced."

While these scores may be generated for marketing purposes, they can also in practice be used similarly to regulated credit scores in ways that influence an individuals' opportunities to find housing, forecast their job security, or estimate their health, outside of the protections of the Fair Credit Reporting Act or Equal Credit Opportunity Act.

Details on what types of data are included in these scores and the algorithms used for assigning attributes to an individual are held closely by companies and largely invisible to consumers. That means there is often no meaningful avenue for either identifying harms or holding any entity in the decision-making chain accountable. Because of this lack of transparency and accountability, individuals have little recourse to understand or contest the information that has been gathered about them or what that data, after analysis, suggests.

Nor is there an industry-wide portal for consumers to communicate with data services companies, as the online advertising industry voluntarily provides and the Fair Credit Reporting Act requires for regulated entities. This can be particularly harmful to victims of identity theft who have ongoing errors or omissions impacting their scores and, as a result, their ability to engage in commerce.

For all of these reasons, the civil rights community is concerned that such algorithmic decisions raise the specter of "redlining" in the digital economy—the potential to discriminate against the most vulnerable classes of our society under the guise of neutral algorithms. . . . .But the ability to segment the population and to stratify consumer experiences so seamlessly as to be almost undetectable demands greater review, especially when it comes to the practice of differential pricing and other potentially discriminatory practices. It will also be important to examine how algorithmically-driven decisions might exacerbate existing socio-economic disparities beyond the pricing of goods and services, including in education and workforce settings.

Insurers' Use of Big Data: Socio-Economic Characteristics Drive Pricing

Insurance-specific examples of Big Data scoring abound. For example, TransUnion recently introduced a criminal history insurance scoring model, based on traffic violations and criminal records to predict claims.

> TransUnion recently evaluated the predictive power of court record violation data (including criminal and traffic violations)
>
> While a court record violation is created during the initial citation, the state MVR is updated later and may be delayed depending on a consumer's response to the citation. For example, if someone pleads guilty and pays a ticket immediately, the state MVR will be updated in approximately two months. If the ticket is disputed in court, in contrast, the state MVR may not be updated for 6–19 months or longer.
>
> Also, as court records are created when the initial citation is issued, they provide insight into violations beyond those that ultimately end up on the MVR—such as violation dismissals, violation downgrades, and pre-adjudicated or open tickets.

Many states specifically prohibit insurers from penalizing consumers for certain violations if they consumer takes a driver safety course – with the goal of promoting driver safety. The TU score undermines this public policy. More importantly, criminal history record scoring reflects and perpetuates historical discrimination in criminal justice. One need only look to the systematic targeting of minorities for minor violations in Ferguson Missouri to understand that this new big data application reflects and perpetuates historical discrimination.

> Another example is the LexisNexis Big Data claims product:
>
> Example, insured calls in, rear-ended, all I got was license plate:
> Claims Data Fill takes that license plate, reach out to DMV to get vehicle registration to get VIN number, we have policy database and get the carrier and policy information, take the registered owner, go out to public records, pull back their address, date of birth, telephone number, social security, wrap that into a package and put it back into our system, 88% of the time done in less than 5 seconds.
> Take minimum information provided at first notice of loss, provide a fraud score at the initial notice of loss. Daily monitoring of claim every time new information comes in, able to run various scores: fraud scores, severity score.

Consumers have no knowledge of the use of these scoring tools and no opportunity to contest erroneous data or faulty algorithms. Regulators have little or no oversight over these models and currently collect no data to evaluate the impacts of these tools on different classes of consumers

Another example recently in the news is insurers; use of price optimization. The price optimization models score consumers' willingness to pay and introduce non-risk related factors into the insurance pricing process. Insurers tap a variety of non-insurance databases to evaluate individual consumers' willingness to accept a price increase without shopping around. We thank Commissioner Rothman for his bulletin to insurers making clear that such pricing practices violate Minnesota law requiring rates to be cost-based and not unfairly discriminatory.

Of great concern to consumers is insurers' use of a variety of socio-economic characteristics of consumers used in pricing auto insurance, from consumer credit information to education levels to occupations to marital status and more. Reliance on these socio-economic factors for pricing is not only intrinsically unfair; these factors are likely proxies for other explicitly-prohibited factors, like race and national origin as well as for income. But, just as important, the use of socio-economic factors for pricing auto insurance – factors over which the consumer has little or no control – undermines the key loss prevention role of insurance. Risk classification in insurance is intended to provide economic signals to consumers to engage in less risky behavior and avoid more risky behavior. Yet charging some consumers more because of their credit history provides no information or incentives for less risky behavior, but simply punishes consumers for being victims of broader economic conditions.

Attached to our testimony is a list of studies of auto insurance pricing by the Consumer Federation of America. The studies are stunning – they show how much a consumer's premium can change simply by being a blue collar worker instead of white collar worker or whether you have a high school degree or a college degree.

Vitally Important to Look at Affordability Issues

It is vitally important to examine auto insurance affordability issues. State law requires drivers to have insurance. Lenders require insurance for vehicle purchase loans. Insurance is required for a consumer to drive and the ability to drive and operate a vehicle is essential for individual economic development, particularly for lower-income consumers. The vast majority of consumers – again, particularly lower-income consumers who live in distant suburbs – require a car to get and hold a job.

States have increased the penalties for and monitoring of driving without insurance. These punitive measures – which include, in some states, taking away civil rights through no pay no play legislation as well as fines and incarceration for driving without insurance – dwarf the efforts by states to monitor or promote affordability for the most vulnerable consumers.

There is ample reason to be concerned that the most vulnerable consumers – those with the greatest difficulty affording auto insurance – face pricing penalties because of their low-income or race. As noted above, the various CFA studies show the massive impact of socio-economic characteristics of consumers on insurance premiums – as opposed to rating factors under the control of consumers and which provide economic incentives for less risky behavior.

Consider the comments of Ed Liddy, then-CEO of Allstate to investment analysts in 2005 regarding more refined pricing

> Tiered pricing helps us attract higher lifetime value customers who buy more products and stay with us for a longer period of time. That's Nirvana for an insurance company. That drives growth on both the top and bottom line.
>
> This year, we've expanded from 7 basic price levels to 384 potential price levels in our auto business.
>
> Tiered pricing has several very good, very positive effects on our business. It enables us to attract really high quality customers to our book of business.
>
> Make no mistake about it, the economics of insurance are driven largely by retention levels. It is a huge advantage. And our retentions are as high as they have ever been.
>
> The key, of course, is if 23% or 20% of the American public shops, some will shop every six months in order to save a buck on a six-month auto policy. That's not exactly the kind of customer that we want. So, the key is to use our drawing mechanisms and our tiered pricing to find out of that 20% or 23%, to find those that are unhappy with their current carrier, are likely to stay with us longer, likely to buy multiple products and that's where tiered pricing and a good advertising campaign comes in.
>
> It (tiered pricing) has raised the profitability of the industry.[1]

[1] Partial Transcript of Presentation to Edward M. Liddy, Chairman and CEO, The Allstate Corporation Twenty-First Annual Strategic Decisions Conference, Sanford C. Bernstein & Co., June 2, 2005.

Insurer pricing is far more granular and detailed today than when Ed Liddy spoke and incorporates far more non-insurance Big Data scoring tools. While insurer pricing has been completely transformed by Big Data, regulatory tools for effective oversight have not kept pace.

Affordability is an issue – the uninsured motorist rate continues at high levels. The Insurance Research Council's most recent analysis covering the 2010-2012 period estimates a national UM rate of 12.6% with much higher rates in some states. It is clear that the primary driver of the UM rate is income – the UM rate increases in poor economic conditions. This high rate – 30 million uninsured drivers – continues despite the increased monitoring and penalties for driving uninsured.

There is clearly a need to analyze auto insurance affordability – what consumers are offered what coverage at what price in what locations – and how does the price these consumers face compare with their financial resources. The need for such monitoring of affordability has been recognized by Congress, which assigned the responsibility to the Federal Insurance Office – even though auto insurance is regulated at the state level.

<u>It is important to analyze affordability in an objective manner and not with a methodology that assumes the answer or changes the question.</u>

While the concept of affordability is straightforward – how does the price of auto insurance faced by consumers compare with those consumers' financial resources to pay for the coverage – there is disagreement about how to specifically measure and analyze affordability. I firmly believe that the analysis of affordability should be data driven and objective. The methodology should not be biased towards any outcome and the analysis should be sufficiently detailed to, one, identify affordability problems if they exist, and, two, reveal information about the causes of affordability problems to inform public policy.

The way to accomplish this is to collect premium and premium quote data at the policy level to see what consumers are offered what prices for what coverages in what locations. These pricing data must be accompanied by loss data at a similarly granular level. Combined with other data – uninsured motorists rates and force-placed insurance and assigned risk activity at small geographic levels as well as economic data like unemployment rates, income and other – these data only allow identification of consumers who either can't afford auto insurance and don't purchase it or consumers whose auto insurance premium is a very large part of their income Most important, this type of granular data allows for analysis of the causes of the problem – whether that is high premiums, low incomes, insurer pricing practices, consumer fraud or other. Stated differently, the affordability analysis needs to be performed without pre-judgment of the outcomes, but in sufficient detail to identify causes and inform public policy.

When the issue of studying auto insurance affordability comes up, insurers try to shift the debate from analyzing availability and affordability issues across different communities and groups of consumers to so-called "cost-drivers" affecting all consumers. While examination of broader cost-drivers in insurance is important, it is a different issue that how the premium needs of insurers are distributed across different groups of consumers through underwriting, rating factors and premium charges.

<u>The data needed for a meaningful analysis of auto insurance affordability are available – the normal business records of insurers.</u>

The reporting of the detailed data on pricing, quotes and claims is reasonable and necessary. Insurers collect and access huge amounts of insurance and non-insurance personal information on individual consumers. It is reasonable for regulators to monitor and for consumers to understand the impact of insurers' use of these data on insurance markets. These types of granular data are collected by other financial service regulators – for example the Home Mortgage Disclosure Act data for loans. These data have enabled regulators, lenders, academics and fair housing/fair lending groups to analyze mortgage and small business lending markets in positive ways.

We are alarmed that at a time when greater transparency of insurer pricing practices is needed because of the various Big Data scoring models they use, insurers are pushing states to adopt laws removing even existing transparency to the public – laws which broaden the secrecy of insurer pricing practices. This is the wrong direction.

Insurer objections to limits on risk classification are without merit

The proposed legislation addresses key issues in the auto insurance market – studying auto insurance affordability issues and providing more effective oversight of insurer pricing practices. Public policy discussion of the types, uses and impacts of the data used by insurers is reasonable and necessary to begin to balance the market power of consumers with insurers. Limitations on those risk classifications which are blatantly unfair, which are proxies for prohibited factors and which thwart public policy for universal coverage and loss prevention will enhance competition and encourage greater social benefit from private markets.

"We simply want to match price to risk."

Insurers typically argue that any limit on risk classification harms competition and, consequently, harms consumers. They argue that, for example, credit scoring has enabled insurers to offer insurance to more consumers and point to historical declines in the number of consumers in assigned risk plans. I'm a firm believer in the power of markets to benefit consumers, but regulation is essential to ensure that such competition is fair. The fact is that insurers' use of credit scoring has resulted in far higher rates for some consumers and lower rates for other consumers. Uninsured motorist rates have not declined as a result of insurers' use of credit scoring.

Insurers' claim that they are singularly focused on deriving the most accurate rates for the risk they insuring is belied by a recent story on MN public radio about price optimization. The industry spokesperson simply confirms what consumers have argued all along – that insurer pricing considers far more than expected claims and includes factors unrelated to cost-based pricing.

> **MN Public Radio, 11/16/2015**
> Insurance Federation of Minnesota spokesman Mark Kulda acknowledges some insurers in Minnesota use price optimization.
> "It's also a practice used by many other industries," he said. "This is not really anything new in the economy. All companies really try to see how much can they charge for their product and what is the most that consumers will bear to pay. And it's no different in the insurance industry."

Insurance is not like other consumer products – state law requires that insurance rates and premium charges be not excessive and not unfairly discriminatory, that rates be cost-based. Few other products or services have similar pricing requirements. And such requirements are reasonable and necessary because insurance is not like other products – it is a required purchase and it is a contract for future benefits if certain events occur.

The confidence fairy

I must also address the confidence fairy argument – that unlimited risk classification allows insurers to have more confidence in writing insurance and therefore makes insurance more available. Putting aside the lack of evidence to support the claim, as discussed above, insurers routinely ignore the fact that the introduction of ever new rating factors – particularly those based on socio-economic characteristics and opaque to the consumer – lead to ever widening spread of rates with ever greater prices for those consumers viewed unfavorably by insurers. There is simply no empirical or public policy basis for unlimited risk classification and broad public policy support for limits on risk classification that promote affordability and empowerment of consumers for behavioral changes to reduce accidents and claims.

Insurers have claimed for years that their ability to use ever more refined and precise rating plans allows them to write more business because they can better match premium to risk. So they argue that any limitations on rating practices will cause them to write less business. This argument may have had some validity 40 years ago when insurers were using only a handful of rating factors. But we have long, long passed the point where more refinement in pricing leads to insurers writing more business.

In the past 10 years rating plans have exploded to include dozens upon dozens of risk classifications with millions or tens of millions of rating cells. The explosion in rating factors is not driven by better matching of premium to risk, but driven by big data algorithms to move from pricing based on risk to pricing based on what the consumer is willing to pay.

"Let's focus on cost drivers."

The most common industry response to auto insurance affordability issues is "let's focus on auto safety and reducing accidents." Auto safety efforts are without a doubt important and should be a priority, but they are not a response to auto insurance affordability issues. These issues address a certain percentage of the population and their affordability issues will not be addressed by lowering overall rates by 5% when they are facing rates that are 200%, 300% of average rates because of socio-economic characteristics outside of their control.

"*We'll raise rates for good drivers."*

Insurers often threaten state legislatures who are considering limitations on credit scoring or other risk classifications by saying that the limitations will force good drivers to subsidize bad drivers and force up rates on good drivers. First, insurance is about spreading risk and is not a pay-as-you-go system. The whole idea of insurance is for people to pay into a risk pool so they don't have to bear the costs of catastrophic events on their own. Second, the claims about subsidies are misleading – the overwhelming majority of drivers will not and does not have accidents in a given year. Third, and most important, limitations on risk classifications are not arbitrary, but reflect public policy about fairness and the need to encourage loss prevention. Limitations on risk classifications address market failures. Finally, insurer threats that they will raise rates for most drivers are empty threats. Insurers will revise their rating plans to do whatever they can to keep offering competitive rates to their most valued customers instead of simply letting these customers leave for another insurer.

If you hear this complaint, my suggestion is to require a prominent disclosure to consumers on every premium quote, declaration page and renewal notice:

> The Minnesota State Legislature and the Minnesota Department of Commerce do not set your insurance rates. Insurance companies set the rates they charge you subject to consumer protections enacted by the Legislature. Insurers are not permitted to base your premium charge on your credit history, race, religion, occupation or level of education.

"Rural drivers will pay more."

You may hear insurers claim that that limitations on risk classification will force rural drivers to pay more. This is a false claim. Prohibiting some unfair socio-economic rating factors will lead to greater weight for factors directly related to actual driving – like accidents and violations, miles driven and driving experience. But, giving greater weight to these factors – particularly miles driven – does not mean that rates will be higher in rural areas than they are now.

Currently, insurers look at claim costs in different geographic areas. Generally, claim costs are higher in areas with greater population density – more vehicles on the roads mean a higher frequency of accidents. Insurers divide the state into geographic rating territories – to oversimplify – St. Paul or Minneapolis might be geographic rating territories while Kittson, Roseau and Marshall Counties might be a rating territory. Each rating territory has a base rate and the more densely populated territories will generally have a higher base rate. So let's say the base rate in St Paul is $800 and the base rate in is $400.

Prohibiting certain rating factors, like credit, education, occupation won't change these base rates. Within the rating territories there will likely be changes as consumers who were penalized for being poor or having other socio-economic characteristics would see more fair rates. But on average, there will not be higher rates in rural areas.

State -insurance regulators and legislators need to step us or risk ceding further authority to the federal insurance office.

While federal agencies need no encouragement to increase their authority, the decades-long history of states failing to even analyze auto insurance affordability issues is an invitation for Federal Insurance Office to take the lead and start collecting data directly from insurers. As states continue to defend state-based insurance regulation, it makes no sense for states to have been --- and remain – passive as the Federal Insurance Office moves toward implementing its affordability analysis independent of the states. Such a result could easily lead to unfounded criticism of state-based insurance regulation.

Thank you again for the opportunity to speak to you today.