Market Regulation Accreditation Program Summary

Comments by

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The NAIC is to be commended for its efforts to develop a process whereby the ability of regulatory agencies to monitor the market conduct of regulated entities can be objectively evaluated. This proposed outline of an accreditation process is an important step in that direction. But one critical and fundamental area is missing from this proposal: how regulators will identify and respond to unfair discrimination. A central the role of state regulators is assuring that prices are not inadequate, excessive, or unfairly discriminatory. Similarly state regulators are charged with assuring that availability of insurance is not based on unfair discrimination. Ameliorating unfair discrimination depends on the capacity of state regulators to collect and analyze data that most do not currently possess.

Collecting adequate data and analyzing that information are widely recognized as essential in carrying out the market regulation accreditation program. As the Summary states on page 2 under the heading **Market Analysis**:

> Each accredited insurance department shall have adequate and effective procedures in place for data collection and regularly scheduled in-depth analysis of relevant data in order to identify regulated entities/practices which may require further analysis.

Regulators will be unable to ensure the absence of unfair discrimination in the pricing and availability of insurance without the use of two forms of data gathering and analysis. Paired-testing and HMDA-like disclosure for home insurers, and the capacity on the part of regulators to analyze these data, are essential.

Paired testing

Fair housing and other civil rights organizations have long used paired-testing to provide the most definitive evidence of the presence or absence of unlawful (and in the case of the insurance industry, unfair) discrimination. The basic concept is fairly simple. Teams of “mystery shoppers” are sent to the same service providers to inquire about a given product or service. Each team consists of individuals or couples who are similar in every respect (for example, income, credit rating, employment status etc. in the case of housing) except for the trait being tested. In the case of tests for racial discrimination in housing white and non-white individuals would visit the same real estate or rental agency and inquire about similar housing. Since these individuals are equally qualified and virtually identical in every relevant way except their race, a reasonable assumption is that

they would be treated the same in the marketplace. If they are not, because all variables except race have been controlled, it can be assumed that racial discrimination has played a role.

Fair housing law enforcement organizations and fair housing groups have used this tool to identify unlawful, and unfair, discrimination against several major home insurers. The incontrovertible data gathered in this way resulted in significant changes in how these insurers market, underwrite, price, and generally serve their communities. This has resulted in the amelioration of unfair pricing and access to products and services to qualified families who previously did not have such access, and to new, profitable markets for insurers.

Perhaps more importantly, initially confrontational relations between some insurers and some consumer groups have evolved into mutually profitable partnerships. For example, after settling a fair housing complaint with HUD, State Farm and the National Fair Housing Alliance (NFHA) are currently collaborating on a media campaign to promote the benefits of living in diverse, integrated communities. And following a jury verdict against Nationwide in a fair housing lawsuit filed by NFHA member Housing Opportunities Made Equal (HOME) these organizations now work together on a regular basis to expand the availability of insurance products to underserved markets.

The collection and analysis of such data, whether done internally or through contractual arrangements with qualified organizations, should be a requirement for the accreditation of any market regulation program.

HMDA-Like Disclosure

Understanding how well an insurer serves a market requires understanding precisely where products and services are being provided, and where they are not. Just as the Home Mortgage Disclosure Act has long required mortgage lenders to publicly disclose the number and type of loans they make by census tract, property insurers should be required to disclose by census tract the number of policies they write, renew, and cancel along with the number of applications they deny and policies they non-renew. (See the attached essay from the National Underwriter for more details.) Mortgage lenders and regulators attest to the fact that HMDA data have enabled them to serve their markets better and provide more effective regulation. And dozens of effective partnerships involving financial institutions and community groups have emerged in recent years.

The limited zip code disclosure requirements for insurers in selected states have had similar outcomes. Wisconsin's zip code data were utilized as part of the evidence that led to a settlement of a fair housing lawsuit against American Family for discriminatory underwriting practices in Milwaukee. This agreement subsequently led to an effective partnership involving American Family, the local NAACP and other community organizations resulting in access to insurance for previously underserved communities and new marketing opportunities for the insurer.

Developing the capacity to collect and analyze these data, or contracting with qualified organizations to conduct such work should also be a requirement for the accreditation of a market regulation program.

The ability to detect unfair discrimination should be a critical component of any market conduct exam. Having effective procedures in place for the collection and analysis of relevant data is essential for any such evaluation. Having the capacity to generate and utilize paired testing and HMDA-like data constitute key components of that effort.

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FINAL SAY

■ another perspective

More Transparency Needed In Sale Of Homeowners Ins.

By Gregory D. Squires
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The current crisis in the financial markets should be a clarion call to all of us about the need for greater transparency in the provision of financial services. The insurance marketplace in particular lacks meaningful public disclosure, limiting our understanding of the way the market is being served and stifling debate about important public policy issues.

Now is the time to support the requirement that insurers provide the same level of public information about applications and policies that the Home Mortgage Disclosure Act has required lenders to disclose about mortgage loans for more than 30 years.

The provision of homeowners insurance, like the availability of mortgage loans, is a critical element in the ability of consumers to build wealth and in the capacity of communities to maintain value.

Both industries are providers of critical financial services and have been determined as a matter of public policy to need some level of regulation. Yet unlike the lending industry, insurers are not required to provide the information that will make appropriate review and regulation possible.

The Home Mortgage Disclosure Act, enacted in 1975, requires most mortgage lenders to disclose data on all loan applications—including race, gender and income of the applicant; disposition of the application; type, cost and amount of the loan; census tract and similar data.

In 2006 (the most recent year for which data are available), information on 27.5 million applications to 8,886 institutions were reported automatically, as a matter of course. As in all the preceding years, the reports provided critical information that allowed policymakers, lenders and community groups to evaluate the state of the market and take the steps necessary to ensure all communities had access to the credit necessary for a healthy economy.

Along with the Community Reinvestment Act and other fair lending laws, HMDA is credited with increasing access to credit in low-income and minority markets. For example, between 1993 and 2000, the share of loans made to blacks increased from 3.8 percent to 6.6 percent; the Hispanic share increased from 4 percent to 6.9 percent; and the share of low-to-moderateincome borrowers increased from 19 percent to 29 percent.

Research by the Federal Reserve, the Treasury, the Joint Center for Housing Studies at Harvard and others has shown that such lending was profitable and the direct result of HMDA, CRA and other policy initiatives, as well as market forces.

According to former Federal Reserve Board Governor Edward Gramlich, who only recently passed away, “there seems little doubt that most of these outcomes would not have occurred in the absence of CRA and other fair lending laws.”

The data publicized in accordance with
HMDA have helped lenders
find new markets, assisted
regulators in efforts
to monitor the market,
and enabled community
groups to form effective
partnerships with both
lenders and regulators.

The value of HMDA
was noted recently by
Douglas Duncan, senior vice president
for research and business development as
well as chief economist with the Mortgage
Bankers Association, when he testified before
the House Subcommittee on Financial
Institutions and Consumer Credit.

According to Mr. Duncan, "MBA uses
HMDA data to assist its members in analyzing
the industry's performance in serving
the nation and identifying new markets
and investment opportunities…The data
fairly present a picture of the industry's
work, offering information to further effective
investment and, where appropriate,
provide flags for further regulatory review."

Referring to the information on lending
patterns provided by HMDA, Federal
Reserve Board Governor Mark W. Olson
reinforced the points made by the MBA
when he told the same subcommittee that
"…the data prompt discussion, investigation,
analysis and research that may deepen
our understanding of why these patterns
occur and allow us to increase fairness and
efficiency in the home loan market."

Such data collection could have similar
salutary effects on the insurance market.
Yet the industry has vigorously opposed
such disclosures, citing three concerns in
particular: the confidentiality of the policyholder
will be violated; trade secrets will be
revealed; and the data will be misinterpreted
by the public and lead to frivolous lawsuits.

These are the same arguments made by
the lending industry before the adoption
of HMDA. The concerns, however, have
proven to be unfounded. Borrower confidentiality
has not been breached, and trade
secrets have not been revealed. There has
been some litigation, but generally where
egregious violations of law have occurred.

It is more reasonable to conclude that access to this information forestalled litigation that might otherwise have been filed by promoting voluntary partnerships among community groups and lenders to address the issues raised by the data.

There has been much talk about the need to modernize regulation of the U.S. financial service industries. The insurance disclosure proposed here constitutes a critical piece of that modernization. NU

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