Consumer Federation of America | CENTER FOR ECONOMIC JUSTICE

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CONSUMER GROUPS PRESS STATES TO TAKE ACTION ON UNFAIR INSURANCE RATING PRACTICES BY INSURERS AND THIRD PARTY ORGANIZATIONS

The Consumer Federation of America (CFA) and the Center for Economic Justice (CEJ) today called on state regulators to stop insurers and third party organizations from using rating practices that lead to unjustified price increases for consumers. In a letter to insurance commissioners, the consumer organizations cited recent actions by Risk Management Solutions (RMS), a purveyor of computer "models" used by insurers to estimate future damage caused by weather related events in setting their homeowners insurance rates.[1] On March 23rd, RMS announced that it was dramatically altering its procedures for estimating the future risk of hurricane damage in a manner that will cause double-digit homeowners insurance rate increases along America's coastline from Maine to Texas.

"RMS claims that this massive rate increase is necessary for scientific reasons, but they appear to be bowing to pressure from insurers, who provide a great deal of financial support to them," said J. Robert Hunter, Director of Insurance for CFA and former Texas Insurance Commissioner. "RMS has dramatically altered the scientific methodology that is being used to predict hurricanes and set consumer rates without offering a justifiable reason. They are breaking promises that were made to consumers over a decade ago when more sophisticated weather modeling was introduced," added Hunter.

The RMS action was taken after extensive consultation with insurers who use the hurricane model and who have been advocating an increase in rates for disaster insurance. "RMS is the vehicle for collusive pricing by insurers and that is not only unfair to consumers, it is anticompetitive," said Birny Birnbaum, Executive Director of CEJ. "We call on state insurance regulators to determine if the actions of insurers and RMS are a violation of anti-trust laws."

CFA and CEJ raised concerns that the RMS action interjects politics into a process that should be based solely on sound science. In the aftermath of the unexpectedly high damage caused by Hurricane Andrew, insurers turned to computer catastrophe modelers like RMS for new approaches to setting rates for catastrophe insurance coverage. The new method was a computer simulation model based on either a 1,000 or 10,000 year weather forecast. Consumers were told that the increase in rates resulting from the new computer catastrophe models would lead to greater rate stability. There would be no need to raise rates after a catastrophic weather event with the use of the new models, because these storms would already have been anticipated when rates were set. However, the new RMS model breaks that promise to consumers and establishes rates on a five-year time horizon, which is expected to be a period of higher hurricane activity.

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[1] The letter, which was sent to Insurance Commissioners and Attorneys General in all East Coast and Gulf Coast states, is available at http://www.consumerfed.org/pdfs/Insurance_NAIC_RMS_Letter_032706.pdf. A copy was also sent to the President of the National Association of Insurance Commissioners and the President of the National Conference of Insurance Legislators.

"The process used by RMS to radically alter its catastrophic model demonstrates that state regulators do not exercise meaningful oversight of risk classification procedures and insurers' use of third party vendors to avoid regulatory oversight and public accountability," said Birnbaum.

Insurers have also utilized third party organizations to provide information for key insurance pricing and underwriting decisions, which helps insurers to avoid scrutiny for their actions. These organizations and the methodologies they use have a huge impact on insurance rates and underwriting decisions, but state insurance departments do not regulate them. Fair Isaac and ChoicePoint, for example, are third party vendors that are not subject to state insurance department oversight. They provide credit scoring and other data used for underwriting and rating that have a profound impact on insurance availability, affordability and rates.

"State regulators and the National Association of Insurance Commissioners have done nothing to prevent the adverse effects of insurers' increased use of credit information or improper use of loss history databases. State regulators have also done very little about risk classification factors that obviously discriminate against low income consumers, including consumer credit information or a consumer's prior liability limits, education and occupation," Birnbaum concluded.

CFA and CEJ urged state insurance regulators and the National Association of Insurance Commissioners (NAIC) to take several steps to address this problem:

1. State regulators should reject the new RMS wind model as the basis for any rate increase and examine how this new model was developed. The states should request or, if necessary, subpoena information on RMS's contacts with the insurance industry to determine whether pressure might have been brought to bear on RMS to raise rates.

2. State regulators must exercise existing regulatory authority, or, if necessary, obtain additional legal authority to regulate third party organizations such as RMS, Fair Isaac and ChoicePoint, whose work has a significant effect on insurance rates and availability.

3. The NAIC should quickly update its model laws and regulations for homeowners and auto insurance to provide greater public accountability for insurers' rating practices and the use of third party vendors in insurance rating, and which address the consumer harm resulting from the use of unjustified rating factors.

CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

CEJ is a non-profit organization that works to increase the availability, affordability and accessibility of insurance, credit, utilities, and other economic goods and services for low income and minority consumers.

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