CFA Consumer Federation of America

TESTIMONY OF

J. ROBERT HUNTER,
DIRECTOR OF INSURANCE,
CONSUMER FEDERATION OF AMERICA

BEFORE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON FINANCIAL SERVICES
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

REGARDING

THE IMPACT OF CREDIT-BASED INSURANCE SCORING ON THE AVAILABILITY AND AFFORDABILITY OF INSURANCE

MAY 21, 2008

Good morning Mr. Chairman and members of the Subcommittee. Thank you for inviting me here today to discuss the impact of credit-based scoring on the availability and affordability of insurance. And thank you for all you are doing for the many consumers of insurance who are being harmed by the use of credit scoring today. My name is Bob Hunter and I am the Director of Insurance for the Consumer Federation of America (CFA). CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. I am also an actuary, a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries. I am testifying on behalf of CFA and the Center for Economic Justice.[1]

At your last hearing on this subject, testimony was delivered by Birny Birnbaum, the Executive Director of the Center for Economic Justice. A statement on insurance credit scoring was also submitted by CFA, Consumers Union, National Council of LaRaza, National Consumer Law Center, and National Fair Housing Alliance. Today, I will touch on a number of the concerns raised in the testimony and statement, which are attached.

<u>KEY FINDINGS</u>

Insurance scoring occurs when insurers use consumer credit information to determine whether a person is eligible for coverage, which company affiliate will offer the coverage, the "rate tier" at that company in which the person will be placed and, finally, the premium the consumer will pay. Insurance scoring is used by nearly all insurers and has grown to become one of the most important factors in determining a consumer's automobile and homeowners insurance premium. Insurance scoring is typically done through the use of a computer model that converts information in a consumer's credit report into a score, or numerical value.

Many organizations have called for a prohibition on insurers' use of consumer credit information for underwriting and ratings. These groups include not only consumer organizations, but civil rights groups, several associations representing insurance agents and some insurers. The case for such a prohibition is strong. There is more than enough information currently available to justify such a prohibition. A closer look at insurance scoring reveals that the practice has the following serious flaws:

- Undermines core functions of the insurance system by decreasing insurance availability and affordability, and undermining the critical role of insurance in encouraging loss prevention;

- Has an adverse, disparate impact on low income and minority consumers and is discriminatory;

- Is based on credit reports that often have erroneous or incomplete information;

---

[1] Center for Economic Justice is a Texas-based non-profit organization that advocates on behalf of low income and minority consumers on insurance, credit and utility issues.

- Is inherently unfair and penalizes consumers who are the victims of economic, medical or natural catastrophes;

- Penalizes consumers because of the business decisions of lenders.

The insurance industry maintains that there are a variety of benefits from their use of credit scoring. Upon examination, these assertions are illusory and contradicted by the available evidence. Ultimately, however, all of the insurer arguments for insurance scoring come down to a single point: insurance scoring is predictive of the likelihood that a consumer will have a claim and consumers will benefit if insurers are able to price more accurately.

The problem with this contention is that insurers cannot tell us what it is about a credit score that is linked with risk. If you ask proponents of the use of credit scoring to explain to a person who suffered a decline in credit as a result of being in Hurricane Katrina, or lost her job because of outsourcing, or lost his job in the current economic downturn, why these events that they had no control over made them a worse auto or home insurance risk, they have no response..

Unlike insurance classifications that were in use before credit scoring was adopted, credit scoring is not based on an appropriate thesis, confirmed by a statistical analysis. In fact, there is no legitimate thesis for the use of credit scoring. There is only an alleged correlation based on proprietary information not open to public scrutiny.[2] However, a correlation in search of an appropriate thesis raises serious questions about the classification that is being used.

The lack of a thesis means that credit scoring violates actuarial principles. Some actuaries say that a thesis is not required because actuarial principles state that a cause and effect relationship is not required. Although this is true, the principles, which were developed by a group of mostly industry-employed actuaries with an overwhelming industry bias, also say that a thesis -- a logical underpinning for the use of the information -- is required. Here is what the principles say, in relevant part, on this subject:

> Classification characteristics may be more acceptable to the public if there is a demonstrable cause and effect relationship between the risk characteristic and expected costs. However, in insurance it is often impossible to prove statistically any postulated cause and effect relationship. Causality cannot, therefore, be made a requirement for risk classification systems.
>
> Often causality is not used in its rigorous sense of cause and effect but in a general sense, implying the existence of a plausible relationship between the characteristics of a class and the hazard insured against. Living in a river valley would not seem to cause a flood claim, but it does bear a reasonable relationship

[2] This is another difference from all previous classes where the data is public and part of rate filings made with insurance departments. Previously, an insurer would propound a thesis and test it with the data. If a thesis was confirmed, the insurer would file for a new class with the commissioner showing the thesis and the data in the rate filing. An example was the use of accidents and tickets. The thesis was that people with more accidents and tickets would be worse drivers in the future because their historic driving record indicated less care in driving. The thesis was confirmed by data that can be viewed in its' entirety in rate filings.

> to the hazard insured against and thus would be a reasonable basis for classification.
>
> Risk classification characteristics should be neither obscure nor irrelevant to the insurance provided; but they need not always exhibit a cause and effect relationship.[3]

Credit scoring is at best obscure relative to auto and home insurance, if not downright irrelevant. Since there is no clear relationship, no thesis, underlying credit scoring, the classification violates actuarial principles.[4]

Some in the industry appear to believe that a correlation between the classification and the risk of loss is all you need to create a class, despite the principles. Taken to its logical extreme, this point-of-view would indicate that race should be used if a correlation existed. Obviously, this is wrong from a public policy perspective. The fact that credit scoring triggers the indirect use of race for insurance underwriting and rating purposes makes it no more socially acceptable. Policymakers need to control the use of such illegitimate classes. Congress should do so since the insurance industry lobby is too strong to overcome in many states.

In fact, there is strong evidence that insurance scoring itself is not a predictor of risk or insurance claims, but, rather, that insurance scoring is a proxy for other factors that are related to claims experience, such as the income, miles driven, or geographic location of the consumer. In particular, insurance scoring is a proxy for race and income. Two independent studies by the Texas and Missouri Departments of Insurance found a strong relationship between insurance scores and race and income.[5] The Missouri study found the single most predictive factor of an insurance score was race.

Even the recent substandard report of the Federal Trade Commission (FTC) on the use of automobile insurance scores, despite relying upon data hand-picked by the insurance industry, found insurance scores were worse on average for African-Americans and Hispanics and that insurance scoring was a proxy for race. Had the FTC actually used an independent and comprehensive set of insurance data, the measured negative racial impact would likely have been much greater.[6] Although the FTC report discounts its own findings and plays down the possibility of racial discrimination, the strong evidence of an adverse, disparate racial impact from insurance scoring justifies a prohibition on its use. Insurers should not be permitted to use a proxy for race when the direct use of race itself for underwriting or rating is prohibited.

---

[3] Risk Classification Statement of Principles, American Academy of Actuaries Committee on Risk Classification, at http://actuarialstandardsboard.org/pdf/appendices/risk.pdf.

[4] There are other actuarial principles that credit scoring violates as well, including the fact that it is not socially acceptable, is subject to manipulation (there are firms that offer, for a fee, to sharply improve your score), and is ambiguous.

[5] Texas Department of Insurance, "Report to the 79th Legislature: Use of Credit Information in Texas," December 30, 2004, page 3. "Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri," State of Missouri Department of Insurance, January 2004.

[6] Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," Federal Trade Commission, July 2007, at http://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf .

In fact, I would strongly encourage the Subcommittee to continue to critically evaluate the FTC credit scoring analysis of automobile insurance scoring, which is deeply flawed and unresponsive to its Congressional mandate. The problems with the report include the failure of the FTC to obtain a comprehensive and independent data set for analysis and the agency's reliance upon a data set hand-picked by the insurance industry. The report also lacks any substantive analysis of the impact of insurance scoring on the availability and affordability of insurance products as requested by Congress, ignores evidence indicating that the correlation between insurance scores and claims is spurious, and fails to analyze the false claim that the use of insurance scoring is legitimate because people who manage their finances well are likely to manage other risks well.[7]

The FTC passed a resolution on May 16 that could lead to a better data collection process for the home insurance scoring study that is now underway. However, given the serious flaws detailed above with the automobile insurance report, we continue to have significant concerns about the FTC's ability and willingness to conduct a thorough, unbiased review of the impact credit scoring on those who purchase home insurance.

Insurers also claim that competition would be harmed and that the availability of insurance would be curtailed if credit scoring was banned. This is a false claim. I need only to point to California, where credit scoring is banned from use in auto insurance. In CFA's recent in-depth study of auto insurance regulation,[8] we found that the state had the best system of regulation in the nation. In particular, California is a leader in protecting consumers from abusive class systems. Rate increases in California were the lowest in the nation over the period we studied. More importantly, despite claims by insurers that a credit scoring ban would harm competition, California had the fourth most competitive automobile insurance market. Further, the number of Californians who were required to receive insurance for the state's high-cost assigned risk plan was very low; only 0.1 percent of the state's automobiles were insured in the plan. The California system proves that robust competition and insurance availability can occur without the use of credit scoring.

<u>LEGISLATION BEFORE THE COMMITTEE</u>

<u>H.R. 5633 -- Gutierrez</u>

CFA very much appreciates the efforts of the sponsors of this bill to curb the inappropriate use of insurance scoring. We support the legislation's goal to ban insurance credit scoring if the use of consumer credit information for insurance underwriting or rating discriminates on the

[7] The fact is that, by the credit modelers own admission, fully 20 percent of the population is unscorable with traditional credit reports because of little or no information in the files. These individuals are disproportionately low income and minority consumers who get charged higher rates through no fault of their own. Even a cursory examination of actual scoring models reveals that many of the factors determining an insurance score have nothing to do with whether a consumer pays his or her bill on time, but with factors related to socio-economic status. Yet, the FTC report dutifully repeats this rationalization for insurance scoring with no critical analysis.

[8] State Automobile Insurance Regulation: A National Quality Assessment and In-depth Review of California's Uniquely Effective Regulatory System, April 24, 2008 at http://www.consumerfed.org/topics.cfm?section=Finance&Topic=Insurance&SubTopic=Insurance%20Regulation.

basis of race or ethnicity. However, as written, we fear that the legislation will not achieve the desired goal:

- The bill could serve to legitimize insurers' use of credit-based insurance scoring so long as the use of the scoring methodology was not found to be discriminatory.

- The bill establishes the FTC as the arbiter of determining racial discrimination, although the agency has virtually no track record or enforcement experience in this area. In fact, the FTC study demonstrated a severe bias against consumers in favor of insurers regarding insurance scoring. We do not trust the FTC to fairly make impartial findings relative to credit scoring. To give just one example of the agency's bias, Congress asked the FTC to study the impact of insurance scoring on the availability and affordability of automobile insurance. Instead of getting data on applications for coverage that resulted in policies being issued or rejected from a large number of insurers serving all parts of the market, the FTC relied upon data handpicked by the industry from a few companies for only the policies they issued. Thus, the FTC had no ability to determine whether insurance scoring resulted in large numbers of consumers being denied coverage, priced out of the market, or charged higher premiums. Yet, despite this obvious limitation, the FTC concluded that credit scoring was a benefit to the majority of consumers. The data problem was brought to the FTC's attention early on, yet despite offers of assistance from state insurance regulators and a period of three years to do the study, the FTC was apparently satisfied to let insurers exercise undue influence over the study through their control of the data.

- The bill lacks an objective standard for identifying racial discrimination, again giving broad discretion to the FTC. As written, the proxy effect language does not clearly and adequately incorporate the legal concept of disparate impact. Under the bill, the FTC could find some statistical correlation to race and income and some proxy effect, but determine that this effect is not substantive and conclude that no discrimination or proxy effect exists. The bill should prohibit BOTH systems that incorporate racial proxies and those that have unlawful disparate impacts.

- To make determinations of discrimination and proxy effect, Congress should vest authority with agencies that have the experience and jurisdiction to regulate insurance and enforce anti-discrimination laws. State insurance departments and the National Association of Insurance Commissioners, who are already authorized to collect the necessary data and take corrective regulatory action, should be allowed to make these determinations. If any federal agency is given authority to make these determinations, the U.S. Department of Justice, not just the FTC, should also be provided with jurisdiction.

- The bill makes no provisions for a private right of action. If the FTC has the final say, there is no recourse for anyone who wants to challenge the racially discriminatory use of credit in insurance. This would be a significant problem for civil rights groups and individual consumers who wish to challenge this practice in the future.

- The bill is unclear about what types of state insurance regulation are or are not pre-empted. Although the bill strives to not pre-empt stricter state laws on insurance scoring, the legislation vests authority with federal agency -- the task of identifying and stopping unfair discrimination – that has traditionally been the role of states.

- The bill does not provide timely assistance for the millions of consumers who are facing higher auto and homeowners insurance rates now because their credit scores have been negatively affected by abusive and reckless lending practices.

We believe it would be simpler to ban the use of consumer credit information for insurance. In the near term, we would encourage you to consider legislation to at least impose a temporary "freeze" on the use of this information by insurers during the current mortgage crisis.

<u>HR 6062 – Waters</u>

CFA supports the bill but we seek clarification on one aspect of the bill.

Since the bill declares that some type of reports, such as motor vehicle records, Comprehensive Loss Underwriting Exchange (CLUE), and medical history records are not consumer reports for purposes of the section, is there any chance that, the way bill is written, it could be interpreted as eliminating adverse action notification for insurers' use of non-credit consumer reports? It should be clarified if there is any chance of such an interpretation.

<u>CONCLUSION</u>

Credit scoring is harmful to consumers, particularly low income and minority consumers. Millions of consumers are threatened with foreclosures and a variety of financial stresses resulting from the sub prime lending crisis, the resulting credit crunch, and the loss of jobs in the current weak economy. It is clearly unfair for millions of consumers to experience higher auto and homeowners' insurance rates because of reckless and abusive practices by lenders or because of conflicts between lenders and bondholders, which are preventing foreclosure assistance. As part of the package of assistance to consumers in financial distress, a ban, or, in the short term, a moratorium on insurance scoring should be enacted.

Credit scoring also undermines the very foundation of a sound insurance system, which involves the use of broad, risk-spreading classes tied to risk factors understandable by consumers that promote loss prevention.

It is time to ban the use of these unfair classes. It is time to pass H.R. 6062.

ATTACHMENT 1

Written Testimony Before the

Subcommittee on Oversight and Investigations
Financial Services Committee
U.S. House of Representatives

October 2, 2007

The undersigned civil rights and consumer organizations applaud Chairman Watt and members of the Subcommittee on Oversight and Investigations for holding this hearing on Credit-Based Insurance Scores: Are They Fair? This statement is intended to supplement the written testimony submitted by the Center for Economic Justice and the National Council of La Raza.

Unknown to most consumers, insurers' use of consumer credit information has spread to almost all insurers and is one of the most important factors in determining how much a consumer pays for auto or homeowners insurance. Insurance companies use credit scores – three digit numbers generated using a consumer's credit report – in insurance underwriting and rate setting. This practice creates wide racial disparities as previous studies have found. Nevertheless, much of the insurance industry relies on credit scoring because it is allegedly predictive in forecasting which consumers will have higher loss ratios. Yet the industry has not been able to provide credible explanation as to why there is a correlation between credit scores and loss ratios.

For these reasons, we echo the call of many organizations and public officials for a prohibition on insurance scoring and insurers' use of consumer credit information for underwriting and ratings purposes.

Before the introduction of the credit scoring systems, the insurance industry had used other unsupported standards and stereotypes with a racial proxy effect. After the major companies were sued for fair housing violations and were forced to eliminate these practices, the industry introduced a new practice – credit-based insurance scoring – that consumer and civil rights groups see as re-introducing unfair racial and ethnic impacts into the pricing of insurance.

Previous studies by the Missouri and Texas Departments of Insurance have found that insurance scoring discriminates against low income and minority consumers because of the racial and economic disparities inherent in scoring. The Missouri study concluded that a consumer's race was the single most predictive factor determining a consumer's insurance score and, consequently, the consumer's insurance premium.

We were pleased that Congress, through the inclusion of Section 215 of the Fair and Accurate Credit Transactions Act of 2003, directed the Federal Trade Commission in conjunction with the Federal Reserve Board to study the impact of credit scoring on the availability and affordability of credit and insurance and to determine whether credit scoring was truly related to insurance losses or simply a proxy for race, income or other factors. The FTC conducted the insurance scoring component of this research.

Unfortunately, we find that the FTC study is fatally flawed in key areas and is not responsive to the Congressional mandate contained in the FACT Act. Most critically, instead of requiring the submission of comprehensive policy data by a large number of insurers, the FTC allowed the insurance industry to self-select the data for analysis. Thus the industry was unnecessarily afforded an opportunity to control the outcome of the study.

Even so, the FTC study found that insurance scores were worse on average for African Americans and Latino consumers, although this finding is downplayed in the report. The study also confirms that despite the growing reliance on credit-based insurance scores, there was no evidence to prove a causal connection between a consumer's score and auto insurance losses. Without the need to demonstrate such a connection, insurers could use any consumer characteristic, such as hair color, to price insurance products.

The FTC report acknowledges that the alleged correlation between risk and credit-based insurance scores might be explained by other factors. Instead of pursuing these other factors, the FTC employed subjective and pejorative racial stereotypes to try to support the alleged link between credit-based insurance scores and legitimate risk. Thus the FTC report mimics the insurance industry blaming-the-victim rationalization of claiming credit history is related to responsibility and risk management. A look at the actual scoring models shows that socio-economic factors have more impact on the score than loan payment history and that an insurance credit score has little to do with personal responsibility and everything to do with economic and racial status.

In short, there is ample evidence to justify banning credit-based insurance scores. Moreover, given the biased and flawed nature of the FTC study on scoring for auto insurance, the undersigned organization encourages Congress to consider assigning responsibility to conduct the homeowners scoring study to another agency, such as the U.S. General Accountability Office, which could then work in conjunction with state insurance regulators who have the necessary authority to obtain the desired data set from the insurance industry.

###

Center for Economic Justice is a Texas-based non-profit organization that advocates on behalf of low income and minority consumers on insurance, credit and utility issues

Consumer Federation of America is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education. www.consumerfed.org

National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC recently released *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide,* available at www.consumerlaw.org.

National Council of La Raza is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve opportunities for the nation's Hispanics. As the largest national Latino civil rights and advocacy organization, NCLR serves all Hispanic nationality-groups in all regions of the country through a network of more than 300 affiliate community-based organizations.

National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights groups, and individuals from 37 states and the District of Columbia. Headquartered in Washington, DC and founded in 1988, NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to housing for millions of people.

Consumers Union of U.S., Inc. Consumers Union (CU) is an expert, independent, nonprofit organization, whose mission is to work for a fair, just, and safe marketplace for all consumers. CU publishes *Consumer Reports* and **ConsumerReports.org** in addition to two newsletters, *Consumer Reports on Health* and *Consumer Reports Money Adviser* with combined subscriptions of more than 7 million. Consumers Union also has more than 500,000 online activists who help work to change legislation and the marketplace in favor of the consumer interest and several public education Web sites. Since its founding in 1936, Consumers Union has never taken any advertising or freebies of any kind. The organization generates more than $160 million in revenue and a staff of more than 500 work at either CU's 50 state-of-the-art labs in Yonkers, NY; its 327-acre auto test facility in East Haddam, CT.; or the three advocacy offices in Washington DC, Austin, TX, and San Francisco, CA.

ATTACHMENT 2

Testimony Before The

House Financial Service Committee
Subcommittee on Oversight and Investigations

Credit-Based Insurance Scores: Are They Fair?

October 2, 2007

Birny Birnbaum
Executive Director
Center for Economic Justice
1701 A South Second Street
Austin, TX 78704
(512) 912-1327
birny@flash.net

1. Introduction

Chairman Watt, Ranking Member Miller and Members of the Committee:

Thank you for the opportunity to discuss insurers' use of consumer credit information for auto and homeowners insurance. My name is Birny Birnbaum and I am the Executive Director of the Center for Economic Justice, an Austin, Texas-based non-profit that advocates on behalf of consumers on insurance, credit and utility matters.

I have been working on insurance credit scoring issues since 1991 as both an insurance regulator – Chief Economist and Associate Commissioner for Policy and Research at the Texas Department of Insurance – and as a consumer advocate. I have testified about insurance credit scoring before legislatures and administrative agencies, including insurance departments and public utility commissions, and provided expert testimony in litigation related to insurance credit scoring. I received my formal training in economics from the Massachusetts Institute of Technology and have been accepted as an expert on both economic and actuarial matters related to auto and homeowners insurance rates and risk classification.

2. Summary of Testimony

Insurance scoring is the use by insurance companies of consumer credit information to determine whether a consumer is eligible for coverage, the types and amount of coverage offered to a consumer and the premium charged to the consumer. The use of insurance scoring has grown to become one of the most important factors in determining a consumer's auto and homeowner's insurance premium and is used by almost all insurers. Insurance scoring is typically done through the use of computer model that converts information in a consumer's credit report into a score, or numerical value, which is then used as an underwriting or rating factor.

Many organizations have called for a prohibition on insurance scoring and insurers' use of consumer credit information for underwriting and rating. These groups include not only consumer organizations, but civil rights groups, insurance agents' groups and some insurers. The case for such a prohibition is strong – there is more than enough information currently available to justify such a prohibition. A closer look at insurance scoring reveals that the practice

- Undermines core functions of insurance system by worsening insurance availability and affordability and undermining the critical role of insurance in encouraging loss prevention;
- Discriminates against low income and minority consumers;
- Is arbitrary and unrelated to how well a consumer "manages" her finances;
- Is inherently unfair and penalizes consumers who are the victims of economic or medical or natural catastrophes;
- Penalizes consumers because of the business decisions of lenders.

The insurance industry claims a variety of benefits from their use of credit scoring. Upon examination, these claims are illusory and contradicted by the available evidence. Ultimately, however, all of the insurer arguments for insurance scoring come down to a single claim: insurance scoring is predictive of the likelihood of a consumer having a claim and consumes benefit if insurers are able to price more accurately.

There is, however, strong evidence that insurance scoring itself is not a predictor of risk or insurance claims, but, rather, that insurance scoring is a proxy for some other factor or factors that are truly related to claim experience. In particular, insurance scoring is a proxy for race and income. Two independent studies by the Texas and Missouri Departments of Insurance found a strong relationship between insurance scores and race and income. The Missouri study found the single most predictive factor of an insurance score was race. Even the recent flawed and biased FTC report on insurance scoring – despite relying upon data hand-picked by the insurance industry – found insurance scores were worse on average for African-Americans and Hispanics and that insurance scoring was a proxy for race. And had the FTC actually used an independent and comprehensive set of insurance data, the measured racial discrimination would have been much greater. Although the FTC report discounts its own findings and plays down the importance of racial discrimination, the finding of racial discrimination from insurance scoring justifies a prohibition. Insurers should not be permitted to use a proxy for race when the direct use of race itself for underwriting or rating is prohibited.

The FTC analysis of insurance scoring is deeply flawed and the report is unresponsive to its Congressional mandate. The problems include:

1. The failure to obtain a comprehensive and independent data set for analysis and the reliance upon a data set hand-picked by the insurance industry. The insurance industry effectively controlled the study by dictating the data that would be used in the study.

2. No substantive analysis of the impact of insurance scoring on the availability and affordability of insurance products as requested by Congress. Because of its reliance on industry-selected data, the FTC performed no analysis of how consumers actually fared from insurers' use of credit scoring.

3. Regurgitating insurer claims about credit scoring despite evidence that contradicts these claims. The FTC ignored evidence indicating that the correlation between insurance scores and claims was a spurious correlation – that insurance scoring was a proxy for some other factor actually related to claims.

4. The failure to analyze the "blaming-the-victim" strategy used by insurers to justify insurance scoring -- the bogus claim that people who manage their finances well are likely to manage their risks well and that's why credit scoring works. The fact is that, by the credit modelers own admission, fully 20% of the population is unscorable with tradition credit reports because of little or no information in the files. These folks are disproportionately low income and minority consumers who get charged higher rates through no fault of their own. And even a cursory examination of actual scoring models reveals that most of the factors determining an insurance score have nothing to do with whether a consumer pays her bill on time, but with factors related to socio-economic status. Yet, the FTC report dutifully repeats this desperate rationalization for insurance scoring with no critical analysis.

5. The failure to examine any alternatives to insurance scoring that are predictive of claims but are not based on any consumer credit information. The FTC ignored research indicating that insurers could eliminate the use of credit information but obtain the same ability to predict claims with advanced modeling and data mining of traditional rating factors. Consequently, the FTC ignored an obvious alternative to insurance scoring that could reduce the impact on low income and minority consumers.

There is no need for further study of insurance scoring to justify its prohibition. The problems with insurance scoring are well documented and the alleged benefits claimed by insurers are illusory. However, if Congress does want additional study, it has become clear that the FTC should not be doing that analysis. The FTC has not only revealed a strong bias toward the insurance industry in the July report on auto insurance, but has indicated it remains willing to allow the insurance industry to control the data for an analysis of insurance scoring for homeowners insurance. Congress should turn to the Government Accountability Office and state insurance regulators for any additional research on insurance scoring. The active involvement of state insurance regulators is particularly important for two reasons. First, state insurance regulators have authority to obtain data from insurance companies and the use of a comprehensive and independent data set is crucial to an unbiased analysis. Second, insurance scoring is primarily regulated by the states. State insurance regulators should be the most knowledgeable about how insurance scoring is used and how it impacts the availability and affordability of insurance.

The remainder of my testimony expands upon these points.

3. Insurance Credit Scoring is an Unfair Practice

Insurance credit scoring is the practice by insurers of using consumers' credit information for underwriting, tier placement, rating and/or payment plan eligibility. The problems with insurance scoring are so great that the practice should be prohibited. Insurance scoring should be prohibited because it:

- is inherently unfair;
- has a disproportionate impact on consumers in poor and minority communities;
- penalizes consumers for rational behavior and sound financial management practices;
- penalizes consumers for lenders' business decisions unrelated to payment history;
- is an arbitrary practice; and
- undermines the basic insurance mechanism and public policy goals for insurance.

There is widespread opposition to insurance credit scoring among consumers and insurance agents. <u>There are hundreds of agents who want to come forward</u> and tell why they are opposed to insurance credit scoring, why insurance credit scoring has worsened insurance availability and how insurance credit scoring has a disproportionate impact on poor and minority consumers. But <u>they can't tell their stories because of their fear of reprisal</u> by the insurance companies they represent. To hear from these agents, the agents must be given protection against these reprisals. To give you a sense of who these agents are, the following agent organizations have come out against insurance credit scoring – National Association of State Farm Agents, National Association of Professional Allstate Agents and the United Farmers Agents Association.

Insurance Scoring is Inherently Unfair

You've just been laid off from your job. Or your daughter has a major medical problem that your health insurance (if you have any) doesn't fully cover. Or you've just gotten a divorce. These three life events account for 87% of family bankruptcies.[9] To "help" you out in this stressful time, your insurance company will raise your homeowners and auto insurance rates because of insurance credit scoring.

The disagreements about insurance credit scoring really boil down to what "fair" means. For insurers, "fair" means that an insurer can produce some kind of data showing a statistical relationship between credit scores and insurance losses. For consumer groups, such a statistical relationship is a necessary, but not sufficient, definition of fair insurance practices. Fair rating factors must also not penalize consumers for rational behavior, for factors outside of their control and for arbitrary practices of insurers and lenders. Fair means that consumers who are the victims of some economic or medical catastrophe are not penalized because they were unlucky enough to lose their jobs, have a family member get sick or get divorced.

When it comes to the real world understanding of fair, insurance credit scoring is terribly unfair.

- Because your credit score depends on having the "right" kind of information in your credit report, you can have a perfect credit history and still get a bad credit score. Contrary to insurer credit scoring myths, your credit score has nothing to do with your "financial responsibility."

- Because your credit report can vary dramatically among the three major credit bureaus, your credit score can vary from good to bad depending upon which bureau provided your insurer with information.

- Because your credit score is based on many things other than how timely you pay your loans, you score can vary dramatically depending on what time in the month your credit report was ordered.

- Because your credit score depends on what type of credit you have, you can get a low score even if you have a perfect payment record. If you have a credit card with a tire company, a loan from a consumer finance company like Household or Beneficial, or have an installment sales contract from a used car dealer, you get a lower score regardless of whether you pay on time. But if you have a gas station credit card, you score is higher!

- Because your credit score depends on the presence of loan information, you get a lower score if you pay in cash or don't borrow much or if you use lenders that don't

[9] 2001 Consumer Bankruptcy Project, cited on page 81 of *The Two Income Trap*, Elizabeth Warren and Amelia Tyagi.

report to credit bureaus. Many younger consumers were penalized with higher rates due to so-called "thin" credit files because the Sallie Mae – the student loan lender to millions – decided it would only report payment history to one of the three major credit bureaus.

- Because your credit score depends on the ratio of your debt to your credit card limit, a consumer who uses one credit card to maximize frequent flier miles gets a lower score than another consumer who charges the same amount but does it on three or four cards.

<u>Insurance Scoring Penalizes Victims or Economic or Medical Catastrophes</u>

Insurance credit scoring is inherently unfair because it penalizes consumers who are the victims of economic or medical catastrophes, such as job loss, divorce, dread disease or terrorist attack. For example, in the aftermath of the September 11 attack, hundreds of thousands of people working in the travel-related industry lost their jobs. Out of this group, thousands had to increase borrowing to offset loss of income or loss of health insurance. Many filed for bankruptcy. In the aftermath of Hurricane Katrina, hundreds of thousands of consumers were displaced and placed in financial stress. It is unfair for insurance companies to further penalize these victims by raising their homeowners and auto insurance rates.

One of the myths perpetrated by insurers to rationalize the use of insurance credit scoring to legislators is the myth of the immoral debtor. Insurers argue that good credit scores reflect the financial responsibility of consumers. And they ask why should financially responsible consumers subsidize the rates of consumers who are not financially responsible? As explained further below, this argument fails because a good credit history does not equate to a good credit score. Stated differently, an insurance score is simply not a measure of financial responsibility.

Regarding the "immoral debtor," data on the causes of bankruptcies reveal that the overwhelming majority of bankruptcies result from job loss, medical problems and divorce. Fully 87% of bankruptcies for families with children arise from these three reasons. And the remaining 13% includes reasons such as natural disaster or crime victim.[10]

In their recent book, *The Two Income Trap*, Elizabeth Warren and Amelia Tyagi study the growth, composition and causes of bankruptcy. They were astonished to find that the number of women filing for bankruptcy grew from 69,000 in 1981 to nearly 500,000 by 1999. As they researched the causes of this phenomenon, they documented the fact that financial strain on families – particularly families with children – resulted from dramatic increases in the cost of housing, health care and schooling combined with deregulation of interest rates for loans and business decisions made by lenders for easy credit. They found that married couples with children are more than twice as likely to file for divorce than couples without children and that a divorced woman raising a child is nearly three times more likely to file for divorce than a single woman without a child. They concluded that "having a child is the single best predictor that a

[10] 2001 Consumer Bankruptcy Project, cited on page 81 of *The Two Income Trap*, Elizabeth Warren and Amelia Tyagi.

woman will end up in financial collapse." Their research shows that the insurer rationalization for insurance credit scoring – "financial responsibility" – is indeed a myth refuted by the facts.

A Good Credit History Does NOT Equal a Good Credit Score

Insurance credit scoring is inherently unfair because a good credit history does not equal a good credit score or favorable insurance treatment. This occurs because insurance credit scores are based not just on bankruptcies and delinquencies, but also on other factors unrelated to credit management. For example, credit scores are often based on the type of credit (consumer finance loans are less favorable than bank loans), the number of credit cards (there is a magic number that is optimal, even if the consumer only uses the retail store cards once to get the first time 10% purchase discount), length of time credit has been established (which is another way of charging younger people more), length of time since last account opened (which penalizes families that have just moved or refinanced their mortgage) and the number of inquiries (which penalizes consumers who shop around for the best rate – behavior that should be rewarded and not punished with higher insurance rates.) While the insurance industry offers a rationale for each of these factors, the fact is that insurance credit scoring casts too wide a net and penalizes people engaged in behavior we would all consider good financial management.

Insurance Credit Scoring Produces Arbitrary Results

Insurance credit scoring is unfairly discriminatory and violates actuarial standards for risk classification because it is an arbitrary process. For example, your score can vary from very bad ("high risk") to very good ("low risk") depending on which credit reporting agency provides the credit information to the insurer because a consumer's information varies among the big three bureaus. A representative from ChoicePoint admitted this in a hearing before the Georgia Insurance Commissioner in 2001. The author recently ordered my three-bureau credit report and found different inquiries in each of the three bureaus – not one single inquiry was reported by more than one bureau.

Insurance credit scoring is arbitrary because a score can change dramatically over a short time frame for no apparent reason. The author' auto credit score in November 2002 (obtained from www.choicetrust.com) was very low – around the 17th percentile. In May 2003, the author's score was in the 82nd percentile. In six months (or perhaps a shorter period), the author's score went from very high risk to very low risk. No other insurance risk factor is so arbitrary.

Consumers Penalized for Lenders' Business Decisions

Over the course of the 1990's consumer debt grew dramatically as lenders made credit more easily available to many consumers. The number of credit card solicitations grew from 1 billion to 5 billion annually. Lenders moved to low- or no-down payment mortgages. Although lenders are certainly free to make business decisions about loaning money, consumers should not be penalized with higher homeowners or auto insurance premiums because of those decisions.

To illustrate the problem, Fannie Mae recently began requiring a 10% down payment for 30 year mortgages on manufactured homes. Previously, consumers could get a loan with no money down. In defending the proposal, Deborah Tretler, vice president of single family homes for Fannie Mae, stated, "We don't serve borrowers well when it is easy for a borrower to get into a home under very flexible terms, only to have them lose their home, their credit ruined and their homeownership dreams turned into a nightmare."[11]

Warren and Tyagi, in *The Two-Income Trap*, explain how lenders make lots of money off of problem borrowers through higher interest rates and substantial penalty fees.

It is not only lenders' lending decisions that make insurance scoring unfair, it is also lenders' reporting decisions to credit bureaus. In some cases, lenders report only partial information about loans to credit bureaus. For example, some major credit card vendors do not report card limits, to prevent competitors from learning about their customers. But by failing to report credit limits, the insurance credit scoring models often use the current balance as the limit – with the result that the consumer appears to be maxing out his or her credit line. Which, in turn, lowers the insurance score.

[11] "Mortgage regulations could stop some would-be homeowners," by Genaro C. Armas of the Associated Press in the September 12, 2003 issue of the *Austin American-Statesman.*

In another example, Sallie Mae, the nation's largest lender for student loans with millions and millions of borrowers, has decided to report loan information to only one of the three major credit bureaus – again, to protect its customer list. If a consumer who has a good student loan payment history seeks auto insurance and the insurer happens to use a credit bureau that Sallie Mae has <u>not</u> reported to, the consumer gets a lower score than he or she should because a lack of information penalizes a consumer in an insurance score.

In yet another example, journalist Ken Harney explains how some lenders refuse to report the credit limits on credit cards and other loans to credit bureaus. Absent this information, the credit bureaus report the current debt balance as the credit limit. This harms consumers because a factor in credit scores is the ratio of current debt to credit limits. Harney cites a consumer who was charged a much higher rate than she would have been had the lenders reported her credit limits:

> *That extra expense would not have been caused by anything she did wrong, but rather by what the card company did without her knowledge: keep her good credit behavior a secret from potential competitors by withholding her credit limit and highest balance, thereby decreasing her credit score. Credit card companies sometimes try to hide their best customers' identities from other lenders trolling the credit bureaus' vast databases to prescreen targets for card offers. Typically the trollers ask the bureaus for lists of cardholders with higher scores, and avoid those with marginal or lower scores.*[12]

These examples of how lenders' business decisions can dramatically affect an insurance consumer's insurance score further illustrate the arbitrary and unfair nature of insurance credit scoring.

Most recently, the explosion in subprime lending included thousands of instances of inappropriate loans to consumers – loans the consumer would clearly be unable to afford even if housing prices continued to grow and interest rates remained low. There were instances of abusive sales practices. Again, the question arises, why should these consumers suffer higher auto and homeowners insurance rates because of the business decisions and practices of lenders?

---

[12] Ken Harney, "2 Missing Numbers Can Doom a Loan," *Washington Post,* 1/1/05, page F1. See also Kenneth Harney, "Credit Card Limits Often Unreported," *Washington Post,* 12/25/05, page F1.

Insurance Credit Scoring Penalizes Consumers in Poor and Minority Communities

In addition to being arbitrary, insurance credit scoring also has a systematic bias against consumers in poor and minority communities, described further below. ***It is important to state clearly that the claim that insurance credit scoring has a disproportionate impact on consumers in poor and minority communities is NOT an argument that poor people are poor financial managers. The two arguments are unrelated because good financial management / good credit history does NOT equate to a good insurance credit score. It is the structure of insurance credit scoring models – and not the financial management habits of low-income consumers – that creates the bias against consumers in poor and minority communities.*** Further, it is unclear how anyone who has actually examined the factors and structure of insurance credit scoring models could legitimately assert that the claim of systematic bias against consumers in poor and minority communities is a critique of the financial management habits of low-income consumers.

Insurance Credit Scoring: 21st Century Redlining and the End of Insurance

There are two main reasons CEJ works on insurance issues, particularly as they impact low income and minority consumers. First, insurance is the mechanism that consumers and businesses use to protect their assets in the aftermath of a catastrophic event – whether that's a fire, an auto accident, a natural disaster, theft. Insurance enables consumers and businesses to preserve and to build assets, wealth and financial security. Insurance is essential for individual and community economic development. And low income consumers should have the same access to these essential financial tools as more affluent consumers. The history of insurance redlining, however, is a story of less access, inferior products and higher prices for low income and minority consumers.

Second, insurance is the primary mechanism for loss prevention – insurance provides economic incentives for less risky behavior and economic disincentives for more risky behavior. Or at least, that is what insurance pricing should do. Insurance pricing should be based on factors that are under the control of the consumer and which make a difference in the likelihood of an auto accident or homeowners' claim. Insurance is the primary tool to encourage behavioral changes that actually reduce accidents, human suffering and property damage.

Insurance credit scoring undermines these public policy goals in at least two ways. First, even if insurance credit scoring did what it's purported to do – charge higher rates for consumers with a poor credit history – it is inherently unfair and undermines the basic purpose of insurance which is to protect consumers' assets in catastrophic times. Consider that 87% of families who file for bankruptcy do so because of one of three reasons – job loss, divorce, catastrophic illness. So even if insurance credit scoring is working as its proponents claim, the practice penalizes those consumers who are victims of an economic catastrophe with, at best, higher rates, and at worst, the elimination of coverage in the time of greatest need.
Second, the use of insurance credit scoring undermines the other core purpose of insurance by giving more and more weight in the rating process to factors outside of the consumer's control and which provide no economic incentive for loss prevention. Insurance credit scoring undermines the loss prevention capacity of insurance because it is unrelated to behavioral

changes that reduce the likelihood of an accident or damage from an event. When you know that insurance rates will go up by 25% if you get a speeding ticket or an at-fault accident, that knowledge affects your behavior. When you get a discount for putting on hail-resistant shingles on your home or installing an anti-theft device in your vehicle, the consumer is in a position to take positive action to not only affect the likelihood of an accident or claim, but also in a position to lower his or her premium. And these types of discounts provide a benefit to some consumers without raising the rates for other consumers – you can give someone a 40% discount for a hail resistant roof and pay for that discount with lower expected losses – so a discount for one does not mean a rate increase for another. With insurance credit scoring, it's less than a zero sum game – since is there no reduction in losses, any discounts for some consumers must be paid for by rate increases for other consumers and insurance credit scoring adds costs to the system.

4. The Impact of Insurance Credit Scoring on Poor and Minority Consumers

Despite insurers' claims to the contrary, it is clear that insurer underwriting and rating practices now emphasize a consumer's economic status rather than their driving record.

4.1 Prior Bodily Injury Limits

For example, several insurers now charge higher rates to consumers because of their prior liability limits. If your previous policy was a basic limits policy, you will be charged more than if your previous policy was, say, 50,000/100,000 limits. The use of prior liability limits by insurers to determine assignment to a rating tier clearly penalizes low income consumers because of their income. Given that insurers are completely willing to use underwriting and rating factors that penalize consumers because of economic status, it should be no surprise that insurance credit scoring has a disproportionate impact on consumers in low-income and minority communities.

4.2 Insurance Credit Scoring Penalizes Consumers in Low-Income and Minority Communities

Despite insurer protests, there is no ample evidence that insurance credit scoring penalizes consumers in low-income and minority communities.

4.2.1 Fair Isaac Admission

On the issue of insurance credit scoring versus income and race, the Executive Vice President of Fair, Isaac and Company, Peter McCorkell, admitted that insurance credit scoring has a disparate impact based upon race and income:

> ***Doesn't scoring result in higher reject rates for certain minorities than for whites?*** Again, the short answer is, "Yes," but it is the wrong question. The question ought to be: "Does credit scoring produce an accurate assessment of credit risk regardless of race, national origin, etc.?" Studies conducted by Fair, Isaac, and Company, Inc. (discussed in more detail below) strongly suggest that scoring is both fair and effective in assessing the credit risk of lower-income and/or minority applicants. Unfortunately, income, property, education, and employment are not equally distributed by race/national origin in the United States. Since all of these factors influence a borrower's ability to meet financial obligations, it is unreasonable to expect an objective assessment of credit risk to result in equal acceptance and rejection rates across socioeconomic or race/national origin lines. By definition, low-income borrowers are economically disadvantaged, so one would not expect their score distributions to mirror those of higher-income borrowers.[13]

4.2.2 Freddie Mac Study

In its 1999 National Consumer Credit Survey, Freddie Mac found:

> Having a poor credit record is a relatively common problem in today's society. Using the combined results from the CCS (i.e., African-Americans, Hispanics and Whites) we estimate that:
>
> 30% of these groups have "bad" credit records
> 13% of these groups have "indeterminate" credit records
> 57% of these groups have "good" credit records
>
> Credit problems persist across income groups. We estimate that:
>
> 36 % of consumers with incomes under $25,000 had "bad" credit records
> 33 % of consumers with incomes of $25,000 to $44,999 had "bad" credit records
> 25 % of consumers with incomes of $45,000 to $64,999 had "bad" credit records
> 22 % of consumers with incomes of $65,000 and $75,000 had "bad" credit records
>
> Minority borrowers are more likely than white borrowers to experience credit problems. For African-Americans we estimate that:
>
> 48% of African Americans have "bad" credit records

---

[13] Page 15, Fall 2000 Issue of *Profitwise*, a publication of the Federal Reserve Bank of Chicago.

16% of African Americans have "indeterminate" credit records
36% of African Americans have "good" credit records

For Hispanics we estimate that:

34% of Hispanics have "bad" credit records
15% of Hispanics have "indeterminate" credit records
51% of Hispanics have "good" credit records

For Whites, in contrast, we estimate that:

27% of Whites have "bad" credit records
12% of Whites have "indeterminate" credit records
61% of Whites have "good" credit records

It is unclear how the quality of credit histories can vary by income and race, but the insurance industry still maintains insurance credit scoring has no disparate impact based upon income and race.

4.2.3 Data from the Survey of Consumer Finances

Statistics the Survey of Consumer Finances, reported in the 2000 Statistical Abstract of the United States reveal that credit characteristics vary not only by age and income, but also over time within age and income segments. Table 792 – *Financial Assets Held by Families by Type of Asset: 1992 to 1998* shows the ownership of any financial assets varies dramatically by age and income. The ownership of financial assets is related to the ability of a family to withstand an economic or medical catastrophe.

Table 796 – *Ratios of Debt Payments to Family Incomes: 1992 to 1998* shows higher ratios of debt payments to family income and much higher ratios of families with payments 60 or more days due for younger and lower income families. The table also shows how these ratios – both of which figure prominently in insurance credit scores – vary over time.

Table 817 – *Usage of General Purpose Credit Cards by Families: 1992 to 1998* shows that younger and poorer families are much less likely to pay off credit card balances each month and far more likely to hardly ever pay off the balance than older or more affluent families. Again, these characteristics – which vary by age and income – figure prominently in insurance credit scores.

4.2.4 The University of Texas Study

Further evidence of the disproportionate impact of insurance credit scoring on poor and minority consumers comes from the report prepared by the University of Texas Bureau of Business Research on the relationship between insurance credit scoring and insurance losses. The authors' analysis of the correlation between insurance credit scoring and insurance losses is unreliable – it relies upon a simple loss ratio methodology that the NAIC insurance credit scoring working group rejected in 1996 as “misleading and counterproductive.” However, the report does reveal other important findings.

The authors found that average and median credit scores were much higher in the standard market than in the nonstandard (so-called “high risk”) market. But the scores were taken from policies issued in 1998 – before the insurers were using credit history to underwrite consumers in the standard and nonstandard markets. Consequently, if credit history was unrelated to underwriting risk factors used by insurers, we would expect average scores to be similar in the standard and nonstandard markets. The fact that the scores were so different between the two markets means that insurers were already using some underwriting factor or factors to distinguish risk of consumers that is correlated to credit.

In addition to showing that credit scores are a proxy for other risk factors used by insurers, the difference in credit scores between the standard and nonstandard markets also indicates that credit scores are correlated to race and income of consumers. Just as low credit scores are more prevalent in the nonstandard market, the likelihood of being denied coverage in the standard market and ending up in a high-cost county mutual grows dramatically as the neighborhood becomes less affluent and less white.

Standard Auto Insurance Market Rejection Rates in Texas versus Race and Income

Automobile Rejection Rate	1996 Average of Non-Anglo Population Percentage	1996 Average of Median Household Income	1996 Number of ZIP Codes
0.0% to 5.2%	4.7%	$22,414	1
5.3% to 10.4%	12.1%	$44,042	74
10.5% to 15.6%	13.6%	$30,565	317
15.7% to 20.8%	20.7%	$24,871	413
20.9% to 26.0%	29.4%	$24,523	280
26.1% to 31.1%	43.0%	$23,456	142
31.2% to 36.3%	54.6%	$21,549	79
36.4% to 41.5%	68.5%	$19,954	65
41.6% to 46.7%	82.7%	$17,682	45
46.8% to 51.9%	83.7%	$16,441	38
Over 51.9%	92.3%	$14,015	26

4.2.5 Factors Used in Insurance Credit Scoring Models are Biased Against Consumers in Low-Income and Minority Communities

A review of the factors contained in insurance scoring models – and the information missing from consumer credit reports and scoring models – further documents the disproportionate impact of insurance credit scoring against poor and minority consumers.

Reason codes for insurance models from ChoicePoint include factors that systematically discriminate against consumers in poor and minority communities. In the ChoicePoint models, a consumer's score is affected by the type of credit and/or the type of lender -- regardless of whether the consumer is current on the payments. A consumer who gets a loan from a consumer finance company gets a lower score than a consumer who gets a loan from a bank – even if the consumer has a perfect payment record. A consumer who has a credit card from a tire store -- such as Goodyear -- gets a lower score just for having that account. A consumer who buys a car through an installment sales contract gets a lower score -- even if the payment record is perfect. Clearly, consumers in less affluent neighborhoods are far more likely to use these types of credit mechanisms than consumers in more affluent communities.

The fact is that the financial institutions in poor and minority communities are different from those in more affluent white communities. And this difference results in a systematic bias in insurance credit scoring models. As a further example, consider payday lenders, check cashing lenders and rent-to-own businesses – which target poor consumers. Even if a consumer was able to pay the extraordinarily high interest rates from these businesses, it would not help the consumer's insurance score – because these institutions do not report to credit bureaus. And the absence of information in a credit report is a credit score negative. Consequently, consumers who pay in cash or who use financial institutions that do not report to a credit reporting agency are penalized with lower scores. Finally, consider a consumer who demonstrates financial responsibility by paying all her utility bills on time for decades. This actual financial responsibility is not rewarded in insurance credit scoring models because these payments do not appear in credit reports.

4.2.6 The Missouri Department of Insurance Study

A few weeks ago, the Missouri Department of Insurance released a study that specifically examined the impact of insurance credit scoring on the availability of insurance coverage in poor and minority communities. This is the first independent study based on detailed insurance credit scoring data using rigorous statistical analysis. The Department collected credit score data aggregated at the ZIP Code level from 12 insurers for the study period of 1999 to 2001. For each Missouri ZIP Code, the Department obtained:

- Mean credit score
- The number of exposures for each of five equal credit score intervals

The Department then utilized a variety of multi-variate statistical techniques to isolate the relationship of income and race to insurance credit scoring, independent of other factors. The study found:

- ***The insurance credit-scoring system produces significantly worse scores for residents of high-minority ZIP Codes.*** The average credit score rank in "all minority" areas stood at 18.4 (of a possible 100) compared to 57.3 in "no minority" neighborhoods – a gap of 38.9 points. This study also examined the percentage of minority and white policyholders in the lower three quintiles of credit score ranges; minorities were overrepresented in this worst credit score group by 26.2 percentage points.

- ***The insurance credit-scoring systems produces*** [sic] ***significantly worse scores for residents of low-income ZIP Code.*** The gap in average credit scores between communities with $10,953 and $25,924 in *per capita* income (representing the poorest and wealthiest 5 percent of communities) was 12.8 percentiles. Policyholders in low-income communities were overrepresented in the worst credit score group by 7.4 percentage points compared to higher income neighborhoods.

- ***The relationship between minority concentration in a ZIP Code and credit scores remained after eliminating a broad array of socioeconomic variables, such as income, educational attainment, marital status and unemployment rates, as possible causes.*** Indeed, minority concentration proved to be the single most reliable predictor of credit scores.

- ***Minority and low-income individuals were significantly more likely to have worse credit scores than wealthier individuals and non-minorities.*** The average gap between minorities and non-minorities with poor scores was 28.9 percentage points. The gap between individuals whose family income was below the statewide median versus those with family incomes above the median was 29.2 percentage points.

Based upon the results of this study, the former Governor of Missouri has called for a ban on insurance credit scoring.

4.2.7 The Texas Department of Insurance Preliminary Report

The Texas Department of Insurance (TDI) reviewed over 2 million policyholder records and obtained policyholder-specific information on race. The TDI report, issued in the beginning of January 2005, states unequivocally that insurance credit scoring discriminates against minority consumers:

> The individual policyholder data shows a consistent pattern of differences in credit scores among the different racial/ethnic groups. The average credit scores for Whites and Asians are better than those for Blacks and Hispanics. In addition, Blacks and Hispanics tend to be over-represented in the worse credit score categories and under-represented in the better credit score categories.[14]

The TDI study confirms and validates the Missouri Department of Insurance (MDI) study. Insurers complained about the Missouri study because it inferred socio-economic characteristics from ZIP Codes to average credit scores. But the MDI methodology is well accepted in the field of fair lending analysis. The TDI study not only confirms the MDI study results – it validates the MDI methodology.

4.2.8 Traditional Credit Reports Penalize Low Income and Minority Consumers

CEJ and other consumer groups have long argued that traditional credit reports penalize low income and minority consumers because the absence of credit information – so-called "thin files" – results in higher premiums. In the past year, the credit report and credit scoring industry has admitted this bias against consumers. Several vendors are now developing "non-traditional" credit reports, which include information not contained in traditional credit reports, such as rent and utility payments and activity related to non-traditional loans. Fair, Isaac, the original developer of lending and insurance credit scoring models claims that 50 million Americans are unscorable using traditional credit information because of thin files.[15] First American, a provider of credit information, claims its non-traditional credit reports will benefit minority and low-income families[16], indicating that traditional credit reports harm these consumers. Insurers have always used traditional credit reports and penalized consumers with thin files and such practices have resulted in disproportionately higher premiums for low-income and minority consumers as well as some seniors.

---

14 Texas Department of Insurance, "Report to the 79th Legislature: Use of Credit Information in Texas," December 30, 2004, page 3.

15 "Giving Credit Where Credit's Due," Kenneth Harney, *Washington Post*, November 11, 2006, Page F1

16 http://www.credco.com/Anthem/default.htm

4.3 Conclusion

In conclusion, the problems with insurance credit scoring are apparent and even acknowledged by the industry, as evidenced by their "compromise" proposal (the NCOIL model) with a variety of purported restrictions and regulatory oversight. But what are the great benefits to consumers that warrant the use of this problematic factor and intense regulatory resources? Ultimately, there are none. Moreover, all the benefits alleged by the insurance industry come down to one claim – the purported statistical relationship between credit scores and loss ratios. And while a definitive statistical relationship is a necessary justification for the use of certain information as an underwriting or rating factor, such a statistical relationship can not be sufficient justification. If it were, then race would be a legitimate rating factor. But lawmakers across the country have decided that race is not a legitimate basis for underwriting for rating insurance. If race can not be used directly by insurers, then insurers should not be permitted to use race indirectly through insurance credit scoring.

5. False Industry Claims About Insurance Scoring

The insurance industry, at one time or another, has claimed insurance scoring is the cause of untold benefits for consumers and has denied any problems or consumer harm resulting from insurance credit scoring. Simply stated, the insurance industry has no credibility when it comes to insurance credit scoring. For example, in 1999, at the same time the industry was denying state insurance regulators the data necessary to evaluate the impact of insurance scoring on low income and minority consumers, the American Insurance Association issued a report claiming a study by one of its member companies (Hartford) had shown "that credit score is not significantly related with income. . ."[17] The insurance industry also claimed no relationship between insurance score and race.[18] Once insurance regulators obtained the data necessary to perform an independent study, the industry claims were proven false. The Texas and Missouri Departments of Insurance both found that insurance scoring has a disproportionately negative impact on low income and minority consumers, as discussed above.

The insurance industry continues to make false claims about the benefits of insurance scoring. Just this week, the industry media organization, the Insurance Information Institute, claimed insurance scoring was responsible for auto insurance rate reductions. As shown below, this claim is incorrect. In fact, insurance scoring has been responsible for excessive auto insurance rates.

Industry Claim 1: Insurance Scoring Is an Accurate Predictor of Claims, Promotes Competition and the Availability of Affordability of Insurance

---

[17] Statement of the American Insurance Association on the Lack of Correlation Between Income and Credit Score, March 1999, page 1

[18] See testimony of Progressive Insurance before the Florida Task Force on the Use of Credit Reports in Underwriting Automobile and Homeowners Insurance, 2001-02.

Insurance scores can help make insurance more affordable.
Insurers have found that using insurance scores as a factor in the underwriting process helps them to more accurately price policies and actually write more policies. In some cases, consumers pay less for insurance. This information helps insurance companies determine a fair premium for each consumer that is related to their potential for filing a claim.

Insurance scoring can help increase the availability of insurance.
Many consumers, who might otherwise have less access to or have been denied coverage for a variety of reasons, are able to find coverage because insurance companies use credit history to underwrite policies.

Insurance scoring promotes competition.

Facts:

Insurance scoring decreases insurance availability by raising rates for those consumers for whom price increases make a difference in the ability to purchase insurance – low income consumers. Objective measures indicate that insurance scoring has decreased competition and worsened insurance availability and affordability.

Insurers claim that insurance credit scoring allows more accurate pricing. If this were the case, we would expect some consumers to pay more and some to pay less while the ratio of claims paid to premiums collected to remain constant. In fact, insurance scoring has led to lower loss ratios and higher profits for insurers. In addition, measures of uninsured motorists by the industry's own research organization indicate more uninsured motorists – direct refutation of the claim that insurance credit scoring promotes greater insurance availability and affordability

Excessive Rates and Profitability:

Private Passenger Automobile Loss Ratios, Countrywide

2000	71.2%
2001	72.7%
2002	67.5%
2003	62.8%
2004	58.6%
2005	60.1%
2006	57.9%

The report *Credit Scoring And Insurance: Costing Consumers Billions And Perpetuating The Economic Racial Divide* analyzes auto insurer profitability over the period in which insurers started using insurance scoring more intensively. The report found over $55 billion in excessive auto insurance premiums for the three years 2004 through 2006.

As the profitability data show, any recent reduction in auto insurance rates has not been caused by insurance scoring. In fact, auto insurance rates are too high and the absence of competition to drive rates to reasonable levels is attributable to insurance scoring. Consider the comments of Ed Liddy, then-CEO of Allstate to investment analysts in 2005:

> 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.[19]

As made clear by Ed Liddy's comments, insurance scoring is used to predict consumer profitability, which is not the same as predicting risk of loss.

Uninsured Motorists
According to a recent Insurance Research Council (IRC) study, the estimated percentage of uninsured motorists increased nationally from 12.7 percent in 1999 to 14.6 percent in 2004. (*Uninsured Motorists, 2006 Edition*) These data directly refute industry claims that insurance scoring promotes insurance availability and affordability.

Residual Market
According to data from the Auto Insurance Plan Service Office, an organization that operates or assists in the operation of assigned risk plans across the country, the number of vehicles insured through assigned risk plans grew by about 70% from 217,200 in 2000 to 368, 831 in 2003 not including the New York assigned risk plan and 100% from 433,242 to 864,074 including New

[19] 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.

York.[20] These data directly refute industry claims that insurance scoring promotes insurance availability and affordability.

No Evidence of Consumer Harm in States Where Insurance Scoring is Banned

In addition, there is no evidence that insurers have restricted their writings in states that ban insurance credit scoring. In California, insurance credit scoring is not permitted for private passenger automobile insurance, yet there are many insurers offering insurance and, in 2003, the percentage of vehicles insured through the involuntary market (assigned risk plan) was 0.3% or 3 out of every 1,000 vehicles insured. In contrast, in 2003 in New York, where insurers use insurance credit scoring, the assigned risk share of the market is 5.5% or 18 times higher than in California

Insurance Credit Scoring is Part of a Trend to Rating Based on Economic Status

The insurance industry has long targeted low income and minority communities with high-cost auto and home insurance products, in the same manner that predatory lenders targeted low-income and minority communities with subprime and predatory loans. A recent risk classification filing in Texas provides a tier matrix based on the following factors, showing that economic status has greater weight in determining a consumer's premium that driving record or miles driven.:

- Prior insurer
- Prior liability limits
- Previous non-standard insurance
- Lapse status
- College education
- Occupation
- Age of vehicle
- Multi-car policy
- Years with current employer
- Home ownership
- Not-at-fault accidents
- Credit score

Some Evidence Refutes the Alleged Relationship Between Credit and Claims

Insurers argue that there is a powerful correlation between insurance scores and expected claims. If such a relationship actually existed, then we would expect that an increase in delinquencies and bankruptcies would be matched by an increase in insurance claims. In fact, the opposite has occurred. Despite rapid increases in bankruptcies and delinquencies since 2000, auto claims have remained stable or declined. This suggests that the correlation between insurance credit scores and claims is not real and that insurance scores are a proxy for some other factor that is truly related to claims.

[20] *Auto Insurance Report*, "Residual Market Growth Continues Despite Strong Voluntary Profit," August 29, 2005. Note, the cited AIPSO data covers 46 states.

Industry Claim 2: Most Consumers Benefit

Most people benefit from insurance scoring.
Most people have good credit and can benefit from insurance scoring. It can help consumers qualify for lower insurance rates and in some cases, even offset a less than perfect driving record.

Most consumers pay less because of insurance scoring.
An NAII member company found that insurance scoring helps it offer lower premiums to nearly 70 percent of its policyholders. Insurance scores enable insurers to price products with greater accuracy, and with every customer paying according to his or her potential for loss.

Facts:

Insurance Credit Scoring Hurts All Consumers
There are two basic public policy purposes of insurance. The first is to provide individuals, businesses and communities with a financial security tool to avoid financial ruin in the event of a catastrophic event, whether that event is a traffic accident, a fire or a hurricane. The is essential financial security tool is accomplished by the spreading of risk over a large number of consumers and business and is typically performed by insurers accepting the transfer of risk from individuals and by spreading the individual risks through the pooling of very large numbers of individual risks. The pool or risks is diversified over many types of perils and many geographic locations.

The second essential purpose of insurance is to promote loss prevention. Insurance is the fundamental tool for providing economic incentives for less risky behavior and economic disincentives for more risky behavior. The insurance system is not just about paying claims; it is about reducing the loss of life and property from preventable events. Historically, insurers were at the forefront of loss prevention and loss mitigation. At one point, fire was a major cause of loss – no more, in large part due to the actions of insurers in the 20th century.

Insurance credit scoring hurts all consumers by undermining the both goals of insurance. It hurts the goal of providing an essential financial security tool by making insurance less affordable and available to the consumers most in need of the tool. It undermines the loss prevention role of insurance by removing the ability of insurance rating to provide economic incentives for less risky behavior and economic disincentives for more risky behavior.

Good Credit Histories Don't Equate to Good Credit Scores
Insurance credit scoring is inherently unfair because a good credit history does not equal a good credit score or favorable insurance treatment. This occurs because insurance credit scores are based not just on bankruptcies and delinquencies, but also on other factors unrelated to credit management. For example, credit scores are often based on the type of credit (consumer finance loans are less favorable than bank loans), the number of credit cards (there is a magic number that is optimal, even if the consumer only uses the retail store cards once to get the first time 10% purchase discount), length of time credit has been established (which is another way of charging

younger people more), length of time since last account opened (which penalizes families that have just moved or refinanced their mortgage) and the number of inquiries (which penalizes consumers who shop around for the best rate – behavior that should be rewarded and not punished with higher insurance rates.) While the insurance industry offers a rationale for each of these factors, the fact is that insurance credit scoring casts too wide a net and penalizes people engaged in behavior we would all consider good financial management.

Over the course of the 1990's consumer debt grew dramatically as lenders made credit more easily available to many consumers. The number of credit card solicitations grew from 1 billion to 5 billion annually. Lenders moved to low- or no-down payment mortgages. Although lenders are certainly free to make business decisions about loaning money, consumers should not be penalized with higher homeowners or auto insurance premiums because of those decisions.

To illustrate the problem, Fannie Mae recently began requiring a 10% down payment for 30 year mortgages on manufactured homes. Previously, consumers could get a loan with no money down. In defending the proposal, Deborah Tretler, vice president of single family homes for Fannie Mae, stated, "We don't serve borrowers well when it is easy for a borrower to get into a home under very flexible terms, only to have them lose their home, their credit ruined and their homeownership dreams turned into a nightmare."[21]

It is not only lenders' <u>lending</u> decisions that make insurance scoring unfair, it is also lenders' <u>reporting</u> decisions to credit bureaus. In some cases, lenders report only partial information about loans to credit bureaus. For example, some major credit card vendors do not report card limits, to prevent competitors from learning about their customers. But by failing to report credit limits, the insurance credit scoring models often use the current balance as the limit – with the result that the consumer appears to be maxing out his or her credit line. Which, in turn, lowers the insurance score.

In another example, Sallie Mae, the nation's largest lender for student loans with millions and millions of borrowers, has decided to report loan information to only one of the three major credit bureaus – again, to protect its customer list. If a consumer who has a good student loan payment history seeks auto insurance and the insurer happens to use a credit bureau that Sallie Mae has <u>not</u> reported to, the consumer gets a lower score than he or she should because a lack of information penalizes a consumer in an insurance score.

Every Consumer Organization and Most Agent Groups Want Insurance Credit Scoring Banned

> The National Association of State Farm Agents, Inc. (NASFA) hereby resolves that we are opposed to any insurance company using credit scoring for the purpose of property and casualty underwriting and rating. We believe credit scoring is part of a marketing scheme designed to curtail market share, avoid rate regulation and it improperly emphasizes credit as an underwriting characteristic without sufficient demonstration of its

21 "Mortgage regulations could stop some would-be homeowners," by Genaro C. Armas of the Associated Press in the September 12, 2003 issue of the *Austin American-Statesman.*

> reliability for underwriting purposes. There is tremendous opportunity to mischaracterize potential insurers and inadvertently or intentionally illegally discriminate. We further support legislation to prohibit credit scoring for the purpose of property and casualty underwriting and rating.

The National Association of Professional State Farm Agents and The United Farmers Agents Association and other agents' groups oppose insurers' use of insurance credit scoring. Every consumer organization opposes insurance credit scoring – Consumer Federation of American, U.S. Public Interest Research Group, state PIRGs, Consumers Union, AARP and many more. Consumers Union recently wrote:[22]

> Even though insurance companies cannot use race or ethnicity to decide who gets insurance and how much it will cost, evidence shows that insurance scores disproportionately affect certain minority groups and low-income consumers, which raises concern that scores can serve as a proxy for race or ethnicity. Research shows that people in areas with a high concentration of minorities are more likely to have lower credit scores.
>
> The consequences are far-reaching. The economic stability of our cities and our nation depends in part on access to fairly priced coverage. Insurance is based on the concept that spreading the risk helps society protect itself from economic devastation and more quickly recover from catastrophes. When insurance costs are inflated for the wrong reasons, people are unfairly cut off from access to its protection. The whole community suffers, and those who cannot afford insurance struggle to recover if disaster hits.
>
> Another hurricane season is already upon us. Based on past years with similar conditions, the National Oceanic & Atmospheric Administration estimates that two to four hurricanes could affect the U.S. in 2006. But there's more trouble on the horizon than just bad weather. In any state that allows insurers to use credit information to rate and underwrite homeowners- and auto-insurance policies, consumers are already in the middle of a storm, and most of them don't know it.
>
> The devastation caused by Hurricanes Katrina, Rita, and Wilma shows us that people without adequate insurance may face compounded tragedy. Since economic losses caused by catastrophe can send a credit score plummeting, even consumers who can afford insurance today may feel the repercussions of credit scoring in their premiums tomorrow.
>
> Consumers Union advocates have been urging legislators and regulators in several states to ban the practice, and we'll continue those efforts.

Polls Show the Public is Opposed to Insurance Credit Scoring

In a poll of Texas consumers conducted from April 28, 2003 through May 10, 2003, 68% voiced the opinion that the Texas Legislature should "ban insurance companies from using a homeowner's credit history to decide whether it will insure a person or to adjust a premium," compared to 23% who voiced support.

---

[22] *Consumer Reports*, August 2006, Page 61

Insurers Hide their Use of Insurance Credit Scoring
If insurers really believed that the public supports the use of insurance credit scoring, why don't we see any insurers' ads or marketing efforts that promote their use of insurance credit scoring? Why don't we see any ads that even mention insurance credit scoring?

Most Consumers Don't Get Lower Rates
Data from actual filings refute the industry claim. My analysis of actual rate filings shows that in many cases, the so-called "discounts" consumers receive from insurance scoring are more than offset by increases in the base rate. The fact is that, because insurance scoring does nothing to reduce insurance claims, insurance scoring simply redistributes premiums among different consumers. And in most cases, the number of consumers who see a premium reduction is the same or less than the number who see a premium increase.

Industry Claim 3: Insurance Scoring is An Objective Tool

<u>Insurance scoring provides an objective tool for decision-making.</u>
This tool does not discriminate against any specific group of customers. It avoids subjective value judgments because the information is based solely on credit-related material.

<u>It provides an objective tool for decision-making that does not discriminate against specific groups or individuals.</u>
Insurers are interested in having available as many tools as possible to assist them in making a fair and objective decision about whom to insure and at what rate. The development of an insurance score only takes into account credit-related information and does not consider race, gender, religion, marital status and birthplace.

<u>Insurance Scores are reliable.</u>
The Consumer Data industry Association, formerly Association of Credit Bureaus, reports that less than 1 percent of all credit report challenges result in a change once the inquiry has been fully investigated. Studies have found that credit reports are more reliable than motor vehicle records. The use of credit reports is routine throughout the financial services industry and is widely accepted by consumers.

<u>Insurance Scores are Not Correlated to Income</u>
March 1999, Statement of the American Insurance Association, "On the Lack of Correlation Between Income and Credit Score When Tested Against the Average or Median Score"

The precise objective of the company analysis was to determine the extent to which the credit score is correlated to income. AIA presented important, new evidence that credit scores do unfairly discriminate against or even negatively impact lower income groups. Indeed, research revealed that the lowest income groups have the highest average credit score.

The analysis concluded that credit score is not significantly correlated with the income for the AIA company's policyholders.

Facts:

Selection of Factors in Insurance Scoring Models Involves Judgment and Bias
The mere fact that insurance scores are produced by a computer model does not mean insurance scores are objective. If the factors that go into the scoring model discriminate against low income and minority consumers, then the model itself will be biased against such consumers. Ad discussed above, two independent studies confirm that insurance credit scoring is highly correlated to income and race.

Insurance Scoring is Arbitrary
There are many example of illogical and arbitrary results from insurance scoring:

- Because your credit score depends on having the "right" kind of information in your credit report, you can have a perfect credit history and still get a bad credit score. Contrary to insurer credit scoring myths, your credit score has nothing to do with your "financial responsibility."

- Because your credit report can vary dramatically among the three major credit bureaus, your credit score can vary from good to bad depending upon which bureau provided your insurer with information.

- Because your credit score is based on many things other than how timely you pay your loans, you score can vary dramatically depending on what time in the month your credit report was ordered.

- Because your credit score depends on what type of credit you have, you can get a low score even if you have a perfect payment record. If you have a credit card with a tire company, a loan from a consumer finance company like Household or Beneficial, or have an installment sales contract from a used car dealer, you get a lower score regardless of whether you pay on time. But if you have a gas station credit card, you score is higher!

- Because your credit score depends on the presence of loan information, you get a lower score if you pay in cash or don't borrow much or if you use lenders that don't report to credit bureaus. Many younger consumers were penalized with higher rates due to so-called "thin" credit files because the Sallie Mae – the student loan lender to millions – decided it would only report payment history to one of the three major credit bureaus.

- Because your credit score depends on the ratio of your debt to your credit card limit, a consumer who uses one credit card to maximize frequent flier miles gets a lower score than another consumer who charges the same amount but does it on three or four cards.

Industry Claim 5: One of Many Factors

<u>It's just one of many factors.</u>
Most companies that use insurance scoring treat it as just one of several factors in the underwriting decision. Generally your insurance score alone is not likely to keep you from getting insurance or cause you to pay more for it, although it can help you get insurance.

Facts:

Insurance Credit Scoring Affects Your Rates – Why Else Would Insurers Use It?

This industry argument is truly a red herring. The fact that insurance scores are one of many factors does not change the fact that a consumer's insurance score affects his or her premium and, typically, is the most important factor in determining that premium. If insurance credit scoring were simply a minor factor and not likely to affect the insurer decision to offer insurance or affect the insurer decision about the price of insurance, why would insurers fight so hard to use it and put up with all the requirements of federal and state law regarding the use of consumer credit reports and insurance scoring?

Industry Claim 6: Rewards Responsible Financial Behavior

<u>Insurance scores reward responsible financial behavior, not just the length of credit experience.</u>
Insurance scoring is designed to examine credit management patterns and the process used provides an objective evaluation of a consumer's credit history whether it is long or short. When a consumer does not have enough history to generate a score, this information often will not be considered as a positive or negative characteristic.

Fact:

This argument represents a reprehensible blaming-the-victim strategy by insurers. In fact, a credit history is not a measure of financial responsibility and a good credit history does not equate to a good credit score.

A Credit Score is Not a Measure of Financial Responsibility

- Limited Info in Credit Report
    - No Utility Payment History
    - No Rental Payment History
    - No Savings Information
    - No Insurance Purchase Information
- Credit Score Factors Unrelated to Payment History
    - Type of Credit
    - Length of Credit
    - Inquiries
    - Balance to Limits
    - Thin Files
- After the Fact Rationale

Insurance Credit Scoring Penalizes Victims of Economic and Medical Catastrophes

Insurance credit scoring is inherently unfair because it penalizes consumers who are the victims of economic or medical catastrophes, such as job loss, divorce, dread disease or terrorist attack. For example, in the aftermath of the September 11 attack, hundreds of thousands of people working in the travel-related industry lost their jobs. Out of this group, thousands had to increase borrowing to offset loss of income or loss of health insurance. Many filed for bankruptcy. It is unfair for insurance companies to further penalize these victims by raising their homeowners and auto insurance rates.

One of the myths perpetrated by insurers to legitimize the use of insurance credit scoring to legislators is the myth of the immoral debtor. Insurers argue that good credit scores reflect the financial responsibility of consumers. And they ask why should financially responsible consumers subsidize the rates of consumers who are not financially responsible? As explained further below, this argument fails because a good credit history does not equate to a good credit score. Stated differently, an insurance score is simply not a measure of financial responsibility.

Regarding the "immoral debtor," data on the causes of bankruptcies reveal that the overwhelming majority of bankruptcies result from job loss, medical problems and divorce. Fully 87% of bankruptcies for families with children arise from these three reasons. And the remaining 13% includes reasons such as natural disaster or crime victim.[23]

In their recent book, *The Two Income Trap*, Elizabeth Warren and Amelia Tyagi study the growth, composition and causes of bankruptcy. They were astonished to find that the number of women filing for bankruptcy grew from 69,000 in 1981 to nearly 500,000 by 1999. As they

[23] 2001 Consumer Bankruptcy Project, cited on page 81 of *The Two Income Trap*, Elizabeth Warren and Amelia Tyagi.

researched the causes of this phenomenon, they documented the fact that financial strain on families – particularly families with children – resulted from dramatic increases in the cost of housing, health care and schooling combined with deregulation of interest rates for loans and business decisions made by lenders for easy credit. They found that married couples with children are more than twice as likely to file for divorce than couples without children and that a divorced woman raising a child is nearly three times more likely to file for divorce than a single woman without a child. They concluded that "having a child is the single best predictor that a woman will end up in financial collapse." Their research shows that the insurer rationalization for insurance credit scoring – "financial responsibility" – is indeed a myth refuted by the facts.

Industry Claim 7: Consumer Protections Exist

<u>The NCOIL Law, as adopted in many states, provides necessary consumer protections.</u>

<u>The Fair Credit Reporting Act provides consumer protections.</u>

Facts:

The NCOIL Model Provides Little or No Consumer Protections.
The NCOIL model law, adopted in many states, allows insurers to continue their insurance scoring practices with few or no substantial consumer protections. I discuss this issue at length in my testimony before the Colorado Legislature in 2004, available on the CEJ web site: www.cej-online.org.

Insurers Seek to Avoid Telling Consumers About Insurers' Use of Credit Scoring
Adverse Action Notices: Insurers have resisted providing adverse action notices to consumers who suffered higher rates because of insurance credit scoring. Insurers claimed that a new business customer – even a customer charged the highest rate because of her credit score – was not entitled to an adverse action notice.

Insurers Oppose Laws That Allow Consumers to Freeze Their Credit Information Because of Identity Theft

New York recently adopted a credit information security freeze law, described by its sponsor as follows:

> "This security freeze acts as a barricade against those who would commit fraud," Senator Steve Saland (R-C, Poughkeepsie), co-sponsor of the legislation, said. "Identity thieves have already preyed on thousands of New York consumers, stealing personal information that leaves consumers severely at risk. This law enables consumers to avoid victimization by empowering them to place security freezes on their consumer reports."

But the New York measure is the only credit freeze legislation passed in the nation this year that does not exempt insurers. Nine other states have passed credit freeze legislation in 2006, (Colorado, Florida, Illinois, Kentucky, Wisconsin, South Dakota, Utah, Kansas, and Vermont), and all of them allow insurers to continue to access credit information for underwriting and other legitimate business purposes, according to the Property Casualty Insurers Association of America (PCI), which has asked Gov. Pataki to veto credit freeze legislation.

PCI says including insurers in the freeze provides no benefit to consumers while increasing costs for the industry.

> "While PCI supports the effort to prevent identity theft, the application of credit freeze legislation should be tailored to address areas in which there is a prevalence of identity theft," said Kristina Baldwin, regional manager and counsel for PCI. "The security provisions in this legislation have no practical application or consumer benefit in the context of insurance."
>
> According to Baldwin, it is "highly unlikely" that illegally procured credit information would be used to purchase insurance. She cites a Federal Trade Commission study in January that found that 99.6 percent of identity theft complaints were related to areas other than insurance.
>
> "Consumers obtain little or no benefit from having a security freeze which applies to insurers. The insurer and the consumer would experience increased burdens, costs and inconveniences associated with this credit freeze legislation. It is important to bear in mind that additional insurance company burdens and costs are ultimately borne by all policyholders through higher premiums. In short, the burdens associated with applying credit freeze provisions to insurers are not outweighed by the very limited consumer benefits which would be achieved through applying credit freeze provisions to insurers," Baldwin added.

The arguments are, of course, a non-sequitor. If a consumer has been a victim of identify theft, then an insurers' use of that that consumer's credit information can hard the consumer because the credit report has been damaged. Why would a consumer want an insurer to use her credit report when it has been damaged by identify theft? Why would an insurer want to use such a report? And why would insurers oppose giving consumers a tool to protect themselves from use of their credit information when they suspect they have been the victim of identify theft?

Insurers' actual insurance credit scoring practices and policies are profoundly anti-consumer. The security freeze position is the latest example of insurers placing their interests above those of consumers.

The recent Supreme Court Decision about Adverse Actions Contradicts Congressional Intent and Denies Consumers Essential Consumer Protections.

As with the security freeze issue, insurers have tried to keep consumers in the dark about insurance scoring practices by denying consumers adverse action notices required under the Fair Credit Reporting Act. Some insurers refused to provide any new business applicant with an adverse action notice – even if the consumer suffered a high premium because of insurance credit scoring. The recent Supreme Court decision in Safeco v Burr and GEICO v Edo did determine that insurers did need to provide adverse action notice to new business consumers who suffered an adverse action, but defied congressional intent and incorrectly defined what constitutes an adverse action. Despite a clear and simple definition of insurance adverse action endorsed by state insurance regulators and the Federal Trade Commission – a consumer suffers an adverse action if she suffers less favorable treatment that she would have received if she had a more favorable credit report – the Court argued that too many consumers would get adverse action notices and endorse a standard based on a so-called "neutral" credit score. Since there is no standard for "neutral" credit score, the Supreme Court decision allows insurers to effectively define which consumers get adverse action notices.