THE REGULATOR™
INSURANCE REGULATORY EXAMINERS SOCIETY

Credit scoring raising hackles, but will regulators lower the boom?

by Scott Hoober
Special to *The Regulator*

EDITOR'S NOTE: The use of credit scoring by insurers was a featured topic at the San Antonio CDS. The following provides IRES readers with further insight into this controversial practice.

This just in! Abecedarian Insurance Co. of Sioux Falls, Tex., has announced sharply lower rates for most of its policyholders, based on the company's new system of rating risk by race.

Just kidding. No way anyone would try to get race-based risk categories past state insurance regulators. Not that they wouldn't be actuarially justified in some cases, an effective way to predict losses and to price policies in some lines. If correlation were the only factor in risk classification, every company would be doing it.

But that's the thing about risk classification: Correlations, no matter how strong, aren't enough — there's also a social dimension.

"A major criterion for risk classification is that it has to be socially acceptable," says Birny Birnbaum, executive director of the Center for Economic Justice in Austin, Tex. "And there's a reason for that: When you have a risk classification, the goal is to affect

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Paul Bicica of Vermont is new IRES president

SAN ANTONIO — Paul J. Bicica of Vermont was installed July 30 as the 2002-2003 President of the Insurance Regulatory Examiners Society at the 14th annual IRES Career Development Seminar.

Ed Mailen of the Kansas Insurance Department was chosen president-elect.

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New IRES President Paul Bicica with outgoing president Jann Goodpaster

SAN ANTONIO

2002 IRES Career Development Seminar

More than 450 of us came to Texas to teach, to listen, to learn and to share a laugh or two.

Stories and photos, pages 9-17

SEPTEMBER 2002

The Regulator™

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THE REGULATOR is published every other month by the

INSURANCE REGULATORY EXAMINERS SOCIETY

www.go-ires.org

Opinions expressed in this publication are the authors' and do not necessarily represent the opinions of the authors' employers or IRES.

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From the President

Taking the reins

It's a bit overwhelming, albeit exciting, taking over the reins of IRES. Since my first CDS, I've gained nothing but respect for the dedicated members; the enthusiastic, intelligent leadership; and the unique vision displayed by the IRES family.

One of my goals this year is to see IRES become more visible as the organization that trains and certifies, as a voice. I'll soon be asking the Past Presidents Council to brainstorm ideas about how we can accomplish this, from the mundane to the glamorous. Newspaper business blurbs about AIEs/CIEs awarded in your state; state training; awards. And we need your ideas. No idea is ever too foolish or mundane or awkward to propose. The only bad idea is the one not expressed. We may not be able to use it, but be assured that every idea will be given a good airing.

IRES is an organization of regulators . . . it is us. There is no Oz-like leadership off to the side manipulating the curtain. We are IRES. Our concerns, our careers, our views. And IRES needs to hear your voices. We may not always agree, but that's what keeps organizations vibrant. And just as importantly, we need your participation. There is no "staff" that puts the CDS together, that gathers speakers and selects topics. It is us.

We at IRES pride ourselves on being an open and welcoming organization and want to continue in that vein. Did you enjoy the CDS? Want to be a part of it next year? The committees would welcome you and there's always room for whatever talents you have. And there is also plenty to be done in other areas. Are you a writer? A techie? Someone with energy? New and fresh perspectives keep us vibrant and exciting. Take a look through the list of committees. I'm sure you'll find one that needs your talents.

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IRES State Chapter News

VIRGINIA — The Virginia IRES members met recently to organize a Virginia chapter. **Weldon Hazlewood** was elected chairperson.The chapter's purpose is to provide training and educational sessions for its 45 members, especially those that need continuing education to maintain their designations. The chapter's meetings will provide training for new examiners from all areas of market regulation, training/ education on new statutes, and information regarding the NAIC and industry news. The chapter will begin with quarterly meetings that will include pre-planned training and educational sessions approved for CE credit. Members representing both the L & H and P & C Divisions of the bureau will share responsibility for the sessions. Future plans may include other states participating in the sessions.

— Submitted by Weldon Hazlewood

President.....cont'd

This article wouldn't be complete without some heartfelt thank you's . . . to David, Susan, Joy, Scott, Art and Paula for their hard work and smiling patience with the CDS . . . to Doug Freeman for relentlessly moving the CDS forward all year . . . to Wayne Cotter for tirelessly putting together *The Regulator* . . . to Jann Goodpaster for her support and smooth transition with no 'hidden boxes' . . . to my Consumer Services Section for their hard work this past year (it is with some regret that I leave them) . . . to the Past President's Council for their work . . . and to all the chairs and committee members who worked so hard to create a successful CDS this year. What you do does not go unnoticed.

Lastly, I want to thank those who mentored and supported me at IRES; you know who you are. I hope I can return some small measure of that to our new members.

Paul J. Bicica

Paul J. Bicica, CIE
IRES President

NEBRASKA — The Nebraska IRES Chapter held a continuing education meeting in June. The speaker was **Jeffrey Skelton**, Assistant Vice President of Personal Insurance Legislative Affairs at Choicepoint. He gave an informative talk on credit scoring. Check with the IRES web site about information on our future meetings.

— Submitted by Karen Dyke

LOUISIANA — The Louisiana IRES Chapter held an organizational meeting June 28 with approximately 50 Department of Insurance employees in attendance. Officers were elected and various committees were established at the meeting. We have initiated a membership drive and expect to complete the initial phase by August 2, 2002. We are currently creating membership packets to distribute at the next meeting. One of our goals is to make staff aware of the benefits of being members of IRES and the educational opportunities available through the Society.

— Submitted by Larry Hawkins

CALIFORNIA — Some IRES members of the California Department of Insurance joined the CPCUs at a lunch meeting at the CDI's Los Angeles office on Aug 7. The presentation was on Defense of Bad Faith Claims. Also, the IRES 2002 San Antonio CDS attendees plan to share the information learned from the various Property and Casualty workshops with the California IRES members in the near future.

— Submitted by Polly Chan

In Memoriam

September 11, 2001

Debate continues on credit scoring

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consumers' behavior — to discourage risky behavior and encourage less risky behavior.

"If a rating factor doesn't make sense, then it can't achieve that goal," Birnbaum added. "And credit scoring is really the best example."

Yet despite the rising chorus of protests over the use of credit scoring for rating and underwriting homeowners and auto insurance, insurers remain intent on retaining this relatively new tool.

Are they right? Is credit scoring a valid measure of risk — and at the same time, not a surrogate for measuring wealth, income, race or other factors? And what is it about credit scoring that makes companies willing to ignore the negatives, from consumer protests to, in some states, restrictive legislation?

Missouri Insurance Director Scott Lakin (standing) moderates a debate on credit scoring. Seated at right is consumer advocate Birny Birnbaum.

Strongly predictive

Why do P&C companies like credit scoring? Easy. Because it works.

"It's a fairly powerful predictor of loss," said Bob Williams, agency group president for Progressive, the nation's fourth largest auto insurer, "and over time has become of larger and larger importance in underwriting for companies.

"It's one of many variables for us, but it is a variable that allowed us to offer lower rates to a majority of our customer population, and allowed us to grow a lot."

Roosevelt C. Mosley, a consulting actuary with Miller, Herbers, Lehmann & Associates, agrees that whatever you may feel in your gut, credit can indeed define levels of risk.

"No matter how you look at it," Mosley said, "credit has a huge separation effect between risks. There's really no way around that. There's something real going on here."

Birnbaum counters: "Whether there's something there or not is a question for statistical analysis. It's clear that there's no logical explanation for it, because if there were, insurers would have come up with it by now.

"How would people react if you went in to get a loan and your banker said, 'Well, I need to look at your driving record before I can decide to give you a loan.' What's that got to do with lending me money? What does looking at my credit have to do with selling me auto or homeowners insurance?"

The answer, if there is one, could come from a comprehensive study, which hopefully some department or company is doing as we speak. Ideally, someone will be able to put a finger on the logical, causal link. But if nothing else, we need to know whether credit scores substitute in some way for race, income, education or some other inappropriate variable. But based on the kind of statistics insurers value most — dollars-and-cents experience out in the real world, in the marketplace — credit scoring passes with flying colors.

As Progressive's Williams said, "We went into it with an attitude of 'Let's look at the data and see what it says.' We've had it instituted for the last four or five years, we're the fourth largest writer, we've got billions of dollars worth of experience on it, and yeah, it's highly predictive.

"We wouldn't use it if it wasn't highly predictive, because we're trying to beat the other guys."

It's clear that the credit scores used in insurance (which, incidentally, are not the same as the ones lenders use) *could* be discriminatory. But in the absence of a definitive study, are they?

As one of the larger auto insurers in the nation, operating in every state but Massachusetts and New Jersey, as well as one of the first to use credit to underwrite, Progressive has a stake in that question. And based on the studies they've done, they feel certain that credit isn't unfairly discriminatory.

"We can prove correlation, and boy, this is correlated," said Williams. "We really can't prove causation.

Is credit scoring here to stay?

"The thing we can do, though, is parse out other variables and analyze things on a multivariate basis to see if cross-correlations between variables are what's driving it, and in fact we do that as we set our rates. And we're fully satisfied."

The problem with that approach, though, is that the company uses only the data it already has on hand. And it doesn't capture data on race or other inappropriate variables. Yet Progressive has done several other, no pun intended, progressive things.

"What we can tell you from our data is a couple of things," Williams said. "One, when we take a look across, say, population, from most urban to most rural, we've got a fairly flat distribution of scores across all those areas. And as we introduced credit in our states, we did not find a skew towards the suburbs, towards more affluent areas.

"In fact, we saw nice penetration in urban areas, some of which have been historically underserved."

> "How would people react if you went in to get a loan and your banker said, 'Well, I need to look at your driving record before I can decide to give you a loan.' What's that got to do with lending me money?"
>
> — Birny Birnbaum

The company also took a look at data that was based on work done by Birnbaum when he was with the Texas department.

"He created a series of analyses around what he called underserved ZIP codes," Williams said. "And we went back and took a look at our credit score distribution across his various levels of ZIP codes, including the most underserved.

"Our credit-score distribution across the most underserved ZIP codes in Texas looked virtually identical to our credit-score distribution up in the ZIP codes that they characterized as not underserved."

How it evolved

Credit has been used for about a decade now, at least by some companies. And until recently, there were no data at all to back up anything but the broadest correlation between credit and risk. And regulators had for the most part done little to rein in insurers.

"The thing that's interesting to me is why regulators have given it such a free pass over the years," said Birnbaum.

"It's a black box, and they've not only allowed its use, they've allowed its explosive growth. If ISO came and said, 'We've developed a new program for risk classifications, so the loss costs are going to be segmented by A, B, C, D, E, F and G. We've done a study that shows that the loss costs differ by 10% for each of those categories.' And then the regulator goes, 'OK, well how did you come up with these numbers?' And ISO says, 'We'd like to tell you, but it's a proprietary model, trust me.'

"The regulators would just laugh. They'd say, 'Come on, if you're going to do any kind of rating classifications, you have to show us the data, you have to let us examine it, to have to let us independently analyze it.' But somehow, when it comes to credit scoring, the regulators haven't done it. The insurers come in and say, 'Oh, yeah, there's this correlation, take our word for it.'

"It's really astounding to me," Birnbaum said, "how regulators have failed to carry out their responsibility to protect consumers on these issues. And this is something that goes back to the mid-'90s."

Whether or not regulators did indeed give insurers a free ride — and many of them, at any rate, certainly did not — clearly the use of credit scoring has evolved over time. If it had been applied in its earliest days as it's being applied today, the protests would likely be muted.

Mosley remembers his first reaction to the concept.

"Four or five years ago, when I first heard of the use of credit for auto and homeowners insurance," he said, "I probably had the same reaction as many other folks did: 'What in the world does credit have to do with auto and homeowners insurance?'"

Today, after evaluating the use of credit for several company clients, Mosley calls himself a converted skeptic.

Williams believes there may also be another reason that credit scoring is being attacked today: the general state of the economy and the insurance industry.

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TO: Weldon, Tommy and Scott
FROM: IRES
RE: Thanks for the memories!!

SAN ANTONIO — Three longtime IRES leaders and career insurance regulators bid farewell to the Board of Directors during the 2002 Career Deveopment Seminar. The Board adopted formal resolutions recognizing Tommy Thompson, Scott Laird and Weldon Hazlewood for their years of service. In our minds they will be neither gone nor forgotten. Following are excerpts from those Board resolutions.

WELDON HAZLEWOOD — "Whereas, R. Weldon ("Wendell!") Hazlewood has served on the IRES Board of Directors for 11 years and whereas Mr. Hazlewood served as an active member of the Publications Committee for five years, and whereas Mr. Hazlewood has served faithfully as a member of the IRES Finance Committee for six years, and whereas Mr. Hazlewood has served as an innovative and competent treasurer of IRES the past three years, now, therefore, be it resolved by the Board of Directors that Mr. Hazlewood's numerous contributions to the growth and success of the Society by recognized . . . ."

TOMMY THOMPSON — "Whereas, Tommy B. Thompson has served on the IRES Board of Directors for seven years, and whereas Mr. Thompson served as an active member of the Finance Committee, and whereas Mr. Thompson served four years as the treasurer of IRES, and whereas, thanks to Mr. Thompson's efforts, the Board was regularly and unfailingly informed that'"We've got money!", be it resolved. . . ."

SCOTT LAIRD — "Be it resolved by the Board of Directors that the numerous contributions made by Scott Laird during the past 11 years be recognized. Mr. Laird's many unrecognized contributions include: numerous years of services as a member of the Publications Committee; service as Editor of the Regulator; 11 years of service on the IRES Board of Directors; volunteering to act as chief teller for vote calculations at many career development seminars; acting as one of the originators of the Al Greer Award; and acting as wise counsel to many IRES presidents over the years."

IRES elects new officers

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Bicica has served as Chief of Insurance Consumer Services for the Vermont Insurance Division since 1990. In the early 1980s, Paul worked for the New York Insurance Department.

Paul holds the CIE and the FLMI professional designations and the Certified Public Manager designation for the state of Vermont. He has been active in IRES for more than a decade, serving on the Board of Directors and the Executive Committee, and as chair of the Society's Consumer Services Section. He also has served as chair of the annual Career Development Seminar.

He is active in his community, serving as a local Justice of the Peace, a member of his town's zoning board, and as captain of his softball and bowling teams. He is an avid collector of New York "doo wop" music.

In addition to Bicica and Mailen, the others elected to the IRES seven-member Executive Committee are: Bruce Ramge, Nebraska, VICE PRESIDENT; Kirk Yeager, Colorado, SECRETARY; Doug Freeman, Missouri, TREASURER; Shirley Jones, North Carolina, AT LARGE; Jann Goodpaster, Oregon, IMMEDIATE PAST PRESIDENT.

Also during the Society's annual meeting, the following regulators were elected to new four-year terms on the IRES Board of Directors:

Bruce Ramge, Nebraska; Christel Szczesniak, Colorado; Ed Mailen, Kansas; Steve King, unaffiliated; Nancy Thomas, Delaware; Katie Johnson, Virginia.

In addition, Jo LeDuc of Wisconsin was elected to a one-year, at-large position on the Board.

President-elect Ed Mailen (left) and 2002 President Paul Bicica

C.E. News

The next CE reporting deadline is Oct. 1, 2002. Don't miss it and risk the suspension of your designation.

The current compliance period is Sept. 1, 2001 – Sept. 1, 2002.

What happens if my NICE compliance report form is received within 30 days of the deadline date?

A $30.00 late fee will be assessed to any designee holder who submits their NICE compliance report within 30 days following the Oct. 1 reporting deadline. (Note: Courses or seminars submitted for credit must be completed prior to the Sept. 1 deadline.)

How do I know I received credit for attending the CDS?

For those of you who picked up your 2002 CDS attendance certificate, you have been granted 15 CE hours automatically and do not need to file a compliance report. You may check the IRES website @ www.go-ires.org to confirm your credits.

If you did NOT pick up your attendance certificate at the CDS in San Antonio, you are required to file a NICE compliance reporting form requesting credit for actual hours attended with a maximum of 12 CE credits available.

CE Reporting deadline is Oct. 1, 2002

CIE·AIE
The Signs of Excellence

N·I·C·E

SAN ANTONIO

Congratulations, new IRES AIEs and CIEs!

The 2002 class of new Certified Insurance Examiners

The 2002 class of new Accredited Insurance Examiners

Quote of the Month

"The top ten insurance Web sites put together get 5.5 million hits per month. To put this in perspective, that's about 2/3 of the monthly hits of Twistedhumor.com."

— Daniel Finnegan, President, Quality Planning commenting during a CDS session on the impact of insurance on the Internet.

Welcome, new members!

Juli-Kay Baumann, TN
Rodney E. Beetch, OH
Jennifer Broadhead, AL
Darrell W. Cartwright, ID
David M. Evans, LA
Gary E. Farmer, KY
Steven C. Gregory, DE
Carol S. Harbeson, AK
Mark Jaster, OK
Theodore Lehrbach, AK
Daniel Pittman, LA
James M. Potter, LA
Clarissa A. Preston, LA
Davida Rabalais, LA
Tim Sanders, AR
Terri Schulz Guidry, LA
Jason Sloper, LA
Catherine S. West, VA
Peggy J. Willard-Ross, AIE, NV

Shirley Robertson of Nevada receives 2002 Al Greer Award

SAN ANTONIO — The 2002 Al Greer Achievement Award recipient is Shirley Robertson. Shirley was presented the award here during the 2002 IRES Career Development Seminar at the Hyatt Regency Riverwalk. The award is given to recognize regulators who demonstrate an overall commitment to professionalism, honesty and service.

Shirley has been involved in insurance for more than 40 years and has spent the last 14 as a market conduct examiner. She is currently a contract market conduct examiner with the Nevada Division of Insurance. She holds the AIRC, AIE and CFE (fraud) designations.

Al Greer recipient Shirley Robertson with her husband Mac (right) and Scott Laird

REMEMBER S

More than 450 regulators and industry experts attended the 14th annual IRES Career Development Seminar at the Hyatt Regency Riverwalk in San Antonio. CDS Chair Doug Freeman of Missouri (top) addresses the opening general session. Wanda Smith and John Reiersen (above left) of the IRES Foundation Board of Directors share a lighter moment. And NAIC President Terri Vaughan of Iowa (above right) gives the luncheon keynote address.

AN ANTONIO!!

IRES wishes to thank the Texas Department of Insurance for all their help in promoting the 2002 CDS. Many thanks also to those regulators and spouses who volunteered at the registration desk! CLOCKWISE FROM TOP LEFT: John Cashin of Stroock & Stroock & Lavan law firm addresses a session on liquidity in the marketplace. • Erin Toll of the Colorado Insurance Department • Attorney Jim McIntyre speaks during a Financial Section breakout • Lee McLellan of Washington, D.C. and Angela Ford of North Carolina help assemble badges and packets for the conference • CDS Chair Doug Freeman of Missouri

Deep in the Heart of San Antonio

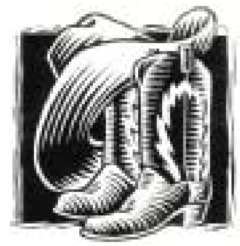

Table hopping at the CDS

The San Antonio Career Development Seminar included a special breakout billed as an open “round robin” for those who wanted a less structured opportunity to learn and discuss. The Round Robin session featured a different topic at each table with a lead presenter for each topic.

The Round Robin sessions were organized and planned by IRES member Jo LeDuc (at right, using laptop) of the Wisconsin Insurance Department.

Jo will be chairperson of the 2003 CDS in Scottsdale and would like feedback from any IRES members about topics or formats for next year. You may send your comments to her at jo.leduc@oci.state.wi.us

> **One of the arguments the [insurance] industry makes is that the state-based system is not capable of adequately dealing in the federal and international arena. I think that was probably true ten years ago; it's not true today.**
>
> — NAIC President Terri Vaughan

Seeking a 'Common Vision'

Editor's Note: *This year's CDS Commissioners Roundtable in San Antonio consisted of Iowa Commissioner and NAIC President* ***Terri Vaughan,*** *Texas Commissioner* ***Jose Montemayor****, Oregon Commissioner* ***Joel Ario*** *and Ohio Commissioner* ***Lee Covington****. Following the Monday-morning session,* ***Scott Hoober*** *and* Regulator *Editor* ***Wayne Cotter*** *put additional questions to the commissioners. This is Part I of the interview; Part II will appear in the November issue.*

Regulator: *Tell us a little more about the medical malpractice situation in the various states. It seems from this morning's Roundtable that this issue tops the list of problems for many commissioners.*

Ario: You're going to see a more focused tort reform debate tied up with health access. That's what's happening in my state.

Montemayor: You'll see immediate solutions like funding for a JUA. Long-term, you'll see many proposals. My governor just came out with an 11-point proposal to long-term modify [medical malpractice] and a central piece is a $250,000 cap for noneconomic damages.

Ario: But Jose, what is the rating issue going to be on the JUA, because we don't have so much of an availability problem, as an affordability problem. So what are your rates going to be in the JUA?

Montemayor: They're benchmarked off of the Texas Medical Liability Trust that insures 10,000 doctors. It's got a third of the market by itself. So we indexed off of that as well as our own experience and priced it at Year 3. They have assessment capacity on top of that.

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Commissioners: 'A common vision'

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Covington: I think Jose is right in saying this JUA may fix the here and now, but the issue is going to be pricing . . . we see nationwide, in 1999 and 2000, malpractice insurers losing something like 50 cents on every dollar and after investment income 18 cents on every dollar. The only thing that can address that is looking at the root causes of [medical malpractice]. The root causes are claims settlement, jury awards and attorney fees. I think a lot people don't recognize that in malpractice somewhere between 60% and 70% of the cost is pure attorney fees, not the settlement costs. So if you don't have a settlement or a jury award, it still costs the system a lot of money.

Vaughan: What I have learned about the Iowa market is that there are a lot of hospitals and doctors that really aren't seeing a big problem. Their rates are going up 10%, maybe a maximum of 20%, in some cases it's even single-digit. The problem is those few hospitals or few physicians who have poor risk management practices at the hospital, they have financial difficulties — which is not uncommon in Iowa because of Medicare reimbursements being so low or they are physicians with a prior claims history or in a targeted practice such as OB-GYN . . . . What's happening is that those insureds that are not acceptable to the standard market are going into the surplus lines market and seeing *huge* rate increases, but those that are staying in the admitted market are generally OK.

Covington: Terri's experience highlights one thing: that the experience across states can be very, very different. Even in my own state, between Cleveland and the rest of the state is a very different environment . . . we are seeing, as Terri said, pockets such as trauma surgeons, OB-GYNs, neuros hit with huge increases. Frankly even for a family doc a 50% increase over a two-year period of time is significant and that's the average in the market in my state. So I wish I was in Iowa.

Vaughan: What the medical society in Iowa is saying is we don't mind paying for medical malpractice, we just want it to stop gyrating all over the place. We want some stability in the rates.

Ario: How do you get that though? In the mid-70s there was a spike, and in the late-80s there was a spike, and now we're in another spike.

Montemayor: I'll tell you what . . . this will give rise to risk retention groups and purchasing groups, all the same issues we've experienced in the past. Something does have to be done long-term. I will tell you it's not going to be easy; it's going to be fierce. Trial lawyers are out there trying to link this to corporate wrongdoing, comparing it to Enron.

Covington: Trial lawyers are saying this crisis was caused by risky investments. The facts just don't bear that out. First of all, a lot of property/casualty companies are not heavily invested in equities. Number two, some insurers are maintaining their investment income and some are losing a small amount. I haven't seen any evidence that insurers are losing money on their investments. That's just a pure red herring.

Montemayor: Completely, but it's out there.

Vaughan: I do think though that if you look at what happened in the stock market, particularly over the last month, it has to have had an effect on the capital and surplus of the industry. And to the extent that [insurers] had excess capacity — and many thought we had excess capacity in the industry — much or maybe all of that is gone.

Covington: Absolutely. I'm not saying that. I'm just saying that [trial lawyers] are talking about risky investments and imprudent and bad business practices and while investment income has gone down, it's just not to the level they're trying to portray in the press.

A packed house of more than 450 regulators and industry representatives watched moderator Bill Bailey (standing) fire questions at insurance commissioners during the San Antonio CDS Roundtable.

Montemayor: No, at least not with property/casualty insurers. They're much more susceptible to the bond market because they're all heavily in bonds. So the interest rate environment has a much deeper impact [on insurers] than anything that has happened in the stock market.

Regulator: *When the federal government considers major changes in the financial services marketplace, are the views of state insurance regulators being properly represented alongside those of securities and banking regulators? Likewise, in the international arena, is the insurance regulator's point of view coming across as clearly and forcefully as that of securities regulators or banking regulators?*

Vaughan: One of the arguments the [insurance] industry makes is that the state-based system is not capable of adequately dealing in the federal and international arena. I think that was probably true ten years ago; it's not true today.

We have ramped up our resources devoted to federal affairs and international affairs. We are extremely active . . . we fund commissioners to go to the International Association of Insurance Supervisors meetings; we're involved in trade negotiations; we are very active on the international scene. We are also very active now in Washington. We've got a team of representatives on Capitol Hill telling our story. They maintain constant communication with the Federal Reserve, the Office of the Comptroller of the Currency, the Treasury, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the alphabet soup of agencies. We're very involved with the Department of Labor, the Health Care Financing Agency — now the Center for Medicare and Medicaid Services — on health issues. I am absolutely confident that that's not an accurate assessment of the situation and I think that the people that are making that are either uninformed about what we're doing or they have other motives.

Ario: One of the things I like to say back when I hear that argument is: "Do you think that applies to the trial lawyers then?" Because I hear you telling me that trial lawyers are extremely powerful all over the place,

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Commissioners: We need a 'common vision'

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[yet] they don't have a national base. They're all local. Why are they so powerful, but we can't do our own business.

Montemayor: One thing we're overlooking is that we are all talking a hell of a lot more to our Congressmen and Senators, and to the White House, whenever we get a chance.

Covington: I would estimate we have contact with our Congressional offices at least once a month, if not more. I bet Terri is there at least once a month, probably more.

Vaughan: More.

Covington: There is interplay with the terrorism bill. Just last week, Terri and staff were on the Senate side on the accounting bill. I was working on the House side on the accounting bill, on a specific issue relating to examinations and audits of insurance companies. We're there. We have our finger on the pulse of what's going on in Washington. We're able to respond very, very quickly.

Vaughan: That's right. As Lee said, we've got commissioners involved. Commissioners can pick up their phones and call their delegations. That happens all the time.

Regulator: *With respect to market conduct, Joel, you made mention of a proposed market conduct Annual Statement during the Commissioners Roundtable earlier this morning. What did you envision there?*

Ario: I look a lot at the financial side to get clues as to what we could be doing on the market conduct side. One of those is the Annual Statement, which is the basis for a lot of financial work and analysis that we do. The question becomes can we do something similar to that on the market conduct side. It's much more difficult. [A Statement] has to be different line by line, but Lee's got a group that's working aggressively at trying to develop some basic questions to ask companies every year.

Regulator: *Average time to pay claims, number of complaints, things like that?*

Ario: For property/casualty it's going to be time frames for claims, and for life I think it's going to be number of replacements and things like that. The basic questions that you can run through a computer program and identify the outliers . . . that's not the only thing you do, but you certainly would look at outliers.

Montemayor: We have looked at that. In fact, there was an early precursor to this. Illinois had a blank; Ohio had a blank for auto and homeowners. It is very useful. I don't know when it will happen, but I predict that at some point our need for data is going to be so great . . . that we will probably evolve to some kind of standardized data calls or some kind of Annual Statement.

Covington: We can take, for example, replacements or the amount of time it takes an insurer to pay a claim or the number of claims that go to litigation. We compare that to a peer group and say OK, just on those pure numbers, do you see anybody that's an outlier. We hope that the outliers will be small and we hope that this will foster best practices . . . and really raise the bar for everyone. NASD has done it; other states have done it and it has proven to be a very useful tool. Some people ask the question: "Is market analysis going to replace examiners?" Not a chance. I see this as more work in some ways. It's just really a refocus of resources into areas and companies that we think may create a risk of harm to consumers.

Ario: It's basically analogous to IRIS ratios. If you have a bad IRIS ratio, it does not mean for sure that you are a problem. It's just a sign to look deeper.

Covington: First of all, you ask the company in and say "Why do *you* think we are seeing these data indicators?" They have said "look, we did this" and we were able to avoid an exam which enhanced the use of our resources.

Part II of the interview will appear in the November issue of The Regulator.

SAN ANTONIO

Susan Morrison (left) and Jann Goodpaster

IRES honors Susan Morrison

SAN ANTONIO — Susan Morrison of the IRES adminstrative staff is the 2002 recipient of the prestigious President's Award bestowed by the Insurance Regulatory Examiners Society.

In making the presentation, IRES President Jann Goodpaster noted that Susan had worked at the IRES office since the Society first began. Goodpaster called Susan "the heart and soul of IRES" who has helped countless members walk through the process of joining IRES, getting an accreditation, register for seminars and other tasks."

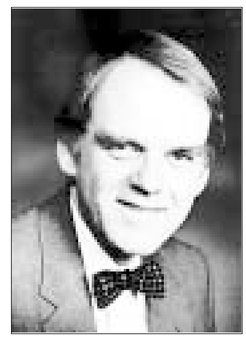
"She has touched everyone's life at IRES," Goodpaster said.

Susan is an employee of Chartrand Communications, which is the Society's management firm, based in Olathe, Kansas, just outside Kansas City.

"One of the smartest things I ever did was hire Susan Morrison," said David Chartrand, owner of the firm. "Now I have to figure out how to keep anyone from stealing her away from us. She's the best there is."

Consumer Advocate wins publications award

SAN ANTONIO — Which *Regulator* article was last year's best? This year's Schrader-Nelson "Article of the Year" award went to J. Robert Hunter for his piece, "Enron's impact on state outsourcing decisions." In his article, which appeared in the March 2002 issue, Mr. Hunter examines whether state insurance department decisions to outsource examination and other functions still make sense in light of recent revelations plaguing the accounting industry and the demise of Arthur Andersen.



Bob Hunter

Mr. Hunter, a former Texas Commissioner of Insurance, is a nationally known advocate for insurance consumers who has contributed various consumer-oriented pieces to *The Regulator* over the past few years.

The Schrader-Nelson Award winner is determined each year by the IRES Publications Committee. Past winners include former NAIC President and Kentucky Commissioner of Insurance George Nichols and former New York insurance regulator Vincent Laurenzano.

Accepting for Mr. Hunter at this year's CDS was fellow consumer advocate, Birny Birnbaum. Mr. Birnbaum is Director of the Center for Economic Justice and was a featured speaker at this year's CDS.

We salute Mr. Hunter for his noteworthy achievement.

Credit scoring: the regulator's role

continued from page 5

"There are a number of elements that are causing nonrenewals and cancels and rate increases, and sometimes it's just plain old base rate increases," he said. "But sometimes the application of credit is blamed for some other things that are going on. It will remain a hot political issue as long as rates are going up."

Ironically, though, more consumers are being helped by credit scoring than are being harmed — and if credit scoring were to go away, many of the good credit risks would see their premiums skyrocket.

Some consumer advocates say it's a wash, and that about as many are helped as harmed. At Progressive, Williams says 60% of its customers get lower rates as the result of their credit scores.

What's a consumer to do?

One of the powerful arguments that Birnbaum and other consumer advocates make is that since there's no obvious link between credit and claims, doing things to improve your credit rating — borrow, but not too often, use more than one credit card — wouldn't be as useful as doing things to reduce losses.

"The inherent problem with credit scoring," said Birnbaum, "is that it not only doesn't involve any loss prevention, it's incapable of promoting loss prevention" because of that lack of a logical link between credit and loss.

Want to reduce your risk of an auto accident? Take a safe-driving course. Want to reduce theft? Get an alarm for your home or car. Want to reduce storm damage? Trim those trees.

Surprisingly, though, the data say there is a link, a strong enough link that taking the time to improve your credit score would, somehow, reduce your claims experience.

Mosley, the converted skeptic, said he and his colleagues were amazed to find that even when it came to claims where no fault was involved — weather-related damage to a roof, say, or comprehensive claims in auto — there was a strong correlation with credit.

"It boggles our minds," he said, "but what we consistently find is that there is a significant difference.

"Even on those claims that are not at fault, the fact that you had a weather claim over the past three years gave you a higher risk level than someone who hadn't had a weather claim over the past three years," he added. "One of the things we found is that those types of risks — people who are more likely to take care of their home, if there's some damage on the roof, get that taken care of, little things that need to be taken care of — they're more conscientious about doing that type of things."

Williams and his colleague at Progressive, John Barbagallo, agree that working at improving your credit score would likely improve your loss experience.

You can't change your credit score overnight," said Barbagallo. "It's based on a pattern of behavior. To materially improve your score, you're going to have to change your behavior, and that correlation would probably still hold."

Williams says when you look at it from the standpoint of financial responsibility, there does seem to be a logical connection, the kind we accept with age, for instance.

"There are good 17-year-old drivers, but as a group, they have higher accidents," he said. "I think you would tend to argue that youths are for one reason or another less risk-averse than mature adults.

"You can apply the same logic with credit. If somebody is risk-averse or prudent in their financial planning or handling, then there's a likelihood that they're risk-averse or prudent in other aspects of their life."

Too-rigid application of credit scoring has caused real problems for agents. After all, they're the ones who know their customers, and they're the ones who have to tell a long-time customer that despite his good record with the company, his premium is going to go up.

That's why Progressive, for one, uses credit scores only on new business.

"We don't apply it after the fact, on renewals," Williams said, "except in instances where it gets better and we can give them a discount. Once you've got a customer on board for a while, you know more about them, and you've got to think differently about how you treat them."

Get the voodoo out

So credit scoring can theoretically be applied in a way that would reduce the lightning strikes from consumers. And yet the protests continue. Though few

Credit scoring: links and correlations?

states have been overly harsh on the companies, a fair number of them have imposed restrictions on the use of credit scores.

So the question remains: If you know credit is a lightning rod, why stick with it?

"Well, it's the holy grail," said Birnbaum.

"It revolutionizes the way they rate and price insurance. It's gone from two or three rating tiers to dozens of rating tiers. And that's why they don't want to give it up."

Companies are indeed adding tiers, and those tiers are separated far more than ever before. A revolution in rating and pricing isn't an overstatement.

As Mosley, the actuary, points out, we're not talking a 5% differential for, say, anti-lock brakes. "With credit," he said, "you're not talking about 5%. You're talking about 100% differentials.

"For the best credit, you've got rates that can literally be half of the rate for the worst credit. If that goes away, now you're talking about some significant changes. The people who are most deserving of the discounts would lose them — their rates would go up significantly."

And, yes, in many cases that means more tiers.

"It depends," Mosley said. "There are a few major players that are able to divvy it up into dozens of tiers, just because that's the way they're set up and they can handle it. It's definitely giving them more separation [into more tiers]. It really lends itself to more risk diversification."

At Progressive, there are now five tiers, and the premium difference from tier to tier can be, from top to bottom, even more than two to one.

"But it's not simply based on the credit score," Williams said. "It's also based on driving record and prior insurance and some other variables that significantly affect that. So credit alone? No.

"Credit has allowed us to have a greater distribution into the lower-rated tiers. Not just greater spread in terms of rate, but greater spread in terms of risk across those rates."

Williams echoes Birnbaum on one point. "It's a biggie," Williams agrees.

"Part of the reason it became the lighting rod, a number of carriers, as they tried to get themselves out of profit problems, seized on retroactively reunderwriting their renewal books in auto and home, based on some elements of credit or financial responsibility."

All that lightning got the companies to hire lobbyists to argue in favor of leaving credit scoring in their toolkits. Despite a fair amount of success, many states have passed new laws and regulations that restrict the use of credit — in some cases, more restrictively than the insurers would prefer. Washington's new commissioner, Mike Kreidler, came into office intent on restricting the use of credit scoring, and the legislation he got passed certainly doesn't conform to the industry lobbyists' agenda.

If other companies follow Progressive's lead and stop retroactive changes to existing customers, perhaps the criticism of credit scoring will become more muted. It's also generally agreed that publicizing the elements of the credit score itself would be a big plus, to give consumers a feel for what factors affected their premiums. (Although if Fair, Isaac — the primary seller of credit scores — did so, it would have a hard time maintaining its market share and price point.)

In Progressive's case, that argument is over. The company uses its own formula, and it provides it to customers.

Williams also said he'd favor requiring companies to file their formulas with the department, but only if they're given some trade-secret protection, one provision of the new Washington regulations.

"We're not going to insist on it for ourselves, because it's our score, and we feel we're better off if people understand what it is and get the voodoo out of it."

There's another, broader objection to credit scoring and its progeny, more tiers and a greater spread of premiums. It has been argued that we're moving away from the basic idea of insurance, going from shared risk to pay-as-you-go. Many states limit territorial rating, and there are numerous other restrictions on not just race, but marital status or sex. Does credit scoring simply go too far?

Williams, for one, thinks not.

"If you take a look at other variables that we use, like driver's age or driving record, it's just one of those classifications," he said. "I don't want you to go away with the impression that we've gotten such a level of sophistication that we can actually predict an individual's likelihood to have an accident or not. It's still a group game." ■

REGULATOR™

Published by the
Insurance Regulatory Examiners Society
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INSIDE: Sights and scenes from the 2002 Career Development Seminar in Texas

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√ Peggy Dozier, Virgina regulator, died July 4. Peggy was a member of IRES for almost 12 years and was an active and loyal member of the Finance Committee. She was a Senior Market Examiner with the Virginia State Corporation Commission's Bureau of Insurance. She is survived by a daughter, son-in-law, and 2 grandchildren, Dana Dozier Rhodes, Wayne, and grandchildren, Sheila and Joshua Rhodes. Peggy, a loyal Dallas Cowboys fan, was from Texas and spent her working years in North Carolina and Virginia.

In next month's REGULATOR:

Commissioners' Interview, Part II
Examining Market Conduct

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