

**Remarks of C. Douglas Cruce  
President of the Michigan Insurance Federation  
to  
Commissioner Frank M. Fitzgerald  
Office of Financial & Insurance Services  
Detroit Hearing on Insurance Scoring  
Thursday, July 18, 2002**

**Introduction**

Good afternoon. I am Doug Cruce, President of the Michigan Insurance Federation. Our association represents more than 30 property-casualty insurance companies doing business in Michigan. Our member companies provide automobile, homeowners, liability, medical malpractice, workers compensation insurance and other property casualty products to individuals and businesses throughout the state and the Midwest. MIF's members also include a select group of law firms specializing in insurance issues. While our insurance company members drive our positions on public policy issues, the expertise of our attorney firm members is invaluable to the industry's understanding of how things work in the "real world".

Mr. Commissioner, I would like to thank you for opening what we consider to be a very important dialog about the practice of insurance scoring. My members believe these hearings have provided a valuable learning opportunity for insurers and consumers alike. We have had an opportunity to see and hear how a complex and often confusing process called "credit scoring" or "insurance scoring" is perceived by the "real world".

**Association Role**

As you know, associations like ours can play a constructive role in these types of discussions. By providing resources like information and access, an association can serve as a bridge between the public, policymakers and industry representatives. This ensures all voices are heard and all questions answered. When you make your recommendations to the legislature this fall it will be the Michigan Insurance Federation that takes the lead for the industry when the legislative debate begins.

A government affairs association can use its advocacy and negotiating skills, together with its in-depth familiarity with a given issue, to help policymakers find a responsible middle ground when tough policy questions are on the table. This is not a simple matter for many associations, since they function as a group and must carefully balance the needs and interests of a variety of individual members. Occasionally, internal policy debates can divide the members of an association, resulting in permanent rifts. However, we know going in that this is part of the process. Seeking appropriate middle ground and searching for the truth behind issues is a central and critical function of advocacy associations.

## **MIF Participation**

With respect to these hearings, MIF has taken its role very seriously. We are fortunate to have a united membership where the issue of insurance scoring is concerned, so during the course of these hearings we have been able to concentrate on providing reliable information and resources to you and your staff as needed. I have personally attended each of these hearings in an effort to pay close attention to this issue as it unfolds, and I've followed up on various testimonies in an effort to learn more.

Our association does not have the staff resources or multi-state presence that some of the other groups testifying here do, and we've greatly benefited from learning how other states handle insurance scoring issues. However, now that the hearings are drawing to a close we believe it's appropriate for us to weigh in on the practice. Unlike many of our national counterparts, the Michigan Insurance Federation has had a strong, front-line legislative presence in this state for 22 years. MIF knows our state lawmakers and what they are and are not likely to do, and we also know that your report will have a major impact on the way they view this issue. It's up to us to represent the industry's point of view during this process.

It has been Michigan Insurance Federation members who have been the primary source of industry testimony for these hearings up to now. Two other insurance companies that testified are not aligned with any state association to my knowledge. Frankenmuth, Westfield, Progressive and Harleysville insurance companies have chosen to openly discuss their views on the practice of insurance scoring at these hearings. Others have submitted written comments to your office. We also have worked closely with the other two non-member companies that chose to speak publicly on this issue and recognize the contributions of Allstate and Fremont Mutual.

Today, our testimony will be on behalf of all of our members who have not been able to testify as part of this process. Commissioner, they are committed to helping you meet your stated objectives here. We understand these to be:

- Determining whether there is a predictive link between credit history and the likelihood that a particular policyholder will file a claim, and
- If it does have predictive value, to determine what the appropriate ground rules for using this information should be.

## **What We Have Learned**

Since these hearings commenced in June, we have, like you, learned a great deal about the answers to these questions. We've also learned some other important things, some of which we found surprising, some of which we anticipated.

Education. First and foremost, I think it's fair to say that insurers may not have spent enough time educating agents and consumers about the benefits of insurance scoring. We

now have a much better sense of the perceptions surrounding this issue and believe we need to use the knowledge we've gained to address those perceptions effectively.

Before I move on from this point, I do want to note that we were particularly enlightened by the agents' testimony in this regard. It appears these businesspeople are finding themselves in the same predicament as everyone else: we live in a society where businesses need to provide ever-greater levels of service for lower amounts of money. Marketing strategies are changing at a rapid pace and some people may be left behind if they do not make adjustments.

In this day and age, everyone expects more for less. Profit margins are tight and time is most definitely money, in the purest sense of the phrase. Just last week, at the Grand Rapids hearing, you heard testimony from an insurance agent who said that using credit information was time-consuming and required him to spend as much as forty minutes securing and providing a quote to his customers. It didn't matter to him that his customers might save a substantial amount of money if their credit histories were taken into account; he was most concerned about managing his workload and providing basic service at the lowest cost possible.

That's understandable. For years, insurance companies have been dealing with this reality too, which is perhaps one reason why they haven't been consistent about explaining the benefits of insurance scoring to the agents. We live in a world where every dollar, where every minute, counts. That's why they all approach the question of how they develop their insurance scoring models, the value they give them in the underwriting and pricing process and yes, even the way they train their agents, in different ways. What may appear confusing and disjointed to the public, captive or independent agents, or even a legislator, may appear rational to someone at the company level doing battle with his competition.

Now let me add one additional note on this subject. While I have acknowledged the insurance industry's inconsistency with respect to education, I would be remiss if I did not tell you we have concerns that the agents are trying to put too much distance between themselves and their companies regarding the issue of educating the public about insurance scoring. Educating consumers is also part of the agent's job; it's what companies are paying them to do. Companies need to evaluate their education process for their agents as it relates to the use of insurance scores, and at the same time, agents need to understand their need to be more pro-active in understanding their role in the process. On two occasions now, once last fall and once again in March of this year, MIF offered to sponsor seminars at the agents trade association's regularly scheduled meetings or even set up a special meeting for this purpose. Neither of those offers were accepted. In fairness to their association, a few vocal members may be making this a difficult and divisive issue for the Michigan Association of Insurance Agents. As I said earlier, this does happen to all associations. However, the notion that some segments of the industry haven't tried to improve agent educational opportunities on insurance scoring couldn't be further from the truth.

*A Profitable Practice?* We have also heard during these hearings that some people believe insurance scoring is, in and of itself, a means of raising rates for the benefit of big insurance companies. In fact, last week we heard some rather extreme testimony from a gentleman describing himself as an “insurance activist” that he believed insurance companies never did anything unless it somehow “ripped off” members of the general public. Although “ripping off” consumers may be a legitimate topic for public debate and there are probably ways that an insurance company could do that, using insurance scores is not one of them.

Insurance scoring is not a direct means of raising a company’s bottom line. If it were, Michigan insurance companies would be showing tremendous profits as a result of their substantial use of credit in setting individual rates. Commissioner, you yourself review company profit and loss statements for every company doing business in Michigan and you know this is not the case. In homeowners and auto insurance lines last year, many companies were paying out as much as \$1.10, \$1.20 or even \$1.45 for every dollar they collected. Those are substantial losses, and I think they demonstrate that insurance companies are not overcharging for their product. Rather, they are trying to do more for their customers with less money, like the insurance agents and almost every other business and industry in Michigan.

In fact, the use of credit is an effort to fairly apportion the cost of losses between the customers they already have, resulting in higher rates for a few and leading to lower rates for most policyholders. During these hearings, you have heard a great deal of testimony from a few members of the general public who say they are outraged by the use of insurance scoring. They were outraged, but several actually knew people who are directly benefiting from it or were benefiting from it themselves. In fact, at the Lansing hearing you heard from one man who had a friend that had his insurance rate reduced by 51 percent – this man thought the rate was actually too low! In Grand Rapids, the gentleman who espoused the rip off conspiracy, acknowledged that his insurance company was actually treating him very well as a policyholder. Upon learning that his company was using credit, he was surprised. Even though he came to complain about insurance scoring, it was being used in rating his own insurance and he was not unhappy with his company.

*Market Effectiveness.* Even individuals that don’t have good credit aren’t necessarily suffering under an insurance scoring system. In Grand Rapids this panel heard from two consumers who openly said they had credit problems and were upset when the companies recently raised their rates because of credit. However, their problem was quickly solved when their insurance agent was able to place them with another insurer that didn’t use insurance scoring. Now, I ask you: where is the public policy concern here? The market is clearly working to provide what is necessary to everyone. Over regulation in the area of insurance scoring could negatively interfere with or hamper the good results that the vast majority of consumers are currently receiving.

## **Issues Often Confused With Insurance scoring**

Many people that have testified before have discussed issues that have nothing to do with insurance scoring in and of itself. The issues of concern seem to include:

- Redlining;
- Discrimination and economic inequality; and
- Higher rates, resulting in more money going to the pockets of big insurance companies.

*Higher Rates.* I want to come back to this rate discussion one more time, because it seems to me there are some critical misconceptions out there that really play into this insurance scoring debate. Many people seem to believe that, when it comes to insurance rates, everyone should be paying the same. However, if that were the case, policyholders who were very low-risk (in terms of claims) would be subsidizing people who make insurance claims all the time. Insurance companies need to have some mechanism for assessing risk in order to make sure that everyone is paying only their fair share, and no more than their fair share.

Whether it's driving record, credit history, or some other vital piece of information that allows an insurer to determine risk, it's in every policyholder's best interest to allow an insurance company to use that information appropriately. It's the only way they can make certain that the right people are paying the right amount for their choice of coverage. If there were evidence that insurers were collecting more than they needed and making tremendous profits, then it would be perfectly appropriate to ask about the rates being assessed, but we know that's not the case.

The insurance business is the only one I know of in which the price is charged long before the product is manufactured, so to speak. A consumer pays a rate, in some cases long before an event takes place. Insurers need to have some reasonable predictor of risk. Individuals who do not understand the process, or who are being charged more because of the process, may never like it. Just because it isn't understood or liked doesn't make it unreliable as a predictor.

*Predictability.* As someone who was once elected to a legislative office, Commissioner, you understand how the public views the process of predicting the outcome of election on the results of a poll of a smaller sample of the voting population with a great deal of skepticism. You also know that, while not 100% accurate, if it is done properly its predictive value can indeed be surprisingly accurate. A similar skepticism seems to exist on the subject of insurance scoring.

And speaking of polls, guess what? Before these hearings began, the Michigan Insurance Federation conducted its own statewide poll on the subject. Our research told us, with no prompting information, that 44% of Michigan's voting population agrees that insurance scoring makes sense, 39% thinks it is a bad idea, and 17% don't have an opinion. Put another way, 61% don't have a problem with it. That's before the interviewer told the respondent anything about the issue. Their response was solely based on information they had prior to the interview. When a brief explanation of the process of insurance scoring was made and they were asked if that understanding caused them to be more, or less likely to condone the process the numbers go even higher in support.

We learned that a large number of Michigan's consumers do actually have an intuitive understanding of this, and of those that do not, most can be convinced. And of those that can't be convinced, most will never be because they do not find it in their own personal interest for a variety of reasons.

*Redlining and Economic Disparity.* Finally, I'd like to talk for a minute about the discrimination issue that's been raised several times during these hearings. We all heard in Grand Rapids about the possibility that redlining was taking place in our state, and that was profoundly troublesome to me and to our member companies. With respect to insurance scoring, we know that discrimination is an unrelated issue – in fact, independent studies have shown that even if someone were foolish enough to try to use racial or economic characteristics to set rates, credit information could not be used for that purpose because it does not contain the data necessary.

I want to make it clear that the Michigan Insurance Federation and its members will not condone nor tolerate illegal discrimination. If we learn that any employee in one of our member companies is using this practice, we will take immediate steps to ensure that it is stopped. If we learn that a misguided agent somewhere in Michigan is using this practice, we will work with the agents' association and others more closely related to this sector of the industry to ensure appropriate action is taken.

### **Conclusion**

Commissioner, you will be working to frame all the testimony you've received into complete, accurate answers to your two original questions. If I may, I'd like to describe what I think we all heard during these hearings.

First, there is a predictive link between credit history and the likelihood that a particular policyholder will file a claim. Based on the testimony offered in these hearings, vast amounts of practical experience, and study and research that is readily available, our association believes there can be no doubt about that.

Also, there will likely be several recommendations made by you and others during the next few months. We have already heard from lawmakers who would like to see an outright ban of the use of insurance scoring. Our association will vigorously oppose any

proposal to ban the use of credit to underwrite risk in Michigan. Likewise, we cannot support any proposal to restrict the practice to only certain lines of insurance, or totally standardize its use.

Our association will work with you and your office to address the problem of consumer education. We realize that this is a critical element that has been missing to date, and that it is, in part, responsible for the misunderstandings that exist. We also are not opposed to looking at requirements related to the quality of the underlying credit data that insurers use, or the possibility that insurers inform consumers of alternatives and how to remedy credit problems.

Once again, you may be wondering why insurance companies aren't providing some of these basic educational services right now. The simple truth is that some have been doing these things, some are preparing to do them, and others are not. Until the advent of these hearings, it was simply not clear how much needed to be done. In addition, as I'm sure you know businesses often will wait for other businesses within the same industry to do their work for them. They hope that the marketplace will work to educate, so they don't have to expend the time and money to do so themselves. As I mentioned previously, the market is very tight right now and every dollar makes a difference. Companies are naturally not going to want to spend in an area where they will see a tangible result. Although this is not an adequate explanation for the current state of affairs on consumer education, it is not unusual in the business world.

Also given these realities, perhaps some baseline standards for the industry are in order, in order to ensure consistency across the board. We don't know for certain that this is the case, but we are open to further discussions in that regard. These hearings have proven extremely valuable and raised numerous important questions. I speak for our organization and others when I say that insurers are eager to do whatever's necessary to make improvements.

In a nutshell, we are open to dealing with some of the problems related to educational and quality standards related to insurance scoring, but we see nothing in these hearings that leads us to believe that a ban on, a standardization or restriction of the insurance scoring practice is warranted.

Thank you again for the opportunity to speak today. I am happy to take questions.