AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

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

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 21, 2008

Printed for the use of the Committee on Financial Services

Serial No. 110–113

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

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

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 21, 2008

Printed for the use of the Committee on Financial Services

Serial No. 110–113

U.S. GOVERNMENT PRINTING OFFICE

43–699 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin,
LINCOLN DAVIS, Tennessee
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
TIM MAHONEY, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
CHRISTOPHER S. MURPHY, Connecticut
JOE DONNELLY, Indiana
ROBERT WEXLER, Florida
JIM MARSHALL, Georgia
DAN BOREN, Oklahoma
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana

SPENCER BACHUS, Alabama
DEBORAH PRYCE, Ohio
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
CHRISTOPHER SHAYS, Connecticut
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
TOM FEENEY, Florida
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
GINNY BROWN-WAITE, Florida
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
STEVAN PEARCE, New Mexico
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
GEOFF DAVIS, Kentucky
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
PETER J. ROSKAM, Illinois
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
DEAN HELLER, Nevada

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

MELVIN L. WATT, North Carolina, *Chairman*

LUIS V. GUTIERREZ, Illinois
MAXINE WATERS, California
STEPHEN F. LYNCH, Massachusetts
NYDIA M. VELÁZQUEZ, New York
MICHAEL E. CAPUANO, Massachusetts
CAROLYN MCCARTHY, New York
RON KLEIN, Florida
TIM MAHONEY, Florida
ROBERT WEXLER, Florida

GARY G. MILLER, California
PATRICK T. MCHENRY, North Carolina
EDWARD R. ROYCE, California
RON PAUL, Texas
STEVEN C. LATOURETTE, Ohio
J. GRESHAM BARRETT, South Carolina
MICHELE BACHMANN, Minnesota
PETER J. ROSKAM, Illinois
KEVIN McCARTHY, California

CONTENTS

	Page
Hearing held on:	
May 21, 2008	1
Appendix:	
May 21, 2008	57

WITNESSES

WEDNESDAY, MAY 21, 2008

Hunter, J. Robert, Director of Insurance, Consumer Federation of America	32
Keiser, Hon. George J., Representative, State of North Dakota, on behalf of the National Conference of Insurance Legislators (NCOIL)	17
McCarty, Hon. Kevin, Insurance Commissioner, State of Florida, on behalf of the National Association of Insurance Commissioners (NAIC)	15
Neeson, Charles, Senior Executive, Personal Lines Products, Westfield Group, on behalf of Property Casualty Insurers Association of America	38
Parnes, Lydia B., Director, Bureau of Consumer Protection, Federal Trade Commission	14
Poe, Eric, Chief Operating Officer, Cure Automobile Insurance	36
Powell, Lawrence S., Ph.D., Professor, University of Arkansas at Little Rock	42
Pratt, Stuart K., President, Consumer Data Industry Association	40
Rice, Lisa, Vice President, National Fair Housing Alliance	34

APPENDIX

Prepared statements:	
Carson, Hon. Andre	58
Hunter, J. Robert	59
Keiser, Hon. George J.	101
McCarty, Hon. Kevin	112
Neeson, Charles	168
Parnes, Lydia B.	173
Poe, Eric	181
Powell, Lawrence S.	193
Pratt, Stuart K.	214
Rice, Lisa	233

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Watt, Hon. Melvin:	
Information from the Web sites of AllState, State Farm, and Travelers Insurance Companies on what factors they consider in determining rates	245
USA Today article entitled, "Credit scores' link to insurance rates tested"	251
Responses to questions submitted to J. Robert Hunter	252
Responses to questions submitted to Lydia Parnes	254
Responses to questions submitted to Eric Poe	257
Responses to questions submitted to Lawrence S. Powell	272
Miller, Hon. Gary:	
Letter from the American Insurance Association, the Financial Services Roundtable, the Independent Insurance Agents and Brokers of America, the National Association of Mutual Insurance Companies, and the U.S. Chamber of Commerce	279
Statement of the National Association of Mutual Insurance Companies	280
Statement of Michael J. Miller and EPIC Consulting	289

Page

Miller, Hon. Gary—Continued
Statement of the Property Casualty Insurers Association of America 294
"The Use of Occupation and Education Factors in Automobile Insurance," State of New Jersey, Department of Banking and Insurance, dated April 2008 296

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

Wednesday, May 21, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128 Rayburn House Office Building, Hon. Melvin L. Watt [chairman of the subcommittee] presiding.

Members present: Representatives Watt, Gutierrez, Waters, Green, Klein, Boren; Miller, McHenry, Royce, Barrett, Roskam, and McCarthy.

Ex officio present: Representative Bachus.

Also present: Representative Lynch.

Chairman WATT. This hearing of the Subcommittee on Oversight and Investigations of the Financial Services Committee will come to order.

I will recognize myself for 5 minutes or less for an opening statement.

This is the second in a series of hearings held by the Oversight Subcommittee to gain more information about the use of consumer credit information in the underwriting and rating of personal lines of insurance, including automobile and homeowners' insurance.

These hearings are warranted because this practice, known as "insurance scoring," and its derivative products referred to as "credit-based insurance scores," or simply "insurance scores," cries out for careful evaluation to determine whether it is consistent with good public policy.

We learned at the Oversight and Investigation Subcommittee's first hearing in October of 2007 that almost all major insurance companies use credit-based insurance scores in some way. Consequently, nearly all Americans who drive cars or own homes must also have good credit if they are to avoid paying high insurance premiums, regardless of their individual claims history or driving record.

We also learned through a report by the FTC that while credit-based insurance scores are predictive of claims risk, or claims, no one can explain why this is the case. We also learned from the last hearing that in three out of four lines of automobile insurance, credit-based insurance scores serve in some measure as a proxy for

race. However, given the data concerns with the automobile study that witnesses discussed extensively at the last hearing, the full extent of the proxy effect still may not be known.

Despite perceived shortcomings of the data, the FTC report concluded that there was some "proxy effect" from the use of credit-based insurance scores, and as noted by a dissenting Commissioner, "Given the incompleteness of the data, it is unclear whether the actual proxy effect might be greater."

Even a minor proxy effect for race gives rise to the most serious public policy concerns. I don't think anyone should favor a system in which either directly or indirectly, racial classifications are allowed to hinder a person in their daily lives, whether in being considered for employment, getting an education, buying a home, getting credit, or purchasing financial products like automobile and homeowners' insurance.

Because of these major public policy concerns, two bills have been introduced. One, H.R. 5633, introduced by Representative Luis Gutierrez, the chairman of the Domestic and International Monetary Policy Subcommittee of the Financial Services Committee, would reign in the use of credit-based insurance scoring by prohibiting the use of credit-based insurance scores where the Federal Trade Commission finds evidence of racial discrimination, or that credit-based insurance scores serve as a proxy for race.

The second bill, H.R. 6062, introduced by Representative Maxine Waters, chairwoman of the Housing and Community Opportunity Subcommittee of the Financial Services Committee, would prohibit the use of credit-based insurance scores altogether in underwriting or pricing personal lines of insurance.

I am going to digress just long enough to say that I am a cosponsor of both of these bills. I actually think I start with the assumption that there really shouldn't be a connection between somebody's credit score and their insurance premium any more than there should be a connection between somebody's driving record and whether they get credit.

But I guess I am willing to be convinced that perhaps there is some utility in the use of these scores, but I am not sure that I can be convinced that if they are a proxy for race, we can justify their use as a matter of public policy, even if there is a correlation between credit scores and insurance premiums, or underwriting of insurance.

So, I am on both bills. I am trying to keep somewhat of an open mind on this issue, but we don't legislate in this committee anyway. We just have hearings and build a record, so my presence on either one bill or the other probably has no significance to my role as chairman of the subcommittee. That is just to put everything on the record.

We hope to shed more light on the pros and cons of each of these two proposals, H.R. 5633 and H.R. 6062, as well as consider changes or other options that might be appropriate at today's hearing.

We look forward to hearing from the witnesses about the potential impact of H.R. 5633 and H.R. 6062 on consumers and the insurance industry. And with that, I will recognize my colleague, the

ranking member of the full Financial Services Committee, Mr. Bachus, for 5 minutes.

Mr. BACHUS. Thank you, Chairman Watt, for holding this second hearing before your subcommittee on the impact of credit-based insurance scoring on insurance availability and affordability. Let me say at the onset that I acknowledge your concerns and those of Mr. Gutierrez. I know that Congressman Green has what I think are good-faith concerns, as has Chairwoman Waters. So certainly I enter this hearing with an open mind.

Credit scores, as we all know, are widely used for a number of purposes other than lending, including employment interviews, apartment rental applications, government licenses, mobile phone services, as well as insurance, which brings us here today. Credit scoring actually can help individuals who manage their financial affairs responsibly, I believe, to get a number of benefits that they might not otherwise receive, based on traditional underscoring criteria such as age, gender, zip code, or income.

So actually I believe in certain cases—and studies have validated this—people have actually benefitted from their credit scores through cheaper insurance or availability of insurance. In fact, I think the FTC confirmed this in a recent study that found the use of credit scores greatly increases fairness and affordability for consumers of insurance products.

They found that more responsible and thus lower-risk drivers get cheaper coverage, but they also found that higher-risk drivers enjoy greater access to insurance because insurers can more accurately price their risk.

They further found that "Credit-based insurance scores appear to have little effect as a proxy for race, although every predictive factor the FTC analyzed had a slight disparate impact on certain ethnic groups." And I think that, obviously, is the subject matter of Mr. Gutierrez' legislation.

For example, they found that prior claims history had a disparate impact on various ethnic groups, with nearly the same percentage of proxy effect to predictive value as credit-based insurance scores. So the use of credit scores for various purposes—not only has the FTC studied it, but it has been extensively scrutinized by State regulators. I will just mention two.

The Texas Insurance Department recently analyzed 2 million insurance policies and found a direct and non-discriminatory correlation between insurance scores and expected losses. It found that the average automobile insurance losses for people with the worst credit scores are double those for people with the best credit scores, while losses on homeowners' policies for people with the worst credit scores are triple those of people with the best scores. The Texas Department further found that these scores were not unfairly discriminatory or based on race or income.

A second study, this one by the Arkansas Insurance Department, yielded similar results, including a finding that 3 times as many consumers received lower insurance rates because of credit score use than received higher rates. In short, the evidence from these studies appears pretty clear that credit scores are one of the most accurate non-discriminatory predictors of insurance risk available.

However—and I think maybe this would be a good starting point for us to make some agreement—most States, after lengthy deliberation, have chosen to adopt a model law developed by the National Conference of Insurance Legislators, and that model recognizes the benefits to consumers of using credit-based insurance scores, but prohibits using credit information as the sole basis for increasing rates or denying canceling or failing to renew coverage.

The model act also includes a number of safeguards, including prohibiting insurers from taking an adverse action against an insured with no credit history. In other words, recent immigrants with no credit history would have to be treated as having a neutral credit score.

In closing, Mr. Chairman, as used in the insurance underwriting process, credit scores appear to be highly predictive of, and many times lower the cost of insurance for consumers. I think they encourage responsible behavior, and they are closely regulated by the States. And I think any legislative attempt to limit or prohibit their use in evaluating risk should be done so very carefully.

I thank you.

Chairman WATT. I thank the gentleman for his opening statement. I now recognize Representative Gutierrez for 5 minutes.

Mr. GUTIERREZ. Thank you very much. I ask that my complete statement be entered into the record.

Chairman WATT. Without objection, it is so ordered.

Mr. GUTIERREZ. Thank you very much. I thank Chairman Watt for calling this hearing, and I appreciate the comments of Ranking Member Bachus, and I thank everybody for joining us here.

I just think that if you have a good driving record, if you stop at stop signs, you don't go through red lights, you don't speed, you don't crash into people's cars, and you don't let your daughter use the car so she can let her boyfriend crash it as they go out dating, if you act in all these responsible manners, you should get a good insurance rate, regardless of what your credit score might be.

Now I remember when I wasn't a Member of Congress, and I remember going to get my first—I couldn't get a credit card, so I had to get a store card—I remember, Montgomery Ward is now defunct, I think. But that was the only place. And you got $200 worth of credit there, and then you moved up to J.C. Penney, and you got another $200 there, and you paid that faithfully, because that was the only way to get credit. I was a college graduate, I had a good job, I just couldn't get credit—couldn't get a mortgage, couldn't buy a house.

But I got those two store cards. Finally, they gave me a credit card, my first VISA credit card. And I remember that they suspended it after 2 years just because arbitrarily they decided one day that I had paid the bills on time, but they just suspended it. I don't know why. I was pretty angry. I remember calling the 1–800 number like 100 times, thinking about how much damage I could cause, inflict some kind of financial pain on them, because they did it for no reason.

I'm sure they wouldn't have done that if they thought I was going to be, you know, a subcommittee chairman on the Financial Services Committee one day. Because I still remember the credit card company that—they didn't cancel my card, they said, "Thank

you for the $35 annual fee. Keep paying, but you can't charge anything more on that credit card."

Now look, we should all understand our personal experiences and the experiences of consumers in America. I just want to reiterate: If you drive safely, if you stop at stop signs, if you don't speed, you don't have accidents, you maintain your car, and you're a safe driver, that should be primarily how it is you get scored in terms of how much insurance you pay. And I think that should be the ultimate goal.

If there are other criterion, maybe we should try to balance and blend them.

Thank you very much, Mr. Chairman.

Chairman WATT. Thank you for your statement.

I recognize the ranking member of the subcommittee, my good friend, Mr. Miller, for 5 minutes.

Mr. MILLER. Thank you, Chairman Watt, for holding this hearing today. This is the second hearing we have had on the impact of credit-based insurance scores on the availability and affordability of insurance.

As numerous States, Federal agencies, and private experts have concluded in studies on this topic, credit-based insurance scores do indeed make insurance more available and affordable for consumers.

Over 30 years ago, Congress passed the Fair Credit Reporting Act, permitting insurers to use credit information to underwrite insurance. Since the law's enactment, several studies have been conducted on credit-based insurance scores, showing a strong correlation between credit history and the likelihood of filing insurance claims.

The credit information enables most consumers to qualify for lower insurance rates, since most consumers have good credit. Insurance companies have even reported that credit scoring may in some cases counter-balance the imperfect driving record of individuals.

After questioning the legitimacy of using credit scores to underwrite risk, and expressing concerns that the scoring method was discriminating against minorities, Congress directed the Federal Reserve Board and the Federal Trade Commission, FTC, to study the effects of this practice on credit and insurance markets, and report their findings to Congress in the 2007 FTC study on the use of credit reports and automobile insurance, and the Commissioners confirmed that credit scores are accurate and objective predictors of risk.

That conclusion drawn by the FTC showed that for financially responsible consumers, credit scores decreased insurance rates. The FTC also confirmed that credit scores make insurance more available for many riskier consumers, for which insurance would not otherwise be able to be determined an appropriate premium.

The FTC disproved concerns that insurance scores somehow serves as a proxy for race, finding that "credit-based insurance scores appear to have little effect as a proxy for membership in racial and ethnic groups in decisions related to insurance." Further, the Commission found that insurers do not use risk models that contain information about race, ethnicity, or household income.

The Federal Reserve Board reported similar findings in their study last year on credit. The Board concluded that credit scoring likely increases the consistency and objectivity of risk evaluation, thus helping diminish the possibility that credit decisions would be influenced by personal characteristics or other factors prohibited by law, such as race or ethnicity.

The favorable study by the FTC and the Federal Reserve Board regarding the beneficial use of credit scores have been echoed by similar findings in the States. For example, the Texas Department of Insurance conducted extensive research on credit scores and reported that there is no way to determine race, ethnicity, gender, age, or economic status by checking a person's credit information.

The Texas study also found that drivers with good credit are involved in 40 percent fewer accidents than those with poor credit. In addition, homeowners' insurance claims for people with bad credit are triple that of people with a better credit history. In fact, the vast majority of States have thoroughly examined the use of credit risk insurance scores and approved their use for pricing risk.

After years of deliberation and study, the National Conference for Insurance Legislatures, NCOIL, established a model allowing the use of credit information in personal insurance as long as it is not the sole factor used in underwriting. The NCOIL model has been adopted by 26 of the States and prohibits insurers from denying, canceling, or non-renewing coverage due only to credit history.

According to the NCOIL in most of these States, insurers are unable to deny consumer's insurance based on a thin credit history or no credit at all. The FTC's conclusion, studies on auto insurance involved a research team of career Ph.D.'s, economists, and consultations with communities, civil rights, consumers, and housing groups, government agencies, and private companies, examination of records, and assurances of reliability and independently tested data. Facts and facts and conclusions are comprehensive and incontrovertible.

Yet after the study was concluded, several of my colleagues were unsatisfied with the result and challenged the Commission's data gathering, insisting that the FTC subpoena further information from insurers. The purpose of this action is unclear to me, considering the fact the Commission testified in October that "The insurance industry was cooperative and forthright with the FTC throughout the process of gathering data and analysis."

They further testified of the extensive cost and drain on resources to the Commission. In more recent discussions with the FTC, I have learned that extensive automobile studies have already cost millions of dollars—that is millions of taxpayer dollars—and that the compulsory request for data from insurers for the homeownership study would cost taxpayers as much as double or triple the amount we have already paid.

I am glad we are going to have the hearing again. I hope that maybe some new information has been gathered. I don't know if that is going to be the case; but I just have a concern when we are using subpoena powers on an industry that the testimony to-date has said has been cooperative. And I also have a concern about the privacy of the information we might gather in the future. The Free-

dom of Information Act is very broad, and I am concerned that might apply here.

I yield back. Thank you.

Chairman WATT. I thank the gentleman for his comments. And while that is not the issue directly today, we had an extensive discussion about that at the last hearing. That is the FTC's decision. We have not directed them to do anything; we just asked them to get us good information. And if they decide that they need subpoenas, fine; if they decide that they do not need subpoenas, if they can get us a good report that tells us what the impact of credit-based scoring is, then that is for the FTC to decide. But we are not trying to micromanage that; I want to assure the ranking member of that.

Are there any other members who wish to make opening statements? I am just trying to get a gauge, so I know how much time to divide—one, two, three on this side; and one on the other side. Okay.

I recognize Mr. Green for up to 5 minutes, if he chooses, and then we will go to the other side.

Mr. GREEN. Thank you, Mr. Chairman. And if I may, let me start by thanking you for allowing me to become a part of the committee. I thank you and the ranking member for accepting me as a member. This is my first hearing. And to you and the ranking member, I greatly appreciate your having this hearing, because it is something that has been of concern to me for some time.

I especially thank the ranking member for his comments. He and I have had many conversations, and I have found him to be a person who is principled and who moves forward based upon what he sincerely believes to be the case. Notwithstanding the fact that he and I may have differences, we do have one thing in common, and that is we enjoy our conversations with each other about our differences.

My concern with this is as was indicated previously: The connectivity between one's credit score and one's driving habits. I am hoping to hear information that can help me to better understand that relationship between one's credit score and one's driving behavior.

I especially concern myself with this because we have young drivers who have no credit scores. It is not unusual for parents to add their children to their insurance, and these children, generally speaking, have little or no credit. How is it that they will inherit the credit of the parent and become a risk by virtue of having been born into a certain family? Is that the way it will work? Do they have a different standard for young drivers who have no credit score, who have not had a track record of driving at all, but perhaps they have been to a driving school and they have had all of the safety courses, such that one might conclude they understand the rules of the road? They don't have a track record of poor behavior. I don't see the connectivity between such a person and a credit score.

It seems to me that if we are not careful, we are going to make it almost impossible to be poor in the richest country in the world. The richest country in the world; 1 out of every 110 persons is a millionaire. But it costs to be poor in America. You pay more for

your insurance; you ride on roads that will do more to your vehicle because of where you live if you are poor, generally speaking. You will probably have to get more wheel alignments. You probably go a store that has prices that are higher than in some other neighborhoods.

And I think that at some point, we have to examine the notion of whether we ought to do things just because we can. Maybe you do have the right to do it, but the question is: Is it the right thing to do?

I am looking for the cause of connection between a credit score and one's driving behavior.

Mr. Chairman, I thank you for the time, and I yield back.

Chairman WATT. I thank the gentleman for his statement. The gentleman from California is recognized for 3 minutes.

Mr. ROYCE. Four minutes, Mr. Chairman?

Chairman WATT. Four minutes. Okay.

Mr. ROYCE. Thank you, Mr. Chairman. I appreciate you holding this hearing.

I would also just like to express my opposition to the concept here of banning the use of credit-based insurance scores, because from the studies I have seen, this is a very effective predictor of the actual risk. It is a predictor of the number of claims that the consumers file; it matches the total cost of those claims. Credit scoring is not based on race. And I think the FTC's report, which came out in July, explained this benefit as have other studies. We have seen a number of studies on this subject.

In the competitive marketplace which exists throughout most of the auto insurance sector, companies have an incentive to provide the lowest actuarially sound rates for the customers. In most instances, a potential customer can get several quotes on auto coverage in a matter of minutes over the Internet or by picking up the phone.

Companies have even began to offer their prices along with the prices of their competitors in the names of attracting additional business. If there are inefficiencies, if there are gaps in coverage, I think a logical place to look would be the current State-based insurance regulatory system. With the exception of Illinois, every State subjects property and casualty insurance products to varying degrees of government price controls. And of course, that discourages companies from operating effectively and efficiently in those States.

Additionally, the bureaucratic delays weigh heavily on the rates paid by consumers. The American Consumer Institute recently found that the cost of excessive regulation at the State level is $13.7 billion annually, paid for by insurance buyers through higher premiums. If Congress really wants to improve the ability of consumers with weaker credit histories to obtain more economical quotes on insurance coverage, we should be looking at ways to bring more competition to those markets.

In the Wall Street Journal, on May 6th, there was an editorial on the Massachusetts Miracle, and that highlighted the recent move by Massachusetts to remove its government-set rates on auto coverage, and as the editorial noted, Progressive Insurance, the third largest insurer in the country, entered the market May 5th

with rates 18 percent below the old price-controlled rates. Overall, premiums in the State are going to fall 8 percent this year as insurers adjust to a world in which they need to compete to attract customers instead of bargaining with their regulator for price hikes.

If more States saw the economic implications of price controls, or if Congress would consider our legislation to create an optional Federal charter, a greater number of consumers, including those this legislation was intended to help, would be on the receiving end of more products, and certainly with much lower premiums.

So in closing, I would caution my colleagues against enacting legislation which leads to banning the use of credit scores by insurance providers as one of the many factors included when setting premiums. I believe the majority of consumers would see higher costs for insurance products if that happened, because their provider would not be able to set actuarially sound premiums.

And again, Mr. Chairman, I offer this other alternative, and I would like to thank you for holding this hearing. I look forward to the testimony, and I appreciate the witnesses coming out to speak to us today.

Thank you, Mr. Chairman

Chairman WATT. I thank the gentleman for his presence and for his opening statement. I recognize my colleague from North Carolina, Mr. McHenry, for 3 minutes.

Mr. MCHENRY. I appreciate the chairman's recognizing me. And I do appreciate him holding this hearing as well.

I think we should have a discussion about how to improve and how to accurately assess credit risk in all financial service products. But it is interesting here that the discussion is about whether or not a credit score should be used, and it is but one of the tools in the tool chest to assess risk.

From what I have read in some studies, it is one of the most effective ways of assessing risk. Insurance is not simply an individual's right, but it should be the ability of the company to accurately assess risk, so that they can more accurately seek payment for that. And I think as such, credit scores are a worthy example of the way an insurance company can assess risk.

I don't think it should be the be-all end-all, and from what I understand from the industry, it is not.

But I would just go back to my experience in college with credit cards. My experience is pretty simple. You know, you go and rack up the credit card debt, which I did, buying cheeseburgers, pizza, and many other things in college, but I had to pay the consequences for that.

And my credit score reflected that, and as such, I was a greater credit risk because of how much fun I had in college, and how I paid for it. And I think that is a fair assessment of how this works.

I think we should go to an additional step—and I would be happy to work with the chairman on this—I do think the issue is not about the insurance industry using credit scores; I think it should be about how these credit scores are derived.

There are a number of different items that are not included in a credit score that could better assess risk for individuals. For instance, most of us have to pay a power bill every month. I think

that would be a positive credit indicator. And I think if the insurance companies could see that they regularly pay their power bill every month, and have never missed a payment, maybe that would be a stronger indicator rather than their overall credit score on whether or not they will pay for their insurance, and be a greater risk.

I think that's a fair assessment. I think we should look at credit scoring rather than really I think a symptom of the underlying disease, which is how these credit scores are derived. I think that's a positive thing; I think we could have some bipartisan support, and I look forward to working with the chairman on those items. Thank you so much for having the hearing today.

Chairman WATT. I thank the gentleman for his opening statement, especially his confessions of his college years. I am glad he cut it off where he did.

[Laughter]

Chairman WATT. I recognize the gentleman from Illinois, Mr. Roskam, for 3 minutes.

Mr. ROSKAM. Thank you, Mr. Chairman. And Mr. Chairman, thank you for holding this hearing today. I attended the last hearing, and I understand where the Majority is coming from in holding the first hearing. And that is, it's a pretty interesting narrative, that if you can thread the pearls to suggest that there is a racial component to a predominant American industry, manipulating a marketplace on the backs of minority groups, that is powerful. That would be outrageous, and all of us would be outraged, and we would be like-minded and say, "That ought not to happen."

But as I listened to the testimony last time, and particularly the study from the Federal Trade Commission, what I heard was essentially that it wasn't happening that way. There were some consumer groups who were testifying, and the more I listened—it's kind of like talking on talk radio to the weird caller that calls in: The more you listen, the more disjointed it starts to sound. So I kind of discounted that in terms of testimony.

And then, as I have been thinking about this, I have come to the conclusion that there are a lot of similarities between credit scoring and student grades and good student discounts. I mean, is there a relationship between someone's driving record and their performance on a history test? Is there a relationship between someone's driving record and their performance on their calculus final? Is there a relationship between someone's driving record and their performance on their English composition? Well, we can't really articulate what it is, but it just so happens to be that it always sort of seems to work out, and that it is a predictor.

So as I was listening to the hearing last time, and I'm just doing research as to this other hearing that has been prompted, in Illinois, as it turns out, there is a carrier in Illinois that is using this, and they are actually increasing their book of business into South Chicago, which is a predominantly minority community.

And so I think what we do today—if this sort of goes the direction that I think it might go—what we do is we risk taking away tools from carriers to offer more coverage to more people, regardless of race and ethnicity and the unintended consequence, I think, becomes a self-fulling prophecy, and it becomes more difficult for

folks to get the type of coverage they need. They are pushed into more residual markets. They are forced to go with the substandard insurance carriers with the great names. What I have learned is the more glorious the name of the insurance company, generally the worse the coverage is, and that, I think, is where we ought not to go.

So I come with an open mind as well. But I also come, having listened to the testimony of the last hearing and being completely underwhelmed, and hoping that this bodes better in terms of the things that we are able to conclude.

I yield back.

Chairman WATT. I thank the gentleman for his opening statement, and I hope he is not underwhelmed. I thank him for being at the earlier hearing, as well as today's hearing, and I think the audience and the witnesses recognize that there is a range of opinions on this issue, and a willingness and openness to understand how this system works, so that we can make good public policy. That is, after all, the reason we have these hearings, to try to get more information about what is happening and what the real life impacts are.

So with that, are there any other members who seek to make an opening statement? We have probably gone a little beyond what we would ordinarily do in opening statements at a subcommittee level, but this is an issue that even the attendance suggests is an issue that people recognize as important. And so I apologize to all of those in attendance if they haven't wanted to hear these opinions, but it sets the basis for our moving forward.

Without objection, all other members and members who have made opening statements, their full opening statements will be made a part of the record, if they wish to submit opening statements.

We will now introduce the members of the first hearing panel, and without objection, the witnesses' written statements will be made a part of the record, and each witness will be recognized for a 5-minute summary of their testimony.

I am going to recognize my good friend from Florida, Mr. Klein, to do his "all-politics-is-local" introduction of his State insurance commissioner. Mr. Klein?

Mr. KLEIN. Thank you, Mr. Chairman.

I appreciate that opportunity, having served in the Florida legislature for 14 years and having the privilege of serving with one of our panelists today, Kevin McCarty, who is the commissioner of the Office of Insurance Regulation in Florida. We have been faced with a number of complicated insurance issues in Florida, some of which have been taken up by this committee, and of course today's issue is just another one that requires some expertise of a broad variety. I think that Mr. McCarty, with his work in our Department of Labor and Employment Security, and his work on worker's compensation issues, will be very helpful.

He has worked in our department for many, many years. He helped the investigation and response following the devastation of Hurricane Andrew. He became our first insurance commissioner, appointed in 2003, and has served in that capacity ever since, but particularly for today's purposes, he is very active with the Na-

tional Association of Insurance Commissioners, which as we all know, is our 50-State member organization that gives us the State perspective, and it is very valuable when we are establishing Federal policy.

So I just want to welcome Commissioner McCarty, and I look forward to his and our other panelists' comments.

Chairman WATT. I thank Mr. McCarty for being here also. I will proceed with introducing the other two witnesses on the first panel, and then I would like to go back and take Ms. Waters' opening statement, if that is okay with the members.

The first witness on this panel is Ms. Lydia Parnes, the Director of the Bureau of Consumer Protection at the Federal Trade Commission. All of the Commissioners were tied up in a meeting today, and asked us to allow Ms. Parnes to testify on behalf of the FTC, and we told them that we thought she would do a better job anyway.

[Laughter]

Chairman WATT. So we thank her for being here.

The third witness on this first panel will be the Honorable George J. Keiser, State Representative of the State of North Dakota, who will be testifying on behalf of the National Conference of Insurance Legislators. We welcome all of the witnesses.

Without objection, I would like to deviate and go back and take the opening statement of Ms. Waters, who was just able to get here. We thank her for being here; she is the lead sponsor of one of the two bills that we are having the hearing about today. I recognize the gentlelady for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I certainly thank you for convening this second hearing on the impact of credit-based insurance scores on the availability and affordability of insurance.

The first hearing you held on this topic last October was very enlightening, but also troubling. In fact, I was so disturbed by some of the testimony that I, along with Mr. Gutierrez, introduced H.R. 6062, the Personal Lines of Insurance Fairness Act of 2008, to ban the practice of using credit scores in the underwriting or rating of insurance premiums.

I am looking forward to hearing our witnesses' testimony on this topic, but I must say that the findings from the first hearing deeply concerned me. The hearing covered a report released in July 2007 by the Federal Trade Commission. The report found that credit-based insurance scores, which are developed and used by the insurance industry, serve as a proxy for race in three out of four lines of automobile insurance.

Specifically, the report found that when credit-based insurance scores are used to predict claims risk, the predicted risk of African Americans and Hispanics increases by 10 percent and 4.2 percent, respectively. Conversely, the predicted risk for whites decreases by 1.6 percent.

To address the proxy issue, Mr. Gutierrez and Mr. Watt introduced, of course, as you have already said, legislation that would prohibit the use of credit scores for insurance underwriting when a proxy effect is found.

However, I must disagree with this approach. While we must do something to address the disproportionate racial impact of this practice, I am also concerned about the overall fairness of this practice. Specifically, credit scores have little, if no bearing on how likely a person is to have a car accident, to break speed limits, or to otherwise engage in risky driving behavior that could result in an insurance claim.

I know that the industry maintains that there is some correlation between low credit scores and increased claims risk; however, a correlation does not imply causation.

I wonder if we would permit other possible correlations, no matter how unrelated to claims risk, to be used to set insurance premiums. For example, if research is found that there was a correlation between zodiac signs and increased claims risks, would it be appropriate to allow such a correlation to be used as a metric for setting insurance premiums?

To make someone pay more for insurance because of a situation in their financial circumstances that has nothing to do with their risk as a poor driver or irresponsible homeowner is simply unfair. It is simply unfair. It is unfair to recent immigrants, to the elderly, and to low-income Americans, all of whom have little credit history.

Furthermore, it is unfair to those Americans who have been hit by the foreclosure crisis, and are now struggling to rebuild or to reestablish their credit.

I could go and on, talking about whom all it is unfair to, but recently, friends of mine were hit with an extraordinary health crisis. They had paid their bills all of their lives and done well, and because of the burden that were confronted with, they fell behind in their payments. And of course, their credit scores went down.

They are good people. Should that credit score have any impact on their ability to purchase insurance? I don't think so. Traditional underwriting standards worked with little problems for several decades before insurance companies began using them for underwriting purposes.

I am interested to hear our witnesses explain why these standards were abandoned, and how they continue to justify the use of credit scores for underwriting, given the concerns I have raised.

Thank you, Mr. Chairman. I appreciate your accommodating my coming in a little bit late, and I will yield back the balance of my time.

Chairman WATT. I thank the gentlelady for being here both for the first hearing and for this hearing and for her proposed legislation.

We are now ready to recognize the witnesses, and each one of you will be recognized for 5 minutes to give a summary of your written testimony. The green light will come on at the beginning, at 4 minutes a yellow light will come on, and at 5 minutes a red light will come on. We would ask you, at that point, to wrap up the thought that you are involved in. We do have a second panel and a number of members who wish to ask questions, so we want to try to keep this moving if we can.

With that, I will recognize Ms. Lydia Parnes, Director of the Bureau of Consumer Protection at the Federal Trade Commission for a 5-minute opening statement.

STATEMENT OF LYDIA B. PARNES, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

Ms. PARNES. Thank you very much. Chairman Watt, Ranking Member Miller, and members of the subcommittee, I appreciate the opportunity to—

Chairman WATT. Can you pull that microphone a little bit closer to you? And if somebody has an empty seat beside them, would they just kind of raise their hand, so that others who are standing might be able to take a seat? I think there are enough seats in here for everybody who is standing, unless you just want to stand. But if you do, I wish you wouldn't stand, blocking the door.

Pull the microphone very close to you, because I was having a little trouble hearing you. And make sure it is on.

Ms. PARNES. Is it working now?

Chairman WATT. Yes.

Ms. PARNES. Better?

Chairman WATT. Thank you.

Ms. PARNES. Okay. Thank you.

I do appreciate the opportunity to appear before you today, as you consider the impact of credit-based insurance scoring on the availability and affordability of insurance. As members of this subcommittee are aware, insurance companies have increasingly used credit-based insurance scores to decide whether and at what price to offer automobile and homeowners' insurance to consumers.

Industry representatives and other proponents contend that by using these scores, insurance companies charge consumers premiums that conform more closely to their individual risk of loss. However, consumer advocates, civil rights groups, and others believe that the use of these scores results in racial and ethnic minorities paying higher insurance premiums than other consumers.

To provide insight on the effect of credit-based insurance scores, Congress, in FACTA, directed that the Commission study the effect of these scores on the availability and affordability of insurance, including the particular impact on racial and ethnic minorities.

In 2007, the Commission released a report discussing the results of a study of the use and effect of credit-based insurance scores on consumers of automobile insurance. The FTC provided the subcommittee with views about this report during its testimony last October. Today, I am pleased to provide an update on the FTC's ongoing study on the use and effect of credit-based insurance scores on consumers of homeowners' insurance.

Last week, the Commission approved a resolution authorizing the use of compulsory process to obtain data for this study. The FTC intends to issue orders to the nine largest homeowners' insurance companies, representing roughly 60 percent of the market of private homeowners' insurance in the United States in 2006.

The FTC has placed on its Web site a draft order setting forth in detail the information it intends to seek from homeowners' insurance companies. The Commission is seeking public comment for 30 days on this draft order consistent with FACTA's direction that the Agency consult with consumer groups, civil rights and housing groups, government officials, and the public at large on the design and methodology of these studies.

After receiving public comments and making appropriate revisions, the Commission will serve orders on the nine largest homeowners' insurance firms in the United States. The FTC would be pleased to keep the subcommittee and its staff informed as the study progresses.

I know, as you have mentioned, this subcommittee is considering two bills addressing the use of credit-based insurance scores. H.R. 5633, the Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008, would amend the Fair Credit Reporting Act to prohibit the furnishing or use of a credit-based insurance score if the Commission determines that the use of scores results in racial or ethnic discrimination or represents a proxy or proxy effect, per race or ethnicity. H.R. 6062 would ban the use of credit scores in insurance underwriting.

The FTC has a longstanding commitment to law enforcement and education efforts in fair lending, and believes that it is vitally important to protect consumers from illegal discrimination based on race or ethnicity.

The Commission, however, has deferred to Congress as to what legislative measures, if any, are appropriate in this area. I would note, however, that from a purely drafting perspective, H.R. 5633 would impose liability based on the determinations of FTC econometric research studies. As discussed in greater detail in the Commission's testimony, the FTC has concerns about using its studies as a trigger for liability.

Thank you for your attention, and I would be pleased to answer any questions that you may have.

[The prepared statement of Ms. Parnes can be found on page 173 of the appendix.]

Chairman WATT. Thank you so much for your testimony.

Commissioner McCarty, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE KEVIN MCCARTY, INSURANCE COMMISSIONER, STATE OF FLORIDA, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Mr. MCCARTY. Chairman Watt, Ranking Member Miller, and members of the subcommittee, I want to thank you for the opportunity to testify on the use of credit-based insurance scores and the provision of personal line insurance products. I am Kevin McCarty, the Insurance Commissioner in Florida. I am also here representing the National Association of Insurance Commissioners.

Proponents have argued over the years that credit scores are predictive of the future losses based on the insurance claims experience, and are a necessary and inexpensive underwriting tool. Critics argue that the use of credit scores discriminates against protected classes of people.

Technology over the years has allowed insurance companies access to enormous amounts of new information, including credit reports. Although some of this information may show actuarial relationships with insurance claims, this does not automatically make it an appropriate, fair, and valid criteria for insurance purposes.

The most notable example of this is the use of race-based rates. In 2002, the NAIC concluded several multi-State investigations on

companies that historically rated life insurance differently based on the race of the applicant.

Even today, Caucasians born in the United States have a longer life expectancy than African Americans. Based purely on this actuarial science, this would indicate a higher premium for life insurance. While the outcome of African Americans paying more is correct from an actuarial perspective, it is certainly counter to equal protections for Americans and is an abhorrent public policy.

The use of credit reports represents many potential problems. Consumer report studies show that 50 percent of the credit reports contained errors, which can be exacerbated today by the increased amount of identity theft and the proliferation of our access to credit.

Thus, even if the methodologies were correct, it is possible that inaccuracies in the reports may in fact invalidate their use.

Credit reports also disproportionately and negatively affect the recently divorced, recently naturalized citizens, the elderly, those of certain religious beliefs that do not believe in the use of credit, and younger individuals who have not established credit histories.

The overwhelming problem with the use of credit scoring is the relationship between credit scores and race, ethnicity, and income.

The 2004 Texas Insurance Department study previously referenced that African Americans have an average credit score of 10 to 35 percent below that of Caucasians. Hispanic scores were roughly 5 to 25 percent below.

I do not believe the insurance industry uses credit scoring to intentionally discriminate or impact minorities. Yet, recent empirical studies demonstrate a negative impact on these protected classes.

I am also concerned about other tools that share many of the same characteristics of using credit scoring. A year ago, I held a public hearing in Florida on occupational and educational rating as an underwriting factor for private passenger autos. Testimony at the hearing and information gathered as a result of that indicated that insurers would refuse to study the underwriting practices on minorities and low-income consumers.

I'm especially troubled by the growing use of occupational and educational rating, and would encourage the subcommittee to broaden the scope of its investigation to consider these unfair regulatory practices.

The 2007 FTC report was very disappointing. The narrative appeared very one-sided in support of the predictive powers of credit scoring, while equally downplaying the negative impacts on protected classes of citizens.

I did agree with one aspect of the FTC report, that the State insurance regulatory community has identified credit scoring as a problem and has taken action. As previously mentioned, 48 States have passed some legislation limiting the use of credit scoring. Many States have adopted laws that require regulators to have access to the internal operations of the credit-scoring models, that the decisions are not based solely on credit reports, and that consumers be notified of the use of these reports, and if there is any adverse decisions based on their credit scores.

It is my sincere desire that the Federal Government assist the States in its regulatory efforts to address this important issue and better protect our consumers.

The proposed bill, H.R. 5633, has many favorable provisions. My colleagues around the country and I welcome a more comprehensive study by the Federal Trade Commission to determine if the use of credit reports disparately impacts minorities and does in fact create a proxy effect.

I am also personally in favor of H.R. 6062, which implicitly accepts the notion that credit scoring disparately impacts minorities based on a 2007 study.

Thank you for holding this hearing and for inviting me to participate. I look forward to your continued leadership on this very important consumer protection issue.

[The prepared statement of Commissioner McCarty can be found on page 112 of the appendix.]

Chairman WATT. Thank you so much for your testimony.

Representative Keiser, State Representative, State of North Dakota, is recognized for 5 minutes.

STATEMENT OF THE HONORABLE GEORGE J. KEISER, REPRESENTATIVE, STATE OF NORTH DAKOTA, ON BEHALF OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL)

Mr. KEISER. Chairman Watt, Ranking Member Miller, and—

Chairman WATT. Pull that microphone closer to you.

Mr. KEISER. Thank you very much for inviting NCOIL to participate in this process.

Using objective methods, which are blind to ethnicity, gender, income, and other factors, credit scoring may offer a consistent, accurate, and valid way to underwrite and rate risk, and may mean lower prices for many consumers, primarily those with lower risk.

However, NCOIL has taken a position that as State legislators, we are concerned about any abuses that might occur relative to the application of the credit scores. We encourage laws that understand and accommodate and benefit consumers. For example, our model has looked at the impact on seniors, has looked at the impact on young people, has addressed the situation where people have an extreme financial crisis occur in their life, and we have attempted to adopt that and address that.

There are 26 States which have currently adopted the NCOIL model that has been developed and it appears to be working relatively well in those States. We believe that an appropriate approach is to allow the States to take the NCOIL model and to modify it when appropriate for their States.

Well, what is the NCOIL model and what does it do? The NCOIL model is non-discriminatory. It assists the young, old, and those who suffer extraordinary events, and requires the provision of updated credit information. It goes beyond Federal law by prohibiting insurers from calculating scores based on income, gender, address, zip code, ethnic group, religion, marital status, or nationality. It also prohibits denying, canceling, or non-renewing coverage due solely to a credit score, or from basing renewal rates solely on credit.

Consumer protection under the NCOIL language, an insurer must use data taken within 90 days from the time of adverse action. It must be disclosed to the consumer that when adverse action is taken, a consumer has the right to appeal or object to it. The insurance companies are required to review any objection and to address it.

Relative to consumers, for young people, for old people who don't have credit—many of the panelists in their opening comments addressed that—the NCOIL model requires either in the cases of what would term "thin credit" that the credit be treated either as neutral on the credit score or in a positive manner.

Inquiries are another big issue relative to credit scores. The NCOIL model offers common sense restrictions on how insurers can treat inquiries the credit card companies make before sending out promotional offers; inquiries based on consumers wisely shopping around for deals on auto and home loans; collection accounts related to sickness or other medical events; and bad credit resulting from extraordinary events like divorce, illness, or death of a spouse, as mentioned earlier.

The NCOIL model says that insurers can give these extraordinary victims a credit pass in those situations. The insurer must re-underwrite and re-rate using new data. If the consumer has overpaid as a result of a mistake made, then they are eligible for a credit or refund for that amount.

If the insurer does take an adverse action due to credit, the insurer must give up to four good reasons why. The insurer must be clear up-front that credit will be used.

In conclusion, we appreciate the work of the subcommittee to ensure that credit history is used fairly. The 26 States regulating credit scoring based on the NCOIL model have responded effectively to an issue demanding a timely solution. States as diverse as New York, North Dakota, Texas, and Maine have successfully used this model to meet their different demographics.

We ask that you recognize the efforts States have made to balance consumer protection with the need for healthy insurance markets and that one-size-fits-all doesn't work.

Federal legislation that would satisfy the laws of these States is unneeded and may actually bring higher rates for consumers who are benefitting from their good credit.

Thank you for the opportunity to appear, and NCOIL looks forward to working with your committee, Mr. Chairman.

[The prepared statement of Mr. Keiser can be found on page 101 of the appendix.]

Chairman WATT. Thank you so much for your testimony, and I thank all of the witnesses for being here today.

I will now recognize each member of the subcommittee for questions of this panel, and I will recognize myself for 5 minutes. I may be a little aggressive in enforcing the 5 minutes against us, since we have a second panel to go after this panel, also.

Representative Keiser, how, if at all, would you distinguish between this, the use of credit scoring here, and the public policy position that we have taken with respect to life insurance, where there is an actuarial, predictive documented relationship? We have said that as a matter of public policy, this is unacceptable; and

even more recently in the House at least, and I think maybe even in the Senate, we have passed a bill that prohibits genetic information from being used. How do you distinguish this from that, if you are able to do that?

Mr. KEISER. Well, Mr. Chairman, I'm not sure that I am 100 percent qualified to answer that question. But let me say that NCOIL, as the policymakers in the State on insurance issues, is extremely concerned in protecting valid predictors of risk, whatever they might be—

Chairman WATT. Even if it is race—

Mr. KEISER. Let me just finish. If they can validly predict risk—and I question, although it's done, that grade point averages for high school students can be a valid predictor of risk for insurance companies, that family history can be a valid predictor for health, when I have an application for life insurance or health insurance; that age can be a valid predictor—those are all valid predictors, we are committed to protecting the industry's opportunity to use valid predictors and at the same time protecting the consumer to ensure that invalid application of predictors doesn't occur.

In the NCOIL model, what we attempted to do—

Chairman WATT. I understand that. You are going back, and I only have 5 minutes, so I am not trying to argue with you on this; I can't distinguish these things.

Let me also, just as a factual backdrop, get you and Mr. McCarty, if you would, to distinguish between—or is there a distinction between being a valid predictor of risk versus a valid predictor of claims? Which one have you determined that credit scores are valid predictors of?

Mr. KEISER. Mr. Chairman, I'll answer first, and then Commissioner McCarty can answer.

Chairman WATT. Go right ahead.

Mr. KEISER. It is my understanding that it is a valid predictor of claims that—

Chairman WATT. Okay—

Mr. KEISER. That credit score is valid predictor of claims—

Chairman WATT. Okay. And that is different, is it not, from being a valid predictor of risk?

Mr. KEISER. Mr. Chairman, from the standpoint of risk of having an accident or something, yes, I would agree. But from an insurance company's management standpoint, I would argue that the claim itself is the exposure to risk that the insurance company has.

Chairman WATT. So if there were other factors that kept people, even if they were in automobile accidents from making a claim, the fact that this predicts their willingness to make a claim, which is what the insurance policy was written for, would be acceptable under what you are saying.

Mr. KEISER. If I understand your question—I'm not sure, Mr. Chairman—but my insurance agent oftentimes tells me, "Even though you have a claim, you sometimes are better off to pay that auto damage yourself, because it is a relatively minor claim, than to apply it to your policy and do the deductible plus $100 or $200." I am well-served from a responsibility standpoint—

Chairman WATT. You are well-served, but would a poor person who didn't have the option of paying that claim himself be well-

served? I guess that is the question. Can you just comment on that, Mr. McCarty? And then I am going to—

Mr. MCCARTY. Thank you, Mr. Chairman. I agree with my colleague that the measurement is a measurement of claims. There's no evidence to suggest that regardless of your credit score, you have more accidents. Certainly a reasonable analysis of that data is that credit scoring is really a proxy for your economic class, or your income; and as a consequence, if you have lower income, you are not able do to as the Representative had suggested, to pay out of pocket. And as a consequence, actually people with more money will forego making a claim, knowing that their insurance premiums may go up in the future, and they have the ability to make that economic choice. Lower-income people do not have that option.

And so what is interesting about the analysis done by the Federal Trade Commission is addressing the issue of claims, which I think can be reasonably explained by you having enough wealth to pay for those claims out of pocket.

Chairman WATT. I recognize the ranking member for 5 minutes.

Mr. MILLER. Thank you very much.

Ms. Parnes, you talked about the individuals, the Ph.D.'s in economics, and you consulted with community groups and civil rights groups and such in your report. Is it fair to say that you're confident in the integrity of your initial report, that you examined the analysis you performed and the findings are correct in that report?

Ms. PARNES. The Commission definitely was confident in the reliability of its initial report. And you know that one of our Commissioners did dissent from that.

Mr. MILLER. Is it fair to say that the FTC doesn't support the legislation, that it would ban credit scores?

Ms. PARNES. The Commission hasn't taken a position on the legislation.

Mr. MILLER. Okay. You heard Chairman Watt say that nobody has asked you to use subpoena power. When we previously talked to the FTC, they said that the industry was very cooperative in providing information necessary to prepare the report. Is that correct?

Ms. PARNES. The industry has been cooperative—

Mr. MILLER. Then why would you use subpoena powers?

Ms. PARNES. FTC studies are important, we think, both in terms of the actual reliability of the study, and also in the perception of its reliability—

Mr. MILLER. So it's not for the quality of the material; it's for perceptions reasons that you are doing it?

Ms. PARNES. Well, there was certainly a lot of concern expressed about our initial report and whether it was adequate, because we obtained the information voluntarily and for a host of procedural reasons. We feel that by using our subpoena authority, we can address those concerns.

And I should add that we use subpoenas often when we are collecting information in studies, and it certainly isn't meant to suggest that the industry that we're working with is in any way uncooperative.

Mr. MILLER. Did you review the Federal Reserve Board study? Are you familiar with it?

Ms. PARNES. I am somewhat familiar with the Board's study.

Mr. MILLER. Because it found that some elderly have better scores, and if this legislation is passed, it would actually harm the elderly. Is that a fair statement?

Ms. PARNES. I know that it found that the results were somewhat similar to the results that the Commission—

Mr. MILLER. Okay. Mr. McCarty, you said you're representing the National Association of Insurance Commissioners? Do they agree with your opinion? They supported that? Have they supported your opinion today?

Mr. MCCARTY. The National Association of Insurance Commissioners supports the testimony today with regard to the need to continue to study this issue, and is deeply concerned about—

Mr. MILLER. Yes, but that's not what you said. You spoke against it. And if this legislation is passed, it would overturn every State law except Hawaii's. Even your own States would pre-empt it.

Mr. MCCARTY. That is correct. The NAIC's position is not supporting—

Mr. MILLER. But you said you were representing them, and that's I don't really think factual, in their opinion. I looked at data that said after all the States in the jurisdiction reviewed the use of credit scores extensively, that it's basically true that only one State out of 56 jurisdictions have actually banned the use of credit scores, including yours.

Mr. MCCARTY. I said I personally favor H.R. 6062.

Mr. MILLER. Okay. I just want to make sure the record is very clear, that is not the position of the National Association of Insurance Commissioners. In fact, as I said, out of 56 jurisdictions, including States, only one State bans it, so there is a huge difference between that and—I mean this would overturn your own State law.

Mr. MCCARTY. Yes, I understand that. And I want to clear—

Mr. MILLER. Well, you're going to have fun going back home, aren't you, on this one? That is going to be an interesting process.

Mr. MCCARTY. I did want to clarify that with regard to H.R. 6062, that was my personal view, not the view of the NAIC.

Mr. MILLER. Yes. Okay. I have no problem with your personal opinion. I mean everybody has a right to one; I just didn't want a perception to be created or anybody to think that you represented the opinion of the National Association of Insurance Commissioners. In fact, it seems to be quite the opposite; your own State legislators would disagree with your opinion today, based on what they voted into law.

Mr. MCCARTY. The National Association supports continued study of this issue, and is deeply concerned about the disparate impact on minorities—

Mr. MILLER. I have no problem with continued studies—that is what we are doing today—

Mr. MCCARTY. And it supports H.R. 5633.

Mr. MILLER. Mr. Keiser, you testified that the State legislators were initially skeptical about credit scores, but ultimately found that they increased availability and affordability for consumers, and they were racially blind, and to help insurers compete. Is that a fair statement?

Mr. KEISER. Representative Miller, that is actually as accurate a statement as I could make regarding that subject. Senator Craig Eiland from Texas—

Mr. MILLER. My time is up, so just in closing, would you agree that if this were enacted, it would really harm seniors? In your opinion?

Mr. KEISER. I could not agree more strongly, and also NCOIL opposes this legislation.

Mr. MILLER. Thank you very much for your testimony.

Chairman WATT. The gentleman from Illinois, Mr. Gutierrez, is recognized for 5 minutes.

Mr. GUTIERREZ. Thank you very much, Mr. Chairman. Director Parnes, it is my understanding that the FTC shared advance copies of its draft report with the insurance trade associations, but not with the insurance regulatory community. Is that the case? And if so, what was the reason behind this decision?

Ms. PARNES. That is not the case.

Mr. GUTIERREZ. You absolutely deny that the FTC shared this with the insurance industry, and not with the regulatory community? Just answer yes or no.

Ms. PARNES. Well, certainly as far as I know—

Mr. GUTIERREZ. Thank you. Director Parnes, the July 2007 FTC report found—I read it—that credit-based insurance scores are a proxy, or a substitute for race or ethnicity in three out of four lines of automobile insurance: Collision; comprehensive; and bodily injury. But in your written testimony for this hearing this morning, you state that the FTC "found that credit-based insurance scores appear to have little effect as a proxy." Your written testimony appears to be backing away from the conclusions of the FTC's report. I hope that is not the case, but I am going to ask you, for the record, do you stand by the original FTC report?

Ms. PARNES. The Commission certainly does stand behind the original report. I think that it may be worth explaining a little about this proxy effect. Proxy, when used in usual conversation, it's kind of like an absolute substitute, something substitutes for another thing. It's an all or nothing. And when we use proxy effect in the study, we were talking about the effect, as you understand of course, of a statistical analysis—

Mr. GUTIERREZ. I guess I understand that. And we only have 5 minutes. But when I read the FTC report, and I read your comments and your written statement for this committee today, they seem to be different. They seem to be backing away. They seem to be kind of light, kind of like, "Well, let me reinterpret, let me reevaluate what the FTC really meant when they issued their report."

They seem different, and I think that most people might—so I just wanted to ask you if they're different, because I read the original report, which gave birth to the legislation that we're proposing. I mean we didn't just base it on thin air; we read your report. And today it seems like, "Well, yes, it's a proxy, but it's no big deal. It's really not that relevant; it's really not that important." That seems to be the way I interpret what you bring to the committee today, vis-a-vis what the committee heard when the FTC first reported.

So I just thought I would ask you.

Ms. PARNES. The Agency has no intent to back away from its earlier report.

Mr. GUTIERREZ. Mr. McCarty, in your written testimony, you referred to "economic advantages" to insurance companies from using credit-based insurance scores that have largely been ignored by empirical studies, including the 2007 FTC study. What are these economic advantages, and why do they deserve any scrutiny?

Mr. MCCARTY. Well, I think the insurance industry and insurance trade associations would argue that using credit scoring is an inexpensive underwriting tool, that it would be more expensive to underwrite if they did not have the ability to use credit scoring freely as one of many tools in their underwriting situation.

The concern is notwithstanding that it is predictive, and that it is inexpensive, if you strike the balances, what impact does it have if there is a disparate impact on races, and how much of that is tolerable?

Mr. GUTIERREZ. I just wanted to share with you, Mr. McCarty, that when I read your testimony, I fully understood the difference between your Association and their position and your personal position here today. So I wouldn't make a big deal out of it. We are elected officials and we are people who represent different views.

Let me ask Mr. McCarty, do you have any information that the FTC may have shared their report with the insurance industry?

Mr. MCCARTY. That was our understanding in our Association, that the report had been shared. I have no evidence to support that, but that was—it was a common understanding. And the reason it came to our attention because we would certainly would have welcomed the opportunity—as the consumer protectors for the State insurance regulators, would have welcomed the opportunity to have reviewed the report in advance as well, to provide some guidance. And hopefully we'll have that opportunity to work collaboratively with the FTC in the future.

Mr. GUTIERREZ. All right. Let me just end by saying that I thank you all for your testimony. I have been here for 16 years, and I assure you that the insurance industry and the financial services industry has no lack of power, no lack of influence on the members of this committee, and no difficulty in getting their way.

That has been my experience during the last 16 years. So I am sorry if I am not real sorry for the insurance industry or for questioning their motivations or their tactics. Thank you very much.

Chairman WATT. I thank the gentleman. The gentleman from North Carolina, Mr. McHenry, is recognized for 5 minutes.

Mr. MCHENRY. I thank the chairman.

Now, Representative Keiser, the Federal Reserve shows that—one of their studies shows that seniors tend to have higher credit scores. I don't know if you have seen that fact. But if this legislation were in place, could it cause higher insurance rates for those with higher credit scores?

Mr. KEISER. Mr. Chairman, and Representative McHenry, I think that is the important point to be made today, that if this legislation were to pass, there would be losers and there would be winners. Those people who currently are having the advantage of having good credit are going to pay higher premiums. Those who have, for whatever reason, not as good a credit score, are going to

pay less. There's no free lunch. The insurance companies are going to make their money.

Now the question is: Do you reward good behavior in the form of good credit? Good credit is a fine thing. And again, NCOIL has been very deliberative on this, and we have attempted to protect those unique situations that occur. Young people, old people with no credit line; those people who have extraordinary circumstances; those people—and I went through it in my testimony to Mr. Chairman—but the point is there is a way to address application of credit scores to make it as reasonable as is possible and as fair as is possible without throwing credit scores out, to the disadvantage of some groups who have worked very hard to establish good credit.

Mr. MCHENRY. Commissioner McCarty, do you have a response to that?

Mr. MCCARTY. I'm sorry. Would you repeat the question?

Mr. MCHENRY. Do you have a response to that?

Mr. MCCARTY. I don't recall your question, sir. I apologize.

Mr. MCHENRY. If you were actually listening to Representative Keiser, I'm asking if you have a response to what he just said. I don't know if you were doing what many behind you were doing, listening to something else. But—

Mr. MCCARTY. No. What our concern is with regard to credit scoring is first of all with it in terms of its potential impact and redistribution with regard to senior citizens; our evidence and our research has found that many senior citizens have thin credit files. My grandfather, for instance, didn't have a credit card; he paid his rent in cash. His credit score probably would not be good, although he was certainly financially responsible.

But the Representative is absolutely right. If you eliminate an underwriting tool for determination of premiums paid, there are going to be some winners and some losers. And what the balance is of that is if credit scoring is used and it has a disparate impact on—racially discriminates against protected classes of people, where do the public policymakers strike a balance—

Mr. MCHENRY. So is your issue with the insurer's use of a credit score? Or is it your belief that a credit score—or maybe both—that a credit score has an innate racial component to it?

Mr. MCCARTY. My concern is both. Historically, insurance has been for two purposes: Number one, to provide for financial security; and number two, loss prevention. And with regard to loss prevention, I don't see how credit scoring really supports that insurance principle, since what we want to do is to get people to drive more responsibly. And I don't see how improving your credit score serves the purpose of loss reduction.

Mr. MCHENRY. But do people not also have to pay for insurance? Therefore, their record of paying or not paying in other financial service products could be an indicator of whether or not they will pay for a renewal of their insurance.

Mr. MCCARTY. Well, that's possible, but the insurance premium is paid up-front.

Mr. MCHENRY. It is—

Mr. MCCARTY. Yes—

Mr. MCHENRY. But under State mandates, doesn't an insurer have to cover them for 30 days? Isn't there a gap by which insurers have to cover?

Mr. MCCARTY. Failure to pay your policy will result in cancellation of your policy.

Mr. MCHENRY. But you have to give them 30 days to do that.

Mr. MCCARTY. You give them a notification, but they will notify you if you don't make that payment. They are not behind in terms of collecting the premium. They will cancel you and earn the premium that you have paid up to that point.

Mr. MCHENRY. There should be an expense associated with that as well, if you're slow to pay or you have to send out multiple notices. So wouldn't an insurer, wouldn't they be wise to know that, up-front?

Mr. MCCARTY. Yes, they would be.

Mr. MCHENRY. So wouldn't a credit score be useful, then?

Mr. MCCARTY. Would a credit score be useful? In my opinion, I think that there are enough built-in costs and expenses, if you premium finance, that the companies who use premium financing are able to secure and to pay for those additional charges.

Mr. MCHENRY. Interesting. Thank you, Mr. Chairman.

Chairman WATT. Thank you.

The gentlelady from California, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much.

Ms. Parnes, I want to know how credit scoring is balanced against the experiences of the driver; for example, in automobile insurance, I would think that the indicators of whether or not you have a lot of tickets, you have had accidents, etc., plays a role. What role does credit scoring play in the decisionmaking?

Ms. PARNES. I don't think that our study told us exactly what role it played.

Ms. WATERS. Did you ask anybody? Without a study? You are the Federal Trade Commission. Do you know whether or not they make these decisions solely on credit scores, or is it a combination of factors?

Ms. PARNES. It's based on a combination of factors.

Ms. WATERS. How do you know?

Ms. PARNES. We know that from talking to people in—

Ms. WATERS. What are the other factors?

Ms. PARNES. The other factors like—

Ms. WATERS. Who knows this information? What are the other factors? How do they do this?

Mr. MCCARTY. They do it on age, your driving history, and claims made in the past. There is a myriad of factors that could be used. Most States have passed some laws that say that you cannot use credit scoring as the sole factor. But that can be somewhat misleading.

It could be the predominant factor, and in some insurance companies—not all—but some insurance companies heavily rely on it because of its predictability.

Ms. WATERS. The Honorable George Keiser, do you know the weight that credit scores have on the decision of the cost of insurance? How heavily does it weigh?

Mr. KEISER. Mr. Chairman and Representative Waters, our insurance commissioner could answer that question, because everything is filed in our insurance—

Ms. WATERS. Are there any companies who use it solely? Or is it 50 percent of the decision? Is it 75 percent of the decision? How does it work?

Mr. KEISER. In our State, and I believe in all States that have adopted the NCOIL model—and that would be 26 States at least—it cannot be used solely. And we have by definition said "solely" would be 51 percent cannot be weighted. So it could be a significant weighting factor, but I cannot answer the specific combination of factors used or the weights applied.

Ms. WATERS. All right. Let's see. Mr. McCarty, would you agree that if you use credit scoring solely or it's heavily weighted to make the decision that it reduces your costs of investigations and of collecting and gathering information, so that you can make determination about one's ability to pay? Does it reduce the costs, the personnel costs, the investigation costs, the vetting costs?

Mr. MCCARTY. According to industry spokesmen and industry trade associations, it is substantially cheaper to use a credit scoring mechanism than it is to do traditional underwriting.

Ms. WATERS. Well, you know, I have looked at this, and I have tried to figure out why there is an argument that somehow credit scoring is a strong indicator. And it just doesn't make good sense to me. I cannot make sense out of it. And I don't even know why the FTC would spend the taxpayer's money, except I guess you were asked to do it. It just doesn't make good sense.

So I am trying to figure out why. And as I listen to all of this, I recognize that the cost of reviewing an application and determining what kind of experiences these drivers in automobile insurance have had, whether or not—it costs a lot of money to do that. And so to just go to the credit score really reduces the cost of the insurance company. And I'm beginning to believe that's really what this is all about.

Mr. Keiser, you mentioned that even GPAs are a good indicator of something. Did you say that?

Mr. KEISER. Representative, absolutely. In our State, good students get a discount.

Ms. WATERS. So you are telling me that a smart student is a better driver.

Mr. KEISER. Good students can get a discount.

Ms. WATERS. Having nothing to do with their driving—

Mr. KEISER. And good students—

Ms. WATERS. Just a moment—

Mr. KEISER. That is correct.

Ms. WATERS. Had nothing to do with their driving record. A low GPA indicates that you're not as good a driver. Is that right?

Mr. KEISER. It is a predictor that is used in some cases.

Ms. WATERS. Well, that is absolutely nonsensical. I know some of the smartest people, I mean geniuses, who are just stupid. I mean they make good grades, but they can't find their way to the toilet. And if you're telling me that's an indicator, I'm more convinced than ever that this is not good. And so—my time is up.

Enough said. I'm moving forward with my legislation. This doesn't make good sense. Thank you.

Chairman WATT. I thank the gentlelady for her testimony. I was going to withhold this until the second panel, but since the gentlelady made inquiries, I wanted to ask unanimous consent to submit information from the Web sites of three insurance companies: AllState; Traveler's; and State Farm, on what factors they consider in determining rates, and I would invite the gentlelady to take a look at these. She will find them very unenlightening in trying to figure out what factors are used.

Mr. MILLER. At the same time—I would like to submit—

Chairman WATT. I recognize Mr. Miller for—

Mr. MILLER. —a letter from the American Insurance Association, the Financial Services Roundtable, the U.S. Chamber of Commerce, the Independent Insurance Agents and Brokers of America, the National Association of Mutual Insurance Companies, and the Independent Insurance Agents and Brokers of America. I would also like to submit: a statement from the National Association of Mutual Insurance Companies; a statement from Michael J. Miller and EPIC Consulting; and a statement from the Property Casualty Insurers Association of America.

Chairman WATT. I have those, sir, and we will make sure they get in the record, without objection.

Mr. MILLER. Thank you.

Chairman WATT. Mr. Boren from Oklahoma is recognized.

Mr. BOREN. Thank you, Mr.—

Chairman WATT. I'm sorry. We have—somebody else came in that I didn't see. Mr. Barrett from South Carolina is recognized for 5 minutes.

Mr. BARRETT. Thank you, Mr. Chairman. I would like to yield 30 seconds to Mr. Miller from California.

Mr. MILLER. Yes. I just wanted to follow up. Mr. McCarthy, you made an interesting comment. You said that the industry relies upon credit scores because of its predictability. It's proven to be right. Nobody knows why, but it's proven to be a predictable measure of determining risk. Is that not a fair statement?

Mr. MCCARTY. Yes. There's a strong correlation between credit scores and claims.

Mr. MILLER. Yes.

Mr. MCCARTY. Predication of claims.

Mr. MILLER. And that's—

Mr. MCCARTY. Not necessarily accidents, but claims.

Mr. MILLER. Okay. But claims. I think that speaks volumes.

Chairman WATT. Would the gentleman yield just for a second?

Mr. BARRETT. Absolutely, Mr. Chairman.

Chairman WATT. This is a good time to—Florida did a study about this claims versus risk issue, in which you found that doctors, accountants, and lawyers all have higher accident rates, yet they get lower rates because of their occupation and education. And your study found that 50 percent of eligible claims are not reported for fear of a rise in insurance premiums. Does that play into your response to Mr. Miller's question?

Mr. MCCARTY. Yes, sir. And this refers back to a public hearing we had with regard to occupation and education used as criteria,

where your doctors, lawyers, etc., who may have a higher claims experience, get more favorable treatment with regard to the cost of premiums. Those with lower education levels and with other occupations like mechanics, etc., pay substantially more, even though the evidence does not support a higher loss ratio. There may be more frequent claims, but that again can be explained by the fact that higher-income individual policyholders have the wherewithal to pay them, whereas lower-income folks will file a claim.

Mr. MILLER. Well, Mr. Chairman, I'm convinced we need to introduce a bill outlawing attorneys, without a doubt. We need to stop those people.

Chairman WATT. You mean just attorneys? Not doctors, or accountants, or—

Mr. MILLER. I might need a doctor. I don't need an attorney.

Chairman WATT. Oh, okay.

I thank the gentleman. I appreciate him, and I will ask unanimous consent for 2 additional minutes for the gentleman, so that he is not deprived of his time.

Mr. BARRETT. Outstanding. Thank you, Mr. Chairman.

Gentleman and lady, thank you so much for being here today. I am certainly a free market believer. I think the less government interference, the better. And I am concerned when we have government mandates, how that affects the market in the redistribution. I would like Ms. Parnes and Mr. Keiser to answer this: Do you think if we ban the use of credit scoring, that we might have a socialization, meaning the lower-risked folks subsidizing the cost of the folks who have a higher credit rating? Either one of you, or both of you, please.

Mr. KEISER. I have already answered that and the answer is "yes."

Mr. BARRETT. I apologize. Same thing.

Ms. PARNES. As I have indicated earlier, the Commission has not taken a position on legislation, and really hasn't considered what the impact of a ban would be.

Mr. BARRETT. Okay. For all three of you, if you would please, let's just say, for example, the credit-based insurance scoring is banned or curtailed, and we went with something different. First of all, what might that be? What is a better way to do that? And would it be less accurate than what we are using now or more accurate? Please answer that one, if you can.

Mr. MCCARTY. Prior to the use of credit scoring, insurance companies had a long, mature history of looking at a variety of factors, including geographic area, the driving experience, number of years you have been insured, have you been continuously insured, your driving history, driving record, traffic violations, etc. Those have been historically used in the determination and underwriting of auto policies. Removing today immediately the use of credit scoring, since it's used very heavily by the insurance industry, would be disruptive. That could be ameliorated to some extent by phasing it out over time.

Mr. BARRETT. Mr. Keiser?

Mr. KEISER. I would simply respond that, again, any valid measures that can be developed for predicting risk exposure claims should be developed for the benefit of consumers in our country.

On the other hand, again, we have to make sure that the abuses that can accompany any of these measures, whether it's credit scoring or any other measure, not be allowed.

Ms. PARNES. The Commission looked at other models, other possible models, and was not able to come up with one in its study.

Mr. BARRETT. Okay. I can think of several different examples where government mandates rather than the free-market process have led to the consequences that we're not looking for. In fact, the one that comes closest to mind is ethanol. We mandate certain things on ethanol, we monkey with the free market process, and all of a sudden food prices go up.

Can you—in the financial realm, can you give me some examples of where government intervention in free market process has led to consequences where the government actually said that they were going to try to fix something, and the opposite consequence happened? Can you give me some examples, any of you?

Mr. KEISER. Well, I think the most obvious one as a State legislator that comes to my mind, was welfare reform when it was federalized. The Federal Government was very quick to send it back to the States once it was entirely mismanaged at the Federal level. And the States have done a fairly good job with that. But in the case of the subject at hand, again, to tie the hands of the industry in terms of valid predictors will create some offset—and there is no alternative.

The insurance companies, I don't believe, are going to lose money. Somehow the cost will be shifted if this legislation were to pass.

Mr. BARRETT. I see my time is up. Thank you, Mr. Chairman.

Chairman WATT. I thank the gentleman. Mr. Boren from Oklahoma is recognized for 5 minutes.

Mr. BOREN. Thank you, Mr. Chairman. I want to say thank you for allowing me to be on this subcommittee, and also, the Housing Subcommittee, with Ms. Waters. I am honored to join both of you, and I know we have worked on a lot of contentious issues over the past couple of years, and hopefully we can work together in the next few years.

I have a couple of questions, very brief. First for Director Parnes, you kind of answered this earlier, but again I would like the answer. Did not the industry provide the data for auto and homeowners voluntarily? Did they come to the Commission and say, "We're going to bring this information voluntarily?"

Ms. PARNES. The industry did provide the information for the auto insurance study voluntarily. We went to the industry, we were directed to do this study, and we talked to the industry about voluntary submissions. And we were able to reach agreement on that.

Mr. BOREN. And did you respond formally to the industry? And if you didn't, why did you not?

Ms. PARNES. Respond formally?

Mr. BOREN. Like in a letter, or some kind of formal response. If they said, "We're going to provide for the homeowners' study," for instance.

Ms. PARNES. Well, for the homeowners' study, we began the process of discussing voluntary submissions. But it was shortly after we

began those discussions, the Commission made the decision that it would proceed through a subpoena process.

Mr. BOREN. Do you think that is premature, to do that, when you have an industry that is basically begging you, saying, "Here is the information, so we're going to take the added step to beat someone over the head when they have actually come to you." That is really not the role of government to hurt someone when they are actually trying to help you and provide information. Is that correct?

Ms. PARNES. Well, it certainly isn't the role of government, and it's not the approach that the Commission has taken. We do use these subpoenas typically when we're doing industry-wide studies. And they're not intended to suggest that the industry that we're studying is not being cooperative.

I think the Commission's concern in the homeowners' study, as indicated earlier, is that the value of Commission studies is really based on both their actual reliability and also the perception of their reliability. And there was a lot of concern expressed about the auto insurance study as not being reliable because the data was submitted voluntarily.

The Commission supports the study, the Commission stands behind it, believes that the study is reliable; but in response to those concerns, decided to pursue information under subpoena for purposes of the homeowners' insurance study.

Mr. BOREN. Okay. One final one for you: Since there are questions as to the Commission's legal authority under either Section 6 of the FTC Act or Section 215 of the FACT Act to compel information from insurers generally or with regard to this specific study, is it possible that actually using these subpoenas would delay the study, or has delayed the study?

Ms. PARNES. Well, we hope that it doesn't delay the study. Certainly if the subpoenas are challenged, there could be some delay, but we will—

Mr. BOREN. Do you know how long a delay that would be? Or, is there is a precedent?

Ms. PARNES. I don't, and I don't know if they will be challenged, either.

Mr. BOREN. Okay. That would be interesting to know if they would be challenged.

I have a question for Commission McCarty. This is actually—I have an e-mail here from my State insurance commissioner, Kim Holland, who is a great friend of mine. And this is what her e-mail basically says: "Oklahoma's experience suggests that the vast majority of our policyholders are not impacted, or actually save money due to credit scoring. We also prohibit most of the activities found objectionable by other regulators, such as—rates to be affected by race, gender, or no credit history." Do you have a response to that? And you know, compare Oklahoma to maybe Florida. What are your thoughts?

Mr. MCCARTY. Yes. I actually discussed this issue on the telephone with Commissioner Holland the other day, and she feels very strongly as long as there is a predictive value, that there is an argument to be made that you're actually providing better value for a majority of consumers, that it is color-blind with regard to—or from the initial question, since the asking about the running of

a credit report does not ask the question up-front, so any consequential racial discrimination is not intentional. And that does represent a view within our organization. Other commissioners would share that view. I do not.

Mr. BOREN. Well, I would love to ask more questions, but it looks like my time is up. Thank you all so much for your testimony.

Chairman WATT. I thank the gentleman for his questions. Can I just have unanimous consent to ask Mr. Keiser one clarifying question? You said that the result of not using insurance scoring for this purpose would result in winners and losers; some people would be adjusted up, and some people would be adjusted down. But if that is a greater reflection of actual risk, are you suggesting that is a bad thing?

Mr. KEISER. Mr. Chairman, I think if it is a valid predictor, and your committee, through the investigation, can determine that, if it is a valid predictor and it can be accomplished inexpensively, it diminishes, number one, the cost to the insured; and number two, if it's a valid predictor, it gives those people for whom it validly predicts good credit a lower rate, those people with poor credit a higher rate.

Chairman WATT. I appreciate that answer, but it is not responsive to the question I asked, unfortunately.

Mr. KEISER. I apologize. I don't understand—

Chairman WATT. And I understood that you had testified to exactly what you just said. The question I'm asking is, if there are winners and losers as a result of using a different kind of mechanism other than credit-based insurance scoring, and you get a more accurate reflection of what the risks actually are, are you suggesting that is a bad thing?

Mr. KEISER. Mr. Chairman, no. I don't believe that measure—

Chairman WATT. Okay. All right. I didn't think you were. I just wanted to make sure that we got that on the record. We obviously know that there are winners and losers. And, as you say, insurance companies will try to find a way to make a profit; that is what they are in business for. But there is an also important factor here in trying to come up with a fair system that does not shift the burden as a result of unfairness in credit scoring to poorer people and minorities. And I wasn't trying to trick you on that; I was just trying to make sure that I understood what you were saying in your testimony.

Mr. MILLER. May I have one minute?

Chairman WATT. Yes.

Mr. MILLER. There are a couple of things I didn't bring up. The State of Oregon decided they wanted to eliminate credit scores, and they went to the voters, and it was overturned 2 to 1. The people said, "No," they think that's a reasonable way to predict rates. New Jersey actually reversed itself when they went the other direction, and came back the other way.

I guess the difference between what a lot of us are hearing, but even Mr. McCarty, you said that the industry relies upon credit scores because of its predictability as it applies to claims, and that is what we are looking at. The testimony I have heard today said that if we eliminated that, seniors are likely to be impacted unfairly by changing the requirements. So until I can find a better

way, or somebody presents a better way of predictability, it seems like the system today is working, and it is predictable. And if I thought it was discriminatory, I would absolutely oppose it. Thank you. I yield back.

Chairman WATT. I thank the gentleman, and I wasn't going to offer this until you raised the question. But—

Mr. MILLER. Oh well, equal time.

Chairman WATT. No. I'm just going to make a unanimous consent request to offer into the record, since you raised the question of the Oregon vote, the information about who paid for lobbying and the amounts that the insurance industry paid for lobbying in Oregon—just for the purpose of completeness of the record.

Mr. MILLER. Well, those people voted for Obama, too, didn't they? Something is wrong with that State. I can tell. I yield back.

Chairman WATT. Thank you. I ask unanimous consent to put an article from USA Today, "Credit scores' link to insurance rates tested," by Christine Dugas, into the record. The article discusses what insurers spent opposing the use of credit scoring in insurance. Without objection, it is so ordered.

We thank these witnesses for testifying. I think you have added immensely to our knowledge base here, and we will excuse you, and call up the second panel of witnesses.

If I could ask the witnesses on the second panel to be seated? We seem to be missing one. In the interest of time, I am going to proceed with the introduction of the witnesses. I think Mr. Poe is here; he must have stepped out for a moment. He has returned.

We are delighted to welcome our second panel of witnesses. They will testify in the following order: Mr. Bob Hunter, director of insurance of the Consumer Federation of America; Ms. Lisa Rice, vice president of the National Fair Housing Alliance; Mr. Eric Poe, chief operating officer of CURE Insurance, a New Jersey-based insurer; Mr. Charles Neeson, senior executive, personal lines products, Westfield Group, who is testifying on behalf of the Property Casualty Insurers' Association of America; Mr. Stuart Pratt, president of Consumer Data Industry Association; and Dr. Lawrence S. Powell, professor, University of Arkansas at Little Rock.

I think all of you were present earlier when I laid out the rules of the road. Each of you will have your entire statement submitted in its entirety for the record, and we would ask you to summarize your testimony in 5 minutes or less. You will get a green light at 4 minutes, a yellow light for the 4th minute, and then a red light at the end of 5 minutes, and we would ask you to wrap up when you see the red light as expeditiously as possible.

With that, Mr. Bob Hunter, director of insurance, Consumer Federation of America, you are recognized for 5 minutes.

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

Mr. HUNTER. Thank you, Mr. Chairman, and members of the subcommittee. My name is Bob Hunter, and I served as Federal Insurance Administrator under Presidents Ford and Carter. I also served as Texas Insurance Commissioner.

Insurance scoring is used to determine whether a customer will be eligible for coverage, and the premiums that the customer will

pay. In response to a question earlier, I would say that for many companies, credit scoring can have a greater impact than claims and other key factors on a final rate of an individual.

CFA and many organizations, civil rights and others, have called for a prohibition on insurance scoring because its use in insurance undermines core functions of the insurance system, decreasing insurance availability and affordability, undermining the critical role of insurance and encouraging loss prevention. It has an adverse disparate impact and discriminates against low-income and minority consumers. It's based on reports that often have errors or are incomplete. It's inherently unfair and penalizes consumers who are the victims of economic or medical or natural catastrophes. It even penalizes them for improper lending business decisions that we've noticed over the last few years. And it violates sound actuarial principles.

The insurance industry claims a variety of benefits; but when you boil it all down, it basically says, "We have a correlation," and therefore we're more predictive with it of the likelihood of a consumer having a claim. If that were true, we would expect an increase in delinquencies in bankruptcies would be matched by an increase in insurance claims. Since 2000, bankruptcies and delinquencies have risen sharply, but auto claim frequencies have declined sharply. This suggests there is no correlation.

Why aren't we seeing the correlation at work over time? Insurers can't tell us what it is about a credit score that is linked with risk. This is what Ms. Waters and others have raised. What is it linked to? If you ask them why a person who suffered a decline in credit because of Hurricane Katrina or losing a job because of outsourcing is a worse risk, they can't answer.

Unlike every insurance class before credit scoring was adopted, credit scoring is not based on a logical rationale confirmed later by a statistical analysis. A correlation alone with no thesis being measured means the credit score violates actuarial principles.

The only thesis insurers have manufactured but cannot prove with data is that people with bad credit are irresponsible. But try telling that to people laid off from a job, or after a major medical problem, or after suffering financial difficulty from a divorce. These 3 life events account for 87 percent of family bankruptcies. That is not irresponsibility; that is life events.

If insurers call this irresponsible, they're even more heartless than I thought. In fact, there's strong evidence that insurance scoring is not a predictor of insurance claims, but rather a proxy for other factors that are related to claims experience, such as income or geographical location of the car. But it also is a proxy for race as well as income.

Two independent studies by Texas and Missouri found strong relationships between race and income. The Missouri department said race was the strongest, when you look at the correlation between race and credit scoring. Even the recent flawed FTC report, as we've already heard, found this correlation. Hopefully, the home insurance study will be better because of what we've heard today that they'll actually collect the data that they didn't have, which was hugely inadequate, the auto insurance study, for reasons I've listed in my testimony.

Insurers claim that competition would be harmed and availability reduced if credit scoring is banned. This is false. I need only to point to California, where credit scoring is banned for use in auto insurance. In our recent in-depth study of auto insurance regulation, we found that State has the best system in the Nation, including the ban on credit scoring. While the insurers claim competition would be harmed by it, our data shows that California has the 4th most competitive market in the Nation, measured by HHI. Plus the assigned risk rate has dropped to only 1/10 of 1 percent of the autos insured in the State.

This proves availability and competition are not harmed by banning the use of credit scoring. Indeed, Massachusetts, which was praised earlier, as becoming less State-controlled, still has prior approval and bans credit scoring. So does Maryland for home credit scoring.

We applaud the sponsors of H.R. 5633 and 6062. We have concerns about the first one, H.R. 5633. The legislation's goal of banning credit scoring if the use of consumer credit information discriminates on the basis of race is a good one, but we fear that the legislation will not achieve the results for a series of reasons I listed in my testimony.

CFA believes that simple banning of credit scoring in insurance is necessary, and everything we've studied indicates it's the right thing to do; therefore, we enthusiastically support Ms. Waters' bill, H.R. 6062.

[The prepared statement of Mr. Hunter can be found on page 59 of the appendix.]

Chairman WATT. I thank the gentleman for his testimony. Ms. Lisa Rice, vice president, National Fair Housing Alliance, is recognized for 5 minutes.

STATEMENT OF LISA RICE, VICE PRESIDENT, NATIONAL FAIR HOUSING ALLIANCE

Ms. RICE. Thank you, Chairman Watt, Ranking Member Miller, and members of the subcommittee for the opportunity to testify today on credit-based insurance scoring.

The National Fair Housing Alliance (NFHA) is a consortium of more than 220 private nonprofit fair housing organizations and State and local civil rights agencies. Our mission is to eliminate all forms of housing discrimination and to expand equal housing opportunities.

It is NFHA's position that Congress should ban the use of credit scoring in insurance. Studies by the Missouri and Texas Departments of Insurance have found that insurance scoring discriminates against minority consumers because of the racial and economic disparities inherent in the scoring systems.

Even though the Federal Trade Commission used data handpicked by the industry for its 2007 study, it found that credit scoring discriminates against low-income and minority consumers and that credit-based insurance scores "appear to have some proxy effect for three of the four coverages studied." Unfortunately, instead of highlighting this discriminatory connection, the FTC chose to restate the arguments of the insurance industry that scores are related to responsibility and risk management.

The industry claims that there are "intrinsic underlying individual biological and psychological characteristics of risk taking in both financial behavior and driving." This argument, however, ignores the fact that racism and discrimination have always been present in our society, and that discrimination is inextricably tied to inequality in our lending and financial markets.

People of color do not have a risk-taking biology. African Americans and Latinos have lower insurance scores because of direct and indirect discrimination in the marketplace. America has a bifurcated lending system that disproportionately discriminates against borrowers of color.

Countless studies and court cases have demonstrated this. My own organization conducted a multi-year lending testing project which uncovered multiple ways in which African Americans were denied lending opportunities, including receiving inferior basis information that their white counterparts were given, being urged, unlike their white counterparts, to go to a different lender, and being told, unlike their white counterparts, that they would not qualify for a loan. This happened even though both the African American and white consumers were equally qualified.

Parenthetically, NFHA has been involved in conducting hundreds, probably thousands of tests of insurance companies, and we have found similar biases there too, based on race.

Our bifurcated lending system has also helped to lead to the current foreclosure crisis. As we all know, African Americans and Latinos were disproportionately targeted for subprime loans and unsustainable mortgages, even when they qualified for better rates. Thus, borrowers who entered the mortgage cycle with sound credit are now facing plummeting credit scores.

It is wholly unfair to further burden borrowers who were unfairly targeted by unscrupulous lenders with higher insurance premiums. These borrowers will not suddenly turn into poor drivers or lax homeowners simply because their credit scores have decreased. Banning credit-based insurance scores is a civil rights issue, which is why NFHA supports H.R. 6062.

We also appreciate the efforts regarding H.R. 5633, but are concerned that the bill lacks an objective standard for identifying racial discrimination, gives broad discretion to the FTC, and has no private right of action. Most importantly, H.R. 5633 could serve to legitimize insurers' use of credit-based insurance scoring in general.

A recent study demonstrates that if you crash your car, you can blame the stars. The study found, looking at records of 100,000 drivers that there is a statistically significant correlation between Zodiac signs and car accidents. Based on the study's findings, Libras, Aquarians, and Aries are the worst drivers. Who knew?

The National Fair Housing Administration was involved in litigation against a major insurance company that utilized a credit scoring model. An analysis of the model, which we could do because of discovery under a protective order, found clear disproportionate impact on African Americans and the price they paid for insurance, which could not be accounted for by differences in the risk they posed. In other words, African Americans paid a higher rate than was commensurate for their level of risk.

We urge you to ban the use of consumer credit information for insurance, and thank you again for the opportunity and the invitation to speak to you today.

[The prepared statement of Ms. Rice can be found on page 233 of the appendix.]

Chairman WATT. Thank you for your testimony.

Mr. Poe, chief operating officer of CURE Insurance.

STATEMENT OF ERIC POE, CHIEF OPERATING OFFICER, CURE AUTOMOBILE INSURANCE

Mr. POE. Thank you very much, Mr. Chairman, and members of the subcommittee for inviting me today to talk about this proposed bill. As you said earlier, I am the chief operating officer of CURE Auto Insurance. We are a regional insurance carrier based out of Princeton, New Jersey. We are licensed to write in the State of Pennsylvania, as well as the State of New Jersey.

I would like to start out by giving some background on our interest in this particular issue. Prior to 2003, in the State of New Jersey, insurance carriers were not approved for the use of credit scores, education, occupation, as well as homeownership status as factors in underwriting.

However, in 2003, the New Jersey government decided that they wanted to attract more market players, new national carriers into the marketplace. And it was at that time they started permitting credit scores, education, occupation, and homeownership. As an organization that writes private passenger automobile insurance, it was at that time that we had to study and analyze these underwriting methods to determine their validity.

After significant review, CURE Auto Insurance determined that while these rating and underwriting variables do correlate to loss ratios, they merely serve as statistical proxies for income, which is why CURE Auto Insurance does not employ any of those factors. However, we believe that we will soon be compelled to for competitive measures if this is not stopped.

To start, I would like to explain some of the conclusions that we found when reading the reports that were issued dealing with credit scores. It appears evident that the auto insurance industry uses loss ratio models as justification for using credit scores, education, as well as occupation. Now showing statistical correlation to these characteristic traits to loss ratios, the entire industry has been able to validate using credit scores and all these other factors.

However, I think it is important for everybody to understand what is a loss ratio. By definition, a loss ratio is the incurred losses and loss adjustment expenses divided by net earned premium. In layperson's terms, it's a measure of profitability which we call rate adequacy.

Surprisingly, what our examination yielded was that the studies dealing with credit scores, education as well as occupation, have made an inappropriate conclusion—that simply because you show a correlation to loss ratios, it means that the variable that you are testing automatically is a predictor of risk.

However, it's important to understand that there's an infinite number of characteristic traits that you can draw correlations to loss ratios, but they would all be invalid if you can explain a more

valid characteristic trait that's imbedded in that variable. The best example that was given before was life insurance and mortality tables with African Americans in the past, with African Americans having shorter life spans. Life insurance companies still aren't able to use it.

My example would be that African Americans have shorter mortality tables not because they're black; it's because socioeconomics are involved with them having lower mortality tables. Because they are in lower-income neighborhoods; it is more likely there are homicides; it is more likely there is crime; it is more likely that because they are less educated on average, they are going to eat worse foods, they are going to have diabetes, and they are going to have high blood pressure. Those are the reasons that are the driving factor of why mortality tables for life insurance may be shorter for African Americans than whites; it's not because of the color of their skin.

Similar to loss ratios that we have here with credit scores. In an example that I just gave, I would say that with credit scores, what we found is that they are very good valid predictors of income, but not necessarily good valid predictors of risk in terms of anything else.

Now our fellow members of our industry would like to disguise the public policymakers as regulators, as well that these rating variables of credit scores possess some unexplainable commonality of why they correlate to risk, and therefore are valid predictors of risk. But this is in light of the fact that all of these variables that we're talking about here have an obvious correlation to income, and it is income that is correlated to loss ratio or profitability for our industry.

Now speaking about credit scores specifically: To clarify first credit-based insurance scores, when we examined them, the differences between an insurance score and a credit score is at least we found to be negligible. Asking how many oil accounts and gas cards somebody has really didn't make a big difference with what you would yield in terms of a credit score versus an insurance score.

But the reason why we concluded that credit scores are correlated to income is because if you look at the FICO credit scoring model and you look at the models in which the companies that offer credit scores to us, you would notice that although 35 percent of your credit score is determined based upon your prior history of making on-time payments, number two in that list is 30 percent going to credit utilization.

Now due to the fact that credit lines by lenders are directly calculated, based upon a borrower's income, this is why we believe the credit scoring model more significantly based our belief on the conclusion that this was a strong predictor of somebody's income.

The best example that I can give is really, looking at somebody who does not make a high income, has a $1,000 credit line granted; somebody who makes a lot of money has a $20,000 credit line granted, if they charge $800 in groceries, there's an 80 percent utilization factor for those people who have low incomes because they are using 80 percent of their credit line.

But I think the reason why the industry really wants to adopt this practice of credit scores is for three reasons. Number one, the industry itself wants to attract high-income drivers for three reasons: Number one, we produce higher revenue streams for people; number two, the insurance industry data-mines for higher-income individuals that yield a lot of money; and number three, richer people can absorb more of their claims, which was spoken to earlier.

Finally, in summary, I just think that the subcommittee needs to be more aware of the fact that the bigger problem in our industry is the use of education and occupation as underwriting variables in our industry. What companies are doing, specifically GEICO, is they are basing whether or not you have a 4-year college degree and whether or not you work in a traditionally high-income earning job, as the basis of putting you in the most expensive insurance company that the affiliate has, and they don't tell them.

So, thank you very much.

[The prepared statement of Mr. Poe can be found on page 181 of the appendix.]

Chairman WATT. Thank you for your testimony.

Mr. Neeson, senior executive, personal lines products, Westfield Group, you are recognized for 5 minutes.

STATEMENT OF CHARLES NEESON, SENIOR EXECUTIVE, PERSONAL LINES PRODUCTS, WESTFIELD GROUP, ON BEHALF OF PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Mr. NEESON. Chairman Watt and members of the subcommittee, thank you for the opportunity to comment on H.R. 5633 and H.R. 6062, legislation that seeks to prohibit the use of information on credit reports for issuing and setting premiums for motor vehicle and property insurance. My name is Charles Neeson, and I appear before you today as a senior executive with Westfield Insurance, and as a representative for the Property Casualty Insurers' Association of America, a national trade insurance association, of which Westfield is a member.

I am also a member of the American Academy of Actuaries and an associate of the Casualty Actuarial Society. An insurance company's ability to more accurately predict losses is a critical component of property underwriting risks. Our industry is united in our concern over the negative impacts that restricting the use of credit-based insurance scores will have on American consumers.

When insurers are able to properly underwrite risks, consumers benefit with lower rates and more choices. Because credit-based insurance scoring is an objective and accurate method for assessing the likelihood of insurance loss, we strongly oppose the passage of H.R. 5633 and H.R. 6062.

Insurance is an incredibly competitive business, and one way for an insurance company such as Westfield to distinguish itself from its competitors is to develop better ways of gauging risk to more accurately price an insurance policy. Westfield Insurance began using insurance scores in 2000 to improve the pricing of our automobile and homeowners' insurance products.

In analyzing the relationship between credit information and our loss data, we found a strong correlation. Used in conjunction with

more traditional rating factors such as vehicle age, performance, gender, territory, and driver age, credit-based insurance scoring allowed Westfield to more accurately price our products and improve our competitive position.

Mr. Chairman, today approximately 75 percent of our auto and home package customers pay less because of insurance scores, while only 8 percent pay more. Outside of Westfield's own experience with credit-based insurance scoring, an annual survey published by the Arkansas insurance department shows that insurance scores either benefit or have no effect on the vast majority of consumers in Arkansas.

The latest survey shows that 90.2 percent of automobile insurance policyholders, and 90.8 percent of homeowners' insurance policyholders either received a discount or were otherwise unaffected by the use of credit-based insurance scores.

In July 2007, the Federal Trade Commission issued a report to Congress on insurers' use of credit-based insurance scores. In that report, the FTC concluded that insurance companies which use credit-based insurance scores are more likely to price automobile insurance more closely to the risk of loss that the consumer poses.

This results, on average, in higher-risk customers paying higher premiums and lower-risk customers paying lower premiums.

The use of credit-based insurance scoring is subject to extensive regulation by the States. The National Conference of Insurance Legislators (NCOIL) promulgated model legislation regarding its use. And most States have either enacted that model or have adopted restrictions similar to those contained in the model.

Insurers that consider credit information in their underwriting and pricing do so for only one reason: Insurance scoring allows them to rate and price business with a greater degree of accuracy and certainty. Sound underwriting and rating, in turn, allows insurers to write more business, which is a direct benefit to consumers. Without the ability to consider credit, many insurers would be less aggressive in their marketing, and far more cautious in accepting new business.

Every serious and reputable actuarial study on the issue has reached the same conclusion: There is a very high correlation between insurance scores and the likelihood of filing insurance claims. And while it is a common criticism of insurance scoring that the exact reason for that correlation is unknown, there are also numerous other rating factors, of which causality is also unknown.

For example, even though there is no definitive explanation as to why married individuals represent less risk than single individuals, marital status is a widely accepted and widely utilized rating variable. Credit-based insurance scoring is an effective tool for insurers, and a fair one to consumers. To protect competition and consumer choice, it is imperative that insurers be permitted to fully price risks, using non-discriminatory and statistically valid tools, such as credit-based insurance scores.

Thank you very much for allowing me to come and testify before you today, and I would be happy to address any questions that you may have on this subject.

[The prepared statement of Mr. Neeson can be found on page 168 of the appendix.]

Chairman WATT. Thank you, Mr. Neeson, for your testimony.

Mr. Pratt, president, Consumer Data Industry Association, you are recognized for 5 minutes.

STATEMENT OF STUART PRATT, PRESIDENT, CONSUMER DATA INDUSTRY ASSOCIATION

Mr. PRATT. Chairman Watt, Ranking Member Miller, and members of the subcommittee, thank you for the opportunity to appear before you today. We commend you for holding this hearing, and my comments will focus on just a few key points drawn from our written testimony.

First, the States have fulfilled their mandate to protect consumers through careful deliberations and extensive oversight of the use of credit histories and scores for insurance underwriting.

Second, our members management of the quality of data in their databases is a proven success story.

And third, the market is addressing the question of consumers with a thin credit report or no credit report at all.

In 1945, Congress enacted the McCarran-Ferguson Act, and in doing so left the regulation of the business of insurance to the States. And perhaps the question before us today is how have they done with regard to the use of credit histories and credit history-based insurance scores as a factor in underwriting for personal lines of insurance? I think the answer is clear and positive for all of us as consumers.

Virtually all States permit and regulate the use of credit histories and scores. These decisions have been made with an eye towards fairness. Studies by regulators have found that the use of credit histories is fair and predictive.

In 2003, in testimony offered on behalf of the NAIC before the full House Financial Services Committee, with regard to a report from the American Academy of Actuaries, they stated the following: "The Academy members have reviewed studies and believe that credit histories can be used effectively to differentiate between groups of policyholders. Therefore, they believe credit scoring is an effective tool in underwriting and rating personal lines of insurance."

There is no dearth of quality oversight regarding the use of credit histories and scores. However, some suggest that credit reports are not accurate and thus shouldn't be used for underwriting. We could not disagree more strongly. Never before have we had so much definitive data with regard to the accuracy of credit reports.

In 2004, the Federal Reserve studied 300,000 credit reports and they found the following to be true: "Available evidence indicates that the information that credit reporting agencies maintain on credit-related experiences of consumers and credit history scoring models derived from these experiences have substantially improved the overall quality of credit decisions while reducing costs of such decision-making."

Consumer experiences in reviewing their credit report disclosures validate the conclusions of the Federal Reserve. Out of 52 million free credit report disclosures provided, only 1.98 percent of these

reviews resulted in a dispute where data was deleted. Often-cited studies with regard to accuracy have been rejected by the Government Accountability Office, and in their 2003 testimony, they state, "We cannot determine the frequency of errors in credit reports based on the Consumer Federation of America, U.S. PIRG, and Consumer's Union studies." Two of the studies did not use a statistically representative methodology because they examined only the credit files of their employees, who verified the accuracy of the information, and it was not clear if the sampling methodology in the third study was statistically projectable.

Our members data management is a success story, and we can all have full confidence in the data upon which decisions are based.

Some suggest that credit history should not be used because some consumers do not have a credit report which can be scored or don't have a credit report at all. State laws address this by prohibiting insurers from denying, canceling, or non-renewing a policy based solely on credit information. And we agree with this position.

The good news, and the real good news for consumers is that CDIA's members are leading the effort to expand the types of payment data, which can be used for underwriting. Several of our members have already brought to market public record data products, which allow a user to consider assets where there's an absence of credit payment history.

Some CDIA members already include utility and telecommunications payment data in traditional credit-reporting databases. Other members of the CDIA are aggregating checking account consumer payment data, where such data is reported directly by the consumer's bank to the database, and some CDIA members provide services where they validate payment data provided by the consumer.

The Political and Economic Research Council's empirical study of 8 million credit reports found the following to be true, including alternative data such as those that I've discussed, are especially beneficial for members of ethnic communities and other borrower groups. Hispanics saw a 22 percent increase in acceptance rates. The rate of increase was 21 percent for blacks, 14 percent for those age 25 or younger, and 21 percent for those who earned $20,000 or less annually.

In conclusion, we believe the right balance has been struck with regard to the Federal and State laws and that no new law is necessary. The States have fulfilled the role expected of them.

Our members' data contributes to fair treatment. A May 18, 2008, Washington Post story reported that a study of an entire year's FHA applications turned up the additional fact that FHA lower-income borrowers typically had higher scores than those with larger incomes. This is powerful new data that should give us confidence in the core value of credit histories. Our members' data is blind to race and ethnicity. Our members' data helps consumers. Consumers want to be recognized for their years of care and responsible actions, regardless of their race or ethnicity.

I thank you, Mr. Chairman, for your time, and I look forward to answering your questions.

[The prepared statement of Mr. Pratt can be found on page 214 of the appendix.]

Chairman WATT. Thank you, Mr. Pratt, for your testimony.

Dr. Powell, professor, University of Arkansas at Little Rock, you are recognized for 5 minutes.

STATEMENT OF LAWRENCE S. POWELL, PH.D., PROFESSOR, UNIVERSITY OF ARKANSAS AT LITTLE ROCK

Mr. POWELL. Thank you, Chairman Watt, Ranking Member Miller, and members of the subcommittee. I'm honored to be invited to share information with you about insurance scoring. I appear on behalf of the Independent Institute as a research fellow. I have a Ph.D. in insurance, and I hold the Whitbeck-Beyer Chair of Insurance and Financial Services at the University of Arkansas at Little Rock.

This is an important topic, given the financial stability the insurance industry provides consumers. And accurate pricing is a cornerstone of the insurance mechanism.

My perspective is that of an educator and a researcher. And I think it's instructive to begin with a big-picture view of insurance pricing. Insurance companies face an unusual challenge; they must set prices for the products they sell before they know all of the costs. To meet this challenge, they employ complex pricing methods developed by actuaries, using economic and statistical techniques.

It should then come as no surprise that some aspects of actuarial science and insurance pricing are puzzling to people who have not developed substantial expertise in this field. Insurance scoring is an example of a beneficial innovation in insurance pricing that causes some people concern.

It's my opinion that thorough consideration of insurance scoring should lead one to conclude it is not only appropriate for insurers, but that using it creates value and promotes fairness in society. There are many compelling arguments in favor of these conclusions.

Given the time limit in this forum, I would like to share with you a fundamental reason why insurance scoring is a good practice, and a fundamental observation suggesting that any potential misuse of insurance scoring cannot persist in the market.

The first fundamental point is that insurance scoring is an extremely powerful and accurate predictor of insured losses. Evidence of this is conclusive. Studies by the Texas Department of Insurance, the Federal Trade Commission, and several others showed that the subset of drivers with low insurance credit scores submit more claims and cause more total loss payments than those with high credit scores.

In fact, it has been shown that drivers with two or more prior losses, but good credit, are less likely to have a loss in the current year than drivers with clean driving records and bad credit. There are many benefits to using accurate predictors of loss in insurance pricing models.

For use of innovative, accurate predictors of loss, such as insurance scores, availability of insurance has improved, competition in insurance markets has increased, and costs have decreased for many insurance consumers.

Many experts believe the coinciding advent of insurance scoring and the decrease in residual market populations for automobile in-

surance are directly linked. By introducing new information to the insurance pricing models, insurers were able to find acceptable risk they were previously unable to identify.

Accurate loss models also benefit society by producing fair outcomes in which insurance premiums are commensurate with risk of loss. When insurers cannot use accurate predictors of loss, low-risk drivers must pay higher premiums to subsidize high-risk drivers. In addition to a general sense of fairness, accurate loss predictors also create incentives for high-risk drivers to take more care in driving.

Effective competition is a fundamental characteristic observed in U.S. insurance markets. Competition prevents insurers from charging excessive or unfair premiums. In 2005, the NAIC data show an average of 157 insurance companies underwriting the private passenger automobile cover in each State. It's therefore reasonable to believe that an insurer cannot systemically overcharge a group of drivers, because then one of the other 156 existing companies, or perhaps a new company, has an opportunity to cover that group of drivers at an equilibrium price.

But we're not here because everyone likes insurance scoring. I've heard critics describe potential or anecdotal unfair outcomes associated with insurance scoring. And I do not dispute the fact that some consumers have encountered individual rating scenarios that seem to lack intuition.

For example, I know of a consumer in Arkansas who received an increase in his premium because his wife canceled a credit card they were not using. However, he called a few competing insurance companies and found one that offered him the same coverage at a significant discount from what he was paying before the change in his credit. And this is an example of competitive markets reaching an optimal outcome.

While competitive markets are very effective at making goods and services consumers want available to them, critics have voiced concerns that when a drop in credit is unrelated to insurance risk, some individuals could be mistreated by insurance scoring. In response to such concerns, almost every State has regulations in place to recognize the benefits of scoring, while limiting its use in these certain scenarios.

I think it's worth noting that many insurers offered the same protections as these regulations require before the laws were enacted. And this is another example of competitive markets creating an optimal outcome.

Thank you again for this opportunity to share with you today. I look forward to addressing your questions.

[The prepared statement of Dr. Powell can be found on page 193 of the appendix.]

Chairman WATT. Thank you, Dr. Powell, and I thank all of the witnesses for their testimony.

I will recognize myself for 5 minutes for questions. Not for the purpose of discounting your testimony, but for the purpose of making sure that we understand that there is some vested interest that the members of your organization have in this, the members of your organization provide the credit scoring that insurance companies rely on? Reports?

Mr. PRATT. To clarify, Mr. Chairman, our members do two things. They provide the underlying credit data, the credit history that is the basis for the score, and in some cases they may be the score provider; in some cases there may be a third-party company that is providing the score which is used by the insurer.

Chairman WATT. Okay. Would you have access to information about what part of your members' business is related to providing insurance credit scoring as opposed to other information?

Mr. PRATT. I can't answer the question here at the table.

Chairman WATT. I understand that. But would you have access to the information if we ask you to obtain that?

Mr. PRATT. I don't know, because it might be market-based, and publicly traded companies sometimes make different decisions about what they want to make public and what they don't, Mr. Chairman.

Chairman WATT. Okay. But I suppose it would vary from company to company?

Mr. PRATT. I have no doubt that different companies would claim different market shares.

Chairman WATT. Mr. Neeson, your company did not use credit-based insurance scores until 2000, is that correct?

Mr. NEESON. That's correct, sir.

Chairman WATT. And what were the factors that you were using prior to your use of credit-based insurance scoring?

Mr. NEESON. The industry is very competitive, and—

Chairman WATT. I'm talking about your company.

Mr. NEESON. Well, I'll just say that the sort of things that we used in the past would be age of driver, marital status, sex of driver, use of car, location of the risk, the limit of liability, the value of the car, the age of the car. Things like that. Prior accidents—I don't know if—

Chairman WATT. Those kinds of things that people would normally associate with having some connection to risk when you're driving?

Mr. NEESON. I would say it would also include things that we talked about earlier, like good student driver discounts.

Chairman WATT. Okay. What percentage, how much weight does your company give to credit scoring versus those other more traditional underwriting factors?

Mr. NEESON. We don't deal in weights in the pricing of a vehicle, but I do know about the kinds of pricing factors—

Chairman WATT. Well, if I walked into your office—

Mr. NEESON. Okay, the weight—

Chairman WATT. You're saying you wouldn't—I mean you have to have a weight.

Mr. NEESON. Yes. For example, I don't know if you've had a teenage driver before, but a teenage driver added to the policy would increase the rates substantially, 3 times, and so forth, whereas the value of having a—

Chairman WATT. Well, would the weight of a credit report be less for a teenage driver?

Mr. NEESON. Far less than that. A 16-year-old driver versus someone with—

Chairman WATT. Mr. Neeson, please listen to my question.

Mr. NEESON. Sure.

Chairman WATT. What percentage weight do you give to credit scoring in determining rates? I appreciate the information about being a teenage driver, but this hearing is about credit scoring, and so it's that particular factor that I'm trying to find out what weight you give to it.

Mr. NEESON. I don't have the exact figures, but I would say that in automobile insurance, that would range from about a 15 to 20 percent discount to a surcharge of 50 percent, something in that neighborhood.

Chairman WATT. I am not talking about the discount; I am talking about the underwriting decision.

Mr. NEESON. Westfield does not use the insurance score as any part of its weighting or whatever, for underwriting. We only use it for pricing, not for underwriting.

Chairman WATT. Oh, okay. Yes.

Dr. Powell, you have talked about the predictive value of insurance-based scores for risk. Let me be clear about whether you are talking about risk or claims. Which one are you talking about when you say risk?

Mr. POWELL. The risk of claims. I don't see where there's a difference if we're talking about an insurance mechanism.

Chairman WATT. Well, there is a difference if somebody has an accident and elects not to file a claim.

Mr. POWELL. Not in the amount of money that is paid out by the insurance company.

Chairman WATT. Okay. So you are talking about the actual amount of claims that people, pay is what you are talking about.

Mr. POWELL. Yes.

Chairman WATT. Okay. That's fine.

My time has expired. I will recognize the ranking member for 5 minutes.

Mr. MILLER. Thank you. We've talked about a lot of things. We've talked about underwriting standards, pricing, loss ratios, profitability, risk have all been used in conversations, premiums based on higher risk, lower risk. Insurance companies are not nonprofit organizations; they are a for-profit industry.

And in order to set premiums, you have to consider risk and the probability of a loss or how many losses, and the factors associated with it.

And I know, Mr. Poe, you testified that CURE does not use credit scores because of your belief that they are proxies for incomes. And that's really completely different than most of the witnesses we have had today; their opinion has really not said that; they have not raised that issue. And yet FHA has now determined they're going to use a new policy; they're going to use credit scores for risk-based pricing. And in fact, the report they just completed, they found that lower-income FHA borrowers have average FICO scores that are higher than for borrowers with larger incomes.

I know that's kind of shocking to people, but that's how FHA is going to do it in the future. Do you think that's a reasonable and appropriate thing for FHA to do?

Mr. POE. You know, I haven't seen the study, but I don't know, so I can't really comment on that.

Mr. MILLER. Okay. Now the study that was generated earlier by the FTC and the Federal Reserve basically said that for whatever reason, credit scores is a predictor of risk loss. I mean, that is what their report came out and said.

Mr. POE. Correct.

Mr. MILLER. Okay. Thank you. Your argument was different, then. I just wanted to get an opinion.

Okay. Mr. Neeson, you were testifying on behalf of PCI, who adamantly opposes H.R. 5633 and H.R. 6062 because these bills would increase prices and reduce the availability for most consumers. What are the facts? And are most of the consumers helped or hurt by credit score usage, in your opinion?

Mr. NEESON. From our own company experience, the vast majority of our customers are benefitting from the use of insurance scores. In my written testimony about our auto home package policyholders, three-quarters of those received discounts and another 15 percent or so are neutral.

In the Arkansas surveys that are run annually, comparable numbers of people benefiting, and neutral persist. In my testimony earlier it was 90.3 and 8 percent. Amazing percentage.

Mr. MILLER. Can you take a credit score on an individual, is there any way you can glean from that gender or race from that credit score?

Mr. NEESON. No.

Mr. MILLER. Okay. So it's pretty much a neutral score. You wouldn't have an idea if it was male, female, black, white—

Mr. NEESON. In the reverse, all insurance companies really have no idea of the race of their customers. Westfield would have no idea of that. And what we do know is that the vast majority of our customers do benefit from insurance scores. By eliminating that I also know that there would be a vast number of people then that would be severely harmed, and those would include groups such as senior citizens on a fixed income, you know, lower-income people who are working hard to pay their bills, to pay their gas bills, to pay their electric, and food costs. In these economic times, it would be very difficult for so many people to have higher payments such as that.

Mr. MILLER. And if insurers are unable to price for risk, for example, because credit score usage is banned, does this increase overall costs for consumers, in your opinion, as the Federal Reserve Board found, because you have to charge higher premiums for risk uncertainty?

Mr. NEESON. Yes. In my opinion, that would be the case. It would be no different. I'm sure that all of you are aware of the difference between Treasury bonds and junk bonds; the risk of each causes a higher rate to be charged for the risks with higher risk of loss and insurance.

Mr. MILLER. Mr. Pratt, you found that the elderly have better scores on average? Based on reports we have seen, the Federal Reserve said that seniors have better credit scores on average. And Mr. McCarty was on the panel before, and he testified to the opposite. But who, in your opinion, would you believe to be correct in that?

Mr. PRATT. The preponderance of the evidence supports the conclusion that seniors more often have higher credit scores. By the

way, the reason for that is in part because they have been in the marketplace longer, so as they have built a history over time and demonstrated—you can have a consumer with a 1-year credit history and a consumer with a 50-year credit history. And even if their credit reports looked exactly the same, there would be some difference in the score, because one consumer is demonstrating good hard work and good behavior for a year, and the other consumer is demonstrating it for 50 years.

Mr. MILLER. Okay. So banning it could particularly harm seniors?

Mr. PRATT. That's possible. That's a possible outcome.

Mr. MILLER. I'm in the situation you're in; I'm out of time, Mr. Chairman, so I yield back. Thank you.

Chairman WATT. Could I ask unanimous consent for 30 additional seconds and ask you to yield just on this last point, because I'm trying to square Mr. Pratt's testimony and Mr. Neeson's testimony.

Mr. MILLER. Oh, sure.

Chairman WATT. Seniors have higher, better credit scores, yet Mr. Neeson said they have—one of the traditional factors that they were taking into account was age. That suggests to me that seniors may have higher incidents of accidents. Is that correct? Or am I wrong about that? Mr. Neeson?

Mr. NEESON. Seniors do have better insurance scores from what at least I've heard.

Chairman WATT. I got that from Mr. Pratt. I'm talking about their driving record.

Mr. NEESON. I've seen where people 60 years old and so forth have better driving, and as they get to be 80 or 90 years old get worse. And that's what I've seen.

Chairman WATT. So you would factor that in—

Mr. NEESON. However, the improved insurance score, these work independently. It's like your value of your car, and the location that you—

Chairman WATT. I appreciate it. I understand they work independently, but they work counterproductively, it seems to me. If you are taking credit scores into account, and seniors have better credit scores, then you must be saying they have less accidents, or they at least, according to Dr. Powell, submit less claims for this to make sense. Otherwise—but I yield back to the—

Mr. MILLER. Can I have 30—

Chairman WATT. Sure.

Mr. MILLER. But I heard the testimony earlier that underwriting standards are different, and that would be the loss ratio, accidents and stuff that they tend to have. And then this would be used after that. Is that not correct?

Mr. NEESON. That's correct. Different insurance companies do—

Chairman WATT. In his company.

Mr. MILLER. Yes.

Mr. PRATT. Could I just add one additional comment, Mr. Chairman?

Chairman WATT. Yes, sir.

Mr. PRATT. It's a personal experience. When I was 24 years old in Texas—

Chairman WATT. Does this have something to do with aging?

Mr. PRATT. It does. It has something to do with aging.

Chairman WATT. All right.

Mr. PRATT. And I needed insurance and I needed a new car, so I went out and bought my new car, and I got my insurance policy. And because I was 24 years old, my insurance premium per month was higher than my car payment per month.

Chairman WATT. I'm sure that has something to do with what we were just talking about.

Mr. PRATT. When I was 25, my insurance premium—

Chairman WATT. You're going to have to make this point a little bit quicker, because my time—

Mr. PRATT. Well, the bottom line is I think the age issue works on both ends. In other words, had a credit score been used, it might have been a counterbalance and actually caused the insurance company to be able to rate me differently and to allow me to pay a lesser price, and not to have used age as the preponderant factor in determining my premium. I think it's just worth the consideration that it works on both ends of the scale, Mr. Chairman.

Chairman WATT. I hope somebody understands the value of that. Because I don't. I'm sorry.

Mr. HUNTER. Mr. Chairman, could I add something?

Chairman WATT. No. All of our time expired 5 minutes ago. I am sorry, but I don't want to penalize the other members of the committee.

I recognize the gentlelady from California for 5 minutes.

Ms. WATERS. Ms. Rice, with the National Fair Housing Alliance, will you please explain the disparate impact on racial minorities from the use of credit-based insurance scores?

Ms. RICE. Well, as is identified in our testimony, discrimination in the marketplace cannot be excised from the credit repository data. And there are so many instances of discrimination in our marketplace where African Americans and Latinos are disparately impacted or disproportionately negatively impacted, such as the current foreclosure crisis that we are experiencing. If you compare the rate of foreclosures across various demographic designations, you'll see that African Americans and Latinos are harder hit by that.

Now they're harder hit not because they posed a greater risk, but they're harder hit because they were disproportionately marketed loan products that were non-performing and that were unsustainable. It had nothing to do with their individual level of risk; it had everything to do with discrimination in the marketplace. And we feel that using credit information, particularly at this juncture, is going to do more harm than good, and we're going to see even greater disparities.

As you've heard other people say before, African Americans and Latinos score anywhere between 10 points and 35 points lower than their white counterparts. And again, we argue that is not because they are more intrinsically or inherently risky, but due to discrimination in the marketplace.

Ms. WATERS. Thank you. Mr. Hunter, do you agree with that?

Mr. HUNTER. Yes. I believe that's correct, and I do believe that's why people are paying more if they're lower income and if they're minorities for insurance.

Ms. WATERS. Mr. Poe, do you agree with that?

Mr. POE. Yes, I do.

Ms. WATERS. Mr. Neeson, do you understand that?

Mr. NEESON. His answer?

Ms. WATERS. No. I have been talking with the three witnesses who preceded you about the disparity in pricing and how it impacts minorities. And I wanted an explanation so that everybody could hear it, to see if you understand it or you agree with it or disagree.

Mr. NEESON. I know that insurance scoring does work within races and nationalities. That was based on the FTC study. It shows—

Ms. WATERS. I'm sorry, what did you just say? It works within? What does that mean?

Mr. NEESON. One of the charts towards the back of the survey shows that those individuals with better insurance scores by race had lower loss costs. And one of the things that we saw—and again, we are not privy to any racial information of the company; but people that live in perhaps urban areas or whatever may have prior claims. And what I have seen is that the—

Ms. WATERS. My question to the first person was to explain the disparate impact on racial minorities from the use of credit-based insurance scores. She did an explanation. My question to you was: Did you understand that, what she said?

Mr. NEESON. I did understand that.

Ms. WATERS. Do you agree with that?

Mr. NEESON. No, I don't.

Ms. WATERS. Thank you.

Let me go on to Mr. Pratt. Did you hear what was explained by Ms. Rice?

Mr. PRATT. I did.

Ms. WATERS. Do you agree with that?

Mr. PRATT. I do not.

Ms. WATERS. I beg your pardon?

Mr. PRATT. I do not.

Ms. WATERS. You do not.

Okay. And lastly, Mr. Powell, did you hear the explanation about the disparate impact on racial minorities from the use of credit-based insurance scores? Do you agree with that?

Mr. POWELL. I heard it; I disagree with the conclusion.

Ms. WATERS. Okay.

Mr. Chairman, your bill—if I may—I know this is a little bit unusual—your bill was introduced because of the disparity. And you said that you had some documentation for it. Would you repeat that documentation?

Chairman WATT. My documentation is based on the FTC's report that credit scores in this case are a proxy for race. And I think—well, that's what we based it on, yes.

Ms. WATERS. I see. Mr. Neeson, have you seen the report?

Mr. NEESON. Yes, I have.

Ms. WATERS. And you think that the FTC is wrong?

Mr. NEESON. I saw that it showed little proxy effect.

Ms. WATERS. I can't hear you.

Mr. NEESON. I heard that it said little proxy effect.

Ms. WATERS. What does that mean?

Mr. NEESON. Negligible.

Ms. WATERS. What percentage? How much? How little?

Mr. NEESON. I don't know.

Ms. WATERS. Mr. Pratt, have you seen the report or read the report?

Mr. PRATT. I have.

Ms. WATERS. Do you think it's wrong? Do you disagree with that?

Mr. PRATT. I think the report shows that with many different underwriting factors, if you pull it out on its own and you don't consider it in the context of the other factors used in the decision, you might find some kind of proxy effect; but I think the key point here is that it was a negligible or minimal proxy effect.

Ms. WATERS. Not enough to be concerned about?

Mr. PRATT. Well, I think the insurance industry, and I suspect all industries, are always concerned to make sure there is not a sizeable proxy effect. Nobody wants that in the real market.

Ms. WATERS. But if it is a proxy effect, it should be corrected. Is that correct?

Mr. PRATT. I think that if—I don't believe that the credit scoring system or the credit reporting system we have today is an enabler of the kind of proxy that I think we're talking about here.

Ms. WATERS. So the FTC report was wrong?

Mr. PRATT. The FTC report suggests minimal proxy effects. You might get that with education. You might find that with geography. You might find that with other factors. And I think that is what is so key in this discussion is that you can hold out any individual factor and potentially find some effect that might speak to race or might speak to ethnicity or might speak to income. I think that's really the key.

Ms. WATERS. Mr. Powell, I saw you shaking your head. That FTC report is just wrong, right?

Mr. POWELL. That specific result I would take issue with. I do not believe that it would withstand any sort of objective scrutiny, based on the way it was calculated. If I were reviewing that as an academic peer reviewer, which is a role that I take on frequently, I would not accept that as something that could be stated as a conclusion, based on the measurement.

Ms. WATERS. I see. Given your academic and intellectual review of the study, could you respond to this committee with you conclusion, based on the study that you have alluded to?

Mr. POWELL. Based on the FTC study—

Ms. WATERS. Yes—

Mr. POWELL. From the results that they present, I would conclude that there is not a detectable proxy, that the result they get is invalid, and they all but say that in their report, that—

Ms. WATERS. Would you present that to this committee? Could we ask you to give us your conclusion in writing, based on your review and your study?

Mr. POWELL. I would be pleased to, yes.

Ms. WATERS. I'm not simply asking for the conclusion, as you are giving it now—

Mr. POWELL. Oh, yes. Sure—

Ms. WATERS. But because of your intellectual study, I would like to see how that is set forth. Thank you.

Mr. POWELL. I'd be happy to.

Ms. WATERS. I yield back the balance of my time.

Chairman WATT. I thank the gentlelady.

The gentleman from Texas, Mr. Green, is recognized for 5 minutes.

Mr. GREEN. Mr. Chairman, because Representative Boren needs to leave, may I switch places with him, please?

Chairman WATT. I would be delighted to have you switch places with Mr. Boren.

Mr. GREEN. Thank you.

Mr. BOREN. Thank you, my good friend, Al Green, and Mr. Chairman.

I just have one question, and starting with Mr. Neeson, going to Mr. Hunter, I would like your response on this. As Kevin McCarty testified in our earlier panel, there are inherent weaknesses in the credit reporting system. Though reports vary, there is no question that many credit reports contain mistakes, and it is a lengthy process to correct mistakes, and on the credit report of our constituents and your consumers.

Additionally, the methodology used in credit scoring is opaque to customers, leading to greater confusion and hurdles in obtaining and maintaining a good credit score. Some business practices in my State of Oklahoma allow a consumer to obtain a policy with their current credit score and their premium with that company will not go above the pricing floor due to this credit score change, due to any credit score change. In fact, the consumer's better credit gets a proportionate decrease in the premium.

So basically, this. If you start getting bad credit—after I go in to meet with my insurance agent, and I get a premium let's say on an automobile, if I have bad credit after that, my premium can't go down because my credit rating goes down. If my credit rating goes up, I actually save money. And so that is kind of a unique thing that is happening in Oklahoma.

What do you all think about that practice? And is that something that our committee needs to kind of look at, at the Federal level? Starting with Mr. Neeson, going to Mr. Poe.

Mr. NEESON. Thank you, Congressman. Again, the industry's extremely competitive and the pricing algorithms for each company vary dramatically, not only in the factors used and the approach used.

For example, as you mentioned, there are a number of companies that use credit at the initial issuing of the policy and then either don't use it later or only use it as an improvement factor. There are also regulations by different States that may or may not require review of credit over, you know, different years.

But the short answer to you is yes, many companies do look only for the improvements, so that it can be used in a positive fashion, again, to retain customers. It's very hard to sell new customers; they want to keep them, so they can continue to have those customers as customers.

Mr. POE. Thank you, Congressman. Actually, I think that probably a bigger impact of the use of education and occupation is far greater than the discussion on credit scores, because if you study the use of education, whether you have a 4-year college degree, or whether you have a masters degree, or whether you work in a white-collar high-paid traditional occupation, it is far greater in the impact of every person, in particular minorities and lower-income people.

So to be honest with you, even if you adopted some sort of practice like that, dealing with credit scores, you would not escape the inevitable impact that education and occupation has in our industry. So I don't think it would make any difference, to be honest with you.

Mr. BOREN. Thank you. Ms. Rice?

Ms. RICE. I think I agree with Mr. Poe that first of all, for consumers sort of coming into the system, you are going to be disproportionately affected, just by sheer virtue of the fact that you are using a scoring mechanism, you are going to be disproportionately negatively impacting African-American and Latino customers coming into the system. So to say that we are going to disparately impact you coming into the system, but you're not going to have to pay a higher premium beyond the higher premium that—the inappropriately higher premium that you paid coming into the system, is not an adequate answer.

Mr. BOREN. Okay. Mr. Hunter?

Mr. HUNTER. Well, if I put myself into the position—I don't agree with the use of credit scoring, as I've indicated—if credit scoring works, then the system you just described makes no sense. I mean if credit scoring really works, and somebody gets a worse score, their rate should go up. And if it gets a better score, rates should go down. And it's not a zero-sum game. Because if the score doesn't go up, that means there's less money coming in from the credit scoring system, which goes into the base premium. That means the people with thin files and all are going to pay more. Today people with thin files pay too much because the neutral rate has off-balance built in from inadequate credit scoring collections like that.

And so the neutral people are going to have pay more, if you don't raise them on the people who are getting worse. But I don't think the whole system should be used at all. But if you use it and you really believe in it, then it makes no sense to cap it.

Mr. BOREN. Thank you all so much. I yield back.

Chairman WATT. The gentleman from Texas, Mr. Green?

Mr. GREEN. Thank you, Mr. Chairman. Let's start with Mr. Neeson. Mr. Neeson, do you agree that persons who are more wealthy tend to elect to have higher deductibles?

Mr. NEESON. I've not done any study on that, so my opinion might be that that would be the case. But—

Mr. GREEN. If this is true—

Mr. NEESON. I don't have that information.

Mr. GREEN. I understand. You don't have the empirical data. But it seems to suggest—my question would seem to suggest that if you have more money, you might have a $1,000 deductible as opposed to a $250 deductible. You have not found that to be the case? Persons who have more money tend to take out higher deductibles?

Mr. NEESON. I have observed that people who want to manage their prices, their costs of insurance, take out higher deductibles. Our agents often encourage customers to have higher deductibles, so that they can manage the expense of their insurance better. That's what I have observed.

Mr. GREEN. And this means, of course, that these persons with higher deductibles are prepared to pay a higher amount of money for any infraction, for an accident.

Mr. NEESON. I think—

Mr. GREEN. Or they should be, because if you have a $1,000 deductible, you're going to pay the first $1,000.

Mr. NEESON. Or they would get a loan to pay for it. Or—

Mr. GREEN. Right—

Mr. NEESON. If they think they aren't going to have a claim.

Mr. GREEN. But generally speaking, this would benefit a person who has the money to pay that $1,000 deductible, wouldn't it?

Mr. NEESON. Very wealthy people may not even choose to purchase physical damage on their cars.

Mr. GREEN. We're not talking about very wealthy, we're talking about people who are more wealthy than some other people.

Mr. NEESON. I don't—

Mr. GREEN. See, I'm not a very wealthy person, but when I was—I've had the privilege of being poor, and to have acquired some amount of status in life. And when I was poor, I had the lowest deductible I could get and I used my insurance every chance I could whenever something happened. But when I gained a little more status, then I decided I wanted to get a $1,000 deductible because I'll pay the first $1,000 to keep you from going up on my policy. That's what I did. Does that make sense?

Mr. NEESON. That does make a lot of sense—

Mr. GREEN. I hope it makes sense, because that's what your agents encourage us to do when we can afford it.

Mr. NEESON. The premium would be higher for the lower deductible, so a lot of people do use higher deductibles.

Mr. GREEN. And do you agree that generally speaking, minorities in this country—just as a matter of fact—tend to be the persons who are less wealthy than others? Generally speaking?

Mr. NEESON. I'm listening to you. I don't have any information on that.

Mr. GREEN. You don't have any observations? Have you kind of looked around?

Mr. NEESON. Certainly.

Mr. GREEN. Have you not noticed? You read the newspaper?

Mr. NEESON. Yes.

Mr. GREEN. Okay. All right. So it's a fair statement, I think.

Mr. NEESON. Yes.

Mr. GREEN. Well, let's just see how your colleagues feel. Do you agree that minorities tend to be poorer than some others in this country? If so, raise your hand.

[Show of hands]

Mr. GREEN. Okay. Everybody seems to agree with this, Mr. Neeson.

Mr. NEESON. There are wealthy people of all races.

Mr. GREEN. Yes, there are. But minorities don't tend to be in a disproportionate number of the more wealthy people of all races. Do you agree?

Mr. NEESON. Yes.

Mr. GREEN. Okay. There are some things that we just have to agree to, we can take notice of, without having to have empirical evidence. So if this is the case, then probably minorities are going to be persons who are not going to have the higher deductibles because generally speaking, you have to be prepared to pay that deduction before you can get your car back and make it road-worthy again.

Let me go on another point quickly. You mentioned teenaged drivers increasing the rate paid by some multiple. What was that number again? Teenage drivers or a teenage driver coming onto a policy?

Mr. NEESON. I've—three or four times.

Mr. GREEN. Three or four times whatever the current premium is? Now this is somewhat enigmatic for me, because I was born into a family that happens to be paying a high premium because of my father or my mother having a low credit score, and now because of my birth—I have no record of driving poorly, I have no credit history, but their premium will go up three or four times, some multiple, just because I was born into the family. Is this true? Of course it is.

Mr. NEESON. The age of the driver? That had nothing to do with credit.

Mr. GREEN. No, but you're going to increase the premium some multiple, based upon what the mom and pop are already paying, right?

Mr. NEESON. That's correct.

Mr. GREEN. Okay. So this driver has no history, has no credit score, but that driver is going to increase the family's premium some multiple simply because he was born.

Mr. NEESON. At least with Westfield, the insurance score is based on the parents, so he would benefit from the better insurance score of the parents—

Mr. GREEN. I understand. But if the parents don't have—suppose they have a poor insurance score, then the parents will pay more because the child was born.

Mr. NEESON. Because of the age. And you would probably agree that youthful drivers do present a higher likelihood of future—

Mr. GREEN. I do—but the question is should the multiple that the parents pay be increased, based upon that driver being born into the family, when the multiple is already high? You see, if you neutralize that driver, then it would be okay. But now what you're saying is that family is going to pay some multiple because that driver was born, and that multiple is based upon the credit score of the parents, not the driver.

Mr. NEESON. I do know that the majority of people do have better insurance scores. And so the parent would likely benefit from that. If we add—

Mr. GREEN. But those that don't, does it benefit those who don't have better credit scores?

Mr. NEESON. They would be paying higher, yes.

Mr. GREEN. They would be penalized?

Mr. NEESON. Yes.

Mr. GREEN. Okay. Thank you.

Thank you, Mr. Chairman.

Chairman WATT. I thank all of the members and the witnesses for their participation in this hearing.

Let me just ask Mr. Neeson one question, if I may. A public policy that says one should not be charged a higher insurance rate because of their race, that seems reasonable, then? Okay. So—

Mr. NEESON. For automobile insurance?

Chairman WATT. Automobile or homeowners'. So if we just passed a law that said, "Thou shall not discriminate in rates based on race," and gave individuals a private right of action, would that be preferable to what we have proposed here?

Mr. NEESON. I know of no company that uses race for pricing—

Chairman WATT. I didn't ask you that. I said, would that be preferable to what has been proposed here? I mean, just a straightforward prohibition on using anything that discriminates, and give individuals the right to enforce it.

Mr. NEESON. I as a person, as an individual, feel that it would be wrong to charge by race for automobile and homeowners' insurance.

Chairman WATT. Okay. Thank you.

I appreciate it.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing, as well as for the earlier panel. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

We thank every single one of you for your participation today. We have been called for votes, and the hearing is concluded anyway, so we came out just in time. Thank you so much. The hearing is adjourned.

[Whereupon, at 1:09 p.m., the hearing was adjourned.]

A P P E N D I X

May 21, 2008

ANDRÉ CARSON
7TH DISTRICT, INDIANA

2455 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-1407
(202) 225-4011

DISTRICT OFFICE
300 E FALL CREEK PKWY N DR. #300
INDIANAPOLIS, IN 46205
(317) 283-6516

Congress of the United States
House of Representatives
Washington, DC 20515-1407

Financial Services Committee
Subcommittee on Oversight and Investigations Hearing "The Impact of Credit-Based Insurance Scoring"
Opening Statement for Congressman André Carson
May 21, 2008

Thank you, Chairman Watt and Ranking Member Miller for holding this important hearing on the impacts of credit-based insurance scoring today. While the lending industry has progressed in its relationships with minority consumers over time, many problems persist. Consider the current housing crisis where 50 percent of African American mortgage consumers received subprime loans along with 40 percent of Latino consumers.

Disparities continue to exist within the insurance industry as well. I think a strong case has been made that many times, the use credit-based scores for insurance has the practical effect of shutting out many minorities from coverage or policy renewals.

Further, insurance companies have cited the Federal Trade Commission's July 2007 report in which credit based scores were listed as a minimal proxy for race as one justification for its continued use. I am skeptical, however, that the report yielded an accurate view of the impact credit-based scoring has on minorities. The information that report is based on came from a small group insurance companies who volunteered the data which certainly raises concerns about integrity of the FTC's conclusions.

I am proud to be a cosponsor of Representative Gutierrez's bill H.R. 5633, The Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008 which addresses many of my concerns by prohibiting consumer reporting agencies under the Fair Credit Reporting Act from providing a credit report for the use of underwriting and rating personal lines of insurance if the FTC finds that the use of such information results in racial discrimination, or is a proxy for race. I am also proud to cosponsor H.R. 6062, introduced by Representative Waters, which prohibits consumer reporting agencies under FCRA from providing a credit report in the underwriting and rating of personal lines of insurance. Both HR 5633 and HR 6062 clarify that insurance companies cannot use race as a factor in determining rate prices or whether or not a consumer is eligible for insurance.

I thank the witnesses for participating in this hearing today and I look forward to our discussion on this important issue. Thank you.

PRINTED ON RECYCLED PAPER

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.

KEY FINDINGS

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.

LEGISLATION BEFORE THE COMMITTEE

H.R. 5633 -- Gutierrez

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.

HR 6062 – Waters

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.

CONCLUSION

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

NCLR
NATIONAL COUNCIL OF LA RAZA

Consumer Federation of America

NFHA
National Fair Housing Alliance

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.

Insurance Scoring Penalizes Victims or Economic or 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. 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 not 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' 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.

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 not 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

Insurance scoring provides an objective tool for decision-making.
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.

It provides an objective tool for decision-making that does not discriminate against specific groups or individuals.
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.

Insurance Scores are reliable.
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.

Insurance Scores are Not Correlated to Income
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

It's just one of many factors.
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

Insurance scores reward responsible financial behavior, not just the length of credit experience.
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

The NCOIL Law, as adopted in many states, provides necessary consumer protections.

The Fair Credit Reporting Act provides consumer protections.

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.

PRESIDENT: REP. BRIAN KENNEDY, RI
PRESIDENT-ELECT: SEN. JAMES SEWARD, NY
VICE PRESIDENT: REP. ROBERT DAMRON, KY
SECRETARY: REP. GEORGE KEISER, ND
TREASURER: SEN. CAROLL LEAVELL, NM

STATEMENT OF THE
NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL)

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

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

WEDNESDAY, MAY 21, 2008

THE HONORABLE GEORGE KEISER
NORTH DAKOTA HOUSE OF REPRESENTATIVES
NCOIL SECRETARY
FORMER CHAIR, NCOIL
PROPERTY-CASUALTY INSURANCE COMMITTEE

EXECUTIVE DIRECTOR: SUSAN F. NOLAN **NATIONAL OFFICE:** 385 JORDAN ROAD, TROY, NY 12180; TEL: 518-687-0178; FAX: 518-687-0401 **WEBSITE:** WWW.NCOIL.ORG
E-MAIL: INFO@NCOIL.ORG **WASHINGTON OFFICE:** 601 PENNSYLVANIA AVENUE, NW, SUITE 900, SOUTH BUILDING, WASHINGTON, DC 20004; TEL: 202-220-3014; FAX: 202-330-9004

Introduction

Good afternoon Chairman Watt, Ranking Member Miller, and Members of the Subcommittee. Thank you for inviting me to testify before the Subcommittee on the very important subject of insurance credit scoring.

My name is George Keiser. I am a North Dakota State Representative. I serve as Secretary of the National Conference of Insurance Legislators' (NCOIL), and I am also former chair the NCOIL Property-Casualty Insurance Committee.

NCOIL is an organization of state legislators whose main area of public policy concern is insurance. NCOIL legislators chair or are members of the committees responsible for insurance legislation in their state houses. NCOIL states represent a large majority of the premium volume written in the U.S.

I am pleased to be here today on behalf of NCOIL to discuss insurance scoring in the context of an NCOIL *Model Act Regarding Use of Credit Information in Personal Insurance*—the only model law that would regulate how insurers use credit data. I have been asked to address why NCOIL investigated the issue; the process by which NCOIL adopted its model law—now used in 26 states; what the model law would allow and prohibit; and the ways in which it protects consumers.

Insurance scoring is an underwriting tool that weighs certain elements of a consumer's credit history in order to produce a numerical score, which many experts believe is an effective predictor of risk.

Regulating using objective formulae—which are blind to address, ethnicity, gender, income, marital status, and other prohibited factors—may offer a consistent, accurate way to underwrite and rate. This may mean greater efficiency in the market, more product offerings, and lower prices for the majority of consumers. Insurance scoring also may be critical to small insurers, who may have fewer underwriting resources than large companies do and may depend on credit history to compete.

However, NCOIL is clear that insurers should not have free reign. Our group feels strongly that state legislators—who are true consumer advocates—have a responsibility to shield consumers from potential abuse and to encourage state laws that go beyond a one-size-fits-all approach. This means understanding and accommodating how senior citizens manage their credit, for example, and how people may struggle financially after a personal, catastrophic event such as extended illness or death of a spouse. Extraordinary events of this nature are likely no one's fault—and our laws should not pretend that they are.

Success of the 2002 NCOIL model proves that states were not willing to sit by and watch insurance scoring unfold. Much to the contrary, states were the ones who recognized a need to act and who did so in great number. My home state of North Dakota—as well as Colorado, Florida, Illinois, Indiana, North Carolina, Ohio, Texas, and 18 others, including New York—

took a uniform, pragmatic approach to best serve our constituents by basing our regulation on the NCOIL model act.

We responded to the concerns of people who were blind-sided by a link between their credit-card debt, for instance, and their auto premiums. Please keep in mind that many of us, as consumers ourselves, had also been unaware.

As well-intentioned as any federal or other proposal may be that would severely limit, or even ban, insurance scoring—and NCOIL believes that these proposals are well-intentioned—we feel deeply that it is more appropriate to take a balanced, state-level approach that addresses what insurance scoring can do while soundly mitigating against the less favorable.

History of NCOIL Interest in Insurance Scoring

A bit about why NCOIL approached this issue: In 2001, around the time that insurance scoring was first making news, a leading NCOIL legislator urged our group to look into the issue and to take action. Specifically, he wanted us to support banning the practice.

This legislator, Rep. Craig Eiland of Texas, was the incoming chair of our Property-Casualty Insurance Committee and was a future NCOIL president. By trade he was, and is, a successful trial lawyer. In response to his request, NCOIL began approximately two (2) years of in-depth debate that, in the end, led to adoption of a model act that Rep. Eiland helped develop.

The NCOIL Process

The NCOIL process was long and thorough—the model law we offer today is the product of some 15 hours of NCOIL debate. We held a special general session on whether insurance scores are fair. We debated the pros and cons of two (2) model laws—a simple version and a more comprehensive approach that we ultimately passed—as well as a host of proposed amendments. We engaged in lively Committee discussions and heard from all key players—regulators, consumers, insurers, agents, actuaries, credit-modeling, and credit-bureau interests—as well as from some of our own legislators who had real doubts about whether insurance scores should be used.

As the dialogue progressed, Rep. Eiland began to see a need for insurance scoring. He worked with a very thoughtful legislator from Illinois—who came from a different political party—and together they helped develop a model law that they both believed was an effective compromise between various interests.

In November 2002, our P-C Committee—spearheaded by Rep. Eiland—held a long, intense hearing with nearly 12 witnesses who offered different perspectives regarding each provision of the draft model. We went line-by-line. The Committee met for hours after the hearing—extending the discussion well beyond our scheduled adjournment—then finalized our review the next morning. We passed the model in a decisive 20-5 vote.

In just a few months, 16 states had passed legislation and/or regulation based on the NCOIL model law. The bill I worked to pass in North Dakota enjoyed the support of our insurance

commissioner and was among the first NCOIL-based bills signed into law—joining the bill that Rep. Eiland helped pass in Texas.

Our model has been challenged by legislators and regulators across the country, and it has emerged as the standard for oversight of credit history in underwriting and rating. One national agent organization has called it the "center of gravity" in the insurance scoring debate.

What the NCOIL Model Act Does

The NCOIL model is non-discriminatory; assists the young, old, and those who suffer extraordinary events; and provides for use of updated credit information. The NCOIL approach applies to personal insurance, including auto and homeowners. It prohibits an insurer from calculating an insurance score based on income, gender, address, zip code, ethnic group, religion, marital status, or nationality.

It prohibits an insurer from denying, canceling, or non-renewing coverage due only to credit history. And it prohibits an insurer from basing renewal rates solely on credit history.

Consumer Protections

Under the NCOIL language, a consumer is not haunted by ancient credit data. In order to take an adverse action, an insurer must use a credit report that was issued or an insurance score that was calculated within 90 days from the time that a policy is written or renewed. The model also requires an insurer to re-underwrite or re-rate if a consumer or his or her agent requests it at annual renewal.

Under the NCOIL language, insurance companies are discouraged from taking an adverse action because a consumer has a "thin" credit file—or, like many careful senior citizens—has no credit card at all.

The NCOIL model offers common-sense restrictions on how insurers can treat certain specific information. Credit inquiries that consumers do not initiate—for instance, inquiries that credit card companies make before sending out promotional credit offers—cannot count negatively. Neither can collection accounts related to a sickness or other medical event for which a consumer could not pay.

Consumers who wisely "shop around" for the best deals on auto and home loans likewise are protected. Multiple inquiries from either the mortgage or auto lending industries can only count—if they count at all—for one credit "hit" per 30-day period.

The NCOIL model act allows an insurer to give a so-called "pass" to persons impacted by extraordinary life events—such as divorce, illness, or death of a spouse, as I mentioned earlier.

If a consumer challenges his or her credit report and has it corrected, the NCOIL model says that an insurer must go back and re-underwrite and re-rate that consumer based on the new information. If the consumer has overpaid, then the insurer must return the amount of overpayment.

If an insurer does take an adverse action due to credit experience, then the insurer must give the consumer up to four (4) reasons why credit was a factor. An insurance company also must disclose up-front that it will use credit information when underwriting and rating. Under the NCOIL model, a company must file its insurance scoring models with the state insurance department, which would consider them trade secret.

In addition, the NCOIL model law outright prohibits credit reporting agencies from selling insurance-related data to third parties that do not deserve it.

Conclusion

We appreciate the work of this Subcommittee to ensure that credit history is used fairly by insurance companies—because if not carefully regulated, it does carry potential for abuse. We ask, however, that in your deliberations you recognize the great strides that states have made to balance consumer protection against the need for healthy insurance markets.

The 26 states around the country that regulate based on the NCOIL model responded effectively to an emerging issue that demanded a public policy response. We acted in a timely and consumer-friendly fashion. It is worth noting that states as diverse as New York and North Dakota, Texas and Maine have successfully used the NCOIL model to suit their very different demographics. Federal legislation that would set aside these strong laws is unneeded and may actually bring unintended, unfortunate consequences, such as higher rates for consumers who would benefit from their good credit.

NCOIL looks forward to working Subcommittee members regarding the appropriate regulation of insurance credit scoring. Thank you for the opportunity to address this Subcommittee, and I look forward to your questions.

APPENDIX

(as of October 12, 2007)

THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

States that Have Enacted the NCOIL
Model Act Regarding Use of Credit Information in Personal Insurance

Since the November 22, 2002, NCOIL adoption of a *Model Act Regarding Use of Credit Information in Personal Insurance*, the following states have enacted proposals similar to the NCOIL model:

STATE	BILL NUMBER	AUTHOR	STATUS
ARKANSAS	SB 846	Sens. Higginbothom/ Holt/ B. Johnson/ Horn/ Bryles	*Signed by Governor Mike Huckabee—4/16/03*
COLORADO	SB 216	Sen. Lamborn	*Signed by Governor Owens—6/17/04*
FLORIDA	SB 40A	Sen. Miller	*Signed by Governor Jeb Bush—6/26/03*
GEORGIA	HB 215	Reps. Golick/Harbin/ Maddox	*Signed by Governor Sonny Perdue—5/30/03*
ILLINOIS	HB 1640	Reps. J. Osmond/Parke/ Mautino/Yarbrough et al.	*Signed by Governor Rod Blagojevich—7/9/03*
INDIANA	SB 178	Sens. Paul/Antich	*Signed by Governor Frank O'Bannon—5/7/03*
IOWA	SB 2257	Sens. Kettering/Bolkcom/ and Stewart	*Signed by Governor Vilsack— 4/7/04*
KANSAS	HB 2071	Senate Committee on Financial Institutions and Insurance	*Signed by Governor Kathleen Sebelius—4/16/03*
LOUISIANA	HB 1448	Rep. Hebert	*Signed by Governor Murphy Foster, Jr.—7/7/03*
MAINE	HB 362	Rep. Canavan	*Signed by Governor John Balducci—5/19/03*
MONTANA	SB 311	Sen. Duane Grimes	*Signed by Governor Brian Schweitzer—4/21/05*
NEBRASKA	LB 487	Sens. Redfield/Combs/ Hudkins/McDonald/Price/ Schimek/Stuhr/Thompson	*Signed by Governor Mike Johanns—4/16/03*

NEVADA	SB 319	Sen. Shaffer	*Signed by Governor Kenny Guinn—6/10/03*
NEW MEXICO	SB 560	Sen. Leavell	*Signed by Governor Bill Richardson—4/6/05*
NEW YORK	SB 5618	Sen. Seward	*Signed by Governor George Pataki—7/27/04*
NORTH CAROLINA	SB 771 (picks up certain provisions from NCOIL model)	Sen. Thomas	*Signed by Governor Michael Easley—6/19/03*
NORTH DAKOTA	HB 1260	Reps. Koppelman/ Grosz/N. Johnson	*Signed by Governor John Hoeven—4/4/03*
OKLAHOMA	SB 539	Sens. Coffee/Horner	*Signed by Governor Brad Henry—4/22/03*
RHODE ISLAND	SB 137/ HB 5362 (picks up certain provisions from NCOIL model to apply to earlier RI statute)	Sens. Bates/Walaska/ et al. and Rep. Kennedy et al.	*Became Law Without Governor's Signature—7/17/03*
TENNESSEE	SB 2259	Sen. Dixon	*Signed by Governor Bredesen— 4/13/04*
TEXAS	(SB 14)	(Sen. Jackson, et al.)	(*Signed by Governor Rick Perry—6/11/03* **Note:** SB 14, an omnibus regulatory modernization bill, includes insurance-scoring language based on the NCOIL model act.)
VIRGINIA	SB 1284	Sen. Puckett	*Signed by Governor Mark Warner—3/24/03*

TOTAL — 22

REGULATORY ACTIONS:

Alabama	127 (Chapter 482-1-217) *(significantly based on NCOIL model)*
Delaware	Regulation 906 *(loosely based on NCOIL model)*
Mississippi	2003-1 *(significantly based on NCOIL model)*
West Virginia	Informational Letter 142A *(incorporates key NCOIL provisions)*

TOTAL — 4

Testimony of
Kevin M. McCarty, Florida Insurance Commissioner,
Florida Office of Insurance Regulation
And Representing the
National Association of Insurance Commissioners

Before the
Subcommittee on Oversight and Investigations
Of the
House Committee on Financial Services

Regarding:
"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

May 21, 2008
Room 2128
Rayburn House Office Building

Kevin M. McCarty
Florida Insurance Commissioner
National Association of Insurance Commissioners

Testimony of Kevin McCarty
Florida Insurance Commissioner
National Association of Insurance Commissioners

Chairman Watt, Ranking Member Miller, and members of the Subcommittee, thank you for the opportunity to testify here today on the use of credit based insurance scores in the provision of personal lines insurance. I would also like to thank you for your leadership on this important issue.

My name is Kevin McCarty, and I am the Insurance Commissioner for the State of Florida. I am also here as the chair of the Property & Casualty Committee of the National Association of Insurance Commissioners. Empirical studies, including the 2007 Federal Trade Commission (FTC) Report, indicate the use of credit-based insurance scores, while accurate predictors of claims activity, disparately impacts certain classes of people.

In my testimony, I will share the State of Florida's actions and the role of credit-based insurance scores in Florida today. I will also provide my thoughts and concerns regarding the 2007 FTC Report. Likewise, I will report on actions by other states on this issue. As appendix one shows, different states have taken different approaches to the issue.

The Use of Credit-Based Insurance Scores in Personal Insurance Lines

Proponents argue that credit-based insurance scores are predictive of an insured's future claims experience, and is a necessary tool for underwriting and/or rating. Critics argue that the use of credit-based scores is merely another example of imposed discrimination against lower income individuals and protected classes of people. That is the heart of the debate: studies do show that credit scores can be predictors of future claim activity, but the same studies also show that the use of these scores disparately impacts certain classes of people, and thus has a discriminatory effect. A *National Underwriter* survey concluded that 14% of insurance professionals believed the use of credit scoring was ethical, 10% believed it was unethical, and the vast majority – 66% - were undecided.

The use of credit scoring forces us to examine the fundamental purpose of insurance, and the acceptability of factors used to determine underwriting and rates. In its simplest form, insurance is a contract that allows an individual or company to spread risk to avoid a catastrophic loss. For illustrative purposes, I will utilize auto insurance as my example. To accurately price this risk, insurance companies have historically used such factors as vehicle type, miles driven, marital status, moving violations and car accidents, among other factors, to assess the risk fully and charge premiums fairly.

We have now entered a new information age. By using an interconnecting network of databases, a dizzying myriad of information may be obtained about an individual through health provider visits, sex offender databases, insurance claims histories, consumer purchase preferences, internet usage, DNA/gene-testing, and credit scoring. It is important to understand that although many of these tools may show mathematical correlations with insurance claims, this does not necessarily make them fair and valid criteria for insurance purposes.

Other Rating Factors Considered to Be Inappropriate

The most notable example of this is the historical use of race in the rating of life insurance products. In 2002, the NAIC concluded several multi-state examinations of companies that rated life insurance differently based on the race of the applicant during the period from the 1930s to the 1970s. Even today, according to U.S. Census Bureau data, a Caucasian born in the United States has a life expectancy of 78 years, while an African-American has the life expectancy of 73 years. Based purely on actuarial rates, this could be used to justify a higher charged rate for life insurance.

While this outcome (African-Americans pay more for life insurance) might be technically correct from a purely actuarial perspective, it is counter to equal protection for consumers and not sound public policy. This is not an isolated example. In the 1990s insurance companies began considering the use of genetic testing for predisposition of inherited diseases as a means to evaluate risk more precisely when offering health insurance. Although this certainly would have produced worthy actuarial correlations justifying higher insurance rates for unlucky individuals

with a proclivity for inherited diseases, the United States Congress began to outlaw this practice in 1996 through the Health Insurance Portability and Accountability Act (HIPAA). Clearly legislators and regulators must weigh the benefits of simplistic claims prediction with sound public policy.

I must admit, the State of Florida has a checkered past of allowing the use of race-based premiums which were used prevalently in the life insurance industry during the period of the 1930s through the early 1970s. Therefore, as Insurance Commissioner, I am particularly sensitive to any rating factors that are highly correlated with race, ethnicity, religious background, or income level as are my fellow commissioners at the NAIC. A year ago, on February 9, 2007 in Tallahassee, I held a public hearing to review the use of occupation and education as underwriting or rating factors for private passenger auto insurance and its potential impact on Floridians. The hearing intended to answer the question of whether the use of occupation and/or education, either intentionally or unintentionally, is acting as a proxy for race. While the use of race as a rating factor was outlawed in Florida, we must remain vigilant of the use of any factors that appear to be highly correlated to race and income level. The findings stemming from this public hearing are detailed in a written report, *The Use of Occupation and Education as Underwriting/Rating Factors for Private Passenger Automobile Insurance*, March 2007, See Appendix 2.

The Credit Reporting System

Other problems with the use of credit scoring are inherent weaknesses in the credit reporting system. Although Congress has taken strides to improve the process, most notably through the Fair and Accurate Credit Transactions Act of 2003, a 2000 study by *Consumer Reports* magazine showed that 50% of credit reports contained errors. This is further exacerbated by identity theft, and also by the proliferation of access to credit as evidenced by the problems in the mortgage industry. Thus, even if this methodology were correct, it is possible that inaccuracies in the underlying data (credit reports) may invalidate their use. Credit reports also disproportionately negatively affect recent divorcees, recently naturalized citizens, the elderly, the disabled, those

with certain religious convictions, and younger individuals who have not established credit histories.

While the use of credit reports may always be problematic, the use of this tool may become increasingly salient given our nation's current economic conditions. Historically, rising unemployment rates, rising home foreclosures, and rising inflation in the costs of goods and services have contributed to a deterioration in credit histories. A downturn in the economy could potentially magnify differences in credit scores among vulnerable populations.

It is also important to note that empirical studies show no significant difference in the magnitude of claims that are filed, but only of the frequency of the claims. This is a subtle but important distinction. The studies show only that consumers with lower credit scores file more claims, not that they have greater loss events. It is quite possible the frequency of insured loss events is the same across populations, but those with higher scores are less likely to file a claim. This may be because wealthier individuals (with higher credit scores) may not file a legitimate insurance claim for a broken window or for minor fender bender, instead electing to pay the repairs themselves so as not to impact their claims history. Conversely, those with lower credit scores may be unable to pay out-of-pocket expenses based on their limited financial resources.

The empirical studies do not focus on this distinction, which leads to another important facet of the debate that has been overlooked. None of the studies to date, including the 2007 FTC study, suggests that the claims being filed are not legitimate, and moreover, that the rates being charged, absent credit-based insurance scores, are not actuarially sound.

Finally, the methodology used to create credit scores and credit-based insurance scores is opaque to consumers, varies from company to company, and can be negatively impacted by sound financial decisions that cannot possibly be linked to automobile or homeowners insurance risks. Not using credit cards, having too few credit cards, or having an installment loan -- all may negatively impact a credit-based insurance score. Consumers' decisions to finance their purchases using a Visa card, a home equity loan, or a department store credit card could negatively impact their credit-based insurance score and their insurance premiums.

Disproportionate Impact of Credit-Based Insurance Scores

The clear problem with the use of credit scoring is the relationship of credit scores to race, ethnicity and income status. The 2007 FTC Report asked and answered its own innocuous question: is credit scoring solely a proxy for race? This "straw man" question was not deserving of this report. Certainly we can all think of African-American and Hispanic acquaintances with excellent credit scores and conversely Caucasians with poor credit scores. If the phrase "solely a proxy" is intended to mean "direct substitute" than clearly credit scoring is not a proxy for race.

A more valid question is to ask whether there is a relationship between credit scoring and race/ethnicity and income status, and whether this relationship is strong enough to prohibit its use given the American values of equal protection and nondiscrimination. The analysis summarized by the FTC Report clearly demonstrates strong correlations between credit scoring and race/ethnicity that are statistically significant.

A Texas Insurance Department's 2004 report showed that African-Americans have an average credit score 10-35% below that of Caucasians, while Hispanics had scores roughly 5-25% worse. Quantifying this to percentile scores, the FTC's Report concluded that African-Americans average credits scores are in the 23rd percentile, while Hispanics were in the 32nd percentile.

Less publicized, but equally important, is the disparate impact on other segments of society. Credit-based insurance scores, because they are based on credit scores, have a negative impact on young people and the elderly. In testimony provided during a hearing in Florida on the use of credit-based insurance scores, an industry actuary admitted that average scores in the 25 to 30 year old age group are disproportionately lower than in older age groups. Other research has demonstrated that the elderly, because they tend to use credit less often and thus have fewer or no credit relationships, frequently have lower or no credit scores. Credit-based insurance scores penalize them as well.

Another consideration is that certain religions and those with certain religious beliefs do not use credit. Thus, some individuals following their religious beliefs will have low or no credit scores

and would be negatively impacted by the use of credit-based standards for rating insurance policies.

It is clear the use of credit-based insurance scores has a disparate impact on consumers of select racial, age, and religious groups. The predictive power of these scores is very likely not measuring any event risk, but rather indirectly measuring socioeconomic status. Some may disagree, but I believe this information is not necessary for proper underwriting and rating of the risks being insured.

I do not doubt that when initially adopted by the industry, there was no intent to use credit scores to impact minorities in a disparate manner or to discriminate. Yet, empirical studies indicate a negative impact on these groups, and the industry's attempt to ignore this issue shows a failure to treat its consumers fairly and equitably.

Florida Actions Regarding Credit-Based Insurance Scores

Based on the preponderance of evidence and after lengthy deliberation and hearings, the 2003 Florida Legislature enacted legislation to limit the use of credit-based scores in the provision of private automobile and personal residential insurance. The law (626.9741, F.S.) is modeled after the National Conference of Insurance Legislators (NCOIL) Model Law, but does differ in some areas to provide stronger consumer protections. Part of that law allows the Florida Financial Services Commission to adopt rules to ensure the spirit and intent of the law is met.

During the rule development process, the insurance industry has vigorously opposed the implementation with four separate legal challenges claiming: the Office did not have the authority to prevent the use of credit scoring as an underwriting/rating tool; the Office did not have the authority to define the term "unfairly discriminatory" as used in the statute; insurers did not have the necessary data to demonstrate the effect of credit scoring on the protected classes; and the definition of "disproportionate impact" was too vague.

The administrative law judge found the Office did have the authority to prevent the use of credit scores, and had the authority to define the term unfairly discriminatory. Moreover, the judge found that the insurers' lack of data was irrelevant. The judge did find that the definition of disparate impact needed to be defined more comprehensively, which the Office is correcting.

Conclusion and 2007 FTC Report

Based on the empirical evidence and the objective facts, I am of the opinion that the negative impact on classes of people based on race, age, and religion outweighs any suggested enhanced accuracy in pricing and underwriting, although the broader regulatory community has differing views.

In addition to credit-based insurance scores, I am also concerned about other tools currently being adopted for use in underwriting and rating that share many of the same characteristics of credit-based insurance scores. I am specifically troubled by the growing use of occupational ratings and education levels, and would encourage this Subcommittee to broaden the scope of its investigation to consider these rating factors as well.

Although there have been numerous academic studies of this issue, I eagerly anticipated the FTC Report mandated by the Fair and Accurate Credit Transactions Act (FACTA) of 2003 for delivery by December 24, 2005. The 2007 FTC Report was disappointing to me and many of my colleagues, as we expected an objective independent analysis. I agree with many of the sentiments expressed by FTC Commissioner Harbour in her dissenting statement.

I am particularly concerned that the data supplied by a handful of firms may have been selected to show the best case for the use of credit-based insurance scores. Despite these best-case scenarios provided by industry, the FTC still ultimately found that using credit scores disparately impacted ethnic minorities.

I am also concerned that no premium data were used, and the narrative appeared one-sided in support of the predictive power of the scores while simultaneously downplaying the negative

impacts. I was also troubled by the alleged economic advantages of using credit-based scores which are often featured as conjectures derived from industry assertions, but without any underlying analysis.

Finally, I am troubled by the process used in this report. I cannot understand why the insurance industry trade associations were privileged with advance copies of the report, while the insurance regulatory community was not. In addition, it is my understanding the regulatory actuaries involved in this project had no prior knowledge of the report's major findings or release.

State Involvement

I did agree with one section of the FTC Report especially as it pertains to Federal involvement in this issue: The state insurance regulatory community has focused on credit scoring problems, and has taken action. Forty-eight states have taken some form of legislative or regulatory action limiting the usage of credit scoring in the provision of insurance products.

Many have adopted model legislation on this issue; some states, like Florida, have adopted variations of this model. Many of these legal provisions pertain to the notification and transparency of the use of credit scoring including giving regulatory bodies access to the scoring model, notifying consumers about its use, and restricting insurance decisions based solely on this model.

Other states have gone further to restrict the use of credit history including the disallowance of credit history information as the sole basis for making underwriting or rating decisions, prohibiting the use of credit history information to cancel or nonrenew existing customers or increase their rates, or banning the use of credit history when underwriting or rating existing customers. Finally, four states have effectively banned the use of credit history information in underwriting or rating for automobile insurance.

The implication of the states' actions is clear. While I support potential action taken by this Subcommittee to limit the use of credit scoring, it is essential that federal action not preempt or

diminish consumer protection efforts already enacted by state legislatures. As state regulators, it is our sincere desire that the Federal government assist, not detract, from the states' regulatory efforts to address this important issue.

While the NAIC has not yet reviewed H.R. 5633, from the perspective of the State of Florida, the proposed bill contains several favorable provisions. Most notably, this legislation would require a more in-depth and objective study by the FTC on the relationship between credit scores and race/ethnicity to determine if there is in fact a "proxy effect" that shows a demonstrable correlation between credit scores and race/ethnicity. However, the FTC should not necessarily be the definitive report. Instead, I envision that other state and federal agencies be allowed to research this issue, and add their data analysis and expertise to substantively affect this debate.

Finally, while the NAIC has not had an opportunity to review H.R. 6062, I am also in favor of this legislation, sponsored by Representative Maxine Waters, which would exempt personal lines insurance from the Fair Credit Reporting Act. This bill implicitly recognizes that the 2007 FTC Report already found that credit scores disparately impacts minorities. Thus, we should initially eliminate the use of credit scoring as a starting point. If the FTC Report and other reports show unequivocally that credit scoring does not disparately impacts ethnic minorities, this issue could be revisited.

Furthermore, by addressing this issue from the perspective of the Fair Credit Reporting Act – not insurance – this is consistent with the federal-state relationship for insurance regulation first established through the McCarran-Ferguson Act of 1945.

However, since I am also here representing the NAIC, I must note that other state commissioners have differing views on this issue. Some states do not perceive credit scoring as a concern if it is one of many rating factors. In addition, some states believe that the process itself is not intended to be discriminatory, and any disparate impact based on race or ethnicity is coincidental. Some regulators believe that a majority of policyholders actually benefit from the use of credit scoring. Finally, other states may not agree for the need to expand this issue to other areas such as rating based on occupation and education.

Thank you for holding this hearing, for inviting me here today to participate, and for your continued interest and leadership on this critically important consumer protection issue. I am pleased to answer any questions you may have.

Appendix 1

NAIC Compendium on State Laws Regarding the Use Of Credit Reports/Scoring in Underwriting

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

The date following each state indicates the last time information for the state was reviewed/changed.

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
AL (2/08)	Reg. 482-1-127-.01 to 482-1-127-.11	Personal lines	Make procedures used to obtain credit reports and insurance scores available to commissioner. If use credit scoring, file the scoring model with the commissioner. May not calculate score based on lack of credit history. May not use credit score as sole reason to deny coverage or refuse to renew.
AK (2/08)	§§ 21.36.460; 21.39.035	Personal lines	If use credit information in underwriting or rating, disclose that fact at the time the application is taken. Must consider in combination with other factors. May not consider absence of credit history or medical accounts. File credit scoring model with commissioner.
	Bulletin B04-11		Use departments' consumer brochures to inform the public about credit scoring.
AZ (2/08)	§ 44-1692	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	§§ 20-2102; 20-2109 to 20-2110	Property and casualty	Must provide specific reasons for adverse decision based on credit history or credit score.
	§ 20-1652	Property and casualty	Must get credit information promptly; cannot cancel or decline coverage more than 30 days after date of application based on credit report.
	§ 20-2113.01	All lines	A consumer reporting agency shall not sell data that includes information about an insurance score.
	§ 20-2110		In the event of an adverse underwriting decision, provide the specific reasons. If based on credit-related information, must decide factors that were primary cause. May not use the following credit-related factors for property or casualty premiums: absence of credit history, credit history based on collection of medical bills, total available credit, etc.
AR (2/08)	§§ 23-67-401 to 23-67-415	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Bulletin No. 14-2004	Personal lines property and casualty	Form for report on number of policies with increase/decrease in premium due to credit scoring.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
CA (2/08)	Civ. §§ 1785.10 to 1785.11	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting. Agency must notify consumer of rights and provide copy of file, including any credit score used.
	Civ. § 1786.18	All lines	May not include specified information in an investigative report except when used in underwriting life insurance expected to amount to $250,000 or more.
	Bulletin 76-3; Civ. §§ 1785.20,;1786.40	All lines	Users of credit reports who deny insurance or increase the prices charged on the basis of information contained in the reports must disclose the information that was the basis for the adverse decision.
CO (2/08)	§ 12-14.3-103	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting. Must notify consumers that will be using credit report for determination of eligibility for coverage or to determine premiums.
	§ 12-14.3-105.3	Life	May use credit report in underwriting life insurance expected to amount to $150,000 or more.
	§ 10-4-116	Personal lines property and casualty insurance	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	§ 10-4-616	Personal lines property and casualty insurance	Must notify consumers that new or updated credit information will be used in insurance underwriting or rating.
	§ 10-4-110.7	Homeowners	An insurer is required to provide notice to an applicant if the insurer uses credit scoring, claims history of the property, or clams history of the applicant in determining whether to insure the applicant's property.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
CT (2/08)	Guidelines for the Examination of Financial History Measurement Programs for Personal Risk Insurance Underwriting and Rating Plans	All lines	File measurement tools with the department. May only be used for new business. May not consider lack of credit history. Demonstrate coordination with expected risk of loss. Disclosure to customer.
DE (2/08)	18-900-906 Del. Code Reg §§ 1.0 to 12.0	Personal lines	May not use credit report or score unless the company has obtained authority to do so in its rate filing. File supporting information showing it is actuarially supported and is not the sole basis for denying coverage or assigning the consumer to a premium class. May not assign a higher rate because the consumer has no credit history. May consider insufficient credit history or no available credit history in setting a premium or rate, or underwriting an insurance policy, to the extent such us is actuarially justified and consistent with the rate filing. Models filed with the commissioner shall be considered as confidential proprietary information.
DC (2/08)	No provision		
FL (2/08)	Rule 69O-125.004	All lines	An insurer shall notify an insurance applicant in writing, or in the same medium as the application, that a credit report will or may be requested as part of the application process. If the application is denied, the insurer must tell the applicant in the notice of the denial how a copy of the credit report can be obtained so the applicant can identify the items that resulted in the denial.
	§ 626.9741	Personal lines Auto and homeowners	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
GA (2/08)	§§ 33-24-90 to 33-24-98	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Reg. 120-2-15-.01 to 120-2-15-.06	Private passenger auto, residential property	Insurer may cancel, nonrenew or decline a policy based on an individual's credit report. Insurer shall file this information quarterly with the commissioner. Insurer shall provide notice and the specific reason for the decision to the insured.
	Reg. 120-2-65-.01 to 120-2-65-.07	Private passenger auto	An insurer shall not use underwriting criteria or guidelines that result in the fictitious grouping of risks and results in unfair discrimination. The use of credit reports in determining an applicant's or insured's acceptability for coverage may create fictitious grouping and unfair discrimination.
HI (2/08)	§ 431:10C-207	Auto	Insurer shall not base standard or rating plan upon a person's credit bureau rating.
ID (2/08)	Bulletin 91-9	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	§ 41-1843	Property or casualty	May not charge a higher rate or cancel coverage based primarily on a credit rating or credit history.
	Ins. Reg. 18.01.19	Personal lines property and casualty	Aggregate weight given to noncredit factors must be at least as great as the aggregate weight given to credit factors. Items identified as trade secrets are not subject to public disclosure. Insurers must retain documentation for 5 years.
IL (2/08)	215 ILCS 157/1 to 157/55	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model) A certification that the treatment is actuarially justified is required.
	215 ILCS 157/22	All lines	Shall review and consider an exception to the risk score based on extraordinary life events, such as a catastrophic illness, divorce, death of a spouse, child or parent, involuntary loss of employment for three months or more, or identity theft.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
IN (2/08)	Bulletin 111 (July 1, 2002); Bulletin 130 (May 26, 2005)	Personal lines property and casualty	Submit to insurance department information on how credit information is utilized in underwriting, including the factors from a credit report that are included in a credit score, the computer model used to determine a credit score, any underwriting guidelines related to the use of credit scores and documentation to demonstrate the correlation between credit information and expected risk of loss. May not use credit scores after 10/1/02 unless the information is filed with the department.
	§§ 27-2-21-1 to 27-2-21-23	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model).
IA (2/08)	§ 515.103	Personal lines Property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model).
KS (2/08)	§§ 40-5101 to 40-5114	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model).
	Bulletin 2004-10 and 2005-1		Answer questions about above legislation.
	Reg. 40-1-50	Personal lines, property and casualty	Document factors considered in addition to credit score. Maintain evidence to support adverse action. Provide an explanation to an insured adversely affected.
KY (2/08)	§ 304.20-040	Auto	May not refuse to issue or renew a policy solely because of credit history, or lack of credit history of the applicant.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
LA (2/08)	§ 22:1214	Auto liability	Prohibits an insurer from terminating, refusing to renew or refusing to issue insurance because the insured has declared bankruptcy.
	§§ 22:1481 to 22:1494	Personal lines property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Directive No. 181 (2004)	Personal lines property and casualty	Directive addresses issues that have arisen in above statute.
	Directive No. 196 (2006)	Personal lines	Right of an insured to be exempt from the use of adverse credit information directly or indirectly caused by Hurricane Katrina and/or Hurricane Rita. All insurers writing personal lines are advised and directed to ignore all unfavorable entries entered into an individual's credit record beginning with entries posted on August 26, 2005, and all entries posted thereafter related to Hurricane Katrina and/or Hurricane Rita.
ME (2/08)	tit. 10 § 1313-A	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	tit. 24-A § 2917	All lines	Insurer must notify policyholder of reason intend to nonrenew, such as "credit report."
	tit. 24-A § 2169-B	Personal lines auto, property and casualty	May not use an insurance score calculated using income, gender, ZIP code, religion, etc. or raise rates based solely on credit score. Provide notice to consumer.
	tit. 10 § 1315	Credit reporting agencies	Disclose procedures to consumers to correct inaccurate credit reports.
	Bulletin 329 (2004)	Personal lines	Guidance on issues that have arisen.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
MD (2/08)	Ins. § 27-501	Private auto and Homeowners	May not refuse to underwrite based solely on credit history.
	Commercial § 14-1202	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	COMAR 31.15.11.01 to 31.15.11.11	Personal lines property and casualty and private auto	Insurers that use credit reports or credit scores must provide the commissioner with underlying information so the commissioner can ensure that reports are used in accordance with the law. Must notify consumers of actual reason for an adverse action.
	Ins. § 27-501	Personal lines property and casualty	May not use credit history to rate or refuse to underwrite homeowners coverage. May not use credit history to refuse to renew an auto policy or increase its premium. May use credit history to rate a new auto policy. Advise applicant that credit history is being used. May not consider the absence of a credit history as a factor.
	Ins. § 11-317	Private auto	Must provide a policyholder statement on rating factors. If use credit scoring, explain how it may cause an increase in premiums.
	Bulletin 02-14; 02-16	Personal lines property and casualty	Address questions in implementation.
MA (2/08)	93 § 51	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	93 § 62	Personal lines	If coverage is denied or price increased because of credit report, must notify consumer of right to receive a credit report.
MI (2/08)	Bulletin 2003-01-INS	Personal lines	File formula used to compute credit score with the department. Must recalculate credit score at least yearly.
	Bulletin 2003-02-INS	Personal lines	Revises 2003-01-INS to require rescoring only at the request of the policyholder. Notify consumers of their score and the discount tier they are in.
	Reg. 500.2151 to 500.2155	Personal lines	Beginning 7/1/05, insurers may not use credit scores as a rating factor.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
MN (2/08)	§ 72A.20 subd. 36	Private passenger auto and homeowners	May not reject, cancel or nonrenew a policy solely on the basis of credit information. If will use credit information, must notify consumer. If use a credit scoring system, must have methodology on file with the commissioner.
	§ 72A.501 subd. 2	Property and casualty	Code sections limiting collection of information do not apply to credit scoring, as long as the agent informs the policyholder.
MS (2/08)	Reg. 2003-1.1 to 2003-1.13	Personal lines	Disclose to consumer that insurer may gather and consider credit information. File scoring models with department. Must inform applicant if credit score or report adversely affected him.
MO (2/08)	Reg. tit. 20 § 500-9.100	Homeowner	Insurer must inform the Dept. of Insurance that it is using credit history as an underwriting guideline.
	§ 375.918	Personal lines property and casualty	May not use credit report or credit score as the sole rating factor. Must disclose the fact that will gather credit information. Must inform applicant if credit score or report adversely affected him.
MT (2/08)	*§ 31-3-111*	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	§§ 33-18-601 TO 33-18-611	Personal lines	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Most recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Advisory Memorandum Dated 9/7/01	Property and casualty	Montana law requires notification to consumers when their credit history adversely affects their ability to obtain or renew insurance.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NE (2/08)	§ 44-7516.01	Private passenger auto	Policy must be accompanied by disclosure stating if any credit-based rating was used to determine rate charged for coverage.
	§§ 44-7701 to 44-7712	Personal lines	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider solely the absence of a credit history. Most recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
NV (2/08)	§§ 686A.600 to 686A.730	Personal lines	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. (NCOIL model)
	NAC 686A § 3		At renewal of a policy, the consumer credit report or insurance score used on the policy with the earliest effective date may be used, provided that the credit information is not more than 36 months old.
NH (2/08)	§ 359-B:4	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	§ 359-B:5	Life	May use credit report in underwriting life insurance expected to amount to $50,000 or more.
	Reg. Ins. 3301.01 to 3310.02	Auto and homeowners	If use credit scoring, must establish written standards to prevent discrimination and submit scoring model to the insurance department for review. Update credit score at least every 3 years. Submit to commissioner information on the factors considered and the statistical validation.
NJ (2/08)	§ 56:11-31	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	Bulletin No. 04-05	Property and casualty	Insurance scoring is permitted, provided that consumer protections are maintained. Submit model to department for review; credit score may be considered as only one of factors in determining rates; provide specific information if the insurer takes an adverse action.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NM (2/08)	Bulletin 2002-001	All lines	All insurers that use credit scoring in underwriting or rate making must submit all portions of the programs that include the use of credit scoring to the Insurance Division.
	§ 59A-17A-1 to 59A-17A-9	Personal lines	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Reg. 13.8.6.1 to 13.8.6.9	Personal lines	Standards for the notification required in statute.
NY (2/08)	General Business § 380-i	All lines	Requires users of consumer reports to advise the consumer of adverse action taken in reliance on the report.
	OGC Opinion No. 96-1	Homeowners	Must give specific reasons for cancellation.
	Ins. Law §§ 2801 to 2809	Personal lines Property and casualty	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Reg. tit. 11 §§ 221.0 to 221.10 (Reg. 182)	Personal lines	May not take an adverse action based on a list of situations and events. Filings of scoring models must include listed information.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NC (2/08)	§ 58-36-90	Private passenger auto	*May not use credit reports as sole rating factor. Must notify consumer if will be used. File scoring models with insurance department.*
	Bulletin 03-B-3		*Requirements for insurers who have trade secret pages in their credit scoring models*
ND (2/08)	§§ 26.1-25.1-01 to 26.1-25.1-11	Personal lines	*May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score. May not consider absence of a credit history unless insurer treats the consumer as otherwise approved by the Insurance Commissioner if insurer presents information that such absence relates to the risk for insurer, if consumer is treated as through the credit information is neutral, or if credit information is excluded as a factor. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)*
OH (2/08)	Bulletin 2002-2	Property and casualty	Insurers must establish that credit history and credit scores are valid risk characteristics. May not use for discriminatory purposes.
OK (2/08)	Guidelines adopted by Oklahoma State Board for Property and casualty Rates 6/15/2000	Property and casualty	Insurers that use credit history or credit scores must provide the board with underlying information to show they are using the information in accordance with OK law. Notify the insured of any adverse action taken as a result of the credit history or credit score.
	Bulletin No. PC 2001-07		Revised credit scoring guidelines.
	tit. 36 §§ 950 to 959	Personal lines	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
OR (2/08)	§ 746.635	All lines	Insurer, agent or insurance support organization may not prepare or request an investigative consumer report about a person involving an insurance transaction unless the insurer or agent informs the person that he may request to be interviewed in connection with the preparation of the report and that the person may request a copy of the report.
	Reg. §§ 836-080-0425 to 836-080-0440	Personal lines property and casualty	Prior to use, must notify consumer that credit history will be used. Must notify consumers during the application process that consumer may request information about the use of credit histories or insurance scores. Notice may be either in writing or in the same medium as the medium in which the application is made. The statement must address the following items: (a) Why the insurer uses credit history or insurance scores, (b) How the insurer uses credit histories or insurance scores, (c) What kinds of credit information are used by the insurer, (d) Whether a consumer's lack of credit history will affect the insurer's consideration of an application, (e) Where the consumer may go with questions. An insurer that uses credit history or insurance score in connection with a renewal shall notify consumer of that use when renewal offer is made. Notice shall address the items above. In addition, insurer shall inform consumer that consumer has a right annually to request the insurer use current credit information in the renewal process and that insurer will update the credit information used upon receiving such a request.
	§§ 746.600 to 746.686	Personal lines	*If adverse underwriting decision, provide consumer with specific reasons. If based on credit score, include specifics of no more than 4 reasons for score. Provide information on how to dispute. May use credit history only in combination with other factors to decline coverage. May not consider absence of history, number of inquiries, total available credit, etc. Consumer may request yearly re-rating. File scoring models with dept. Prohibits an insurer from rerating the policy or consumer when the consumer's marital status changes because of death or divorce. Allows an insurer to consider the last five years of claim history when rating a policy, however a insurer can use a longer claim history for the purpose of providing a discount. Allows insurer to consider the second or any subsequent claims in the last 5 years to determine whether to issue or renew a policy.*

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
PA (2/08)	Department Policy 40 P.S. § 1184; 40 P.S. § 1224; 75 Pa.C.S.A. § 1793; Tit. 31 Ch. 67.33	Personal Lines	The use of credit-based insurance scores is limited to new business underwriting eligibility and underwriting tier placement with the following requirements: 1) underwriting tier placement must be based upon mutually exclusive underwriting criteria that are kept on file at the company; and (2) underwriting tier placement must not be used at renewal, except where that use will result in placement into a lower rated tier. *Note: Companies using credit information as part of their new business pricing or tier criteria are expected to comply with the disclosure and adverse notice provisions of the federal Fair Credit Reporting Act.*
RI (2/08)	§ 6-13.1-21	All lines	May not request a credit report without first notifying the insurance applicant. If deny coverage or charge more, must notify consumers that is due to credit report.
	§§ 27-6-53; 27-9-56; R27-25-011; R26-16-007	Homeowners and personal auto	May use credit scoring for rating and underwriting only if the insurer demonstrates the predictive nature of the score to the insurance department. If requested by customer, must do new credit score every 2 years and lower rates if score is better. May not use revised score to raise rates except as noted. Rates may only be changed at time of renewal. List of factors that may not be considered. Reporting agency may not sell data or lists that include information about credit report.
	Bulletin 2002-16	Homeowners and personal auto	May not decline insurance for a new consumer based solely on the credit score. If use in rating, must demonstrate the statistically predictive nature of the score in the rate filing.
SC (2/08)	§ 38-73-740	Auto	Credit report used as basis for rate classification must be kept on file by the insurer for 3 years, and be available to the applicant.
	§ 38-73-425	Property and casualty	An insurer may use absence of credit as a criterion for underwriting if the insurer presents information satisfactory to the director.
	Bulletin 2002-04	Private passenger auto	May not refuse to insure, cancel or non-renew based solely on credit history or credit score. A filing including credit scoring must include justification. Disclose to consumer that insurer may gather and consider credit information.
	Bulletin 2004-09	Property and casualty	If insurers use lack of a credit score as an underwriting criteria, must provide the department with support.
	Bulletin 2004-12	Property and casualty	Must get approval from department before using lack of a credit score as a criterion for underwriting.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
SD (2/08)	Bulletin 2002-3	Personal lines property and casualty	May not use credit information as the sole rating factor.
TN (2/08)	Department Policy	All lines	Justification for use of credit scoring must be provided in the filing. Credit scoring cannot be the sole basis for determining rates.
	§§ 56-5-401 to 56-5-407	Personal lines property and casualty	May not include ZIP code as a factor. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. File scoring models with department. (NCOIL model)
	Bulletin Dated 12/13/04	Personal lines	Sets procedures for filing of credit scoring models.
TX (2/08)	Business and Commerce § 20.02	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	Business and Commerce § 20.05	Life	May use credit report in underwriting life insurance expected to have a value of $150,000 or more.
	Reg. 28 TAC §§ 5.9340 to 5.9342	Personal lines	Filing requirements for credit scoring models.
	Reg. 28 TAC §§ 5.9940 to 5.9941	Personal lines	Disclosure statement for consumers on how score is calculated, right to appeal, requirement for actuarial justification. Rate differences due solely to use of credit scoring must be supported by actuarial analysis
	Ins. §§ 559.002 to 559.151	Personal lines	Insurer may not use credit scoring that is computed using factors that constitute unfair discrimination. Shall not refuse to renew an insurance policy solely based on credit information. If credit information is used in underwriting or rating, disclose that fact at the time the application is taken. May not consider medical history codes. File scoring models with department.

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
UT (2/08)	§ 31A-22-1307	Homeowners liability	Insurer that uses credit reports in underwriting must comply with federal Consumer Credit Reporting Act.
	§ 31A-22-320	Auto	May only use credit information to reduce rates or in conjunction with other factors.
	Reg. R590-219-1 to R590-219-8	Private passenger auto	Inform consumer of factors used in adverse underwriting decision. May not use credit information to cancel or nonrenew coverage that has been in place 60 days or more or as the primary reason to refuse to issue a new policy.
VT (2/08)	No provision		
VI (2/08)	No provision.		
VA (82/08)	§§ 38.2-2114; 38.2-2212	Auto, fire	Insurers shall not refuse to renew an insurance policy solely based on credit information contained in a consumer report, bearing on an individual's creditworthiness, credit standing or credit capacity. If credit information is used in part, it shall be based on a consumer report procured within 120 days from effective date of nonrenewal.
	Administrative Letter 2002-6	All lines	Any insurer intending to use credit score must file the model prior to their use.
	§§ 38.2-2126; 38.2-2234	Homeowners, renters, auto	May not include income, gender, race, religion, marital status, ZIP code, nationality, etc. as factors. May not base rates solely on credit score or consider absence of a credit history. Must recalculate credit score after 3 years. May not consider medical history codes. (NCOIL model)

© 2008 National Association of Insurance Commissioners

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

2/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
WA (2/08)	§ 19.182.020	All lines	Consumer reporting agency may furnish credit report where the insurer intends to use it for underwriting.
	§ 19.182.040	Life	May use credit report in underwriting life insurance expected to amount to $50,000 or more.
	§ 48.18.545	Personal lines	Credit history may not be used to cancel or non-renew insurance. May only be used to deny coverage if combined with other substantive underwriting factors.
	§ 48.19.035	Personal lines	Credit history shall not be used to determine insurance rates unless the credit scoring models are filed with the commissioner. May not use certain attributes of credit history in credit scoring model.
	Reg. 284-24A-001 to 284-24A-065	Personal lines	Regulation describes standards that apply to insurers that use credit history.
WV (2/08)	§ 91-8-3	Auto	Dept. of Motor Vehicles may furnish credit information from its files where an insurer intends to use it for underwriting.
	Informational Letter No. 142A (August 2003)	Personal lines	Guidelines for filings containing credit scoring. Data may not be used in unfairly discriminatory manner. May not be sole basis for deciding whether to write coverage. If used for rating, must recheck scores of policyholders after 3 years.
	§ 33-6B-3	Auto	May not decline a policy based solely on adverse credit report.
	§ 33-17A-6	Property	May not decline a policy based solely on adverse credit report.
WI (2/08)	Bulletin dated 6/16/97	Personal auto and homeowners	Can use credit reports but not as the sole reason to refuse, cancel or nonrenew a policy.
WY (2/08)	§ 26-2-134	Personal lines, auto, homeowners	Authority to adopt regulation to provide that credit history may not be sole factor and to require disclosures. Protect consumers against unfair discrimination.

This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Every effort has been made to provide correct and accurate summaries to assist the reader in targeting useful information. For further details, the statutes and regulations cited should be consulted. The NAIC attempts to provide current information; however, readers should consult state law for additional adoptions.

© 2008 National Association of Insurance Commissioners

Appendix 2

The Use of Occupation and Education as Underwriting/Rating Factors for Private Passenger Automobile Insurance

March 2007

Report of commissioner, Kevin M. mccarty

Florida office of insurance regulation

The use of Occupation and Education as underwriting/rating factors for private passenger automobile insurance

March 2007

EXECUTIVE SUMMARY

The Office of Insurance Regulation ("Office") held a public hearing on February 9, 2007 in Tallahassee to review the use of occupation and education as underwriting or rating factors for private passenger auto insurance and its potential impact on Floridians.

In Florida, as well as nationally, the insurance industry has had a checkered past in its use of race and other proxy factors that intentionally or unintentionally negatively impact minorities and low-income individuals. While the use of race as a rating factor was outlawed in Florida, the two factors mentioned above, occupation and education, have emerged in the rating and underwriting of auto insurance and appear to be highly correlated to race and income-level.

Under some rating plans, consumers with more professional occupations (doctors, lawyers, architects), and advanced college degrees are being offered preferred driver rates. Conversely, individuals with blue-collar jobs, and a high school education or less are paying higher premiums for similar risk factors, as exhibited by several online quotes for auto insurance requested by the Office from one of the major auto insurance writers in Florida. With all other factors remaining equal, except for changes to the online applicant's education and occupation, the results were startling. One online quote comparison demonstrated a significant difference in the quoted auto insurance rate when the two factors are adjusted, accounting in that instance in a 300% higher rate for the less educated and less skilled applicant.

Testimony at the public hearing on February 9, 2007, and documents received and reviewed prior, during and after the hearing reveal:

- ***There is a demonstrable correlation between occupation, education and income-level and ethnicity, which was not disputed by the insurance industry.***

- ***Insurance industry representatives all claim ignorance of the relationship between occupation, education and income-level and race despite the existence of publicly available U.S. Census Bureau Data***

- ***Insurers do not collect data from consumers on race or income-level, and refuse to study the impact of underwriting practices on minority and low-income consumers.***

- ***The insurance industry does not believe that corporate responsibility extends to ensuring its practices do not disparately impact minority or low-income Floridians; but instead maintains that it is the Florida Legislature's responsibility to define public policy on this matter in the insurance marketplace.***

- ***It appears that wealthier individuals are more likely to pay small claims out-of-pocket, and avoid making insurance claims, giving some occupations better loss ratios despite higher accident rates.***

- ***As measured by one company's use of occupation and education the magnitude of the premium difference can be very significant.***

- ***Companies that do not use occupation and education as rating factors may potentially be at a competitive disadvantage because they may lose the wide range of business offered by higher income policyholders. Foregoing whatever predictive value these factors may have might also put these companies at a disadvantage. Thus, from an economic point of view, this practice is likely to proliferate regardless of its negative effects on policyholders struggling to overcome disadvantages.***

- ***While the prohibition of the use of these factors, much like in the prohibition of the use of race, could lead to some economic inefficiencies in insurance markets, it may be beneficial to the overall economy and citizenry to prohibit use of these factors as a matter of public policy***

- ***At least one major auto insurer that currently uses education and occupation as part of its underwriting, asserts it would absolutely not use these factors if it were determined the factors had a disparate impact on protected classes.***

- ***A national insurance organization whose members write 56 percent of the private passenger auto insurance market in Florida stated that a public policy concern can override the use of these factors even if there is an actuarial basis for it.***

The transcript of the public hearing held on February 9, 2007, consisting of two volumes, is attached to this Report as **Exhibits 1 and 2**.

BACKGROUND ON THE USE OF EDUCATION & OCCUPATION AS RATING FACTORS

One of Florida's greatest strengths is its rich culture and ethnically diverse population. Regrettably, Florida has another history: one of slavery, Jim Crow laws, as well as discrimination that led to the modern civil rights era. This willful discrimination was pervasive and permeated the institutions of education, government, and commerce --- even the insurance industry. While Florida leaders have since prohibited the use of factors such as race in determining employment and housing decisions, some vestiges of discrimination remain.

In 2000, the National Association of Insurance Commissioners ("NAIC") initiated a Race-Based Premium Working Group to examine the use of race-based premiums for life insurance. The Office was an active participant in this endeavor, which included a questionnaire to all life insurance companies nationwide about past practices. This ultimately resulted in several multi-state market conduct examinations, and multi-million dollar settlements to correct past wrongdoing.

The review period varied based on the company, but usually encompassed 1900-1970, although many policies were still "on the books." The findings were disturbing. Historically several life insurance companies bifurcated rate tables for "Caucasian" and "not-Caucasian," charging higher rates for non-Caucasians. Company documents offered a very interesting defense for this policy: they claimed this was not discriminatory, but merely reflected the statistical differences between life expectancies for Caucasians versus non-Caucasians. Although there may have been some validity to this statement, the insurance industry does not exist in a moral, ethical, or historical vacuum. Despite this "actuarial justification," legislatures around the country banned the use of race regardless of the statistical reasoning.

In reaction to these changes, some companies adjusted their underwriting standards in an unexpected manner: they began to use other factors that served as proxies for race and income status. The two most notable factors included education and occupation.

According to one multi-state examination report concluded by Maryland[1], after the race question was deleted from the application in the 1960s, several companies "appeared to use occupation as a substitute for race." ***Occupations subject to substandard rating included maids, bootblacks, busboys, car wash workers, garbage or ash collectors and janitors.*** The multi-state reported noted, "Non-Caucasian workers were disproportionately represented in the [these] disadvantaged occupations."

The report further compared rating books before and after race was removed from the application and noted:

1) The rating books removed race from the rating methodology, and
2) Occupational Rating Classification replaced the use of race, and
3) No other changes were made.

Both the company and regulators agreed the company engaged in "socio-economic underwriting." All four states involved in the examination, Maryland, Florida, Pennsylvania and Virginia believed there was enough evidence to conclude that the use of occupation in this instance violated all four states' statutes regarding non-discriminatory practices.

In a similar examination conducted by the State of Ohio a rating book for Cooperative Life Insurance Company[2] (CLIC), not only was there ***a substandard rating for occupations like butlers, barbers, valets, cooks, elevator operators and waiters --- but the rating book warned against, "low-grade industrial or illiterate types."***

The Use of Occupation and Education as Rating Factors Continues

The presumption that the use of occupation and education as rating factors ended with the conclusion of the aforementioned life insurance industry multi-state examinations is erroneous.

[1] The State of Florida, Pennsylvania, and Virginia also joined this examination. Monumental Multi-State Exam Report # 789-00 (Maryland).
[2] Actuarial Report – Race Based Pricing Activities with Respect to the Life Insurance Business of Nationwide Life Insurance Company, July 6, 2004 – State of Ohio.

The venue, however, has changed --- to the underwriting and rating of private passenger auto policies.

On March 20, 2006, the Consumer Federation of America ("CFA") issued a press release warning that the nation's fourth largest auto insurer, GEICO, was using occupation and educational attainment to rate auto insurance policies, and that Liberty Mutual Insurance and Allstate Insurance were beginning to use these rating factors as well. J. Robert Hunter, Director of Insurance for CFA, and the former Insurance Commissioner for the State of Texas, challenged state insurance regulators to ban the use of education and occupation for rating policies as these factors are highly correlated with race and income level.

In response, The Property Casualty Insurers Association of America (PCI), a trade association that represents 1,000 member companies that write roughly 40% of the nation's property & casualty business issued its own press release on March 21, 2006. The PCI defended GEICO's use of education and occupation as "valid factors for insurers to use in the marketplace."

As early as 2004, the Office began taking active measures to have auto insurers remove the occupation and education variables from the insurers' underwriting/rating plans used in Florida. In 2004, as a condition of "approving" a filing, those auto insurers using either occupation or education, or both factors, in their underwriting plans were advised to cease doing so within 1 year.

In response to these measures taken by the Office, AIG, in a letter dated May 5, 2004, expressed that AIG "is amiable to remove this factor [occupation] from our scoring models contingent on the following conditions: The [Office] promulgate a Regulation that requires all personal automobile writers to stop using the occupation factors at the same time, or, all carriers using this factor have agreed to remove the factor within the same time frame."

While Florida law specifically outlaws the use of race for rating insurance policies, there is no specific statutory prohibition against using potential proxy factors that are highly correlated to

race, such as educational attainment and occupation that would create a disparate impact on racial minorities and low income Floridians.

Section 627.917, Florida Statutes, states that the Financial Services Commission can establish a uniform statewide risk classification reporting system for auto policies provided it does not discriminate based upon race, creed, color or national origin. Pursuant to this private passenger auto risk classification reporting system statute: "The classification system may include any difference among risks that can be demonstrated to have a probable effect upon losses or expenses ..."

The insurers that have begun to use occupation and/or education as rating factors claim these factors are predictive of losses, and thus are not prohibited by Florida Statute, regardless of the potential impact. The auto rating statute states that rates are not unfairly discriminatory with respect to a group even though they are lower (and, by implication, higher) than rates for nonmembers of the group. Rates are only unfairly discriminatory if they clearly fail to reflect equitably the difference in expected losses and expenses or if they are not actuarially measurable and credible and sufficiently related to actual or expected loss and expense experience of the group to assure that nonmembers of the group are not unfairly discriminated against. It is this definition that governs the Office's determination of whether a rate is unfairly discriminatory.

The Public Hearing on the Use of Occupation and Education as Rating Factors for Private Passenger Auto Insurance

The Florida Insurance Commissioner, through a Notice of Hearing to the industry, as well as subpoenas directed to auto insurers currently using occupation and education as rating factors, compelled testimony from the industry, consumer advocacy groups, and from the public to explore this issue, and the rationalization underlying the use of these factors. Members from four insurance groups testified including GEICO, Liberty Mutual, the AIG Insurance Group, and New Jersey CURE Auto Insurance. In addition, members from insurance trade organizations including the Property and Casualty Insurance Association of America (PCI), the

Consumer Federation of America, the National Association of Mutual Insurance Companies (NAMIC), the Insurance Information Institute (III), the Florida Insurance Council, the Florida Justice Association, and Florida's Consumer Advocate also testified.

The issue is simple: allowing the use of occupation and education as rating factors appear to disproportionately favor non-minorities and higher-income individuals while negatively impacting minorities and low-income individuals by charging these groups, albeit somewhat indirectly, higher auto-insurance rates relative to others with similar risk characteristics.

Following the Office's attempts in 2004 to have automobile insurance carriers in the state remove the two factors, the Office began monitoring this trend, and has recently been very specific in not "approving" the rate filings that use the two factors at issue, but instead, warning companies that although the Office is concerned about the impact of these practices, it does not have statutory authority to deny these practices. While the Office has not "approved" these plans, it had no other recourse under current statutes and rules but to allow them to come into effect due to the deemer provisions of the law.

This issue also has gained national attention following the Consumer Federation of America's letter to all insurance commissioners explaining its research regarding GEICO's practices. In 2006, Commissioner McCarty commissioned an internal study of the correlation between education/occupation and ethnicity and income, which found strong correlations, ultimately concluding that logically any plan that utilized these factors would negatively impact minorities and low-income individuals.

Prior to the public hearing, the Office identified eight main investigatory questions to understand these issues:

1. Is there a correlation between occupation/education and race and/or income status?
2. Is the insurance industry aware of such correlation between occupation/education and race or income?
3. Does the insurance industry believe its corporate responsibility extends to ensuring its policies do not negatively impact people due to race or income-level?
4. Has the insurance industry researched the impact of its practices on Floridians as it relates to minority or low-income individuals?

5. Is there a correlation between occupation/education and loss ratios and or accident statistics?
6. If it is demonstrated the use of occupation and education negatively impact protected classes, what is the magnitude of this impact?
7. If the Florida Legislature does not change the laws, and this practice is allowed to proliferate, what will be the potential impact on the auto insurance industry?
8. If these factors were not allowed for underwriting factors, would the auto insurance industry still be competitive?

THE CURRENT USE OF OCCUPATION AND EDUCATION AS RATING FACTORS

Even before the eight investigatory questions are explained, it is important to understand how the industry is currently using occupation and education. Although a few industry representatives stated broadly, "they have been using these factors for years," the current incarnation of the usage of these factors is a relatively new phenomenon, and is utilized in different forms by three auto insurers in Florida that collectively write approximately 17.1% of the auto insurance market in Florida, insuring over 1.9 million vehicles.

The testimony elicited the forms of current use, and revealed several critical facts. It is important to understand that these factors can be used in two different phases: (1) Underwriting --- which is to determine whether to insure the individual; and (2) Rating – which is to determine the actual premium paid by the customer. During this investigation, the Office learned about another practice, which is a blending of underwriting and rating, the practice of "tiering"

GEICO utilized "tiering" most directly, and this report will use this company's experience as an example. Currently GEICO has four companies that operate in the State of Florida: Government Employees Insurance Company (which is the origin of the name "GEICO" but does not technically incorporate that acronym), GEICO General, GEICO Indemnity, and GEICO Casualty. During the underwriting phase, a customer will apply for coverage on-line or via a telephone operator, and believes they are applying for coverage from "GEICO." Based on the underwriting criteria (including occupation and education), customers are placed into different companies. The preferred-risk customers are placed into Government Employees

Insurance Company or GEICO General (with the lowest rates), the intermediate-risk customers are placed into GEICO Indemnity, while the sub-standard risk customers are placed into GEICO Casualty. Based on GEICO's placement statistics, it appears that customers gaining the preferred status (and lowest premiums) are far more common:

GEICO Coverage in Florida, 2006

Company	# of Insured Vehicles	Avg. Annual Premium
GEICO /GEICO General	990,262	$938.70
GEICO Indemnity	174,823	$1,183.70
GEICO Casualty	110,613	$1,474,90

It also appears that GEICO is not equally receptive to all segments of the population (favoring those with higher education and better occupational status). During the testimony, the Office learned that customers are usually not informed they were rejected for the preferred company (Government Employees Insurance Company or GEICO General), and placed into another company.[3]

Liberty Mutual has two companies writing auto insurance in Florida, Liberty Mutual Insurance Co. (the preferred company with lower rates), and Liberty Insurance Co. (sub-standard risks and higher rates). In the initial determination, occupation, employment status, and education are determinants for being offered coverage from Liberty Mutual Ins. Co. In response to direct questioning during the public hearing, Christopher Cunniff, VP of Personal Marketing, stated, "Yes, it is possible that some small segment of customers, the use of that variable [education and occupation] does push their slotting decision from one company to another."[4] However, once in the insurance companies, education and occupation are not used as rating factors by the

[3] GEICO is currently defending itself against a lawsuit filed in 2006 in federal court by several African-Americans who were either former or current GEICO policyholders, alleging that the use of education and occupation factors are discriminatory or have a discriminatory impact, Patricia Amos, et al. v. GEICO, U.S. District Court for the District of Minnesota, Case # 06-cv-1281. Transcript of public hearing, Volume 1, page 81, lines 2 – 14; Vol. 1, page 88, lines 8 – 13. GEICO states the allegations are "absolutely baseless".

[4] Transcript of public hearing, Volume 1, page 97, lines 14 – 17.

Liberty Mutual Companies. This contrasts with GEICO, where further tiering decisions are made within each company.

One potential problem of this "slotting" technique is that individuals may be "parked" in the substandard risk company. Even if a person achieves a higher level of education, or changes to a more preferred occupation, they can only switch companies after three years, "if they are clean," remarked VP Cunniff.[5]

The American International Group, Inc. ("AIG") Companies use occupation, but do not use education in their underwriting and premium practices. While AIG does have three auto insurers writing in Florida, AIG does not use the same type of "tiering" techniques used by GEICO and Liberty Mutual, but places customers based on their distribution channels. However, within their underwriting tiers (which ultimately affects rating and premiums), occupation is used as a determining factor.

The Office is vested with the responsibility to ensure rates are not "excessive, inadequate, or unfairly discriminatory,"[6] and it appears that these underwriting and rating factors will *prima facie* result in higher premiums for those who can least afford it: lower-income, and less educated individuals.

I. IS THERE A CORRELATION BETWEEN THESE FACTORS AND RACE AND/OR INCOME STATUS?

Although racial differences between education and occupation have narrowed since the "Jim Crow" period examined during the race-based life insurance premiums initiative --- a wide gap still exists.

The U.S. Census Bureau conducted a comprehensive study of race/ethnicity and occupation in for its *Selected Occupational Groups by Race and Hispanic Origin for the United States, 2000.*

---

[5] Vol. 1, page 97, lines 23 – 25.
[6] Section 627.0651, Florida Statutes.

The table below, based on U.S. Census Bureau Data, shows disparities among the types of jobs by different races & ethnicities:

Category	Management, Professional, & Related Occupations
Caucasian & Asian*	37%
Black/African American	25%
Hispanic or Latino**	18%
American Indians, Native Alaskans, Hawaiians, & Pacific Islanders	24%

** Non-Hispanic*
*** Any Race*

Although this is national data, we can still observe dramatic differences: Caucasians and Asians are twice as likely as Hispanics to have management or professional jobs.

The chart below, based on data from he U.S. Census Bureau, shows educational attainment also has large disparities across ethnic and racial groups in Florida:

Bachelor's Degree or Higher
Florida, 2005

Category	Percent with Degrees
Caucasian & Asian*	29%
Black/African American*	13%
Hispanic or Latino**	21%

** Non-Hispanic*
*** Any Race*

Source: U.S. Census Bureau: Educational Attainment of the Population 18 Years and Over, by Age, Sex, Race Alone, and Hispanic Origin, for the 25 Largest States: 2005

Unlike the occupational data, this is Florida specific data, and also shows large disparities: Caucasian and Asian non-Hispanics are more than twice as likely to have a college degree as Blacks/African Americans.

For both occupation and education, as a group, Caucasians and Asians are more likely to have professional and managerial jobs, as well as college degrees. Not only would utilizing these factors negatively impact minorities (as a group), but also using a combination of these factors may magnify the "inequality effect."

II. IS THE INSURANCE INDUSTRY AWARE OF SUCH CORRELATION BETWEEN OCCUPATION/EDUCATION AND RACE OR INCOME?

Although one may think it is "common knowledge," that there are inequalities in America that contribute to minorities being less likely to obtain college degrees, or have higher incomes, shockingly the representatives of the insurance industry claim to be oblivious of such a relationship. In fact, at times the public hearing was reminiscent of hearings involving the tobacco industry where tobacco lobbyists claimed there were no studies proving tobacco use caused cancer.

Asked pointedly by Commissioner McCarty whether the use of occupation and education would disparately impact protected classes of minorities, Hank Nayden, VP and General Counsel for the GEICO group answered, "...to our knowledge, there is no credible data and no credible study reflecting that."[7] Later in the testimony, Commissioner McCarty asked the same witness if he has looked at the U.S. Census Bureau data on this relationship between occupation and race, Mr. Nayden conceded, "I have not."[8]

The Commissioner again emphasized this question with representatives testifying on behalf of Liberty Mutual. Asking whether the company had looked at U.S. Census Bureau data regarding the relationship between occupation, education, and race and/or income, Christopher Cunniff, VP of Liberty Mutual's Personal Marketing admitted, "I have not, and I'm not aware of anyone at Liberty who has."[9]

Similarly, during the questioning of AIG company representatives, when asked by Deputy Commissioner Belinda Miller about studies showing relationships between occupation and income or race, Mr. Fedak VP of AIG Direct's Southeast Region, answered, "I'm not aware of any studies, other than analyzing our own book of business."[10] Further questioning revealed

---

[7] Vol. 1, page 38, lines 7 - 10.
[8] Vol. 1, page 50, line 24.
[9] Vol. 1, page 101, lines 23 – 24.
[10] Vol. 2, pages 160 – 11, lines 25 and 1.

that since AIG does not collect data regarding ethnicity or income, no such relationship studies could be performed based on their book of business.

The industry's denial of knowing about the statistical correlations between education, occupation and race and/or income strained credulity, Steve Parton, General Counsel for the Office asked rhetorically whether this was "willful blindness" by the industry. However, it should be noted that CFO Eric Poe of New Jersey CURE Auto Insurance Company committed to not using this factors stated:

> ***"...for an entire industry that is predicated on how smart we are, we would be probably the dumbest industry in the world not to know that those statistical correlations exist."***[11]

III. DOES THE INSURANCE INDUSTRY BELIEVE ITS CORPORATE RESPONSIBILITY EXTENDS TO ENSURING ITS POLICIES DO NOT NEGATIVELY IMPACT PEOPLE DUE TO RACE OR INCOME-LEVEL?

Based on the testimony presented February 9, 2007, the simple answer appears to be "no."

During his testimony at the public hearing, Alex Hageli of the Property & Casualty Insurance Association of America (PCI) stressed that as long as the outcomes are actuarially based, the insurance company should be allowed to use it. Moreover, when asked about disparities in outcomes and whether that should be allowed he stated, "I believe that's a question the Legislature needs to address."[12]

When asked to contemplate hypothetical variables like eye color, cell phone usage, the number of plasma TVs in the household or birth order, Mr. Hageli answered plaintively, "If there's an actuarial basis for it, it should be used unless there is some overriding public policy concern"[13]

---

[11] Vol. 1, page 33, lines 14 – 17.
[12] Vol. 2, page 128, lines 15 –18.
[13] Vol. 2, page 135, lines 17 – 21.

Later when asked pointedly about the use of race in rating life insurance (as it was conceded African-American's have lower life expectancies than Caucasians), Mr. Hageli implied it could be used, "Except for the fact that it's prohibited by law."[14]

Other industry representatives did not go this far. Commissioner McCarty asked GEICO representatives, "If, in fact, it were determined, hypothetically, that it [using occupation and education as rating factors] had a disparate impact on protected classes, would GEICO continue to use it?"[15] Mr. Nayden of GEICO responded, "absolutely not."[16] However, after presented with U.S. Census data showing disparities, Mr. Nayden seemed unconvinced of the relationship: "And to our knowledge, there is no credible data and no credible study reflecting that [disparate impact]."[17]

When Commissioner McCarty asked the same question of Liberty Mutual's representatives: "If education and occupation criteria used in underwriting or rating were shown to have a disparate impact on protected classes of people ...would your company continue to use it?"[18] Mr. Cunniff of Liberty Mutual waffled: "Well that's a hypothetical question which I can't answer, and certainly we wouldn't comment in advance on business plans with our company."[19]

While they too did not specifically state it is the companies' responsibility to understand these relationships, the AIG companies were less vociferous in defense of this practice. Mr. John Fedak, VP of AIG Direct's Southeast Region summarized their companies' position: "...if the OIR requires insurance carriers to remove occupation from the rating process, our tiering model will be revised and will become less accurate in predicting losses."[20]

In summary, the industry does not seem to believe that it is within their corporate responsibility to ensure that rating and underwriting practices do not negatively impact society, as long as the

[14] Vol. 2, page 141, lines 13 – 14.
[15] Vol. 1, page 37, lines 20 – 23.
[16] Vol. 1, page 37, line 24.
[17] Vol. 1, page 38, lines 7 – 8.
[18] Vol. 1, page 101, lines 3 – 8.
[19] Vol. 1, page 101, lines 9 – 12.
[20] Vol. 2, page 155, lines 1 – 4.

practices have actuarial justification. Instead, it is the perception of the industry that this is a public policy question, and it is the responsibility of the Florida Legislature and regulators --- not the insurance industry to ensure these practices do not negatively impact society.

IV. Has the insurance industry researched the impact of its practices on Floridians as it relates to minority or low-income individuals?

The insurance industry professes ignorance as to the relationship between occupation, education and income-status or race, and believes it is the Florida Legislature's responsibility, not that of the industry, to determine what factors are inappropriate. Given these facts, it should not be surprising the industry has not researched this question. It has not.

Yet what is surprising is the industry has established a mechanism that makes it impossible for any auditor to research this specific information by intentionally never collecting any relevant data. While the industry portrays this as the moral high road because policyholders may be offended by being asked information about income or race, it uses the resulting ignorance to claim that anything it may do cannot possibly be discriminatory because it does not even have race or income information. The argument confuses intent with results but sounds appealing at first.

The State of Florida application for employment asks the ethnicity and age of the applicant on a voluntary basis for information purposes (to ensure non-discrimination), while mortgage companies and credit card companies routinely request income information. Insurers make hyperbolic statements such as, "No study has shown our policies have a disparate impact". Such statements are true by tautology --- no study can be condueted without the information of the race and income level of the applicant.

This opinion was most passionately advocated by Mr. Nayden of GEICO who stated, "There is no study that finds that the use of education or occupation as a risk selection characteristic has

an adverse impact on minorities or low income individuals."[21] Yet, when asked whether GEICO could collect and/or analyze this data to determine potentially negative impacts, Mr. Nayden responded emphatically, "We have no interest in collecting or analyzing any data on race."[22] This comment was echoed by Mr. Cunniff of Liberty Mutual: "Liberty does not ask or measure or track either income or race, so we have no internal studies ..."[23] We may observe that no external studies are possible either, given that the entities in control of the information desire to remain blissfully ignorant.

To demonstrate the nexus between occupation groups and income level, Eric Poe of the CURE New Jersey Auto Insurance showed that GEICO's rating manual offered the worst (highest premium) category for military personnel in Pay Grade E-4 or lower, which equates to someone earning less than $24,000 a year.[24] Based on GEICO's 2004 rating manual filed with the Office of Insurance Regulation – this is correct.

In response Mr. Nayden remarked the Office has "an old underwriting guideline," but the newer guidelines do not use military pay grades.[25] However, upon further questioning by Susan Dawson, Assistant General Counsel with the Office, Mr. Nayden admitted GEICO currently uses military rank, which is highly correlated to income level within the military.[26]

The industry's position is that using education and/or occupation is "blind" based on race or income. Yet, without collecting any data on this issue, the impact itself must remain invisible. Some of the occupations in GEICO's preferred auto group include doctors, lawyers, and engineers while those in the lowest rating categories include blue and gray-collar workers, service and long-haulers, it is difficult to fathom how their policies could not produce a negative impact on disadvantaged groups.

---

[21] Vol. 1, page 46, lines 5- 8.
[22] Vol. 1, page 38, lines 20 – 22.
[23] Vol. 1, page 113, lines 17 – 21.
[24] Vol. 1, page 22, lines 9 – 23.
[25] Vol. 1, pages 41 - 42.
[26] Vol. 1, page, 42, lines 22 – 25, and page 43.

While the Office agreed that collecting information about race and income could be perceived as offensive, minorities and low-income individuals may be equally offended to learn much larger proportions of them are paying higher rates than the majority racial group and higher income white-collar professionals, and are being rejected by the preferred companies within an insurance group without their knowledge.

V. IS THERE A CORRELATION BETWEEN OCCUPATION/EDUCATION AND LOSS RATIOS AND OR ACCIDENT STATISTICS?

Underlying the industry's entire argument is a statistical correlation between occupation, education and auto loss ratios. Representatives from AIG were even more specific, in that by using multivariate regression analysis, there is an *independent* relationship between occupation and auto loss ratios, which can be demonstrated when other factors are held constant. Regrettably, these data cannot be reviewed in this report as some of this involves proprietary information.

During the public hearing, Attorney Susan Dawson elicited testimony from representatives from GEICO regarding a 2003 study completed by Quality Planning Corporation, a division of Insurance Services Office, Inc. (ISO). This study showed that several white-collar careers had higher risk for an accident:

2004 Quality Planning Corporation Study
Accidents Per 1,000 Per Year

Rank	Occupation	Accidents per 1,000
# 1	Student	152
# 2	Medical Doctor	109
# 3	Attorney	106
# 4	Architect	105
# 5	Real Estate Broker	102
# 6	Enlisted Military	99
# 7	Social Worker	98
# 8	Manual Laborer	96
# 9	Analyst	95
# 10	Engineer	94

Many of these occupations including medical doctor, attorney, architect, and engineer appear in GEICO's most preferred rating class.

When asked to explain this apparent discrepancy, Mr. Hageli of PCI speculated that certain jobs may require travel at unusual hours, or be subject to greater distractions (including cell phone usage) causing a greater risk of accident.[27] When pressed for an example, he gave a real estate broker. Yet, Mr. Hageli's explanation seemed unconvincing, as high cell phone usage by attorneys, doctors, and real estate brokers should make their premiums higher --- not lower.

A better explanation was presented by Eric Poe of New Jersey CURE Auto Insurance who stated, "Studies have shown up to 50 percent of eligible claims are not even reported to insurance companies because of the fear that their rates will go up. Unfortunately, lower income individuals do not have the ability to make that choice."[28] For evidence, Mr. Poe cited a report by the 1998 Joint Economic Committee from the U.S. Congress.

Paul Lavrey, actuary for GEICO, agreed stating that "our experience would be based on what we know about, which is the losses that are reported." Moreover, "I'm sure some claims aren't

[27] Vol. 2, page 126, lines 21 – 25.
[28] Vol. 1, page 14, lines 7 – 9.

reported and we don't know about them so we wouldn't have that."[29] Regarding the number of claims that are not reported Mr. Nayden added, "We're not aware of a study, but we would certainly like to review it, if you have one."[30] Mr. Cunniff, of Liberty Mutual, did try to offer a better defense of this stating that many auto claims are third party claims that would be difficult to nonreport, moreover, there are some legal requirements that require multi-car accidents to be reported.[31]

Yet the end result is the same, assuming both the industry studies showing preferred white-collar jobs like doctors, lawyers and architects, have lower loss ratios, yet according to Quality Planning's study have greater amounts of car accidents, it does appear there is some "self-insurance." Basically, wealthier consumers are paying lower-amount claims out-of-pocket rather than filing claims.

VI. IF IT IS DEMONSTRATED THAT THE USE OF OCCUPATION AND EDUCATION NEGATIVELY IMPACT PROTECTED CLASSES, WHAT IS THE MAGNITUDE OF THIS IMPACT?

Another factor is the amount of the effect. Even assuming occupation and education are accurate predictors of auto loss ratios, and that industry data has roughly similar experience in this regard, it does seem odd that the variations among insurers are of such a significant magnitude, especially given its actuarial basis.

AIG Company representatives (which use only occupation, not education) assert the differences are not significant: "There's a potential in certain extreme circumstances for a person's tier that they're assigned to move by two tiers based on the occupation variables, and that would result in approximately a 30 percent rate difference."[32] When asked specifically whether it could be higher, Mr. Fedak stated, "That would be a maximum."[33]

---

[29] Vol. 1, page 77, lines, 16 – 22.
[30] Vol. 1, page 78, lines 8 – 12.
[31] Vol. 1, page 109, lines 11 – 20.
[32] Vol. 2, page 168, Mr. Bowman's testimony.
[33] Vol. 2, page 168, line 6.

While the Liberty Mutual testimony focused on other areas, the GEICO testimony elucidated several interesting numbers regarding differences in occupation, education, and its affect on premiums. One of the reasons GEICO is easy to analyze is that it has an interactive rate estimator on its website which can be used to see the effect of specific occupations and education levels while holding other demographic information constant. The Office of Insurance Regulation presented three comparisons:

	High School/ Blue-Collar	Advanced Degree/ Professional	% Difference
Comparison 1[34]	$4,225.36	$1,403.59	201%
Comparison 2[35]	$884.84	$714.04	24%
Comparison 3[36]	$1,027.29	$1,280.79	25%

Eric Poe of New Jersey CURE Auto Insurance stated the differences varied by as much as 50-70%, although in some cases the difference could be as much as 200% as in Commissioner McCarty's example.[37]

While GEICO representatives seem to imply these were isolated incidents, interestingly a reporter from the St. Petersburg Times conducted his own research on his vehicle, comparing the rates for "Bob" --- a 50 year-old janitor with no high school education, and "Joe" a Ph.D. computer executive attempting to insure the same 2002 Toyota Camry in the Tampa area.[38] His results: Bob the janitor would be pay premiums 66% higher for the exact same vehicle.

---

[34] Example included a single male, age 23, living in Hialeah, with a 2000 Chevrolet Malibu LS, 4 door sedan, Drives up to 15,000 miles a year, one speeding ticket, no accidents within 3 years. BI limits $15,000/$30,000; PD $10,000; PIP $10,000 with $250 deductible; UM: $15,000/$30,000; non-stacked, Comprehensive $500 deductible, Collision $500 deductible. Six-month policy.

[35] Example included a single male, age 25, living in Jacksonville, with a 2005 Honda Accord, 4-door sedan, Drives up to 15,000 miles a year, one speeding ticket, no accidents within 5 years. BI limits $25,000/$50,000; PD $25,000; PIP $10,000 with $0 deductible; UM: $25,000/$50,000; non-stacked, Comprehensive $500 deductible, Collision $500 deductible. Six-month policy.

[36] Example included a single male, age 24, living in West Palm Beach, with a 2002 Buick Park Avenue, 4-door sedan, Drives up to 15,000 miles a year, one speeding ticket, no accidents within 3 years. BI limits $15,000/$30,000; PD $10,000; PIP $10,000 with $250 deductible; UM: $15,000/$30,000; non-stacked, Comprehensive $500 deductible, Collision $500 deductible. Six-month policy.

[37] Vol. 1, page 12, lines 7 – 11.

[38] "GEICO Gives Different Rates for Drivers Depending on their Jobs," St. Petersburg Times, Robert Trigaux, February 12, 2007.

While GEICO claims their models incorporate up to 27 factors, it does appear that some factors are given greater weight than others --- and that education and occupation factors may be more important than miles driven, marital status or age in calculating an insurance premium.

VII. If the Florida Legislature does not change the laws, and this practice is allowed to proliferate, what will be the potential impact on the auto insurance industry?

The problem is simple: if occupation and education are truly predictors of loss, the companies that do not adopt these practices are at a competitive disadvantage vis-à-vis insurance companies that do adopt this practice.

The most pervasive use of this practice is currently that of GEICO, which is the third largest private passenger auto writer in Florida, and the fourth largest writer in the United States.[39] In a statement to the Commissioner and the panel, Mr. Cunniff of Liberty Mutual observed, "I would say that as a general rule we are aware of what competitors are doing."[40]

In their defense, Mr. Nayden of GEICO used as evidence GEICO's double-digit growth and that "the company's growth across all occupations and educational levels give the lie to any notion that certain individuals are being harmed by our underwriting practices."[41] The fact that nearly 1 million policyholders are in GEICO's preferred company, while less than 300,000 have policies with the substandard companies casts serious doubt on this assumption --- while all companies may be growing, GEICO companies appealing to those with higher occupation and more professional occupations seem to have achieved greater market penetration.

In his testimony, Eric Poe stated about CURE New Jersey Auto, "...we [the insurance community & state government] have to make moves to ban the use of this or we are going to be compelled to adopt this rating practice."[42] The Consumer Federation of America voiced its agreement, "...GEICO's continued use of the education and occupation criteria will lead to negative competition in the insurance marketplace and that it will encourage GEICO's

[39] Vol. 1, page 35, lines 15 – 17.
[40] Vol. 1, page 119, lines 23 – 25.
[41] Vol. 1, page 48, lines 9 – 15.
[42] Vol. 1, page 10, lines 7 – 18.

competitors to follow suit, because those competitors will see that GEICO is taking away their more affluent clients."[43]

Based on the testimony provided, it would appear that auto insurer's use of these factors is poised to increase. These factors, could lead proliferate within the auto insurance industry, in much the same way that the use of race as an underwriting factor became pervasive throughout the life insurance industry between 1900 to 1970.

VIII. IF THESE FACTORS WERE NOT ALLOWED FOR UNDERWRITING FACTORS, WOULD THE AUTO INSURANCE INDUSTRY STILL BE COMPETITIVE?

Other than having predictive value, the main argument for the inclusion of education and occupation as rating factors is the concept of competition. Perhaps best articulated by Dr. Robert Hartwig of the Insurance Information Institute, "...a system of rates that accurately reflects risk and costs is fair and it is equitable. States that restrict actuarially valid underwriting criteria implicitly subsidized drivers with relatively poor records at the expense of the state's better drivers."[44]

Even more dramatically, representatives from PCI stated this will lead to overall price increases: "When you have less competition, you have less market forces forcing prices down," Mr. Hageli continued, "If you begin, as regulators, to tell them what they can and cannot do, they're going to be more conservative. I mean that to me seems to be pretty commonsensical."[45] NAMIC also agreed, "... limitations and restrictions on underwriting freedom stifle innovation and thereby hamper competition, ultimately harming consumers and society in general."[46]

These arguments do have some merit. However, this can be applied to all types of regulation -- as regulation, whether it be standardizing forms that people can understand, prohibiting use

[43] Vol 2, page 149, lines 7 – 12.
[44] Vol. 2, page 193.
[45] Vol. 2, page 131, lines 14 – 20.
[46] Vol. 2, page 185, lines 4 – 14.

of specific language in advertising, or creating solvency requirements to ensure against bankruptcy --- all regulation implicitly limits freedom of insurance companies in exchange for a perceived societal benefit.

The one statement that remained unanswered was posed by the Insurance Commissioner Kevin McCarty during the testimony of PCI: "Certainly the life insurance business is as robust today as it's ever been and we don't allow race-based rates."[47] Moreover, in the same vein, disallowing the use of a factor by all companies (in this instance race) creates a level playing-field for all insurance companies to compete based on factors that are allowed. Based on information received as part of the Office's investigation of this matter, companies that use the factors view the college-educated population as a more profitable group. Companies that do not use occupation and education as rating factors may potentially be at a competitive disadvantage because they may lose the wide range of business offered by higher income policyholders.

[47] Vol. 2, page 131, lines 8 – 13.

Florida's Office of Consumer Advocate also agrees, "I believe that if a particular rating variable has an extraordinary disparate impact on a particular prohibited class or group of prohibited classes, that that variable in effect is a proxy for prohibited classes and should be prohibited."[48] Thus, even though some inefficiencies in the auto insurance market may be created by disallowing the use of factors such as race, income level, or factors that may be intentional or unintentional proxies for race and income levels such as credit scores, occupation and education --- the prohibition of such use may be in the public interest, despite modest insurance sector inefficiencies. The relationship between race and income is illustrated by data from the U.S. Census' "Income, Earnings, and Poverty From the 2004 American Community Survey," issued August 2005:

Median Incomes by Race

Race and Hispanic Origin	Men	Women
Caucasian alone	$42,707	$32,034
Caucasian alone, not Hispanic	$45,573	$32,678
African-American alone	$32,686	$28,581
American Indian	$32,113	$25,752
Asian alone	$46,888	$36,137
Hawaiian and Pacific Islander	$32,403	$27,989
Other Race	$26,679	$23,565
Two or More Races	$37,025	$30,729
Hispanic Any Race	$26,749	$24,030

Median Incomes by Education

Education	Men	Women
Less than High School	$21,760	$13,280
High School Graduate	$31,183	$19,821
Some College or Associates Degree	$37,883	$25,235
Bachelor's Degree	$52,242	$35,195
Graduate or Professional Degree	$68,239	$46.004

[48] Vol. 2, page 217, lines 16 – 21.

Median Incomes by Occupation

Occupational Fields	Men	Women
Management	$65,393	$48,118
Business and Financial Operations	$57,922	$42,256
Computers and Math	$66,130	$56,585
Architecture	$64,496	$51,581
Health Care Practitioner	$69,124	$45,380
Health Care Support	$25,774	$22,658
Farming, Fishing	$22,124	$17,098
Construction	$33,064	$29,289
Transportation	$31,840	$22,434
Personal Care and Service	$27,258	$19,789
Educational	$47,963	$36,891
Office and Admin Support	$35,216	$29,006

One of Florida's greatest strengths is its rich culture and ethnically diverse population, and it would be unfortunate if the insurance industry, through its practices, either intentionally or unintentionally, engaged in discriminatory practices based on a person's ethnicity or income status. Similar to credit scoring, it is possible that clear legislation with rule making authority will be needed to restrict the use of education and occupation as underwriting and rating factors.

Hearing before the House Financial Services Subcommittee on Oversight and Investigations

"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

Testimony of Charles Neeson, Westfield Group on behalf of Property Casualty Insurers Association of America

May 21, 2008

Chairman Watt and Members of the Subcommittee:

Thank you for the opportunity to comment on H.R. 5633, legislation that seeks to prohibit the use of information in credit reports for issuing or setting premiums for motor vehicle or property insurance. My name is Charles Neeson and I appear before you today as both a Senior Executive with Westfield Insurance and as a representative of the Property Casualty Insurers Association of America (PCI), of which Westfield is a member. PCI is a national property casualty trade association comprised of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. I am a member of the American Academy of Actuaries and an Associate in the Casualty Actuarial Society.

An insurance company's ability to more accurately predict losses is a critical component of properly underwriting risks. When insurers are able to properly underwrite risks, consumers benefit with lower rates and more choices. Because credit-based insurance scoring is an objective and accurate method for assessing the likelihood of insurance loss, we strongly oppose passage of H.R. 5633 or H.R. 6062.

Insurance is an incredibly competitive business, and one way for an insurance company to distinguish itself from its competitors is to develop better ways of gauging risk to more accurately price an insurance policy. By analyzing historical policyholder information such as loss and claims data, insurers have found that certain personal attributes correlate with the level of risk that an individual represents.

For example, insurance companies have found that gender and age, regardless of race or ethnicity, correlate to future loss. Loss data indicates that young males are more likely to incur losses than older males, or even young females. Additionally, historical data reflects a high correlation between the type of automobile driven and the number of losses incurred. Individuals who drive high-performance vehicles are approximately 36 percent more likely to be involved in automobile accidents than those who drive standard automobiles.

Likewise, historical data reflects a strong correlation between the timeliness with which an individual pays his bills and the average number of homeowner insurance losses that individual will incur. Individuals who are delinquent in paying their bills two or more times within the last two years are approximately 80 percent more likely to file an insurance claim than those who pay their bills on time.

It is precisely this type of information that forms the basis for credit-based insurance scores, alternatively referred to as insurance scores. Westfield Group began using insurance scores in 2000 as a part of an effort to improve the pricing of our automobile and homeowners' insurance products. In analyzing the relationship between credit information and our loss data, we found a strong correlation. Used in conjunction with more traditional rating factors such as vehicle performance, age, gender and territory, credit-based insurance scoring allowed Westfield to more accurately price our products and improve our competitive position. Today, approximately 75 percent of our policyholders pay less because of the use of insurance scores, while only eight percent pay more. In other words, without the use of credit-based insurance scores, three-quarters of our policyholders would be paying more for their insurance than they are now.

Outside of Westfield's own experience with credit-based insurance scoring, an annual survey published by the Arkansas Insurance Department shows that insurance scoring either benefits or has no effect on the vast majority of consumers in Arkansas. The latest survey shows that 90.2 percent of automobile insurance policyholders and 90.8 percent of homeowners insurance policyholders either received a discount or were otherwise unaffected by the use of credit.

It is important to understand how insurers use credit information and to note that there are significant differences between the credit scores used by lenders and the credit-based insurance scores used by many insurers. Although both are derived from information found on credit reports, the information is measured differently. Insurers use credit information in developing insurance scores to predict the likelihood of future insurance loss. Credit-based insurance scores provide an objective measurement of how one manages the risk of credit. Lending institutions, on the other hand, use credit scores to

determine the availability, amount and price of credit products offered to the consumer. Lending institutions use credit to determine the likelihood of repayment. The most significant difference between insurers and lending institutions is that insurers never consider income. Insurers measure "how," not "how much."

In July 2007, the Federal Trade Commission (FTC) issued a report to Congress on insurers' use of credit-based insurance scores entitled, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance." In its report, the FTC concludes that insurance companies which use credit-based insurance scores are more likely to price automobile insurance more closely to the risk of loss that consumers pose, resulting, on average, in higher-risk consumers paying higher premiums and lower-risk consumers paying lower premiums. Additionally, the FTC concludes that credit-based insurance scores permit insurance companies to evaluate risk with greater accuracy. Finally, the report finds that credit-based insurance scores do predict risk within different racial, ethnic and income groups and that the "use of credit-based insurance scores do not act solely as a proxy for membership in these groups."

The use of credit-based insurance scoring is subject to extensive regulation by the States. The National Conference of Insurance Legislators (NCOIL) promulgated model legislation regarding its use, and most States have either enacted the model or adopted restrictions similar to those contained in the model. One of the main provisions of the model is that an insurance score cannot be the sole reason for denying, canceling or non-renewing an insurance policy. The model also contains numerous other important consumer protections, such as prohibiting the use of credit information related to medical collection accounts.

Insurers that consider credit information in their underwriting and pricing decisions do so for only one reason – insurance scoring allows them to rate and price business with a greater degree of accuracy and certainty. Sound underwriting and rating, in turn, allows insurers to write more business - a direct benefit for consumers. Without the ability to consider credit, many insurers would be less aggressive in their marketing, and far more cautious in accepting new business. Consider:

- The FTC study noted that the majority of consumers have good insurance scores and that "[c]redit-based insurance scores may benefit consumers overall."

- In a cover letter to a study of credit-based insurance scores issued by the Texas Department of Insurance, former Commissioner Jose Montemayor declared, "Credit scoring, if continued, is not unfairly discriminatory as defined in current law, because credit scoring is not based on race, nor is it a precise indicator of one's race." With respect to the impact of a ban on the use of credit information, Mr. Montemayor commented, "Be advised, however, that banning credit scoring overnight, by rule or law, creates pricing and availability disruptions in a market ... Premiums would go up for a large number of policyholders if the collar on credit scoring (or any other risk variable for that matter) is set too narrow, because it would force an immediate price shock that would be unrelated to a change in risk."

Every serious and reputable actuarial study on the issue has reached the same conclusion: there is a very high correlation between insurance scores and the likelihood of filing insurance claims. And while it is a common criticism of insurance scoring that the exact reason for that correlation is unknown, there are also numerous other rating factors for which causality is unknown. For example, even though there is no definitive explanation for why married individuals represent less of a loss of risk than single individuals, marital status is a widely-accepted and widely-utilized rating factor.

Credit-based insurance scoring is an effective tool for insurers - and a fair one for consumers. To protect competition and consumer choice, it is imperative that insurers be permitted to fully price risks using nondiscriminatory and statistically valid tools such as credit-based insurance scores.

Thank you for allowing me to come and testify before you today. I would be happy to address any questions you may have on this subject.

PREPARED STATEMENT OF

THE FEDERAL TRADE COMMISSION

on

"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

Before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE COMMITTEE ON FINANCIAL SERVICES

Washington, D.C.
May 21, 2008

I. Introduction

Chairman Watt, Ranking Member Miller, and members of the Subcommittee, I am Lydia Parnes, the Director of the Bureau of Consumer Protection at the Federal Trade Commission ("Commission" or "FTC").[1] The FTC appreciates the opportunity to appear before you today to provide an update on the Commission's study of the use and effect of credit-based insurance scores on consumers of homeowners insurance. Last week, the Commission approved a resolution authorizing the use of compulsory process to obtain data for this study. Pursuant to this resolution, the FTC intends to issue orders to the nine largest homeowners insurance companies in the United States. Using this process will allow the agency to obtain the information it needs to conduct its empirical analysis in a manner that will provide to all interested parties confidence in the results. In addition to this update on the homeowners insurance study, this testimony presents general views on proposed legislation that would accord legal significance to the results of the Commission's studies of the use and effect of credit-based insurance scores on the consumers of automobile and homeowners insurance.

II. Background on Credit-Based Insurance Scores

Over the past decade, insurance companies have increasingly used information about credit history in the form of credit-based insurance scores to decide whether to offer consumers automobile and homeowners insurance, and, if so, at what price. Credit-based insurance scores are numerical summaries of a consumer's credit history. These scores typically are calculated using information about past delinquencies and information on the public record (e.g.,

---

[1] While the views expressed in this statement represent the views of the Commission, my oral presentation and responses to any questions you have are my own, however, and do not necessarily reflect the views of the Commission or any Commissioner.

bankruptcy); debt ratios (i.e., how close a consumer is to his or her credit limits); evidence of seeking new credit (e.g., inquiries and new accounts); the length and age of the credit history; and the use of certain types of credit (e.g., automobile loans). Insurance companies use scores as a factor when estimating the number or total cost of insurance claims that prospective customers (or customers renewing their policies) are likely to file. Insurance companies then use this information, along with various other rating variables, to assign consumers to risk pools and to determine the premiums that consumers pay.

Insurance companies and other proponents of credit-based insurance scores contend that these scores assist in predicting risk of loss more accurately, thereby allowing insurance companies to charge consumers premiums that conform more closely to their individual risk of loss. However, consumer advocates, civil rights groups, and other opponents of credit-based insurance scores raise the concern that the use of these scores results in members of certain racial and ethnic minority groups paying higher insurance premiums than other consumers.

To assist policymakers in evaluating these arguments, Congress, in Section 215 of the Fair and Accurate Credit Transactions Act ("FACTA"),[2] directed federal agencies to conduct empirical studies of the impact of credit-based insurance scores on the availability and affordability of insurance.[3] Among other things, Congress specifically directed that federal agencies focus their empirical analysis on the effects of scores on members of racial and ethnic

---

[2] 15 U.S.C. § 1681 (note).

[3] The FTC and the Federal Reserve Board are required to conduct these insurance studies and a credit study. The Commission has undertaken the insurance studies. The Federal Reserve Board has conducted a study of the impact of credit scores on the availability and affordability of credit, and it published its results in a report released in 2007. *See* Federal Reserve Board, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (August 2007).

minority groups.

III. FTC Credit-Based Insurance Score Studies

To comply with Section 215 of FACTA, the Commission has undertaken studies of the impact of credit-based insurance scores on consumers of automobile insurance and homeowners insurance. The FTC's automobile insurance study used data that a consortium of insurance firms voluntarily submitted to the agency. Specifically, the FTC staff obtained, through a third-party actuarial firm, automobile insurance policy data for five firms representing 27 percent of the United States automobile insurance market in 2000. Commission staff supplemented and confirmed this data with information it obtained from a variety of other public and private sources. FTC staff then conducted an econometric analysis of this data.

In July 2007, the Commission issued a report describing the results of its automobile insurance study.[4] In the report, the FTC made a number of findings. First, the Commission found that insurance companies are increasingly using credit-based insurance scores in making decisions as to coverage and premiums. Second, it found that credit-based insurance scores are effective predictors of risk measured by the number and total cost of claims policyholders will file. Third, the FTC found that credit-based insurance scores are distributed differently among racial and ethnic groups, and therefore likely have an effect on the insurance premiums that these groups pay, on average, with non-Hispanic white and Asian-American consumers paying less and African-American and Hispanic consumers paying more. Finally, it found that credit-based

---

[4] Federal Trade Commission, *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* (July 2007), *available at* http://www.ftc.gov/os/2007/07/P044804_FACTA_Report_Credit-Based_Insurance_Scores.pdf. In connection with the issuance of this report, Commissioner Leibowitz issued a concurring statement and Commissioner Harbour issued a dissenting statement.

insurance scores appear to have little effect as a "proxy" for membership in these groups in estimating risk associated with automobile insurance.

Some people who reviewed the automobile insurance study were concerned about the design and methodology used. Among other things, they stated that the data staff collected was insufficiently reliable and robust for a number of reasons, including: (1) the Commission did not choose the insurance firms that provided the data; (2) the participating firms provided only limited data, excluding application data and other information; and (3) the data submitted voluntarily would have been more reliable if it had been submitted pursuant to compulsory process. On October 2, 2007, the Commission testified before this Subcommittee and responded to these concerns.[5]

In addition, the FTC has been moving forward with the homeowners insurance study. To further promote confidence in the results of this study among all interested parties, the Commission last week approved a resolution authorizing the use of compulsory process under Section 6(b) of the FTC Act and Section 215 of FACTA to obtain information for this study from homeowners insurance companies. This week, the FTC also announced that it intends to use compulsory process under that resolution to obtain information from the nine largest private providers of homeowners insurance in the United States. These nine firms had roughly a 60 percent market share of the private homeowners insurance market in 2006. In addition, the nine homeowners insurance companies have significant shares of the homeowners insurance market in every state with a sizeable racial or ethnic minority population.

---

[5] *See* Prepared Statement of the Federal Trade Commission, *Credit-based Insurance Scores: Are They Fair?*, before the Subcommittee on Oversight and Investigations, Committee on Financial Services, United States House of Representatives (Oct.2, 2007), *available at* http://www.ftc.gov/os/testimony/P044804_Credit-based_Insurance_Scores.pdf.

The FTC has placed on its website a draft model order setting forth in detail the information it intends to seek from homeowners insurance companies pursuant to compulsory process. The draft order requires that firms provide a combination of data, documents and narrative responses on the following: policyholder information; premiums; details on coverage; risk characteristics; claims; rating and underwriting guidelines, including the use of credit-based insurance scores and credit history information; and agent compensation and pricing discretion. In addition, the draft model order also requires that firms provide any data they maintain on insurance applications and quotes, information that was not included in the database voluntarily submitted for the study on automobile insurance.

The FTC is seeking public comment for thirty days on its draft model order. Soliciting comment is consistent with FACTA's direction that the agency consult with consumer groups, civil rights and housing groups, government officials, and the public on the design and methodology of these studies. Seeking comment also may elicit information as to whether there are means available to obtain necessary data from homeowners insurance companies at a lower cost to insurance companies. After receiving public comments, the Commission intends to make appropriate revisions to the draft model order and then serve it on the nine largest homeowners insurance firms in the United States.

The Commission would be pleased to keep the Subcommittee and its staff informed as to the progress of its study on the effect of credit-based insurance scores on consumers of homeowners insurance.

IV. The Proposed Legislation (H.R. 5633)

On March 13, 2008, Chairman Gutierrez introduced a bill, H.R. 5633, The Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008,

which would impose limits on the use of credit-based insurance scores. The proposed legislation would amend Section 604 of the Fair Credit Reporting Act ("FCRA")[6] to prohibit credit reporting agencies from furnishing and insurance companies from using a credit-based insurance score in making insurance granting and pricing decisions if the Commission determines that the use of the score results in racial or ethnic discrimination, or represents a proxy or proxy effect for race or ethnicity in these decisions. Any such FTC determinations likely would be made only in the context of the findings and conclusions of the automobile and homeowners insurance research studies conducted pursuant to FACTA.

As demonstrated by its longstanding commitment to law enforcement and educational efforts in fair lending,[7] the FTC believes that it is vitally important to protect consumers from illegal discrimination based on race or ethnicity. The proposed legislation is intended to prohibit insurance companies from using credit-based insurance scores to discriminate on the basis of race or ethnicity. It apparently would impose liability based on the determinations of FTC econometric research studies. The FTC's studies, however, assess the general effect of credit-based insurance scores on consumers of insurance, not the specific impact of a particular commercial[8] or proprietary credit-based insurance score on the customers of any individual

---

[6] 15 U.S.C. § 1681b. FACTA is part of the FCRA.

[7] Recent Commission testimony describes in more detail the nature and scope of the agency's fair lending activities. *See* Prepared Statement of the Federal Trade Commission, *Home Mortgage Disclosure Act Data and FTC Lending Enforcement*, before the Subcommittee on Oversight and Investigations, Committee on Financial Services, United States House of Representatives (July 25, 2007), *available at* http://www.ftc.gov/os/testimony/P064806hdma.pdf.

[8] Some insurance companies purchase commercial credit-based insurance scores rather than developing their own proprietary risk scoring models. Even if insurance companies use the same commercial credit-based insurance scores, they may incorporate these scores into their

insurance company. Moreover, even if the FTC's studies did determine the effect of a specific company's use of a particular credit-based insurance score, the Commission is concerned that the proposed legislation would assign liability based on these determinations without allowing those who would be liable an opportunity to offer evidence and arguments as to why they should not be held liable.

The Commission respectfully suggests a different approach if the drafters want to prohibit the furnishing or use of credit-based insurance scores to discriminate on the basis of race or ethnicity in the granting or pricing of insurance. The FTC suggests that the drafters consider the legal standard and enforcement scheme of existing fair lending laws, which prohibit other acts and practices that discriminate based on race or ethnicity, as a possible model for the credit-based insurance score context. The Commission would be pleased to work with the Subcommittee and its staff on any such revisions.

V. Conclusion

The Commission is committed to completing the studies of credit-based insurance scores that FACTA requires. The FTC hopes that its approach to the homeowners insurance study promotes confidence in its results among all interested parties. The Commission also hopes that its views on the proposed legislation are useful to the drafters.

---

underwriting and rating processes in different ways and the demographic characteristics of the customers of insurance companies can vary widely. For these reasons, the impact of the use of one of these commercial scores for racial and ethnic groups may well vary widely by company.

Written Testimony of Eric S. Poe, Esq. CPA and Chief Operating Officer of CURE Auto Insurance before the Subcommittee on Oversight and Investigations, House Committee on Financial Services U.S. House of Representatives May 21, 2008

Mr. Chairman and Members of the Subcommittee, thank you for inviting me to testify today on issues related to the proposed bill to ban the use of credit scores for auto insurance. This is an important issue for the U.S. private passenger automobile insurance industry, which is my company's industry, and I appreciate your interest.

I am the Chief Operating Officer of CURE auto insurance, a regional auto insurance headquartered in Princeton, New Jersey. CURE is licensed to write private passenger auto insurance in both Pennsylvania and New Jersey. We were founded in 1990 and currently rank as the 4th largest direct writer for auto insurance in New Jersey.

Prior to 2003, New Jersey auto insurers were not approved to use credit scores, education level, professional occupation, or homeownership status as factors in our rating or underwriting. However, in 2003, New Jersey's desire to attract several new national auto insurers into its marketplace led the regulators to permit these rating factors.[1] It was during this time that CURE analyzed these underwriting methods to determine their validity.

After significant review, CURE auto insurance determined that while these rating and underwriting variables do correlate to loss ratios, they merely serve as a statistical proxy for income. CURE does not employ these factors in its rates or underwriting. However, we will soon be compelled for competitive purposes, to adopt the practice or face losing our more profitable risks to competitors who utilize these factors.

[1]New Jersey Citizen Action. 2007. "Risky & Wrong: NJ Auto Insurance Rates for Lower Income and Minority Drivers Detailing the Discriminatory Price Impact of GEICO's Use of Occupation and Education in Determining Auto Insurance Rates for NJ Drivers." http://www.njcitizenaction.org\crapress2007feb28.html (accessed May 18, 2008).

INTRODUCTION

It is well documented that the auto insurance industry has used illustrations of loss ratio models as justification for using an individual's credit score,[2] education level and professional occupation.[3] By showing statistical correlations of these characteristic traits to corresponding loss ratios, the industry has effectively validated the concept that these factors, in fact, measure risk. However, I believe it is important to clarify, more carefully, the term "loss ratio" used by the insurance industry in these reports. By definition, a loss ratio is the incurred losses and loss-adjustment expenses divided by net earned premium. Stated simply, it is the costs associated with claim losses for the group in ratio to how much was collected in premiums for insuring that particular group. It is important to understand that loss ratio correlations used in this fashion are really used to measure rate adequacy for that particular group, not necessarily their predictive value to risk.

Surprisingly, our examination of the studies done relating to credit scores, education level and professional occupation led us to the opinion that an inappropriate conclusion had been drawn. The inappropriate conclusion found in each of these reports was that when a strong statistical correlation was found related to a given rating variable it was concluded that the rating variable therefore must have a predictive value for risk.[4]

---

[2] Federal Trade Commission. 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance." http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf, footnote. 37, p. 21. (accessed May 18, 2008). Originally published in Michael J. Miller and Richard A. Smith, "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity: An Actuarial Study by EPIC Actuaries, LLC (June 2003) [hereinafter EPIC Study]", available at http://www.progressive.com/shop/EPIC_CreditScores.pdf

[3] State of New Jersey Department of Banking & Insurance. 2008. "The Use of Occupation and Education Factors in Automobile Insurance." http://www.state.nj.us/dobi/division_insurance/ed_occ.html (accessed on My 18, 2008).

[4] Federal Trade Commission. 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance." http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf (accessed May 18, 2008). Originally published in Michael J. Miller and Richard A. Smith, "The Relationship of Credit-Based Insurance Scores to Private Passenger

However, it is important to understand an infinite number of characteristic traits may show correlations to loss ratios, but these loss ratio correlations will become invalid if they can be explained by another more valid characteristic trait imbedded in the chosen variable.

For example, in 2006 a comprehensive study of more than 15 million policyholders and two million claims showed that individuals who live within one mile of a restaurant, car dealer, elementary school, or liquor store would have an increased likelihood of filing a physical damage claim with their auto insurer for their car as opposed to those who did not. The study showed that the increase in loss costs for people who lived within a mile of those establishments were between 18-30% higher than those who did not.[5] From a cursory glance it appears that this data would actuarially justify the ability for auto insurers to class drivers who live within one mile of these particular businesses and charge them a higher rate.

However, because lower income individuals are more commonly found to be over-represented in urban areas which typically have their residences within one mile of a restaurant, car dealer, elementary school, or liquor store, it may be the imbedded characteristic trait of a person's income that, in fact, causes this loss ratio correlation. While merely living within one mile of these businesses does not logically cause someone to be a higher risk, it is reasonable to conclude that for a claim of small value lower income drivers are more likely to file a claim with their auto insurer while a higher income driver will forgo filing it all together.

In summary, if one assumes that the income of an individual is not properly accounted for by other risk factors already used in determining rates for car insurance, then these lower income drivers will in-fact produce higher loss ratios,

---

Automobile Insurance Loss Propensity: An Actuarial Study by EPIC Actuaries, LLC (June 2003) [hereinafter EPIC Study]", available at http://www.progressive.com/shop/EPIC_CreditScores.pdf.

[5] Quality Planning Corporation. 2005. "Why People Who Live Close to Restaurants Are More Likely To Have an Accident and Pay More for Auto Insurance Quality Planning Corporation." http://www.qualityplanning.com/qpc_resources_public/news/051206%20QPC%20Locations_F.htm (accessed on May 18, 2008).

and you would see a loss ratio correlation to income. More importantly, any characteristic trait that is tied to income will logically also produces similar loss ratio correlations given this assumption.

It is our belief that our fellow industry members would rather disguise to the public policymakers and regulators that these rating variables of individuals possess an unexplainable commonality that produces a correlation to risk. This is in light of the fact that all of these variables are correlated to income, and it is income that is correlated to risk.

USE OF CREDIT (INSURANCE) SCORES BY THE AUTO INSURANCE INDUSTRY

Tracking the history of the FICO credit score and its current use of three main credit bureaus today, it is clear that the original purpose behind the credit scoring system was to predict the likelihood of a person repaying debts on time and repaying the original loan.[6] We concluded through our analysis that while credit scores by the credit reporting agency did produce a correlation to loss ratios when applied to our own company data, there appeared to be strong evidence to support that the loss ratio correlations could be explained by an alternative variable – the income of an individual. This conclusion was drawn when we learned that an individual's prior on-time payment history to their creditors only constituted approximately 35% of their overall FICO/credit score,[7] while the category of credit utilization (outstanding balances to available credit) constitutes for approximately 30% of their total FICO score.[8] Due to the fact that credit lines offered by lenders are directly calculated upon a borrower's income and the scoring model reduced a person's credit score significantly based on the

[6] Wozniacka, Malgorzata and Snigdha Sen. 2004. "Credit Scores – What You Should Know About Your Own." http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/scores.html (accessed on May 18, 2008).
[7] myFICO. "What's In Your FICO Score." http://www.myfico.com/CreditEducation/WhatsInYourScore.aspx (accessed on May 19, 2008).
[8] myFICO. "What's In Your FICO Score." http://www.myfico.com/CreditEducation/WhatsInYourScore.aspx (accessed on May 19, 2008).

consumer's outstanding debt to their granted credit line, we concluded that credit scores used in this fashion is a strong predictor of a person's income.

Illustration of Impact of Income on FICO Credit Score: Based on annual gross income disclosed on a credit application, a low income individual is granted a $1,000 credit line, while similarly a high income earner is granted a $20,000 credit line with a credit card lender. Assumption: both individuals purchase $800 of groceries for the month on their credit card. If a FICO credit score is calculated during the time when the balance is $800, the negative impact to the lower income individual is far greater because their credit utilization is 80% compared to the higher income individual whose credit utilization is 4%. [the lower income person's credit score will have their credit score lowered significantly due to their excessive credit utilization ($800 of $1,000 available credit= 80% credit utilization) while the impact on the higher income individual's credit score is negligible ($800 of $20,000 available credit = 4% credit utilization).][9]

In fact, the 2007 Federal Trade Commission (FTC) study which examined the impacts of credit scoring on race shows that the same population negatively affected by the use of credit scores is the same ethnic groups who comprise of the lowest income earners according to the U.S. Census. These reported findings provided more support to our conclusion that an individual's income does correlate to loss ratio.[10]

[9] Simon, Jeremy. 2007. "Boost your credit score by raising your credit card limit." http://www.creditcards.com/credit-card-news/boost-credit-score-raise-credit-card-limits-1267.php (accessed May 19, 2008).

[10] Subcommittee on Oversight and Investigations House Committee on Financial Services. "Prepared statement of the Federal Trade Commission on Credit-based Insurance Scores: Are They Fair?" October 2, 2007, p. 6.

WHY AUTO INSURERS WANT TO ATTRACT AND INSURE HIGHER INCOME DRIVERS

Higher income drivers are more attractive to the private passenger auto insurance industry for several reasons: (A) a larger potential revenue stream for other products, (B) data mining, and (C) higher absorption of lower level claims.

A. POTENTIAL REVENUE STREAMS

Higher income drivers offer a larger revenue stream to auto insurers because they have the ability to purchase other products from multi-line insurance carriers such as GEICO, American Express, Liberty Mutual, State Farm, Allstate and Progressive.

Generally, lower income individuals' most significant assets are their automobiles.[11] The lower income population is not likely to own a home,[12] own a boat, they are unlikely to purchase financial planning services, need large life insurance policies, and don't have any need to purchase umbrella policies. Therefore, the lower income population provides no other potential revenue streams for multi-line insurance companies making them less attractive to insure.

B. DATA MINING

Auto insurers desire higher income drivers for data mining purposes as well. For example, at GEICO.com, despite clear statements to their users that they don't sell any information provided to their company for a quote, when one agrees to

[11] According to a 2002 Pew Hispanic Center 25% of Latinos owned no assets other than a vehicle or unsecured liabilities as compared to 6% of Whites. Eric Rodriguez, "Credit-based Insurance Scoring: Why Latinos Pay More for Auto Insurance Than They Should." National Council of La Raza, October 2, 2007, p. 3.

[12] 2007 only half of Latino households own their own homes compared to more than three-quarters of non-Hispanic Whites. Eric Rodriguez, Credit-based Insurance Scoring: Why Latinos Pay More for Auto Insurance than They Should." National Council of La Raza, October 2, 2007, p. 3.

the terms and conditions for use of their highly advertised website they also agree to permit GEICO to share their information with any of their "marketing partners."[13] Data mining the information of high income individuals is a very lucrative business. Although it is not widely known to the public, many national data mining companies purchase information files from the majority of auto insurers which contain information regarding a person's credit score, their occupation, education level, their cars and where they live.[14] More troubling is the trend by auto insurers to run "reverse credit scores" without the submission of an applicant's social security number by using their name and address to look up their credit information on the credit reporting agency database. Although the user may consent to the terms and conditions of the insurers website for credit reports to be conducted, it is our contention that an individual who purposefully does not submit a social security number has no awareness that this reverse credit report is being searched and shared with other marketing partners.

C. HIGHER ABSORPTION OF LOWER LEVEL CLAIMS

The National Highway and Safety Association reported in 2000 that roughly half of all PDO (property damage only) accidents go unreported each year[15] "due to concerns about insurance or legal repercussions." Unfortunately, only certain individuals with higher income levels have the luxury of not reporting accidents and paying for the damage themselves.

As a result, higher income drivers are more attractive to the auto insurance industry because higher income driver's have the option to absorb minor claims

13 http://www.geico.com/about/terms-of-use. (accessed on May 15, 2008).

14 Delaney, Kevin J., and Emily Steel. 2007. Firm Mines Offline Data to Target Online Ads. *The Wall Street Journal online*, October 17: B1.

15 National Highway Traffic Safety Association. 2002. "Economic Impact of U.S. Motor Vehicle Crashes Reaches $230.6 billion,NewNHTSAStudyShows."http://www.nhtsa.com/portal/site/nhtsa/template.MAXIMIZE/menuitem.f2217bee37fb302f6d7c121046108a0c/?javax.portlet.tpst=1e51531b2220b0f8ea14201046108a0c_ws_MX&javax.portlet.prp_1e51531b2220b0f8ea14201046108a0c_viewID=detail_view&itemID=2d673e37bdd9ff00VgnVCM1000002c567798RCRD&pressReleaseYearSelect=2002 (accessed on May 18, 2008).

out of their own pocket as opposed to filing a claim with the insurance company following an accident.

Therefore, it is reasonable to assume that the people who make less are more likely to file claims.[16] As a result, loss ratios on policies most likely will correlate to income as well as any characteristic trait that correlates to income. This is the reason why credit scoring, educational attainment, high income occupations and home ownership status, which all correlate to income, will have similar correlations to loss ratios.

INDUSTRY PRACTICES OF MULTI-AFFILIATED COMPANIES

Unbeknownst to consumers, most multi-state, multi-line auto insurance carriers have more than one company filed with each respective state that they are licensed to write. These multiple affiliate companies all bear the familiar trademark name of the company which leads consumers to believe they are only one entity.

Large group affiliate auto insurance companies have been successful at drawing a distinction between "underwriting" and "rating" of polices[17] when ultimately deriving the price to charge a consumer for auto insurance. The "underwriting" process begins when the multi-affiliate group assigns placement eligibility into one of the companies based upon a person's certain characteristic trait, while the "rating" process is when the insurance company uses the rates filed within that affiliate company to determine the final premium to be charged. Despite these

[16] Supported in the FTC 2007 study Fig 3, that shows that the correlation to loss ratios are stronger for collision claims, and weaker for bodily injury liability claims.

[17] Federal Trade Commission. 2007. Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance. http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf. (p.16) (accessed May 18, 2008). Originally published in Michael J. Miller and Richard A. Smith, "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity: An Actuarial Study by EPIC Actuaries, LLC (June 2003) [hereinafter EPIC Study]", available at http://www.progressive.com/shop/EPIC_CreditScores.pdf.

distinctions, it is important for the committee to understand whether you term a variable an "underwriting" variable or a "rating" variable either way they will each have drastic impacts on the ultimate premium charged to an individual.

GEICO's USE OF EDUCATION AND OCCUPATION FOR "UNDERWRITING"

During our analysis of the competitive marketplace in 2004, we learned that GEICO's ratemaking practices are threaded through its use of up to four separate GEICO insurance companies – GEICO, GEICO General, GEICO Indemnity and GEICO Casualty. The use of GEICO to bear the same trademark name, allows them to provide consumers the illusion that they are insured by one entity. However this is not the case as each GEICO affiliate company charges entirely different rates for the same coverages. Drivers qualifying for GEICO's preferred insurance company receive the best (lowest) rates, while drivers who do not quality for GEICO's preferred company receive rates from one of GEICO's substandard insurance companies and pay substantially higher rates. Having up to four separate companies to underwrite drivers and four distinct and separate rates associated with each company, GEICO is capable of charging drivers that possess the same rating variables and coverage completely different rates based upon their "underwriting" variable of an individual's education level and professional occupation. Remember, factors such as driving record, geographic location and car type are taken into account only after a consumer is placed in one of GEICO's four companies through this process.

Drivers who possess higher educational attainments and hold white collar occupations are provided eligibility into the preferred GEICO Company. Conversely, individuals without a 4-year degree and "blue collar" nonprofessional jobs are typically only offered insurance through one of GEICO's sub-standard companies and provided significantly higher rates.

Most notable, individuals are not even informed when they are rejected by the preferred GEICO Company based solely on their education and/or occupation. By purposefully failing to notify applicants of their rejection from the preferred GEICO Company due to

their lack of education or professional occupation, GEICO effectively bypasses any public scrutiny of its practice, which places an even larger burden on the legislature to protect the consumer from this practice.

Our comprehensive examination of GEICO's underwriting practices led us to conclude that the only clear homogeneous characteristic traits common among these preferred occupational groups are the traditional higher income levels associated with their occupations, further supporting our conclusion that income is truly the driver of loss ratio correlation and profitability for the GEICO Group of Companies.

ALLSTATE'S USE OF HOME OWNERSHIP STATUS AS AN "UNDERWRITING VARIABLE" AND ITS IMPACT ON RACE

A review of Allstate's recent filings suggests that regardless of driving record, an individual will not be eligible for their "preferred" company with their lowest rates if they don't own a home. Such evidence once again supports the contention that higher income earners produce correlations to loss ratios and profitability. Unfortunately the result of employing such underwriting rules tied only to homeownership status, is that certain minority groups and income classes are under-represented in the homeownership population in the United States.[18]

CONCLUSION

We believe the issue before the committee can be narrowly isolated to a question of public policy. Unlike other traditional business industries, it should be noted that auto liability insurance is mandated in the vast majority of the states. If lower income drivers are not capable of affording car insurance they face fines and possible imprisonment. Therefore, a fundamental measurement of a healthy and successful insurance pooling mechanism is when the equal opportunity exists for

[18] 2007 only half of Latino households own their own homes compared to more than three-quarters of non-Hispanic Whites. Eric Rodriguez, "Credit-based Insurance Scoring: Why Latinos Pay More for Auto Insurance Than They Should." National Council of La Raza, October 2, 2007, p. 3.

individuals to control the affordability of their car insurance. When mandated, insurance in a society becomes unaffordable and uncontrollable by any portion of the market segment, it is a signal that the system needs correction. Unlike factors such as age, usage, and driving record, which are widely accepted factors that provide equal opportunity for drivers to change, these socio-economic factors are clearly discriminatory against lower and middle income classes and need to be prohibited immediately.

Since the documented proliferation of the use of credit scores as well as these other more damaging rating and underwriting practices, the reported number of uninsured motorist population has continued to grow at an alarming pace.[19] This supports the notion that families at the bottom end of the income scale have very little disposable income, and every dollar spent on premiums for auto insurance represents money that could be spent on other essentials, such as food, shelter and health care. The difficulty lies in the fact that owning a car can be extremely important in terms of finding and holding down a job or providing an opportunity for a person to climb the economic ladder.[20]

In summary, we urge the Federal Legislature to:

- Make effective bans on the use of all rating and underwriting variables that are inherently tied to the income of an individual,
- Prohibit the use of multi-affiliate companies with separate rating structures which have no valid purpose except to adopt these discriminatory practices, and
- Require full disclosure of all rating and underwriting methods to improve transparency to the public

[19] Insurance Information Institute. 2008. "Compulsory Auto/Uninsured Motorists." http://www.iii.org/media/hottopics/insurance/compulsory (accessed May 18, 2008).

Without these fundamental changes to our industry it is clear that the highest rates for car insurance will be charged to the segment of the population that can least afford it regardless if they commit themselves to responsible driving. Furthermore, such a rating and underwriting practice will only insure those who fall in the highest income scale from receiving the lowest rates. I am hopeful that you see the social injustice that belies this practice and continue to take steps to control such conduct.

At CURE auto insurance we firmly believe in healthy competition in our marketplace however we simply do not believe in competing upon these discriminatory grounds.

Sincerely,

Eric S. Poe, Esq., CPA
Chief Operating Officer
CURE Auto Insurance

The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance

Lawrence S. Powell, Ph.D.
Whitbeck-Beyer Chair of Insurance and Financial Services
University of Arkansas-Little Rock
326 Reynolds Center
2801 S. University Avenue
Little Rock, AR 72204

lspowell@ualr.edu
501.773.7577

Research Fellow
The Independent Institute
1319 18th St. NW
Washington, D.C. 20036

Introduction:[1]

Insurance companies face an unusual challenge. They must set prices for the products they sell before they know all of the costs. To meet this challenge, they employ complex pricing methods developed by actuaries using applied economic and statistical techniques. It should then come as no surprise that some aspects of actuarial science and insurance pricing are puzzling to people who have not developed substantial expertise in this field.

Insurance scoring, the use of credit information in insurance underwriting and pricing, is an example of a beneficial practice that is sometimes misunderstood. Insurance scoring benefits consumers in several ways, all of which stem from its accuracy as a predictor of insured losses.

The purpose of my testimony is to present comprehensive information about insurance scoring in a non-technical format. In Section 1, I present a brief conceptual summary of insurance pricing and insurance scoring. In Section 2, drawing from existing studies, I present evidence that insurance scores are powerful and accurate predictors of insurance losses. In Section 3, I conclude with discussion of the appropriateness of insurance scoring.

Section 1: Insurance Pricing and Insurance Scoring

An insurance company facilitates risk pooling, reducing the uncertainty of individual pool members. Uncertainty decreases because the ultimate value of the group's losses is more predictable than that of an individual. Swiss mathematician Jacob Bernoulli first proved this phenomenon, known as the law of large numbers, around 1690. Relying on the law of large numbers, a group of pool participants can each pay the average or expected loss of the group, rather than paying for a much less predictable and potentially larger individual loss on one's own.

Risk pooling is most effective when all members of the pool have the same expected loss. Insurance companies rely on risk classification systems to ensure that groups of insureds pay premiums commensurate with their exposures to risk. When insurers pool exposures with unequal expected losses, the low-risk group must subsidize

[1] Much of this testimony is drawn from a study I am writing for the Independent Institute.

the high-risk group. This creates an incentive for low-risk pool members to purchase less insurance than high-risk pool members, a scenario called adverse selection. Adverse selection can break down the risk pooling mechanism and, in extreme cases, lead to insolvency of the pool.

Insurance companies use information about applicants for insurance to classify them into groups with very similar expected loss. Of course, no risk classification system is perfect. In addition to other restrictions, insurers can only use rating information if it is cost effective, meaning the cost of obtaining the information is less than the difference in expected loss between groups. For example, assume there are only two types of drivers, low-risk and high-risk. The low-risk group has expected loss of $500 and the high-risk group has expected loss of $700. If it costs more than $100 to classify a driver, it will be more cost effective to simply pool them together and charge both groups $600. However, if an insurer can identify low-risk drivers for, say, $20, it benefits the low-risk drivers to charge them $520, and charge the high-risk drivers $720. On the other hand, insurers could be more precise in risk classification if they hired private investigators to follow each driver for six months before offering an insurance policy. Obviously, this would cost more than $100, and raise privacy concerns. To have enough money in the risk pool to cover expected losses, low-risk drivers would have to pay more than $600. In this case, there is no justification for such an unfair classification.

There are many variables insurers use to classify drivers based on expected loss. These include, but are not limited, to geographic location, age, gender, marital status, miles driven, type of vehicle, use of vehicle, driving record, and insurance score. An insurance score is a numerical prediction of propensity for loss estimated using certain information from a driver's credit history. The actuarial literature shows it is one of the most accurate and cost effective loss predictors available (EPIC, 2003).

There are several apparent misconceptions about insurance scores. To understand why insurance scores are beneficial to insurance systems, it is important to start with an accurate description that is free of incorrect assumptions. The variables commonly used to estimate insurance scores include measures of performance on credit obligations, credit-seeking behavior, use of credit, length of credit history, and types of credit used

(FTC, 2007). They do not include income, wealth, race, ethnicity, or any prohibited factor.

Insurance scores and credit scores are calculated using some of the same information, but they are not equivalent. The important difference is that credit scores use these variables (and others) to estimate the probability of a borrower defaulting on a financial obligation, while insurance scores estimate the probability of having insured losses.

An important fact often overlooked in the debate about insurance scoring is that the only way including insurance scores in an insurance rating model can result in higher premiums is for the sample population with lower scores to have more insured losses. As I describe in more detail in Section 3, any deviation from using the most accurate, cost effective predictors results in unfair outcomes and damage to the insurance mechanism.

One observed barrier to understanding insurance scoring is manifest in the common criticism that there is not an intuitive link between insurance scores and driving ability. While several studies develop potential causal links between insurance scores and driving, I find it more compelling to recognize an alternative relation. The use of insurance scores does not rely on a link between credit information and "driving ability." Rather, it is a link between insurance scores and insured losses.

There are many factors unrelated to driving ability that increase the likelihood of insured losses. For example, someone who always makes debt payments on time to avoid higher interest rates the next time they borrow may also choose not to file a small insurance claim to prevent an increase in insurance premiums in the future. It may also be the case that insurance scores measure hazards other than lack of driving ability.

Section 2: Predictive Accuracy of Insurance Scores

The correlation between driving outcomes and credit information appears in academic literature as early as 1949 (Tillman and Hobbs, 1949). Over time, evidence of the empirical relation between automobile insurance losses and insurance scores has developed to address not only the simple correlation between insurance costs and insurance scores, but also the additional predictive power and accuracy insurance scores contribute to insurance pricing models containing traditional pricing variables.

In this section, I review methods and results from several studies investigating the relation between insurance scores and insurance losses. The findings consistently and conclusively demonstrate that insurance scores are highly correlated with losses. The studies also show that insurance scores supply information about insurance losses not contained in other underwriting and rating variables.

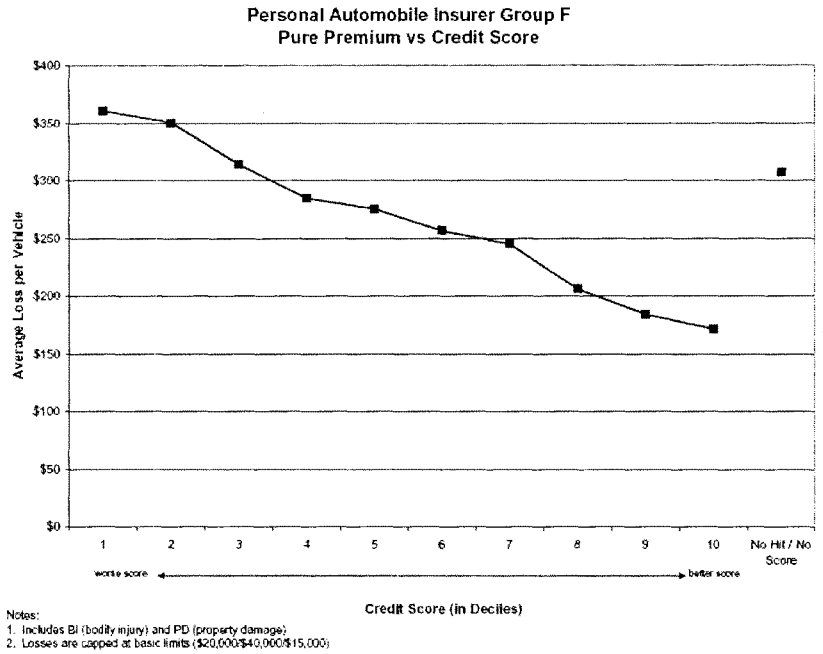
More than a dozen studies related to insurance scoring have appeared in the public domain in the last decade. To improve the exposition of information, I present evidence from various studies in order of increasing complexity. This does not exactly match the temporal order in which studies were released. Furthermore, many of studies produce very similar evidence and reach nearly identical conclusions. I make an effort to report from the most recent and clear studies.

The most basic result is the simple correlation between insurance scores and losses. A study conducted by the Texas Department of Insurance in 2004 (TDI, 2004), firmly establishes the simple correlation between insurance scores and losses. Using data representing approximately 2 million insurance policies, the authors group exposure units by deciles of credit scores and graph the coinciding average loss frequency and loss amount.

Figures 1 and 2 appear in TDI (2004) as Charts 7 and 9, respectively. Figure 1 shows that average loss per vehicle declines steadily across deciles of credit score. Those with the lowest scores average approximately $360 per vehicle, while those with the highest scores average approximately $175 per vehicle. Similarly, Figure 2 shows number of claims per 1,000 exposures decreasing from approximately 110 for those with the lowest scores to just over 60 for those with the highest scores. These results are qualitatively similar across all of the companies reporting automobile insurance data for the study.

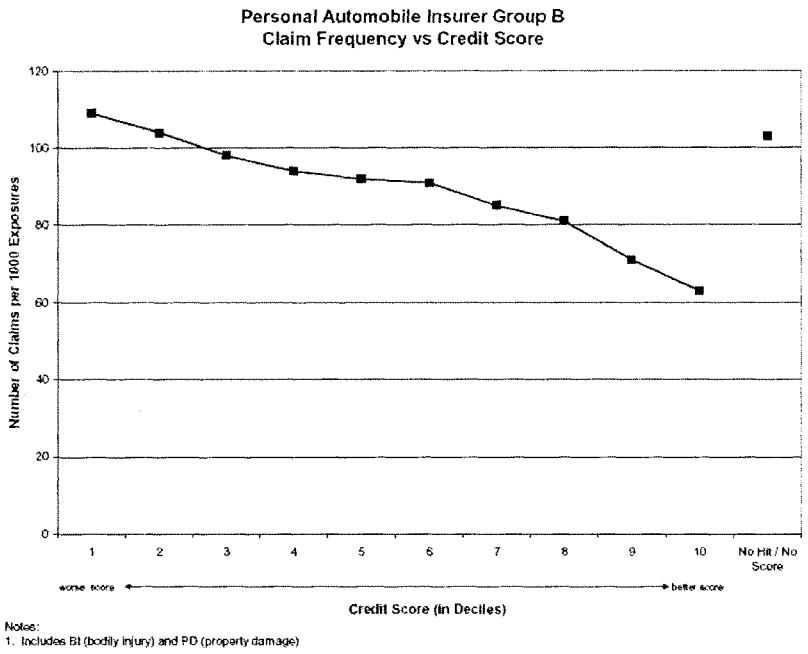
Several other studies reach similar conclusions using data from nationally representative samples (EPIC, 2003 and FTC, 2007), rather than the single state sample used by TDI.

Figure1: Credit Score and Average Loss per Vehicle



Source: TDI (2004)

Figure2: Credit Score and Number of Claims per 1000 vehicles



Source: TDI (2004)

Critics of TDI (2004), including the Texas Department of Insurance itself, point out that simple correlation between a rating variable and losses is neither necessary nor sufficient to establish its validity as a predictor of losses. This is true because no variable can produce a more accurate prediction of losses alone than when combined with other accurate predictors of losses. Therefore, in addition to simple linear correlation between predictors and losses, one must also consider the interactions among a group of predictor variables. To do so requires multivariate analysis.

Multivariate analysis, as the name implies, involves analysis of two or more predictor variables at the same time. EPIC (2003), FCT (2007) and a second study by the Texas Department of Insurance (TDI, 2005) employ multivariate analysis to determine if

insurance scores are risk related. I summarize the analysis and primary findings of these studies below.

TDI (2005) examines a large database of personal automobile and homeowners insurance policies in Texas. The authors performed multivariate analysis considering the interaction of insurance scores and several other common predictors of insurance losses. They find that the strong correlation between insurance scores and losses persists even when controlling for other underwriting factors. TDI (2005) concluded that, "credit scoring provides insurers with additional predictive information, distinct from other rating variables, which an insurer can use to better classify and rate risks based on differences in claim experience." The authors also find that "use [of insurance scoring] is justified actuarially and it adds value to the insurance transaction."

EPIC (2003) examines a nationally representative sample of insurance scores, underwriting data, and policy outcomes (losses). The study produces four primary findings: First, insurance scores are correlated with risk of loss, even after controlling for relationships with other variables. The correlation is due primarily to loss frequency rather than loss severity. Second, insurance scores are correlated with some other common risk factors; however, even after controlling for other factors, insurance scores significantly increase the accuracy of the risk assessment process. Third, insurance scores are very powerful predictors of loss relative to other common risk factors. Finally, results from the study apply generally to all states and regions.

FTC (2007) also examines a large, nationally representative database to determine the relation between insurance scores and losses. The study finds that "even when non-credit variables are included in the analysis, credit-based insurance scores continue to predict the amount that insurance companies are likely to pay out in claims to consumers." More specifically, they find insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims. The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer. Thus, on average, higher-risk consumers will pay higher premiums and lower-risk consumers will pay lower premiums.

These recent studies envelop a spectrum of backgrounds and data sources. Private groups and government agencies conduct them. They represent a single state and national samples. They employ different measures and methodologies. Nonetheless, they all reach the same general conclusion: that insurance scores are highly predictive of losses, even when controlling for other factors. As noted at the outset, insurers are unique in the U.S. economy as they do not know the ultimate cost of their product when they sell it so having a tool to more effectively predict losses helps insurers more fairly, for all consumers' benefit, price their products.

Section 3: Appropriateness of Insurance Scores

Regulators require insurance rates to meet three criteria. They must not be inadequate, excessive, or unfairly discriminatory.[2] A rating criteria is unfairly discriminatory if it is does not bear a reasonable relationship to the expected loss and expense experience among insured exposures. Given the evidence presented in Section 2, insurance scores clearly meet the third criterion. However, some people remain uncomfortable with application of credit information in insurance rating. In this section, I describe the individual and societal benefits of insurance scoring. Finally, I present evidence that competition in insurance markets prevents discrimination based on any factor other than expected losses.

Insurance scoring benefits society in several ways. All of the benefits accrue from improved efficiency and accuracy of risk estimates. The first benefit is that insurance scores provide a very high level of accuracy for a relatively small cost. Using insurance scores reduces cost for insurance companies. Because the market for insurance is competitive, this savings is passed through to consumers as lower premiums. Data from a recent report by the Arkansas Insurance Department indicates that if insurance scoring were eliminated as a rating factor, nearly 91 percent of automobile and homeowners insurance consumers would incur a rate increase. Using a slightly different method, the FTC (2007) study estimates that insurance scoring results in a decrease in insurance premiums for 59% of drivers.

[2] Almost every state also imposes additional restrictions on the use of insurance scores in the ratemaking process.

The next benefit of insurance scoring is that improved accuracy may make insurers more willing to offer insurance to high-risk consumers for whom they would otherwise not be able to determine an appropriate premium (FTC, 2007). For example, insurance scoring information can allow an insurer to offer coverage to drivers living in a geographic area with high traffic density at a price the driver can afford. Without information from insurance scores, insurers would not be able to differentiate sufficiently among these drivers. Therefore, they would not be able to offer the coverage at a lower price for the lower-risk drivers living in the area. Consistent with this assertion, FTC (2007) finds limited evidence that the advent of credit scoring in automobile insurance coincided with substantial decreases in residual market mechanisms. This suggests insurers, with the benefit of credit information, are more willing to offer coverage to high-risk drivers (at a risk-based price) than they were before the introduction of insurance scores.

Another advantage of using insurance scores is it improves accuracy of information used to classify drivers. In addition to calculating more accurate loss predictions, the scores, themselves, are less likely to contain material factual errors than are several of the driving history variables used to underwrite insurance. Studies by Associated Credit Bureaus (ACB, 1992) and Trans Union report material errors in credit information in only 0.2% of credit records. In striking contrast, a study by the Insurance Research Council (IRC, 1991) found public information available on only 40% of a sample of known automobile losses. Underreporting of traffic citations also appears problematic. IRC (1991) indicates less than a third of all traffic citations are accurately reported in state driving records. Furthermore, consumers have a strong incentive to correct inaccurate credit information; whereas the opposite incentive exists for driving records. This is true because recorded driving events can only be adverse events. Data describing instances in which drivers avoid collision by defensive driving and alertness are not collected.

The final benefit of insurance scoring I would like to address is that, because scoring produces more accurate loss estimates, it results in outcomes that are more equitable for individuals and society as a whole. As noted in Section 2, insurance scoring is likely to make the price of insurance better match the risk of loss posed by the

consumer. Thus, on average, higher-risk consumers will pay higher premiums and lower-risk consumers will pay lower premiums (FTC, 2007). This addresses a very common problem in the insurance mechanism called cross-subsidization.

When insurers cannot accurately classify applicants for insurance, they must either decline applications, or charge the same premium to high-risk and low-risk drivers. The latter case obviously leads to cross-subsidization – when low-risk drivers must over-pay to make up for underpaying high-risk drivers. However, the former case, declining applications for insurance, ultimately leads to the same outcome. This is type of cross-subsidization is facilitated by residual markets for insurance.

Each state has a residual market mechanism to make insurance available to drivers whom the voluntary market will not cover. Residual market mechanisms effectively set a maximum price that insurers may charge for insurance. If insurers are not willing to offer coverage at this price, consumers may purchase coverage at this price from the residual market. However, if the premium is not enough to cover losses and expenses, insurers in the voluntary market must make up the deficit in proportion to their market shares.

FTC (2007) shows that as insurance scoring has become more common in ratemaking models, the populations of states' residual markets have decreased. This suggests insurance scoring results in more equitable or fair outcomes compared to less accurate rating models that do not use insurance scores.

Perhaps the most controversial result appearing in FTC (2007) is the study's assertion that insurance scores exhibit a proxy effect for race. Objective consideration of this result leads me to doubt its validity. The econometric test used to support the existence of a proxy effect is flawed such that it would not withstand the scrutiny of a legitimate academic peer-review process. Clearly, the lack of objective confidence in the result suggests that public policy should not be altered to address this weak finding.

Another way to address the appropriateness of insurance scoring is to consider the level of competition occurring in insurance markets. If insurance markets are competitive, insurers will not be able to charge excessive or unfair prices. If an insurer tries to set prices based on anything other than expected losses and costs, it will either,

suffer substantial losses if the price is too low, or, if the price is too high, it will lose market share as its competitors offer a lower price to the same consumers.

Effective competition is a fundamental characteristic observed in U.S. insurance markets. Competition prevents insurers from charging excessive or unfair prices. In 2005, NAIC data show an average of 157 insurance companies underwriting the private passenger automobile cover in each state. It is, therefore, reasonable to believe that an insurer cannot systematically over-charge a group of drivers because one of the other 156 existing companies, or perhaps a new company, has an opportunity to cover that group of drivers at an equilibrium price. Compare such competition to other "required" services such as phone, gas, electric, etc. where consumers have at best the choice between two companies.

We are not in this hearing because everyone likes insurance scoring. I have heard critics of insurance scoring describe potential or anecdotal unfair outcomes associated with its use. I do not dispute the fact that some consumers have encountered individual rating scenarios that seem to lack intuition. For example, I know of a consumer in Arkansas who received an increase in his premium because his wife cancelled a credit card they were not using. However, he called a few competing insurance companies and found one that offered him the same coverage at a significant discount from what he was paying before the change in his credit. This is an example of competitive markets reaching an optimal outcome.

While competitive markets are very effective at making the goods and services consumers want available to them, critics have voiced concerns that when a drop in credit is unrelated to insurance risk some individuals could be mistreated by insurance scoring. In response to such concerns, almost every state has regulations in place to recognize the benefits of insurance scoring, while limiting its use in certain scenarios. I think it is worth noting that many insurers offered the same protections as these regulations require before the laws were enacted. This is another example of competitive markets creating an optimal outcome.

Conclusion

Setting reasonably accurate prices for insurance is a difficult task because insurers must establish prices without the benefit of knowing all of the costs involved. To offset this hardship, actuaries have developed complex pricing models using applied economic and statistical tools. While this complexity is necessary, it unfortunately leads to a lack of understanding among people who have not developed such specific expertise.

Insurance scoring is an example of a beneficial tool used in ratemaking that is often misunderstood. Insurance scores are relatively powerful and accurate predictors of losses, even when controlling for other factors known to be correlated with losses. When insurers use insurance scores to improve the accuracy of predicted losses, it benefits individuals and society. It increases the equity or fairness in insurance pricing outcomes because, on average, premiums are closely related to consumers' risk of loss. Insurance scoring also adds value to insurance transactions. It reduces the overall cost of providing insurance because insurance scores are accurate and inexpensive rating variables.

Finally, the vigorous competition exhibited by the property and casualty insurance industry suggests that pricing of insurance based on anything other than expected losses is nearly impossible. Insurance markets show strong signs of effective competition including a large number of suppliers and low barriers to entry.

Lawrence S. Powell
Curriculum Vitae

Whitbeck-Beyer Chair of Insurance and Financial Services
Associate Professor of Risk Management and Insurance
College of Business, Department of Economics and Finance
University of Arkansas at Little Rock
2801 S. University Ave., Little Rock, AR 72204

Telephone: (501) 569-8894
(501) 773-7577
Fax: (501) 569-8871
E-mail: lspowell@ualr.edu

Education:

Ph.D. University of Georgia, Athens, GA 2002
Major concentration: Risk Management and Insurance
Minor concentration: Finance

B.B.A. University of South Carolina, Columbia, SC 1996
Majors: Finance and Insurance

Employment:

University of Arkansas, Little Rock, AR – 2004 – present
Associate Professor of Risk Management and Insurance – 2008 – present
Whitbeck-Beyer Chair of Insurance and Financial Services – 2005 – present
Assistant Professor of Risk Management and Insurance – 2004 – 2008
University of Arkansas for Medical Sciences, Little Rock, AR 2006 – present
Assistant Professor of Health Services Research (courtesy appointment)
University of North Carolina at Charlotte, Charlotte, NC – 2003 - 2004
Visiting Assistant Professor of Risk Management and Insurance
University of Arkansas, Little Rock, AR – 2002 - 2003
Assistant Professor of Risk Management and Insurance
University of Georgia, Athens, GA – 1998 - 2002
Graduate student & Instructor
Rosenfeld-Einstein Insurance Agency, Greenville, SC – 1997 - 1998
Director of Select Business Unit
South Carolina Medical Malpractice JUA, Columbia, SC – 1997
Claims investigator
Northwestern Mutual Life Insurance, Columbia, SC – 1996
Internship

Research Interests:

Insurance regulation, insurance fraud, and insurer capital structure

Consulting Interests:

Economic litigation support
Economic analysis of legislation & regulation
Insurance policy interpretation
Insurance training & continuing education
Actuarial science
Insurer formation and operations

University Teaching Experience:

Principles of Risk and Insurance

Commercial Property and Casualty Insurance

Employee Benefits

Corporate Risk Management (undergraduate and MBA level)

Actuarial Science (doctoral research committee)

Health Services Research (doctoral seminar)

Selected Honors and Awards:

Harper W. Boyd, Jr., Professor of Excellence, UALR College of Business, 2007-2008

Excellence in Research Award, UALR College of Business, 2007

Risk Theory Seminar presenter – 2003 & 2004

Maurice Doan Scholarship for Outstanding Contributions to Teaching – 2002

University of Georgia Outstanding Graduate Teaching Award – 2002

Kemper Fellowship – 2000 - 2002

Spencer Scholar – 1999

Peer Reviewed Publications:

Powell, Lawrence S., David W. Sommer, 2007. "Internal versus External Capital Markets in the Insurance Industry: The Role of Reinsurance," *Journal of Financial Services Research*, v31: 173-188. Also appears in *Proceedings of the Risk Theory Society, 2003*

Hoyt, Robert E., David B. Mustard, and Lawrence S. Powell, 2006. "The Effectiveness of State Legislation in Mitigating Moral Hazard: Evidence from Automobile Insurance," *Journal of Law and Economics,* v49 (October 2006): 427-450. Also appears in *Proceedings of the Risk Theory Society, 2004.*

Hoyt, Robert E. and Lawrence S. Powell, 2006. "Assessing Financial Performance in Medical Professional Liability Insurance," *Journal of Insurance Regulation*, v25, n1 (Fall, 2006): 3-13

Hoyt, Robert E., David W. Sommer, and Lawrence S. Powell, 2007. "Computing Value at Risk: A Simulation Assignment to Illustrate the Value of Enterprise Risk Management," *Risk Management and Insurance Review*, v10,n2: 299-307

Powell, Lawrence S., David W. Sommer, and David L. Eckles, forthcoming. "The Role of Internal Capital Markets in Financial Intermediaries: Evidence from Insurance Groups," Forthcoming in *Journal of Risk and Insurance*.

The Assault on the McCarran-Ferguson Act and the Politics of Insurance in the Post-Katrina Era. Forthcoming in *Journal of Insurance Regulation*

Monographs:

Profitability in Medical Professional Liability Insurance (with Rob Hoyt) available at www.hcla.org/studies.html

Insurance Premium Taxes in Arkansas, prepared for Arkansas State Chamber of Commerce and Associated Industries of Arkansas

Pricing and Reserving Practices in Medical Malpractice Insurance (with Rob Hoyt) www.piaa.us/pdf_files/press_releases/PIAA_FTCR_04252006.pdf

The Assault on the McCarran-Ferguson Act and the Politics of Insurance in the Post-Katrina Era. *NAMIC Issue Analysis*, September, 2007

A Trending Approach to Measuring the Effects of Tort Reform on Medical Malpractice Insurance (with Rob Hoyt). Forthcoming as Manhattan Institute Center for Legal Policy *Civil Justice Report #11*.

Performance of Medical Malpractice Insurers: An Historical Perspective and Current Developments (with Rob Hoyt)

Chapters in Books:

"Basic Statistical Concepts," (with Daphne Williams) in the International Risk Management Institute's *Risk Financing*, (IRMI, Dallas, TX, 2006)

Research under Review:

The Effect of Liability Environment on Tort System Costs: Evidence from Automobile Insurance (with Rob Hoyt). Available from SSRN http://ssrn.com/abstract=808404. Under review at *Journal of Risk and Insurance*

Regulation of Reinsurance Recoverables: Protection or Protectionism? (with Cassandra Cole and Kathleen McCullough) Released in SSRN Insurance Law, Legislation, & Policy Working Paper Series, Vol. 1, No. 22: August 16, 2006, http://ssrn.com/abstract=922057. Under review at *Journal of Risk and Insurance*

The Effect of Insurance on Cancer Screening (with Rhonda Henry-Tilman, Glen Mays and Kevin Ryan) under second review for American Cancer Society research grant

Working Papers:

The Effect of Liability System Environment on the Cost of Medical Malpractice Insurance (with Rob Hoyt)

A Trending Approach to Measuring the Effects of Tort Reform on Medical Malpractice Insurance (with Rob Hoyt)

Insurance Premium Taxes in Arkansas

Pricing and Reserving Practices in Medical Malpractice Insurance (with Rob Hoyt)
Tort Reform and Commercial Automobile Insurance Costs (with Rob Hoyt and Tommy Stith)
Measuring the Effects of Insurance Regulation with Stock Price Data: The McCarran-Ferguson Act (with Rob Hoyt and Randy Dumm)

Work in Progress:

On the Corporate Demand for Insurance: Evidence from Small Business Activity (with Andre Liebenberg)
Information Asymmetry and Insurance Pricing: Evidence from Traffic Violations (with Gary Wagner)
The Effect of Liability System Environment on the Quality of Medical Care (with Rob Hoyt and Kathleen McCullough)
State Reinsurance Facilities and Health Insurance Coverage (with Kevin Ryan)
The Effect of Second Injury Funds on Workers Compensation Insurance Costs
Accident or Litigation Externalities of Driving: Comparing the effects of Traffic Density and Fraudulent Claiming Behavior on Automobile Liability Costs (with Rob Hoyt)
INSURANCE CHOICES: Competition and the Future of Property and Casualty Insurance Markets (Editing book for The Independent Institute)

Invited Presentations at Universities

University of Arkansas Department of Economics – Fayetteville, AR – April 2006
University of South Carolina Department of Finance – Columbia, SC – October 2007
Shanghai Normal University, Finance School, Shanghai, China – November 2007
University of Arkansas for Medical Science – Little Rock, AR – May 2008

Research Presented at Professional Meetings:

American Risk and Insurance Association Annual Conference 08/2007
Quebec, Canada
Tort Reform and Commercial Automobile Insurance Costs (with Rob Hoyt and Tommy Stith)
Southern Risk and Insurance Association Annual Conference 11/2006
Hilton Head, SC
Tort Reform and Commercial Automobile Insurance Costs (with Rob Hoyt and Tommy Stith)
American Risk and Insurance Association Annual Conference 08/2006
Washington, DC
Regulation of Reinsurance Recoverables: Protection or Protectionism? (with Cassandra Cole and Kathleen McCullough)
A Trending Approach to Measuring the Effects of Tort Reform on Medical Malpractice Insurance (with Rob Hoyt)
Southern Risk and Insurance Association Annual Conference 11/2005
Orlando, FL

The Value of Tort System Fairness: Evidence from Automobile Insurance (with Rob Hoyt)
American Risk and Insurance Association Annual Conference 08/2005
Salt Lake City, UT
Internal Capital Market Efficiency of Financial Intermediaries: Evidence from Property-Liability Insurers (with David Eckles and David Sommer)
Southern Risk and Insurance Association Annual Conference 11/2004
Charleston, SC
The Value of Tort System Fairness: Evidence from Medical Malpractice Insurance (with Rob Hoyt)
Internal Capital Market Efficiency of Financial Intermediaries: Evidence from Property-Liability Insurers (with David Eckles and David Sommer)
American Risk and Insurance Association Annual Conference 08/2004
Chicago, IL
The Value of Tort System Fairness: Evidence from Automobile Insurance (with Rob Hoyt)
Risk Theory Society Annual Meeting 04/2004
St. John's University - New York, NY
The Effectiveness of State Legislation in Mitigating Moral Hazard: Evidence from Automobile Insurance, (with Rob Hoyt and David Mustard) Forthcoming in *Proceedings of the Risk Theory Society*
Southern Risk and Insurance Association Annual Conference 11/2003
Clearwater, FL
The Value of Tort System Fairness: Evidence from Automobile Insurance (with Rob Hoyt)
The Role of Internal Capital Markets in Financial Intermediaries: Evidence from Insurance Groups, (with David W. Sommer)
American Risk and Insurance Association Annual Conference 08/2003
Denver, CO
The Role of Internal Capital Markets in Financial Intermediaries: Evidence from Insurance Groups, (with David W. Sommer)
Risk Theory Society Annual Meeting 04/2003
Georgia State University - Atlanta, GA
Internal versus External Capital Markets in the Insurance Industry: The Role of Reinsurance, (with David W. Sommer) Appears in *Proceedings of the Risk Theory Society* http://www.aria.org/rts/rts2003/proceedings03.htm
American Risk and Insurance Association Annual Conference 08/2001
Indianapolis, IN
The Effectiveness of Antifraud Legislation: Evidence from Automobile Insurance, (with Robert Hoyt and David Mustard)
Internal versus External Capital Markets in the Insurance Industry: The Role of Reinsurance, (with David W. Sommer)
Southern Risk and Insurance Association Annual Conference 11/2000
San Antonio, TX
Internal versus External Capital Markets in the Insurance Industry: The Role of Reinsurance, (with David W. Sommer)

Southern Risk and Insurance Association Annual Conference 11/1999
Orlando, FL
The Effectiveness of Antifraud Legislation: Evidence from Automobile Insurance
(with Robert Hoyt and David Mustard)

Consulting and Industry Activities:

Arkansas Center for Health Improvement, Little Rock, AR
Evaluation of AR Health Net program – 2008
Hope, Fuqua and Campbell, Little Rock, AR
Expert consultant for litigation – 2007, 2008
National Association of Mutual Insurance Companies, Indianapolis, IN
Legislative research consultant – 2007
Annual Conference Speaker – 2007
Farm Bureau Conference Speaker – 2008
The Independent Institute, Oakland, CA
Research Fellow, 2007 – present
Editor/director for insurance regulation project, 2007 – present
Competitive Enterprise Institute, Washington, DC
Insurance Regulation Working Group, 2008
Arkansas Physicians Mutual Insurance Company, Little Rock, AR
Director/consultant, 2007 – present
Dunnottar Insurance Group, Atlanta, GA
Director/consultant, 2007 – present
Stephens Insurance Services, Little Rock, AR
Employee training seminar – 2007
State Farm Insurance Company, Bloomington, IL
Expert consultant for insurance legislation – 2007
Progressive Insurance Company, Mayfield Village, Ohio
Expert consultant for insurance legislation – 2007
Nelson Mullins Riley & Scarborough, Columbia, SC
Expert consultant for litigation – 2007
Hamilton, Altman, Canale and Dillon. Fairfax, VA
Expert witness – 2007
Health Coalition on Liability and Access, Washington, DC
Legislative research consultant – 2006
Physicians Insurers Association of America, Washington, DC
Legislative research consultant – 2006, 2007
Manhattan Institute Center for Legal Policy, New York, NY
Research associate – 2006
Griffith Foundation for Insurance Education
Insurance regulation research – 2006
NCOIL Workshop faculty – 2007
Byrd Law Firm, Little Rock, AR
Expert witness – 2006
Arkansas State Chamber and Associated Industries of Arkansas, Little Rock, AR
Expert consultant for insurance legislation – 2005, 2006, 2007
Institute for Defense Analysis, Alexandria, VA

DHS, SAFETY Act Economic and Technical Reviewer, 2004 – present

Academic Professional Service:

Southern Risk and Insurance Association
Member 1998-present
Executive board 2006 – present
Session moderator at annual conference 2004, 2005, 2006
American Risk and Insurance Association
Member 2000-present
Session moderator at annual conference 2005, 2006, 2007
Program review committee 2007
RMIR Award committee 2007
Journal of Insurance Regulation
Spencer L. Kimball Article Award Committee 2004, 2005
Journal of Insurance Issues
Don Hardigree Award Committee (for best article) 2006
Ad hoc reviewer for:
Journal of Risk and Insurance, The Independent Review, Geneva Papers on Insurance: Issues and Practice, Risk Management and Insurance Review

Community and Industry Service:

Health Information Security and Privacy Collaboration, Stakeholder – 2006
Arkansas Insurance Legislation Task Force, Member – 2004-present
Arkansas Heath Insurance Expansion Initiative Roundtable, Working Group Member – 2005-present
Arkansas Health Insurance Expansion Initiative Roundtable Meeting, Keynote Speaker 05/2005, "A Framework for Considering Health Insurance Expansion."
Central Arkansas Association of Health Underwriters Luncheon 9/2004, Presentation "The Related Issues of Rising Healthcare Cost and the Uninsured Population"
Charlotte Chapter CPCU Luncheon, Keynote Speaker 10/2003 "Challenges of Tort Reform"
Central Arkansas Association of Health Underwriters, member – 2005-present; legislative committee 2006-present
Arkansas Association of Health Underwriters – 2007-2008
Legislative chairman
Arkansas Insurance Adjusters Association, member – 2005
Organized and facilitated Arkansas Insurance Day – 2004-2005
Licensed instructor for Continuing Insurance Education in Arkansas and North Carolina

University Service:

University of North Carolina at Charlotte
Business Continuity Planning Committee – 2003-2004
Gamma Iota Sigma Faculty Sponsor – 2003-2004
University of Arkansas at Little Rock
Employee Benefits Committee – 2004-present

Subcommittee on Graduate Student Health Insurance, Chairman – 2007
University Research Committee – 2005-present
Appointed to doctoral faculty for Applied Science Ph.D. program – 2005-present
Donaghey Scholars Committee – 2005-present
Campus Campaign Steering Committee – 2006-2008
Search Committee to fill Ford Chair in Finance, Chairman 2006-2007
NCAA Self-Study Review Committee, 2007

STATEMENT OF

STUART K. PRATT

CONSUMER DATA INDUSTRY ASSOCIATION

WASHINGTON, D.C.

BEFORE THE

Committee on Financial Services

Subcommittee on Oversight and Investigations

House of Representatives

ON

"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

May 21, 2008

Chairman Watt, Ranking Member Miller and Members of the Subcommittee, thank you for this opportunity to appear before this Subcommittee. I am Stuart Pratt, President and CEO of the Consumer Data Industry Association (CDIA).

The CDIA is an international trade association representing approximately 300 consumer data companies that are the nation's leading institutions in credit and mortgage reporting services, fraud prevention and risk management technologies, tenant and employment screening services, check fraud prevention and verification products, and collection services.

We commend you for holding this hearing, and welcome the opportunity to share our views.

My comments today will focus on:

- The states' extensive oversight of the use of credit histories and scores for insurance underwriting;
- Congressional oversight of the Fair Credit Reporting Act is substantial;
- Our members' management of the quality of data in their databases, which is a success story proven by studies and consumers;
- How the market is addressing the question of consumers with a thin credit report or no credit report at all; and
- Brief comments on H.R. 5633 and 6062.

I) State Oversight of Insurance Industry Use of Credit Histories and Scores for Insurance Underwriting.

The question of the use of credit histories for insurance purposes is not new, and there is no shortage of investigation and oversight of this factor. CDIA has been a constructive voice in these many state-level deliberations.

As you know, virtually all states permit the use of credit histories and scores for insurance purposes, and the states have not made these decisions capriciously. They have sought and found an empirical basis for the use of credit histories and credit-history-based insurance scores.

For example, states have formally studied the question of the use of credit histories for insurance underwriting, and many, including Arkansas, Texas and Virginia, have issued reports about these issues. State legislatures have spent countless hours holding hearings, debating testimony, listening to their regulators and ultimately enacting laws which recognize the predictive value of credit histories and credit-history-based insurance scores.

Voters themselves have also supported the use of credit histories. For instance, a state ballot initiative in Oregon led to a rejection of a proposed ban on the use of credit histories and scores by a vote of 65.21% to 34.79%. Insurance commissioners themselves have held hearings in their respective states and have issued regulations

regulating the use of scores. The National Association of Insurance Commissioners has also hosted forums on the use of credit histories and scores for underwriting on multiple occasions without coming to the conclusion that a ban is appropriate. Finally the National Conference of Insurance Legislators held extensive meetings on the subject and ultimately approved model legislation to ensure the fair use of credit histories and scores. This robust system of oversight by the states is not static and continues today.

II) Congressional Review of FCRA and Credit Histories and Credit-based Insurance Scores for Underwriting

In 1996, and again in 2003, the congress extensively reviewed and materially updated the Fair Credit Reporting Act. In neither case did it choose to ban the use of credit histories or scores, nor did it suggest that such a ban was appropriate.

In fact, the Fair and Accurate Credit Transactions Act of 2003[1], often known as the FACT Act, was considered a tremendous bipartisan success. It originally passed by the House by a vote in this committee of 63-3 and by the House by a vote of 392-30. Regarding the Senate efforts, Senator Sarbanes (D-MD), then ranking member on the Senate Banking Committee, was quoted in the Congressional Record as saying that

> *"I want to acknowledge the thorough examination of these important issues provided by the comprehensive series of six hearings on this subject that Chairman Shelby held in the Banking Committee. The bill passed unanimously out of the Banking Committee on a voice vote on September 23, 2003 and was adopted 95-2 on the floor on November 5,*

[1] PL 108-159

2003. These votes, I believe, are a testament to our chairman's willingness to work on a bipartisan basis."[2]

As we all know, through the bipartisan FACT Act Congress tasked the FTC and FRB with producing a report focusing on the use of credit histories and scores used for credit and insurance underwriting.

The FTC concluded that:

"Credit-based insurance scores may benefit consumers overall. Scores may permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums."

We again commend this committee for holding a hearing on the FTC's first report to hear first-hand from the FTC what it found in its review of automobile insurance policies.

Finally in August 2007, the Federal Reserve also issued its long-awaited credit scoring report. The report, produced as required by FACTA Sec. 215, "assess[es] the effects of credit scoring on credit markets". "In the broadest terms" the Federal Reserve finds:

> "Results obtained with the model estimated especially for this study suggest that the credit characteristics included in credit history scoring models do not serve as substitutes, or proxies, for race, ethnicity, or sex. The analysis does suggest, however, that certain credit characteristics serve, in part, as limited proxies for age. A result of this limited proxying is that the credit scores for older individuals are slightly lower, and those of younger individuals somewhat higher, than would be the case had these credit characteristics not partially proxied for age. Analysis shows that mitigating this effect by dropping these credit characteristics from the model would come at a cost, as these credit characteristics have strong predictive power over and above their role as age proxies."

[2] Senate Record (GPO Version) – Page S15806 – November 24, 2003.

III) Credit Histories – Background

In the process of working with state oversight processes, whether it involves an insurance commissioner or a legislative hearing, there are some questions which are often asked of us. We hope the following review of some of these core questions and our answers is helpful in this Committee's inquiry.

1) How are consumer reporting agencies regulated, particularly those which produce the types of consumer reports often termed credit reports?

The FCRA regulates the operations of all consumer reporting agencies (CRAs) and thus there are many types of databases used by the insurance industry which are covered by the statute. As previously discussed, the FCRA is a very contemporary consumer protection statute. Rights accorded to consumers are extensive and included below is the FTC's own accounting of those rights:

A Summary of Your Rights
Under the Fair Credit Reporting Act

The federal Fair Credit Reporting Act (FCRA) is designed to promote accuracy, fairness, and privacy of information in the files of every "consumer reporting agency" (CRA). Most CRAs are credit bureaus that gather and sell information about you -- such as if you pay your bills on time or have filed bankruptcy -- to creditors, employers, landlords, and other businesses. You can find the complete text of the FCRA, 15 U.S.C. 1681-1681u, at the Federal Trade Commission's web site (*http://www.ftc.gov*). The FCRA gives you specific rights, as outlined below. You may have additional rights under state law. You may contact a state or local consumer protection agency or a state attorney general to learn those rights.

- **You must be told if information in your file has been used against you.** Anyone who uses information from a CRA to take action against you -- such as denying an application for credit, insurance, or employment -- must tell you, and give you the name, address, and phone number of the CRA that provided the consumer report.

- **You can find out what is in your file.** At your request, a CRA must give you the information in your file, and a list of everyone who has requested it recently. There is no charge for the report if a person has taken action against you because of information supplied by the CRA, if you request the report within 60 days of receiving notice of the action. You also are entitled to one free report every twelve months upon request if you certify that (1) you are unemployed and plan to seek employment within 60 days, (2) you are on welfare, or (3) your report is inaccurate due to fraud. Otherwise, a CRA may charge you up to eight dollars.

- **You can dispute inaccurate information with the CRA.** If you tell a CRA that your file contains inaccurate information, the CRA must investigate the items (usually within 30 days) by presenting to its information source all relevant evidence you submit, unless your dispute is frivolous. The source must review your evidence and report its findings to the CRA. (The source also must advise national CRAs -- to which it has provided the data -- of any error.) The CRA must give you a written report of the investigation, and a copy of your report if the investigation results in any change. If the CRA's investigation does not resolve the dispute, you may add a brief statement to your file. The CRA must normally include a summary of your statement in future reports. If an item is deleted or a dispute statement is filed, you may ask that anyone who has recently received your report be notified of the change.

- **Inaccurate information must be corrected or deleted.** A CRA must remove or correct inaccurate or unverified information from its files, usually within 30 days after you dispute it. **However, the CRA is not required to remove accurate data from your file unless it is outdated (as described below) or cannot be verified.** If your dispute results in any change to your report, the CRA cannot reinsert into your file a disputed item unless the information source verifies its accuracy and completeness. In addition, the CRA must give you a written notice telling you it has reinserted the item. The notice must include the name, address and phone number of the information source.

- **You can dispute inaccurate items with the source of the information.** If you tell anyone -- such as a creditor who reports to a CRA -- that you dispute an item, they may not then report the information to a CRA without including a notice of your dispute. In addition, once you've notified the source of the error in writing, it may not continue to report the information if it is, in fact, an error.

- **Outdated information may not be reported.** In most cases, a CRA may not report negative information that is more than seven years old; ten years for bankruptcies.

- **Access to your file is limited.** A CRA may provide information about you only to people with a need recognized by the FCRA -- usually to consider an application with a creditor, insurer, employer, landlord, or other business.

- **Your consent is required for reports that are provided to employers, or reports that contain medical information.** A CRA may not give out information about you to your employer, or prospective employer, without your written consent. A CRA may not report medical information about you to creditors, insurers, or employers without your permission.

- **You may choose to exclude your name from CRA lists for unsolicited credit and insurance offers.** Creditors and insurers may use file information as the basis for sending you unsolicited offers of credit or insurance. Such offers must include a toll-free phone number for you to call if you want your name and address removed from future

lists. If you call, you must be kept off the lists for two years. If you request, complete, and return the CRA form provided for this purpose, you must be taken off the lists indefinitely.

- **You may seek damages from violators.** If a CRA, a user or (in some cases) a provider of CRA data, violates the FCRA, you may sue them in state or federal court.

The FCRA gives several different federal agencies authority to enforce the FCRA:

FOR QUESTIONS OR CONCERNS REGARDING:	PLEASE CONTACT:
CRAs, creditors and others not listed below	Federal Trade Commission Consumer Response Center - FCRA Washington, DC 20580 1-877-382-4367 (Toll-Free)
National banks, federal branches/agencies of foreign banks (word "National" or initials "N.A." appear in or after bank's name)	Office of the Comptroller of the Currency Compliance Management, Mail Stop 6-6 Washington, DC 20219 800-613-6743
Federal Reserve System member banks (except national banks, and federal branches/agencies of foreign banks)	Federal Reserve Board Division of Consumer & Community Affairs Washington, DC 20551 202-452-3693
Savings associations and federally chartered savings banks (word "Federal" or initials "F.S.B." appear in federal institution's name)	Office of Thrift Supervision Consumer Programs Washington, DC 20552 800-842-6929
Federal credit unions (words "Federal Credit Union" appear in institution's name)	National Credit Union Administration 1775 Duke Street Alexandria, VA 22314 703-518-6360
State-chartered banks that are not members of the Federal Reserve System	Federal Deposit Insurance Corporation Division of Compliance & Consumer Affairs Washington, DC 20429 800-934-FDIC
Air, surface, or rail common carriers regulated by former Civil Aeronautics Board or Interstate Commerce Commission	Department of Transportation Office of Financial Management Washington, DC 20590 202-366-1306
Activities subject to the Packers and Stockyards Act, 1921	Department of Agriculture Office of Deputy Administrator - GIPSA Washington, DC 20250 202-720-7051

2) What are credit reports, what information do they contain?

The term "credit report" is not defined by the FCRA. The FCRA defines the term consumer report and a subset of this term are those reports which include credit payment data and other similar data. The type of information contained in a credit report is:

- Identifying Information – Name, Current and Previous Addresses, Social Security Number, Date of Birth;
- Credit History – History of satisfying obligations to retail stores, banks, finance companies, mortgage companies and other lenders;
- Public & Collection Agency Records (that bear upon credit-worthiness) – Judgments, Foreclosures, Bankruptcies, Collections, Tax Liens, Garnishments; and
- Inquiries – Identifies credit grantors or other parties authorized by the consumer that have received a copy of the consumer's credit report, typically during the past 2 years. Also, lists companies who received consumer information for the purpose of offering credit or other promotions.

Notably, credit reports do not contain information about an individual's race, color, religion, or national origin.

Note that the vast majority of data in our members' systems simply confirms what most of you would expect: consumers pay their bills on time and are responsible, good credit risks. This contrasts with the majority of systems maintained in other countries, such as Japan or Italy, which store only negative data and do not give consumers recognition for the responsible management of their finances. Ultimately, the U.S. credit reporting system is the benchmark for other countries, and results far greater fairness measured by the allocation of risk relative to the price paid by a consumer.

3) Are credit reports accurate?

The accuracy of all consumer reports (including credit reports) is a matter of law and is also a marketplace expectation. Never before in the history of this nation do we have so much definitive data on the accuracy of credit reports.

First, the Federal Reserve Board studied approximately 300,000 credit reports for purposes of determining the quality of data. Their report included the following finding:

> *"This analysis of the effects of data problems on credit history scores indicates that the proportion of individuals affected by any single type of data problem appears to be small..."*
>
> *"Available evidence indicates that the information that credit-reporting [sic] agencies maintain on the credit-related experiences of consumers, and the credit history scoring models derived from these experiences, have substantially improved the overall quality of credit decisions while reducing the costs of such decision making." Avery, Robert, et al., Federal Reserve Bulletin, "Credit Report Accuracy and Access to Credit", Summer 2004.*

Further, since December 2004, consumers themselves have been reviewing their credit report disclosures at rates never before seen in the history of the industry due to the system designed by our members to give consumers free access to them. Ultimately the consumer experience in reviewing their own credit report disclosures validates the conclusions of the Federal Reserve study. Between 2004 and 2006, more than 52 million free credit report disclosures were provided to consumers who exercised their rights under the FACT Act. Approximately 90% of consumers had no questions or disputes regarding their reports, and, only 1.98% of them resulted in a dispute where data was deleted from the file.

Users of credit reports have similar experiences regarding dispute rates and the accuracy of the data used for underwriting. Consider the following, which involves 17 million credit reports:

> "In 2001, Allstate ordered over 17 million credit reports. The number of written requests from consumers disputing information on their credit report totaled less then 3,000, or .017 percent of the total number of reports ordered. Of the number of legitimate disputes, only some would have any bearing on the insurance score because we only look at certain characteristics. Of the number affecting the insurance score, only some would affect the discount amount because the score must change by a certain amount to move into another discount category. Thus, the number of inaccurate credit reports that affect the premium charged is at most a subset of a subset of a subset of .017 percent."[3]

While there have been prior efforts to quantify the accuracy of data, none involved large or valid samples of data. In fact the General Accountability Office makes the following observation regarding these efforts:

> *"We cannot determine the frequency of errors in credit reports based on the Consumer Federation of America, U.S. PIRG, and Consumers Union studies. Two of the studies did not use a statistically representative methodology because they examined only the credit files of their employees who verified the accuracy of the information, and it was not clear if the sampling methodology in the third study was statistically projectable." Statement of Richard J. Hillman, Director, Financial Markets and Community Investment, General Accountability Office, Before the Senate Banking Committee, July 31, 2003.*

The data cited above speaks to the success of our members' ongoing efforts, though they are always striving to ensure the quality of the data coming into in their systems. Following is a sampling of just some of the strategies they employ in this regard:

New data furnishers – all of our members utilize specialized staff, policies and procedural systems to evaluate each new data furnisher and assist them in becoming compliant. Common practices include reviews of licensing, references, and site visits. All apply robust tests to sample data sets and all work with the furnisher to conform data reporting to the Metro 2 data standard. Once a furnisher is approved, there may be ongoing monitoring of this data reporting stream during a probationary period of time.

[3] Allstate Insurance Company's Additional Written Testimony: Allstate's Use of Credit Scoring, before the Michigan Office of Financial and Insurance Services, July 23, 2002.

Ongoing furnishing – Our members employ a variety of practices to ensure continued and on-going accuracy:

• Producing reports for data furnishers which outline data reporting problems, including errors in loading data and data which is not loaded. This reporting process ensures data furnishers are receiving feedback regarding the quality of their data furnishing practices;

• Cross-referencing data in certain fields to look for logical inconsistencies is often used as a data quality check;

• Historical data reporting trends, at the database level or data furnisher level, are used as baseline metrics upon which to evaluate incoming data;

• Manual reviews of data can occur when anomalous data reporting trends are identified; and

• Reviewing incoming data for consistency with the Metro 2 data standard.

Furnishers and Metro 2 Data Reporting Standard

CDIA members have also voluntarily developed a data reporting standard for all 18,000 data sources which contribute to their databases; the latest iteration of this standard is titled Metro2.

Standardizing how data is reported to the consumer is a key strategy for improving data quality by creating a uniform and universal method of data sharing.

Use of the Metro 2 data reporting format is climbing steadily. In 2005 CDIA reported that approximately 50 percent of all data provided to our members' data bases was reported using the Metro2 Format. Today, this percentage has grown to 81.3 percent. Our members' data quality teams believe this 62.6 percent increase is directly attributable not only to our members' tenacious efforts, but also to the FACT Act's focus on accuracy and the proposed guidelines and rules governing accuracy and integrity of data.

In addition to our members' individual efforts to encourage adoption of the Metro 2 Format, CDIA provides furnishers with free access to a "Credit Reporting Resource Guide," which is the comprehensive overview of the Metro2 Format. This guide is designed for all types of data furnishers, to encourage the proper use of the format.

This Guide also provides specific guidance for certain types of furnishers, such as collection agencies, agencies which purchase distressed debt, all parties which report data on student loans, child support enforcement agencies and utility companies, which may have unique issues that need to be addressed.

More than 500 of these guides are provided free of charge to data furnishers each year. Further, since 2004, CDIA and its Metro2 Task Force have held workshops for thousands of data furnishers on a range of specialized topics regarding Metro2 including, for example:

• Reporting Requirements for Third Party Collection Agencies and Debt Purchasers; and

• Reporting Requirements Specific to Legislation & Accounts Included in Bankruptcy.

4) What about the data sources themselves and accuracy?

As this Committee knows better than any other in the House, there are also legal requirements that data furnishers must abide by to ensure that the data that they submit to a consumer reporting agency is accurate.

The FACT Act made a number of significant changes to the FCRA to enhance the accuracy of consumer credit files.[4] For instance, data furnishers are prohibited from furnishing data they know is inaccurate, and they have an affirmative duty to correct and update information. The new FACT Act regulations in the pipeline will also enhance accuracy.

- Direct Disputes - The FRB, NCUA and FTC have published proposed guidelines and regulations that would provide consumers with the opportunity to initiate disputes directly with data furnishers, as opposed to going through the CRA to run that dispute;

- Accuracy and Integrity – The same agencies have also published proposed guidelines and regulations to address the accuracy and integrity of the data furnished to consumer reporting agencies ; and

[4] Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003, Dec. 2004, vii.*

- Red Flag Guidelines – New rules have been finalized for resolving address discrepancies. Resolving such discrepancies at the account opening will reduce the likelihood that data reported to a consumer reporting agency is inaccurate.

However, Congress must give these rules and regulations time to work before making additional changes to the process. In fact, the FRB and FTC issued a FACTA required study in August of 2006 that concluded that no new legislative requirements should be instituted at this time:

> "The FACT Act Section 313(b)(4) requires the FTC and the Board include in this report any legislative or administrative recommendations for improvements to the dispute process that the agencies jointly determine to be appropriate. The agencies recommend that no legislative action be taken at this time, in large part because the agencies believe such action would be premature. The FACT Act imposes a number of new requirements on CRAS and furnishers that should enhance the consumer dispute process and improve accuracy, including measures to reduce identity theft and new requirements on furnishers. Many of these requirements are being implemented, and their effects on the dispute process have yet to be seen. This is particularly important given the voluntary nature of the reporting system and the uncertainty of how additional requirements and burdens would affect that system." Federal Trade Commission "Report to Congress on the Fair Credit Reporting Act Dispute Process", August 2006, Pp. 34.

5) What about consumers whose credit reports cannot be scored or who simply do not have one?

CDIA's members are at the forefront of studying this question and bringing forward market-based solutions. Interestingly enough, as Mr. Birnbaum of the Center for Economic Justice pointed out in his earlier testimony on this topic before this Committee, many "non-traditional" lenders, such as rental landlords, finance companies and other lenders, often do not report any data to credit bureaus. This means that consumers who have not been part of the system, who do not have established credit, may have difficulty establishing credit, trapping them in a catch-22.

Fortunately, the National Conference of Insurance Legislators (NCOIL) model bill addresses this problem with regards to insurance scoring by prohibiting insurers from "denying, canceling, or non-renewing a policy based solely on credit information, without considering any other applicable underwriting factor. *(Note: This provision would prohibit an insurer from refusing to insure an applicant or insured because the person's insurance score fails to meet or exceed a minimum numeric threshold, unless at least one other applicable underwriting factor is considered.)*" (Emphasis in original)

However, what this committee needs to know is that there is tremendous progress and real-world products on the market today that are helping to further address the issue of how consumers with little "traditional" payment history can establish credit and benefit from a positive payment history in a traditional underwriting process.

Publicly Available Data - Several of our members already compile public record data which can then be used for underwriting loans. A consumer's ownership of a home, a car or other asset can help contribute to an underwriting process. These data are commercially available today, are being used in credit underwriting processes where there is no traditional credit report or one which cannot be scored.

Rental and Utility Payment Data – A number of our members are adding utility and telecommunications payment data to traditional credit reporting databases. These data are being used in credit underwriting decisions today. We also have members who are in direct discussions with rental payment data sources to expand reporting of these data for underwriting purposes. Other members of the CDIA are aggregating consumer payment data where such data reported by the consumer's bank through direct payments made from checking accounts.

Validating Consumer-Submitted Data – A number of our members also provide services where they will validate payment data (paid bills, etc.) provided by a consumer directly to a lender. In some cases a scoring system is built into these models.

Empirical Studies Suggest a Promising Future – The Political & Economic Research Council[5] has engaged in empirical studies of the question of using various forms of payment data for purposes of underwriting. In their most recent study, "Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data" the Council, which was funded by CDIA and its members and which

[5] www.infopolicy.org

involved the use of 8 million credit reports, suggests that:

> *"Including alternative data was especially beneficial for members of ethnic communities and other borrower subgroups. For instance, Hispanics saw a 22 percent increase in acceptance rates. The rate of increase was 21 percent for Blacks; 14 percent for Asians; 14 percent for those aged 25 or younger; 14 percent for those aged 66 older; 21 percent for those who earn $20,000 or less annually; and 15 percent for those earning between $20,000 and $29,999. In addition, renters (as opposed to homeowners) saw a 13 percent increase in their acceptance rate, and those who prefer Spanish as their primary language saw a 27 percent increase in their acceptance rate."*

FTC FACT Act Study – The December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act indicates that bill payment histories at utilities and telecommunications companies could be utilized as a source of predictive data.

With this positive context in mind, it is important for this Committee to know that there are barriers to wide-spread reporting of key payment which may impinge on fully integrating such data into underwriting processes. For instance, anecdotally we have heard that some companies do not want to incur the expense and potential liability associated with reporting information to a credit bureau. State Public Utility Commissions (PUCs) may also have barriers that prevent then from reporting.

IV) Comments on H.R. 5633 and H.R. 6062

Finally, Mr. Chairman, you asked us to comment on H.R. 5633 and 6062. It is our view that the right balance has been struck today with regard to the role of the federal government and the states, and that no new law is necessary.

As discussed at the opening of our statement, the states have been active on the question of the use of credit histories and scores both legislatively and through the regulatory process. Regulatory reviews and insurance commission powers at the state level are ongoing and robust. Reviews by NCOIL and NAIC have also held extensive inquiries. Consumer protections are robust and protective at the state level and the federal Fair Credit Reporting Act has been the focus of very recent and extensive oversight and new regulations continue to be issue as a result of the FACT Act.

We are concerned about the underlying hypothesis of the proposed legislation which suggests that it is best to study a single underwriting factor in a manner that does not put it into the proper context of the other factors which are used during the same underwriting decision. Further, while we have great respect for the Federal Trade Commission, only the states have the proper market context to understand how best to use their extensive powers to regulate the use of all factors in underwriting processes.

Ultimately we believe that our members' data contributes to proper risk attribution, and thus helps to ensure that ensuring consumers receive the lowest price and are rewarded for their years of care and good decisions, regardless of their race or ethnicity.

Thank you for your time, and I look forward to answering any questions.

Written Testimony of
Lisa Rice
Vice President, National Fair Housing Alliance

Before the House Financial Services Committee
Subcommittee on Oversight and Investigations

"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

May 21, 2008

National Fair Housing Alliance
1101 Vermont Avenue, NW
Suite 710
Washington, DC 20005
(202) 898-1661
fax (202) 371-9744

Written Testimony of Lisa Rice
Vice President, National Fair Housing Alliance
Before the House Financial Services Committee
Subcommittee on Oversight and Investigations
"The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance"

May 21, 2008

My name is Lisa Rice and I am the Vice President of the National Fair Housing Alliance (NFHA). I want to thank Chairman Watt, Ranking Member Miller, and the members of this Committee for the opportunity to testify today on credit-based insurance scoring.

Founded in 1988 and headquartered in Washington, DC, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Through comprehensive education, advocacy and enforcement programs, NFHA works to eliminate housing discrimination and protects and promotes residential integration and equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

Congress should ban the use of credit scoring in insurance because it has been shown time and time again to have a disparate impact on people of color and women. The National Fair Housing Alliance is especially concerned about the use of credit scoring in homeowner's insurance, but is opposed to its use in all personal lines of insurance.

Insurance Credit Scores and Race Discrimination

Before the introduction of the credit scoring systems the insurance industry had used other unsupported standards and stereotypes with a racial proxy effect. These included restricting coverage altogether or limiting the type of coverage offered based on either 1) the age of the housing; 2) the market value of the housing; or 3) the ratio between the market value and the replacement cost amount of the house. These policies have been demonstrated to have a discriminatory effect against Latinos and African-Americans. After several 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 racial and ethnic effects into the eligibility and pricing of insurance.

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.[1]

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

The relationship between insurance credit scores and race is so strong that even though the Federal Trade Commission used data handpicked by the industry for its 2007 study of auto insurance, the Commission found that credit scoring discriminates against low income and minority consumers, and that insurance scoring was a proxy for race. The study states that "the FTC's analysis indicates that credit-based insurance scores appear to have some proxy effect for three of the four coverages studied, but that this is not the primary source of their relationship with claims risk."[2] The FTC report also found that Latinos and African-Americans are over-represented among consumers with the lowest credit scores. It reported that "more than one-half of all African-Americans have credit scores in the lowest quarter of the overall score distribution, and one-half of all Hispanics have credit scores in the lowest third of the overall score distribution." This means that African-Americans and Latinos pay more, on average, for auto insurance than non-Hispanic Whites, simply because of their credit scores, not because of any risk related to driving.

The FTC study also confirmed that, despite growing reliance on credit-based insurance scores, scant evidence exists to prove there is a meaningful 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 or zodiac sign, to price insurance products.

FTC and the Insurance Industry: Blaming the Victim

The FTC report mimics the insurance industry's "blame the victim" mentality 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.

Insurance industry experts argue that using scoring systems is appropriate because there is a statistical relationship between the scores and certain outcomes tied to risk. For example, Patrick Brockett, Ph.D., Professor at the University of Texas at Austin, in referring to Actuarial Standard No. 12, argued that the statistical relationship between scoring mechanisms and risk outcomes justifies the use of the systems, even in the face of evidence that African-Americans and Latinos have lower scores than their White counterparts. Actuarial Standard No. 12 states that it is not necessary to prove causality between a variable and a particular outcome. Showing a strong statistical relationship between a variable and a particular outcome is sufficient. In other words, according to the standard, when building a scoring model, one need not be concerned with demonstrating or proving that any given variable used in the model actually has a causal relationship with any given outcome or result. One only need demonstrate that there is a high statistical correlation between a given variable and a given result.

Dr. Brockett argues that there are "intrinsic underlying individual biological and psychological characteristics of risk-taking in both financial behavior and driving." He states, "the connector between insurance losses and credit scores is the psychological dimension." Dr. Linda Golden, also a professor at the University of Texas at Austin also claims that insurance scoring ferrets out

[2] *Credit Based Insurance Scores: Impacts on Consumers of Automobile Insurance: A Report to Congress by the Federal Trade Commission.* July, 2007, page 69.

a risk-taking personality trait. As she puts it, "Biochemistry influences personality. Our biochemistry may be the determinant of our personality, which then may have a strong influence on risk-taking impacting our credit scores, helping to explain in the bigger picture why credit scores predict."[3]

If one were to simply accept this argument on its face, one would have to conclude that, since African-Americans and Latinos generally have lower insurance scores than do Whites, that African-Americans and Latinos have risk-taking biochemistry that cause them to live riskier lives, hence the lower scores.

The FTC study mimicked this argument by citing Brackett and Golden in its report and surmising that "a driver with a low credit-based insurance score may be in a distressed financial situation. This may cause stress that makes the consumer a less attentive driver. Being in a distressed financial situation also might give the driver a greater incentive to try to obtain payment under an insurance policy."[4]

Lending Discrimination in the Marketplace

However, this stance by the industry completely ignores the fact and reality that African-Americans and Latinos do not have lower insurance scores because they somehow have "intrinsic underlying individual biological and psychological" risk-taking characteristics. African-Americans and Latinos have lower insurance scores because of direct and indirect discrimination in the marketplace.

America has a bifurcated lending system that has negative effects on African-Americans and Latinos. It always has. There has never been a time in our history when African-Americans and Latinos have participated in the financial mainstream markets to the same degree as their White counterparts. Lower credit and insurance scores among Latinos and African-Americans are a function of the U.S.'s bifurcated lending system in which Latinos and African-Americans are disproportionately represented in unregulated and debilitating financial markets.

Mortgage lending in the United States did not become widely used until the early 1900s as urbanization began to take root. As more people began flooding urban centers, the demand for credit grew prompting the savings and loan industry to expand. During this time, Jim Crow laws and Black Codes overtly and openly prohibited housing and lending opportunities for African-Americans and other people of color. Exclusionary zoning practices were the norm in our communities. According to Steve Dane, a leading fair lending and civil rights attorney, it was during the early part of the 20th century that "economic theorists and appraisers began espousing the view that economic value and loan risk were related to race." Real estate, lending and appraisal manuals readily embraced the idea that racial homogeneity was key to sustaining home value and that the racial characteristics of the neighborhood affected real estate value and, therefore, loan risk.

---

[3] "Actuaries Have Special Role When Explaining Credit Scores and Losses", *Insurance Journal, Property Casualty Magazine*, November 16, 2007 edition.
[4] Federal Trade Commission, op. cit., page 32.

Indeed appraisal manuals created by the American Institute of Real Estate Appraisers listed a ranking of races and nationalities to indicate their impact on real estate value. The most favorable groups were listed at the top. The least favorable groups were listed at the bottom. One of the rankings appeared as follows:

1. English, Germans, Scotch, Irish, Scandinavians
2. North Italians
3. Bohemians or Czechs
4. Poles
5. Lithuanians
6. Greeks
7. Russians, Jews (lower class)
8. South Italians
9. Negroes
10. Mexicans.

This bias created and fostered the separate and unequal financial system that still exists today. Racism is still present in the American marketplace and it is inextricably tied to inequality in our lending and financial markets.

Several studies have revealed discriminatory lending practices. A study by the Department of Housing and Urban Development found that African-American and Latino homebuyers "face a statistically significant risk of receiving less favorable treatment than comparable Whites when they ask mortgage lending institutions about financing options."[5]

An earlier analysis by Fannie Mae of the Boston Federal Reserve's research that revealed high levels of lending discrimination, verified that African-Americans were much more likely than their White counterparts to receive a loan denial. Fannie's Mae's research concluded that the Boston Fed's finding that lenders rejected minority loan applicants 56 percent more often than similarly situated White applicants was accurate. Moreover, Fannie Mae found additional evidence to support the Boston Fed's findings.[6]

The National Fair Housing Alliance conducted a multi-year lending testing project which was reviewed by Margery Turner and Felicity Skidmore. NFHA's lending testing uncovered multiple ways in which African-Americans were denied lending opportunities in the financial mainstream markets including: 1) differences in the qualitative and quantitative information provided to African-American and White loan seekers with African-Americans receiving inferior treatment; 2) lenders' urging African-American customers but not white customers to go to another lender for service; 3) lenders' indicating to African-American but not White customers that loan procedures would be long and complicated; 4) African-Americans' being more likely than their equally qualified white counterparts that they would not qualify for a loan; and 5)

---

[5] Turner, et al. *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions.* The Urban Institute, 2002.

[6] Carr and Megboulugbe. "The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited." *Journal of Housing Research*, Volume 4, Issue 2, Fannie Mae, 1993.

White customers' being much more likely to be coached on how to handle the lending process and deal with problems in their financial profiles. Turner and Skidmore concluded that NFHA's testing provided "convincing evidence of significant differential treatment discrimination at the pre-application stage."[7]

The denial of affordable, quality credit to deserving consumers of color has lead to the voluminous growth of the subprime market. Amazingly, while mainstream, prime lenders had paltry penetration levels among borrowers and communities of color, their subprime affiliates and subsidiaries over-penetrated the market using aggressive marketing tactics. Multiple reports and analyses have revealed that African-Americans and Latinos are more apt to access credit in an unregulated, high-cost environment and that these groups are much more likely than Whites to obtain unsustainable loans. A study by the Consumer Federation of America found that African-Americans and Latinos are more likely to receive payment-option mortgages. Indeed, Latinos are nearly twice as likely as non-Latinos to receive payment-option mortgages. African-Americans were 30.4 percent more likely than non-African Americans to receive payment-option mortgages. African-Americans were more likely than non-African-Americans to receive interest-only loans, which have proved to be a highly volatile loan product.[8]

Unfortunately, African-Americans and Latinos are much more likely to fall prey to high-cost and abusive financial services because predatory lenders set up shop in predominately African-American and Latino communities and aggressively market unsustainable and volatile loan products to these populations. According to the 2006 HMDA data, African-Americans and Latinos are much more likely to receive a subprime loan than their White counterparts. Roughly 54% of African-Americans and 47% of Latinos received subprime loans compared to approximately 17% of Whites. ***Even higher income African-Americans and Latinos receive a disproportionate share of subprime loans. According to one study that analyzed more than 177,000 subprime loans, borrowers of color are more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in creditworthiness.***[9]

Subprime lenders assert that the higher fees they charge are required due to the added risk that their borrowers present. However, both Fannie Mae and Freddie Mac have reported that a significant number of borrowers who received subprime loans would have qualified for a prime loan. Moreover, Federal Reserve Governor Edward Gramlich noted that half of subprime borrowers had credit scores of 620 or higher. (At the time of his statement, a score of 620 would qualify a borrower for a prime loan.) Even the subprime industry itself boasted to its investors that a substantial portion of its borrowers were prime borrowers. According to a study conducted by the Wall Street Journal, this number may be as high as 61 percent.[10]

---

[7] Turner and Skidmore. *Mortgage Lending Discrimination: A Review of Existing Evidence.* The Urban Institute, 1999.

[8] *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders.* Consumer Federation of America, May, 2006.

[9] See Bocian, D. G., K. S. Ernst, and W. Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, May 2006, p. 3.

[10] "Subprime Debacle Traps Even Very Creditworthy," *Wall Street Journal*, December 3, 2007.

While not all subprime loans are predatory and while predatory lending can certainly be found in the prime market, it is true that subprime loans are much more volatile than prime loans. Additionally, certain loan features typically characteristic of subprime mortgages, including prepayment penalties and yield spread premiums, contribute to the unsustainable nature of these loans. Again, African-Americans and Latinos are more likely than their White counterparts to receive loans with these harmful features.

An analysis by the Center for Responsible Lending shows that borrowers residing in zip codes whose population is at least 50 percent minority are 35 percent more likely to receive loans with prepayment penalties than financially similar borrowers in zip codes where minorities make up less than 10 percent of the population.[11] Moreover, an ACORN study revealed that high income African-Americans in predominantly minority neighborhoods are three times more likely to receive subprime loans than low-income whites.[12] Since borrowers with subprime loans are *eight times more likely to default* than those with conventional loans, it is highly unlikely that homeowners and prospective homeowners with good credit actively look to secure a subprime loan.[13] A more likely explanation is the use by some lenders of shrewd and deceptive sales techniques designed to induce families to act contrary to their best economic interests.

Not only do African-American and Latino borrowers receive a disproportionate share of subprime loans but they are also more frequently victimized by payday lending. This form of lending comes at an extremely high cost. The typical fee on a $300 payday loan is about $45 and carries an annual percentage rate of over 400 percent. People who tap into payday loans are quickly ensnared in an invidious cycle of debt. The overwhelming majority of payday loans are made to borrowers with five or more payday loans per year.

Payday lenders are highly concentrated in predominantly Latino and African-American neighborhoods as well as low-income communities. As the map below of the distribution of payday lenders in the District of Columbia reveals, there are few payday lending shops in predominately White neighborhoods. This pattern is typical across the country. A study of payday lending in Illinois revealed that payday lenders are much more concentrated in zip codes with high African-American and Latino populations[14]. Yet another study conducted in North Carolina revealed that payday lenders were disproportionately concentrated in African-American neighborhoods[15].

---

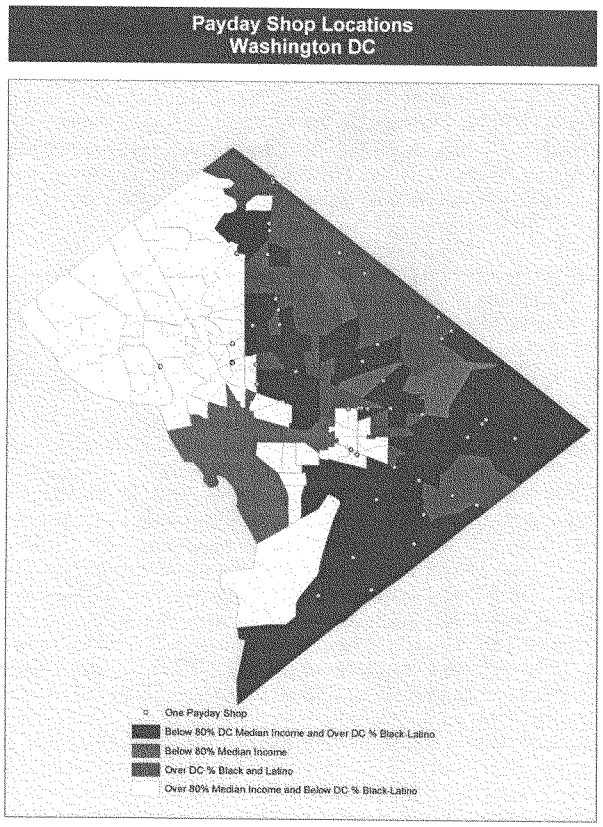
[11] Bocian, D.G. and R. Zhai, *Borrowers In Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending, January 2005.

[12] *The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities*. ACORN 2006.

[13] See Kilborn, P., "Easy Credit and Hard Time Bring a Flood of Foreclosures," *New York Times*, November 24, 2002; cited in Squires, G. D., "The New Redlining," in Squires, ed., *Why the Poor Pay More* (Westport, CT: Praeger, 2004), pp. 1-23; p. 3.

[14] The Woodstock Institute. Reinvestment Alert No. 25, Chicago, Il. (April, 2004). http://woodstockinst.org/document/alert_25.pdf.

[15] Davis, D., et al. *Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods*. Center for Responsible Lending, Durham, NC., 2005



These facts underscore the tenuous homeownership status so many Latinos and African-Americans face – again, not because they somehow pose some intrinsic risk but, rather because controllable forces are at work negatively impacting the ability of these communities to obtain access to quality credit. African-Americans and Latinos face added barriers when trying to become homeowners or trying to sustain homeownership status. ***According to a HUD study analyzing homeownership sustainability patterns among first-time homebuyers, it takes African-Americans and Latinos longer to become homeowners. However, once homeownership status is attained, these groups lose their status the quickest. The study reveals that the average homeownership stay for Whites, Latinos and Blacks is 16.1 years,***

12.5 years and 9.5 years respectively. The relatively short homeownership period for Blacks and Latinos is most likely linked to the higher probability that these groups receive higher-cost and subprime loans. Moreover, after first-time homeowners enter the foreclosure cycle, it takes African-Americans and Latinos much longer to recover from the devastation. ***After foreclosure, the duration of renting or living with relatives is 10.7 years for Whites, 14.4 years for African-Americans and 14.3 years for Latinos.***[16]

Current Foreclosure Crisis Has Put the Financial Profiles of Millions of Families at Risk

The bifurcated lending system in the U.S. has not only compromised the credit profiles of millions of African-Americans and Latinos but has helped lead to the foreclosure crisis our country now faces. Borrowers who clearly entered the mortgage cycle with sound credit are now facing plummeting credit scores and years of work to rebuild their profiles. This scenario will be disproportionately experienced by borrowers of color who were the borrowers most likely to receive subprime and non-traditional mortgages.

It is wholly unfair to further burden borrowers who were unfairly targeted by unscrupulous lenders with higher insurance premiums. These borrowers will not suddenly turn into poor drivers or lax homeowners simply because their credit scores have decreased.

As described above, many borrowers, indeed if some reports are to be believed most borrowers who received non-traditional, subprime loans, received these loans not because their financial profiles warranted it; rather, they received the loans due to, in some cases predatory practices, and in other cases, slick and aggressive marketing and less than transparent loan procedures. In fact, most of these borrowers did not pay an interest rate that was commensurate with their level of risk. They, instead, paid an interest rate that benefitted the loan originator or broker.

Obviously, since credit scoring mechanisms are built on data retrieved from the credit repositories, it will be impossible to excise the effects of discriminatory and predatory lending from the scoring models. This means that victims of predatory lending, a majority of whom are borrowers of color, will pay more for their insurance products simply because they were victimized by unscrupulous lenders.

Current Legislation: HR 6062 and HR 5633

Banning credit-based insurance scoring is a civil rights issue. We are happy to see that Representatives Watt, Gutierrez, Waters, and Frank have sponsored legislation related to eliminating the racial discrimination intertwined, or even inherent, in credit-based insurance scoring. I would like to take a moment to give you our feedback on the two current bills, H.R. 5633 and H.R. 6062.

NFHA supports HR 6062, Personal Lines of Insurance Fairness Act of 2008, in that it bans the use of consumer reports and consumer information in the underwriting or rating in connection

[16] Donald R. Haurin and Stuart S. Rosenthal, *The Sustainability of Homeownership: Factors Affecting the Duration of Homeownership and Rental Spells.* U.S. Department of Housing and Urban Development Office of Policy Development and Research, December, 2004.

with personal lines of insurance. We have outstanding questions about how the law would be enforced under an amended Fair Credit Reporting Act. We also have outstanding questions about allowing the use of Comprehensive Loss Underwriting Exchange (CLUE) database, because of our serious concerns about the current use of this database. But we look forward to working with the members to assure the best bill possible.

We also appreciate the efforts regarding HR 5633, Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008, but have a number of concerns about the bill as proposed. We fear that the legislation, as written, will not ban insurance credit scoring if the use of consumer credit information for insurance underwriting or rating discriminates on the basis of race or ethnicity.

Instead, *HR 5633 could serve to legitimize insurers' use of credit-based insurance scoring in general.* So long as the FTC claimed that it did not find the use of a scoring methodology to be discriminatory, an insurance company could continue to use the methodology.

In addition, *HR 5633 establishes the FTC as the arbiter of determining racial discrimination although this agency has virtually no track record or enforcement experience in this area.* In fact the FTC study published last summer demonstrated a severe bias against consumers and for insurers on insurance scoring, as mentioned above.

In HR 5633, the determination of discrimination or proxy effect is the responsibility of the FTC. The FTC has already stated that it sees no discrimination and no substantive proxy effect (in spite of the fact that the details of its study show otherwise). The FTC says that it sees no statistical definition of discrimination or degree of statistical relationship with race that constitutes discrimination or proxy effect. The FTC made this finding even though it did not conduct disparate impact testing or attempt to build a model that had a less discriminatory effect. Consequently, the FTC will bless insurance scoring.

In the same vein, HR 5633 makes no provisions for a private right of action. If the FTC has the final say, there would be no recourse under this bill for anyone who wants to challenge (in court, for example) the racially discriminatory use of credit in insurance. This would be a real problem for civil rights groups and individual consumers for challenging this practice in the future.

HR 5633 lacks an objective standard for identifying racial discrimination, giving broad discretion to the FTC. As written, the proxy effect language does not clearly and adequately incorporate the legal concept of disparate impact. Currently in the bill, the FTC could, using statistics, find some correlation to race and income and some proxy effect, but determine it is not substantive and conclude no discrimination or proxy effect results. A policy could be discriminatory without necessarily being discriminatory *statistically*. Instead, the language in the bill should prohibit BOTH systems that incorporate racial proxies and those that have unlawful disparate impacts.

It is important to note that, as Actuarial Standard No. 12 states, it is not necessary to find a causal relationship between a variable and a particular outcome; it is sufficient to find a significant statistical relationship between a variable and a particular outcome.

A recent study conducted by InsuranceHotline.com, demonstrates that if you crash your car, you can "Blame the Stars"[17]. According to the study, there is a statistically significant correlation between zodiac signs and car accidents. The study looked at the records of 100,000 North American drivers from the past six years. Based on the study's findings, Libras, Aquarians and Aries are the worst drivers. However, Leos and Geminis were found to be the best drivers. Several years ago, a California based insurer found similar types of correlations between zodiac signs and driving patterns.

Should we be advocating the consideration of an insured's zodiac sign in order to determine eligibility or set premium rates? Some things are beyond the pale. Just as we would not, encourage utilizing zodiac signs to set rates, it is equally ridiculous to use credit repository data to set insurance eligibility standards and/or rates.

The National Fair Housing Alliance was involved in litigation against an insurance company that utilized a credit scoring model. I cannot share the name of the company because the discovery conducted as a result of this litigation was done so under protective order. However, I can share that, because we had access to the insurer's scoring model, we were able to determine if there was a discriminatory impact on African-Americans. In fact, an analysis of the scoring mechanism found clear disproportionate impact on African-Americans and the price they paid for insurance. ***An analysis of the system also revealed that the difference in premium paid by non-minorities versus African-Americans could not be accounted for by differences in their risk profiles.*** This resulted in an unnecessary level of disproportionate impact that could not be explained by differences in risk. However, the differences in premium were directly related to differences in race.

Why? We found what we found because you cannot use a dataset that does not capture and accurately and adequately reflect the true experiences of a particular demographic group to build a scoring model. If you do, you will build a model that does not optimize its predictive value for that demographic. You cannot build a scoring model using data from credit repositories and expect that a) there will be no discriminatory effect in the model; and b) that the model will be able to accurately and adequately capture the behavior of the under-served groups. Credit repository data is replete with the effects and results of decades of discrimination in our markets. We cannot excise that information.

Moreover, credit repository data does not adequately capture the true patterns of under-served groups. One reason is because many financial vehicles that provide services to under-served groups do not report positive information to the credit repositories. For example, many community development financial institutions (CDFIs) that specialize in providing quality, affordable, sustainable credit to under-served groups often do not report data to the credit repositories. This is because they often do not have enough records to report data to the repositories. TransUnion requires a creditor to have at least 100 records in order to submit data. Therefore, if a CDFI does not have at least 100 loans on its books, it is unable to report positive payment data to TransUnion and other repositories.

---

[17] Reuters, "Crash Your Car? Blame the Stars", MSN Money, 2006. http://articles.moneycentral.msn.com/Insurance/InsureYourCar/StudyLinksZodiacAndCarCrashes.aspx.

Ironically, if a CDFI borrower has trouble paying his or her loan and the file is turned over to a collection agency, this negative information can be reported to the credit repositories. Additionally, if a borrower is subjected to a foreclosure, this negative information is also reflected in the credit report regardless of the size of the creditor.

It is also important to note that some creditors do not report positive data to credit repositories simply because they choose not to do so. There is no law requiring a creditor to report data; the system is voluntary. We believe this practice has disproportionately impacted communities of color in a negative way since the financial institutions that typically do not regularly report positive data to the repositories are either unregulated or sparsely regulated entities.

Because it is impossible to remove bias from information reported to credit repositories, and because data reported to the repositories does not completely and adequately capture the experiences of under-served groups, utilizing the data weakens the predictive power of scoring models and compromises any results.

HR 5633 could interfere with state-based insurance regulation and makes unclear 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 confers onto a federal agency the task of identifying and stopping unfair discrimination which traditionally has been the role of states. In addition, it confers onto a federal agency the task of determining which state laws are "stronger" and which are "weaker."

Conclusion

The utilization of credit scores will cause a discriminatory effect. While the industry may argue that there is a correlation between insurance scores and losses, the industry cannot provide enough empirical data to demonstrate that the use of the models are justifiable given the discriminatory outcomes. Moreover, the current foreclosure crisis will result in credit deterioration for millions of Americans. HR 5633, in its current state, does not provide timely assistance for the millions of consumers who face higher auto and homeowners insurance rates because of abusive and reckless lending practices.

The National Fair Housing Alliance advocates instead for a ban on the use of consumer credit information for insurance, as is the goal of HR 6062. Short of a full ban, we would encourage you to consider legislation proposing a temporary "freeze" on the use of this information by insurers during the current mortgage crisis. It would be unfair to punish victims of this crisis with increased insurance costs.

Thank you again for the invitation to speak to you today.

About Allstate
Allstate Overview
General Information
Products Overview
Corporate Advocacy
Foundation Grants
Advertising Campaign
Financial and Other Reports
History and Timeline
Awards and Recognition
Senior Management Team
Board of Directors
Executive Speeches
Doing Business with Allstate
Career Opportunities
Corporate Governance
Investor Relations
Media Newsroom
Corporate Citizenship
Sponsorships & Events

Allstate's Use of Credit Information to Evaluate Insurance Policies

En Español

Understanding your insurance score

We realize that our rating process may be unfamiliar to some of our customers, so we've put this summary together to help you understand:

- Why Allstate uses certain elements from your credit history
- How this process may affect your premium
- What measures we've adopted to keep your personal information safe.

Our use of credit information enables us not only to offer lower premiums to many customers who otherwise would pay more for their insurance; it also allows us to provide insurance coverage to more drivers and homeowners than we previously could.

How do we determine your rates?

Before determining your rates, Allstate considers many pieces of information, such as your coverage limits, your loss history, where you live or, for auto policies, where you keep your car. For example, if you applied for an auto policy from Allstate, to determine your premium we would consider such factors as:

- **What type of car you drive:** How old is it? What safety features does it have?
- **Who drives the car:** What is the age, driving record and gender of each driver?
- **How you use the car:** How far do you drive? Do you use the car to commute or for pleasure? Where do you keep (garage) your car?

We also consider your insurance score, a calculation based on elements from your credit history. Over the years we've found that including insurance scores helps us better predict the likelihood of experiencing an insurance loss. This helps us match our rates to the risk we're assuming.

What is an insurance score?

Your insurance score is different from your credit score. For example, a mortgage company uses your credit score to determine your credit worthiness and your ability to pay your mortgage. It's important to understand that while Allstate uses certain elements from your credit history, we never see your credit score, and we're not evaluating your overall credit worthiness. We simply use elements from your credit report that have proven effective in predicting insurance losses. We calculate your insurance score using the following types of information:

- **Your payment history:** Have you made late payments or missed a payment?
- **Length of credit history:** How long have you been using credit?
- **Your current balance on each account compared to your highest balance:** For example, if you had high credit card balances before are they lower now?
- **Number of credit accounts:** How many accounts do you have? This may include credit card accounts or installment loans.
- **Credit inquiries:** How often have lenders made inquiries into your credit report? This does not include "soft inquiries," such as when a company reviews your credit report to make a promotional offer. (Credit inquiries are not used in all states.)
- **Bankruptcies, foreclosures and other collection activity** (Bankruptcy information is not used in all states.)

Please keep in mind that the types of credit information we consider when calculating an insurance score can vary from state to state. Should you have any questions regarding Allstate's use of your credit history, particular to the state you live in, please contact your Allstate representative or call 1-800-ALLSTATE.®

The length of time that we look back over your credit history varies. For inquiries, we review the past two years; for other credit variables, we review the past five years (except in Maryland). Only the length of your credit history is considered for more than five years and this generally has a positive effect on your insurance score.

Allstate understands that people sometimes face difficult circumstances, such as job loss, divorce, or large medical bills. We consider many factors when determining an insurance score, so a single negative event does not necessarily mean you will get a higher than average premium. It's possible that a negative event, such as a delinquency, may be offset by other positive factors like a long credit history.

In addition, please remember that although certain types of inquiries in your credit report can adversely impact your insurance score, not every inquiry will have this effect. For instance, in determining your insurance score, we do not consider:

- Promotional inquiries
- Account review inquiries
- Inquiries you make yourself in order to get a copy of your credit report, or
- Inquiries Allstate or any other insurer initiates to review your credit history for insurance purposes.

For more information about insurance scores, you may want to look at the Insurance Information Institute Web site at www.iii.org. The Insurance Information Institute is not affiliated with Allstate but can provide you with information about how insurance scores are used across the industry.

Why does Allstate use credit information?

Since the 1980s, Allstate has used credit information as a way to evaluate insurance applications. Since then, our experience has confirmed that people with better insurance scores tend to have fewer insurance losses. There is no definitive explanation as to why this is true, but our experience insuring millions of cars and homes confirms the predictive power of credit information. Since 1999, we've leveraged all that we've learned about credit information from our research and experience to help us set rates.

Our rating system is one of the most sophisticated in the industry. By including insurance scores in the rating formula we're better able to identify the insurance risk each individual represents. Instead of assigning all of our customers to a few, broad rating groups, we are able to make finer distinctions and offer more rating groups. This lets us offer customers rates that are more closely aligned with their likelihood of insurance loss. Ultimately, we are able to insure more people using these methods.

Does Allstate's scoring model consider ethnicity or income?

No. None of the insurance scoring models we use consider ethnic group, religion, nationality or income.

Can insurance scores change over time?

Your insurance score is a snapshot at the moment the credit report is ordered of how you've used credit over a span of years. Because there are so many complex considerations involved in calculating your insurance score, even if you change some behaviors, it may not have the effect you want. However, we do recommend that you regularly review your credit report for accuracy, pay your bills on time, and only open new credit accounts as needed.

For more information about insurance scores, managing personal finances and your credit rights, we encourage you to visit the Federal Trade Commission Web site at www.ftc.gov.

At Allstate, we're continually reviewing and refining our system for calculating premiums. Considering a customer's insurance score is just one more way we're working to keep our customers in Good Hands.®

What about people like me who use credit cards responsibly?

The use of credit cards can have a positive effect on your insurance score, if you are not delinquent in your payments or significantly overextended. The presence of reasonable balances on credit card accounts is common among customers receiving our best scores. It's important to remember that the presence of any one characteristic will not necessarily prevent you from getting a lower rate.

We'll keep you informed

At Allstate, we think you should know how your credit information is used as well as its impact on your premium. We'll let you know if you don't receive our lowest premium based on your insurance score. You're also entitled to an annual, free copy of your credit report from consumer reporting agencies, and we suggest you review it so that you can make sure it accurately reflects your credit history. If it doesn't, we encourage you to contact Trans Union – the consumer reporting agency we obtain credit reports from – and request a correction.

You can contact Trans Union at:
Trans Union National Disclosure Center
2 Baldwin Place
P.O. Box 1000
Chester, PA 19022
(888) 503-0049

The credit report that Trans Union sends you will include a form that you can complete if you feel any of the information is incorrect.

We protect your privacy

We know your credit information is highly personal and needs to be protected. Your insurance score is generated by a secure computer system. Your agent will never see your credit report; neither will the call center representative who takes your call. No one at Allstate sees your credit report unless you request additional information about our decision that requires us to personally review your report. Even then, there's only a small, select group of employees who have access to your credit report and who will examine your credit information to address your concerns.

For more information, view our privacy statement at www.allstate.com/about/privacy-statement-alic.aspx.

The factors mentioned in this answer may vary from state to state based on legal or regulatory restrictions, or market conditions. If you have an Allstate policy with an insurance score, your insurance score may have been based on some or all the factors described in this answer.

Like a good neighbor, State Farm is there.®

Insurance | Mutual Funds | State Farm Bank®

Text Size: A A A

Access account info Log in Register

Search: Powered by Google™

Home > Insurance > Auto Insurance > What affects the price of Auto Insurance?

Auto
Homeowners
Condo Owners
Renters
Life & Annuities
Health
Disability
Long-Term Care
Business
Boat
Other Insurance

Login
Register
Find Agents
Claims Center

Service Center
Learning Center
About Us
Contact

Search Site
Powered by Google™

Search

What affects the price of Auto Insurance?

The price of auto insurance varies by company and by:

What you buy

- How many coverages you buy
- The deductibles

What kind of car you drive

If you are buying or selling a car, you will need to re-evaluate your auto insurance needs.

Generally, the more expensive the car, the more you pay.

Where you drive

Generally, due to higher rates of vandalism, theft and accidents, urban drivers pay more for insurance than those in small towns or rural areas.

How much you drive

People who use their car for business and long-distance commuting normally pay more than those who drive less.

Your age, sex and marital status

Accident rates are higher for all drivers under age 25, especially young males and single males. Insurance prices in most states reflect these differences.

Your driving record

Drivers who cause accidents generally must pay more than those who are accident-free for several years.

Your credit history

Studies have shown that credit history is a powerful predictor of future auto insurance losses. Many insurance companies consider certain credit characteristics in addition to many other factors when determining an individual's rate.

What can I do to save money on my auto insurance?

If you're shopping for a car, consider how your choice will affect premiums.

Some insurers increase premiums for cars more susceptible to damage or occupant injury, and lower rates for those that fare better than the norm.

Ask about discounts for good students, insuring more than one vehicle, accident-free driving, and others.

Consider joining a car or van pool, or finding other transportation to work. If you reduce your driving mileage enough, you may lower your premiums.

Drive carefully. Please select a state or province to learn more about the specific discounts available in your area:

Select your state/province

Save money. See if you are eligible for a discount!

Disclosures

Licensing Information

Related Links

What affects the price of auto insurance?
How much auto insurance do I need?
What discounts are available?
What are my coverage and deductible options?
Vehicle Ratings
Most Stolen Vehicles

Learn More

Insurance and new teen drivers
Insurance and college
Insurance and moving
Insurance and getting married
Our Financial Strength Ratings
Buying a car?

Credit History And Insurance

What Does Credit History Have To Do With Insurance?

Print This Page
E-mail This Page

Report Your Claim Directly
We'll get to work immediately.
24 / 7 / 365
1-800-252-4633
(1-800-CLAIM33)
For Boat/Yacht Claims
1-800-772-4482
For Flood Claims
1-800-505-0193

Over the last few years, many insurance companies have started using credit information to help determine what a customer pays for an insurance policy. In fact, over 90% of insurance companies use insurance scores, according to a study by Conning Research and Consulting Inc., a Hartford, Conn.-based research firm.

To help you better understand how your credit-based insurance score is calculated and how that "score" impacts what you pay for your policy, we have developed the following list of frequently asked questions. Please note that the use of insurance scores varies by state.

> What is an insurance score?
> Why do companies use insurance scores?
> What information affects my insurance score?
> What if there is an isolated problem on my credit report?
> How does Travelers use my insurance score?
> The information in my credit history is personal and sensitive. What protection do I have against misuse?
> Will my agent have access to my credit report?
> How can I improve my insurance score?
> What if I need more specific information about insurance scores?

What is an insurance score?

An insurance score is determined by reviewing a consumer's credit history. A carefully developed and tested computer model performs this analysis, and looks at information such as payment history, whether you have filed for bankruptcy, if you have bills with a collection agent, any outstanding debts you may have, and the length of your credit history.

Unlike a "credit score," which is typically used when you are seeking a loan, an insurance score is used to help insurance companies accurately assign the best price available for your policy.

When calculating your insurance rate, insurers typically group consumers into categories. For example, driving record and age are the most often used categories to help calculate the cost of a customer's auto insurance policy. Insurance scores are just another method insurance companies use to determine what you pay for your policy.

According to extensive industry and independent research, people with certain patterns in their credit history that result in a lower insurance score are more likely to have claims that need to be paid by their insurer. For instance, keeping your credit card balances below the maximum limit and making regular, on-time payments will result in a higher score. On the other hand, if you have a history of "maxing-out" your credit cards to their limits and submitting payments late, your score will be negatively impacted, meaning a lower score.

An insurance score DOES NOT take into account income, race, gender, religion, marital status, national origin, or geographic location. It only reviews your credit history.

< TOP >

Why do companies use insurance scores?

Since insurance scores have been proven to be highly predictive of the potential for future losses, they help insurance companies determine the likelihood that a customer will file a claim, and thus allow carriers to set rates that are accurate and appropriate for each customer. This enables carriers to offer insurance coverage to a broader range of customers. What's more, many of these customers benefit from the use of insurance scores in the form of lower prices.

Insurance scores are used in the same way as other traditional underwriting factors. As a group, people with certain patterns in their credit history receive lower insurance scores and are more likely to experience a loss and file a claim. They are charged a higher premium to reflect that risk. This allows Travelers, and other insurers, to give better rates to consumers with higher insurance scores, who are less likely to file a claim.

Credit history helps predict the potential for future losses, but it is not the sole factor in determining the cost of your policy. It is one of several factors used to arrive at the best rate possible. The age of a driver and prior claim history are two other important factors that are also used to determine your rate.

< TOP >

What information affects my insurance score?

In determining your insurance score, the following information is used:

> Payment history (Do you generally pay your bills on time or are you more than 60 days late?)
> Bankruptcy, foreclosures and collection activity
> Length of credit history
> Amount of outstanding debt in relation to credit limits (Are you "maxed-out" or are you well within your limits?)
> Types of credit in use (e.g., mortgages, installment loans)
> New applications for credit you have requested

< TOP >

What if there is an isolated problem on my credit report?

Travelers recognizes that sometimes people face difficult circumstances, such as medical collections, divorce, or job loss. We have created an Insurance Scoring Resource Center (ISRC) to assist our independent agents and customers with issues like this. In most cases, an isolated instance of a late payment will not have a significant impact on your insurance score if you otherwise have an established pattern of responsible credit use. Your Travelers agent will contact the ISRC on your behalf if you have questions.

< TOP >

How does Travelers use my insurance score?

Travelers uses your insurance score together with a number of other factors (including the factors mentioned above) to determine the best pricing level available to you. Generally

speaking, customers who have higher insurance scores and no prior claims or accidents, qualify for our best price.

For those customers with prior claims or accidents, a higher insurance score will help them qualify for a better rate than a similar customer who has a significantly lower insurance score. In turn, customers with no prior accidents or claims, but who have low insurance scores, may also qualify for a competitive rate.

< TOP >

The information in my credit history is personal and sensitive. What protection do I have against misuse?

Numerous federal and state laws and regulations are in place to protect you.

Under federal law, if the information in your credit history results in an "adverse action," by a company, that company must notify you and inform you about how to obtain a free copy of your credit report. You will also be provided with a description of your right to dispute the accuracy or completeness of your credit history.

< TOP >

Will my agent have access to my credit report?

No. Your agent will be informed of your overall score when the policy proposal is created, but will not have access to the underlying information used to calculate that score.

< TOP >

How can I improve my insurance score?

One of best things you can do is to make sure you pay your bills on time. That will help little by little with your credit history. You can also review how much credit you have. Are you up to your limit on a credit card? If so, that may also be considered an unfavorable factor. Consider how to reduce your debt without creating additional credit activity. Also, review your credit report regularly. Resources such as the American Insurance Association (www.aiadc.org) provide additional information about how to improve your credit history. Click here for a list of some ways to improve your insurance score.

< TOP >

What if I need more specific information about insurance scores?

The Insurance Information Institute Web site (www.iii.org) contains a great deal of specific information on this topic under the "Credit Scoring" link. It also contains links to other helpful resources.

< TOP >

Privacy | Legal Notices | Producer Compensation Disclosure
©2008 The Travelers Companies, Inc.

Search How do I find it? Subscribe to paper »

Advertisement JOIN THE GREEN EFFORTS
Sign up for daily Green Living tips on your cellphone
Grab the USA TODAY Green Widget for climate headlines
Get expert advice from seasoned reporters at USA TODAY
CLICK

Credit scores' link to insurance rates tested

Updated 10/29/2006 11:15 PM ET

WHAT INSURERS SPENT OPPOSING MEASURE

Insurance companies have donated $3.7 million to try to defeat Oregon's ballot measure 42, which would bar insurers from using credit scores to set insurance rates. Insurers' contributions against the measure:

State Farm	$731,909
Farmers Group	$658,526
Safeco	$361,828
Allstate	$342,990
Progressive	$244,036
St. Paul Travelers	$188,388
American Family Mutual	$170,177
Nationwide	$163,922
Geico	$137,753
Hartford	$132,885

Source: Money in Politics Research Action Project

By Christine Dugas, USA TODAY

Oregon is the latest battleground in an effort by consumer advocates to block insurers from using credit scores to set auto and homeowner rates.

On Nov. 7, Oregonians will become the first voters in the USA to decide whether to bar insurers from setting premiums based on such factors as credit history, debt load and bill-paying habits.

The insurance industry, which opposes the measure, is pumping millions of dollars into an ad campaign to defeat it. The outcome will be closely watched by other states that could come under pressure to take similar steps if the Oregon ballot measure succeeds. Hawaii, California and Massachusetts already have bans.

The battle comes as the use of credit scores — 92% of insurers factor them into auto rates, Conning Research & Consulting says — is under scrutiny elsewhere:

• The Michigan Court of Appeals will decide whether insurers can use credit scores to set rates. The state insurance department had barred such use of the scores, but its ban was struck down by a state judge.

• The U.S. Supreme Court has agreed to review lawsuits that complain that insurance companies failed to inform consumers that low credit scores led to higher rates. The lawsuits argue that failure to do so violated the Fair Credit Reporting Act.

• Oregon lawmakers in 2003 barred the use of credit scores to set rates for consumers with existing insurance policies. Measure 42 on the Nov. 7 ballot would go further by banning the use of credit scores in calculating rates for new customers.

"We've always been concerned that credit scores create unfair insurance rates," says Norma Garcia, senior attorney at Consumers Union. "And the use of them is increasing."

Only about one-third of consumers know that their credit history could affect their insurance premiums, a 2005 report by the Government Accountability Office found.

The industry argues that eliminating credit-based scoring would likely mean that people with good credit would end up paying higher insurance rates. But Garcia notes that in California, insurance rates have dropped since the use of credit scores was banned.

Insurers also argue that people with low credit scores are likelier to file insurance claims. "People who manage their finances well tend to also manage other important aspects of their lives responsibly, such as driving a car," the Insurance Information Institute says.

Consumers Union says there's no proof of that. A review of how credit scores are used to set rates in Texas found that the scores have more to do with economic status than with personal responsibility, says Birny Birnbaum, a former Texas insurance regulator who is executive director of the Center for Economic Justice, a consumer advocacy group.

Posted 10/29/2006 10:56 PM ET

Updated 10/29/2006 11:15 PM ET E-mail | Save | Print | Reprints & Permissions | RSS

Sponsored Links

Related Advertising Links What's This?

Reynolds Plantation
Lake & Golf Community with 5 courses - located 75 miles from Atlanta.

Top-Rated MBA Online
Earn Your MBA In 2 Years. No GMAT Required. 100% Online Program!

Advertisement

RESPONSE TO QUESTION 1

As I detail in my written testimony, it is actuarially unsound to have no logical predicate for a classification system. A logical predicate is not the same as a cause and effect relationship. For instance, a logical predicate for use of driving record as an auto insurance classification system is that people with recent accidents and tickets have shown, through their record, that they will not be as good drivers as a group as those with no accidents and tickets in the coming year. The data correlates with this thesis. However, all people with accidents are not going to have worse records next year than all people that have clean records, only the class as a whole will. There is no cause and effect relationship in the use of driving record.

In credit scoring there is no logical basis, only a data correlation "discovered" by those who could profit by selling services based on credit score. A couple of decades ago, the state of California "discovered" a similar correlation without a logical thesis when it found, in a review of motor vehicle records, that hair color was significantly correlated with accident frequency. Obviously we would never urge that it be used as a classification factor, but it has as solid a basis as credit scoring to be so used.

RESPONSE TO QUESTION 2

NCOIL has offered model legislation on the use of credit scoring for insurance purposes, which has been adopted by several states. The legislation would allow insurers to continue to use credit scores to grant insurance policies and establish rates, even though serious concerns have been raised about the logic of using credit history to predict consumer accident propensity (why would getting laid off in a recession make a person a worse driver?), the inaccuracy of these scores, and the disproportionate impact that this practice has on low income and minority consumers. NCOIL's model bill would only limit the use of credit scoring if it is the sole factor used in the underwriting or pricing of insurance, which means that the bill offers no protection, as credit scoring is never the sole factor used for these purposes. The NCOIL model is a sham, put forth by the insurers as a bill to use when a state is trying to really protect consumers.

A detailed critique of the many problems with the NCOIL model on credit scoring is found at pages 16 to 22 of the Testimony of the Center for Economic Justice before the Colorado legislature found at http://www.cej-online.org/bb%20co%20test%20040218.pdf.

RESPONSE TO QUESTION 3

CFA's in-depth review of auto insurance markets and regulation in all 50 states and the District of Columbia can be found at http://www.consumerfed.org/pdfs/state_auto_insurance_report.pdf. In this study we show that California is the fourth most competitive state as measured by the HHI and

also has had to lowest total rate increases for consumers of any state over the last 20 years. California has accomplished this despite having never permitted credit scoring for use in underwriting or pricing of auto insurance.

06/20/2008 10:50 FAX 202 326 3585 002/004

Bureau of Consumer Protection

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

June 20, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Watt:

I am writing in response to your question regarding the Federal Trade Commission's May 21, 2008 testimony on the impact of credit-based insurance scores on the availability and affordability of insurance. I welcome this opportunity to provide the additional information requested by the Subcommittee in the question and answer below:

1. **You suggest on page 8 of your testimony that federal legislation regarding credit-based insurance scores should mirror existing fair lending laws. Please explain further.**

The Federal Trade Commission ("Commission" or "FTC") has not taken a position as to whether any federal legislation should be enacted regarding the use of credit-based insurance scores. However, if Congress decides to enact such legislation, the FTC believes that existing anti-discrimination laws may offer useful models.

Federal and state anti-discrimination laws vary with regard to who is empowered to enforce them, what legal standards are applied, and what remedies are available. The Commission enforces the Equal Credit Opportunity Act (ECOA) and Regulation B,[1] which prohibit discrimination in credit transactions. ECOA is one model that would be useful to consider in connection with credit-based insurance scores.

The ECOA prohibits creditors from engaging in acts and practices which discriminate against consumers in credit decisions on several prohibited bases, including race and national origin.[2] The Federal Reserve Board has promulgated Regulation B to implement the ECOA. Federal banking agencies enforce ECOA and Regulation B with regard to the creditors within

---

[1] 15 U.S.C. §§ 1691 *et seq.* (ECOA); 12 C.F.R. §§ 202.1 *et seq.* (Regulation B).

[2] 15 U.S.C. § 1691(a).

their respective jurisdictions, such as banks, thrifts, and federal credit unions.[3] The FTC enforces the ECOA and Regulation B with regard to creditors which other agencies do not regulate.[4]

When enacting ECOA, Congress directed courts to interpret that statute to include the analytical approach developed in discrimination cases under Title VII of the Civil Rights Act of 1964.[5] Accordingly, courts have adapted both disparate treatment and disparate impact theories to cases brought under the ECOA and Regulation B.[6] When engaging in a disparate impact analysis, courts use a three-step examination, inquiring: (1) whether a company's practice has a different effect on members of a protected class than other consumers[7]; (2) if so, whether the company has a legitimate business need for the practice; and (3) if the company has such a need, whether there were less discriminatory alternatives available to the company.[8] Of course, whether this analysis will result in the company being held liable will depend on the facts of the particular case.

The ECOA and other anti-discrimination laws may provide drafters with important insight as to how to craft standards and an enforcement scheme to address credit-based insurance scores. The Commission therefore suggests that the drafters may wish to consider using these laws as models in developing proposed legislation in this area. In addition, because states traditionally have regulated the business of insurance, including enforcing laws prohibiting unlawful discrimination in insurance, the drafters may want to consider the states' proper role, if any, in enforcing any federal laws prohibiting or restricting the use of credit-based insurance scores.

---

[3] 15 U.S.C. § 1691c(a); 12 C.F.R. § 202.16(a)(1).

[4] 15 U.S.C. § 1691c(c); 12 C.F.R. § 202.16(a)(2).

[5] *See* S. Rep. No. 94-589, at 4–5 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 403, 406; *see also Bhandari v. First Nat'l Bank of Commerce*, 808 F.2d 1082, 1100 (5th Cir. 1987), *vacated on other grounds*, 492 U.S. 901 (1989).

[6] *See, e.g.*, *Faulkner v. Glickman*, 172 F. Supp. 2d 732, 737 (D. Md. 2001); *A.B. & S. Auto Serv., Inc. v. S. Shore Bank of Chi.*, 962 F. Supp. 1056, 1060 (N.D. Ill. 1997); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266, 18,268 (Apr. 15, 1994) (adopted by, among others, the banking agencies, HUD, and the FTC).

[7] *See, e.g.*, *Coleman v. Gen. Motors Acceptance Corp.*, 196 F.R.D. 315, 323 (M.D. Tenn. 2000), *vacated and remanded on other grounds*, 296 F.3d 443 (6th Cir. 2002); *Jones v. Ford Motor Credit Corp.*, No. 00 Civ. 8330, 2002 U.S. Dist. LEXIS 1098, at *12 (S.D.N.Y. Jan. 22, 2002); *see also* 12 C.F.R. § 202.6(a)-2 (Supp. I, Federal Reserve Board Official Staff Commentary to Regulation B).

[8] 12 C.F.R. § 202.6(a)-2 (Supp. I, Federal Reserve Board Official Staff Commentary to Regulation B).

I appreciate this opportunity to respond to your question in connection with the FTC's recent testimony. If you or your staff have additional questions or comments, please contact me or have your staff contact Jeanne Bumpus, the Director of our Office of Congressional Relations, at (202) 326-2946.

Sincerely,

Lydia B. Parnes

Lydia B. Parnes
Director

ERIC POE, ESQ, CPA
CHIEF OPERATING OFFICER
CURE AUTO INSURANCE

ANSWERS TO ADDITIONAL QUESTIONS FOR THE RECORD JULY 14, 2008
FOR THE SUBCOMMITTEE OF OVERSIGHT AND INVESTIGATIONS

PREFACE

LOSS RATIOS: A MEASUREMENT OF PROFITABILITY, NOT NECESSARILY RISK

In general terms, a "loss ratio" is defined as losses and expenses divided by premiums. Thus, the term loss ratio is an industry term that is a measurement of profitability. Any study that shows statistical correlations between a certain variable and loss ratios should be interpreted to mean that the selected variable relates to profitability, but not necessarily to risk. Depending upon what is defined as "risk," a specific variable correlated to loss ratios may not be the best indicator of risk. For example, if risk is defined as the risk of "an insurance company not being profitable" then a study that shows credit-based insurance scores correlated to loss ratios would validate that credit based insurance scores are related to that risk.

However, if risk is defined as the risk of "a driver being convicted of a moving violation" then the best study to prove that credit-based insurance scores relate to "risk" would be one that shows credit-based insurance scores correlating to moving violation convictions by drivers, not to loss ratios.

The basis of many of the studies on credit-based insurance scores[1], which conclude that credit-based insurance scores are a strong predictor of risk for auto insurance, is flawed because they assumed mere loss ratio correlations to credit-based insurance scores proved risk related to

[1] Bureau of Business Research, McCombs School of Business, The University of Texas at Austin, "A Statistical Analysis of the Relationship Between Credit History and Insurance Loss" (Mar. 2003).

drivers, when in fact, they simply proved that credit-based insurance scores were related to loss ratios and profitability.

INCOME RELATED TO CREDIT-BASED INSURANCE SCORES

If credit-based insurance scores correlate to an individual's income, then any correlation found with credit-based insurance scores to losses or loss ratios would more appropriately validate the predictive value of a person's income to losses or loss ratios.

Not surprisingly, the recent Federal Trade Commission (FTC) report found that there was a strong correlation to credit scores and neighborhood income[2], which solidifies the concept that the more valid underlying variable embedded in the credit-based insurance scores themselves is a person's income. Therefore, it is reasonable to conclude that higher income drivers are indeed more likely to have better credit scores and result in higher profitability within the industry. Once this key concept is understood, it becomes clear that any underwriting or rating variable that correlates to a person's income will also show a correlation to loss ratios and profitability.

Notably, during the FTC study where it collected data from 5 different insurance companies that represented 27% of the entire auto insurance industry for the basis of its analysis it found:

"Comparing our sample with Census data on car owners, we see that our sample underrepresented minorities and residents of low-to-moderate income tracts, and overrepresented non-Hispanic whites and residents of upper-income tracts."[3]

This finding highlights that insurance companies that have already adopted these socio-economic rating factors, such as credit-based insurance scores, have the effect of attracting and benefitting higher income drivers who have purchased insurance through these companies.

---

2 Supported in the FTC 2007 study Fig 10 and 11, that shows the distribution of scores by neighborhood income and the distribution of neighborhood income, by score decile. Federal Trade Commission. July 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance."
http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insuranee_Scores.pdf (accessed May 15, 2008).

3 Federal Trade Commission. July 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance." P.5.
http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf (accessed May 15, 2008).

WHY AUTO INSURERS WANT TO ATTRACT AND INSURE HIGHER INCOME DRIVERS

Higher income drivers are more attractive to the private passenger auto insurance industry for several reasons: (A) potential revenue streams for other products, (B) data mining, and (C) higher absorption of lower level claims.

A. POTENTIAL REVENUE STREAMS

Higher income drivers can offer a larger revenue stream to multi-line insurance carriers such as GEICO, American Express, Liberty Mutual, State Farm, Allstate and Progressive because they have the ability to purchase additional products.

Generally, lower income individuals' most significant assets are their automobiles.[4] The lower income population is not as likely to own a home,[5] or a boat, and they are unlikely to purchase financial planning services, large life insurance policies, or umbrella policies. Therefore, the lower income population provides fewer potential revenue streams for multi-line insurance companies making them less attractive to insure.

B. DATA MINING AND PRIVACY CONCERNS

Unbeknownst to most consumers, when they obtain a quote from an insurance company website, many insurance companies sell their personal data to third-party data mining companies. This information can be sold or shared with third parties regardless of whether the individual decides to buy a policy from the car insurance company or not, because the user has consented to the terms and conditions of the website. For example, at GEICO.com, despite statements to their users that they do not sell any information provided to their company for a quote, when one agrees to the terms and conditions for use of their website they also agree to permit GEICO to

---

4 Carasso, Adam and Signe-Mary McKernan. The Balance Sheets of Low-Income Households: What We Know about Their Assets and Liabilities. November 2007. http://aspe.hhs.gov/hsp/07/PoorFinances/balance

5 Wikipedia. Updated on July 5, 2008. "Household income in the United States." http://en.wikipedia.org/wiki/Household_income_in_the_United_States (Accessed on July 11, 2008)

share their information with any of their "marketing partners."[6] Data mining the information of high income individuals and consequently selling that information is a very lucrative business. Although it is not widely known to the public, data mining companies purchase information files from the vast majority of auto insurers which contain information regarding a person's credit score, occupation, education level, as well as their vehicle and residential information.[7]

Adding to the privacy concerns of this practice are the growing trends by auto insurers to run "reverse credit scores." By solely using an applicant's name and address, auto insurance companies are now capable of obtaining a person's credit information by running a reverse "look up" of the credit database. This process occurs even when the applicant purposefully withholds their Social Security number from the website. Although the user may consent to the terms and conditions of the insurer's website, it is highly doubtful that an individual who purposefully withholds a Social Security number is aware that the company is running their credit report and sharing or selling it to all of their marketing partners.

C. HIGHER ABSORPTION OF LOWER LEVEL CLAIMS

The National Highway and Safety Association reported in 2000 that roughly half of all property damage only (PDO) accidents go unreported each year[8] "due to concerns about insurance or legal repercussions." Typically, only individuals with higher incomes have the financial resources to pay for the damage out of pocket.

As a result, higher income drivers are more attractive to the auto insurance industry because higher income drivers have the option to absorb minor claims out of their own pocket as opposed to filing a claim with the insurance company following an accident.

---

[6] GEICO. 1996-2008. "Terms of Use." http://www.geico.com/about/terms-of-use (accessed on May 15, 2008).

[7] Delaney, Kevin J., and Emily Steel. 2007. Firm Mines Offline Data to Target Online Ads. The Wall Street Journal online, October 17: B1.

[8] National Highway Traffic Safety Association. 2002. "Economic Impact of U.S. Motor Vehicle Crashes Reaches $230.6 Billion, New NHTSA Study Shows."
http://www.nhtsa.com/portal/site/nhtsa/template.MAXIMIZE/menuitem.f2217bec37fb302f6d7e121046108a0c/?javax.portlet.tpst=1e51531b2220b0f8ea14201046108a0c_ws_MX&javax.portlet.prp_1e51531b2220b0f8ea14201046108a0c_viewID=detail_view&itemID=2d673e37bdd9ff00VgnVCM1000002c567798RCRD&pressReleaseYearSelect=2002 (accessed on May 18, 2008).

Therefore, it is reasonable to conclude that people who earn less money are more likely to file claims.[9] As a result, loss ratios as a whole will be worse for lower income drivers. This would hold true for any characteristic trait that correlates to a person's income. This is the reason why credit scoring, educational attainment, high income occupations and home ownership status, which all correlate to a person's income, will all have similar correlations to profitability (loss ratios).

[9] Supported in the FTC 2007 study Fig 3, that shows that the correlation to loss ratios are stronger for collision claims, and weaker for bodily injury liability claims. Federal Trade Commission. 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance." http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf (accessed May 15, 2008). Originally published in Michael J. Miller and Richard A. Smith, "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity: An Actuarial Study by EPIC Actuaries, LLC (June 2003) [hereinafter EPIC Study]", available at http://www.progressive.com/shop/EPIC_CreditScores.pdf

QUESTION 1: WOULD PASSAGE OF H.R. 6062 CREATE A LEVEL-PLAYING FIELD FOR THE INSURANCE INDUSTRY?

Answer: Yes, if H.R. 6062 was passed, every private passenger auto insurer in the United States would compete on a level playing field. Currently, auto insurers that strongly oppose the use of credit-based insurance scores because of their inherent correlations to a person's income are placed at a competitive disadvantage of losing their higher income drivers to those insurers who adopt the practice.

Underwriting by insurance companies is the process of identifying and calculating the risk of loss from policyholders. During this process, insurance companies establish who will receive a policy, and then determine the appropriate premium to be charged for each risk. An individual insurance company can incur unnecessary financial losses if the underwriting methodology it uses to appraise risks is inaccurate. However, while underwriting methods can affect an individual company's losses relative to its competitors, it is important to understand that the process of underwriting does not affect overall losses of the insurance industry.

Underwriting needs to be distinguished from risk prevention or loss control methodologies. Risk prevention or loss control methods such as mandatory seat belt laws can certainly increase or decrease total dollar amount of losses suffered by the industry. However, there is no evidence on the record, nor has it ever been contended by the insurance industry that banning the use of credit-based insurance scores as an underwriting tool will cause more drivers to be involved in more accidents, drive more negligently, or raise any significant expenses to the industry. The entire industry of private passenger auto insurance will suffer the same total expected losses across the entire industry, whether or not there is a ban of a specific practice used in underwriting. Since the banning of an underwriting method does not threaten to increase the losses that the industry will suffer as a whole, the focal point of H.R. 6062 is that of public policy fairness.

IMPACT OF CREDIT BASED INSURANCE SCORES

Charles Neeson's testimony, representing Westfield Insurance Group, underscores the impact that credit-based insurance scoring has on those who are not considered good credit risks.

Charles Neeson testified that 75% of his policyholders pay less because of the use of credit scores by his company, while only 8% pay more.[10]

Although these statistics may appear to support the use of credit-based insurance scores because it helps the overwhelming majority of drivers, it also illustrates the extreme impact on rates charged to the 8% of drivers who have poor credit scores regardless of their driving record. Simply stated, the total dollars needed to pay claims have to balance, so when 8% of the drivers with poor credit scores constitute the eumulative discounts given to 75% of those who benefit from good credit scores, the poor credit score drivers are paying on average over 9 times the amount in higher rates than the discounts given to "good" credit score drivers. This is completely independent of whether they have ever received a ticket or been involved in an accident.

Furthermore, the recent FTC study on the use of credit-based insurance scores for car insurance found that during the time when the use of credit-based insurance scores was proliferating, the number of uninsured motorist claims also increased in those states that permitted its use. It found:

"These results are consistent with the hypothesis that scores, because they raise the premiums of some consumers, cause a larger share of consumers to drive without insurance and/or more risky consumers to drive without insurance"[11]

In summary, the severe negative impact that the adoption of credit based insurance scores has on safe drivers coupled with such strong correlations to a person's income only emphasizes how important public policy legislation like H.R. 6062 is to those who are not fortunate enough to earn a high income and have a good credit score.

---

[10] Hearing before the House of Financial Services Subcommittee on Oversight and Investigations. "The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance." Testimony of Charles Neeson, Westfield Group on behalf of Property Casualty Insurers Association of America. May, 21, 2008. p. 3. http://www.house.gov/apps/list/hearing/financialsvcs_dem/neeson052108.pdf (accessed on July 7, 2008).

[11] Federal Trade Commission. July 2007. "Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance." P. 41. " http: //www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf (accessed May 15, 2008).

QUESTION 2: PLEASE EXPLAIN THE PRACTICE OF INSURANCE COMPANIES USING "MULTIPLE AFFILIATES" TO STEER LOWER INCOME CONSUMERS TO AFFILIATE COMPANIES THAT CHARGE HIGHER RATES.

Undoubtedly, the most rapidly growing and yet largely unknown practice that is being perpetrated by national auto insurance companies is their creation and use of affiliate companies to charge lower income drivers the highest rates for car insurance regardless of their driving record.

INDUSTRY PRACTICES OF MULTIPLE AFFILIATE COMPANIES

Unbeknownst to consumers, most multi-state, multi-line auto insurance carriers have "multiple affiliate" companies with each respective state that they are licensed to write. The insurers that have multiple affiliate companies include: State Farm, Allstate, Liberty Mutual, and GEICO Group of Companies. These multiple affiliate companies all bear their familiar trademark name in order to deceive consumers to believe they are offered services from only one entity. For example, Allstate Group issues policies through Allstate Indemnity Company and Allstate Insurance Company. The sole purpose behind the creation of multiple affiliate companies is simply to "redline" the driving population by offering lower rates to those individuals most likely to earn higher incomes.

The term "redlining" was coined in the late 1960s by community activists in Chicago. It describes the practice of marking a red line on a map to delineate the area where banks would not invest; later the term was applied to discrimination against a particular group of people (usually by race or sex), no matter the geography. [12] Here, my fellow insurance industry colleagues have created multiple affiliate companies which have the effect of redlining but tailored specifically to the field of auto insurance.

This form of sophisticated redlining is achieved through the purposeful creation and distinction made by the industry between "underwriting" rules and "rating" rules when calculating the price to charge consumers for auto insurance. The underwriting rules which once were interpreted by regulators and legislators alike to broadly mean any characteristic trait used to select and rate risks by an auto insurance company are now being narrowly defined by the industry to mean

[12] Wikipedia. Updated on July 5, 2008. "Redlining." http://en.wikipedia.org/wiki/Redlining (accessed on July 8, 2008).

only those characteristic traits of an individual that a multiple affiliate group company uses to base their placement into one of their affiliate companies. Contrastingly, these underwriting rules are being distinguished from rating rules in that rating rules are being carved out of the broad definition of underwriting rules and defined as only those characteristics of a driver that are used to increase or decrease the rates charged within the company, or in this case within the affiliate company after the placement of the driver into a particular affiliate is already determined. Despite these narrowly defined differences between underwriting and rating rules, it should be understood that they will all have the same affect of ultimately determining the premium charged to an individual driver.

By establishing these new distinctions in terms, these auto insurance companies have essentially created "high income" affiliate companies and "lower income" affiliate companies by simply adopting underwriting rules that serve as proxies for a person's income. As a result, these multiple affiliate group of companies can charge lower income safe drivers higher rates for car insurance than identical higher income drivers.

GEICO'S USE OF EDUCATION AND OCCUPATION AS "UNDERWRITING CRITERIA"

During our analysis of the competitive marketplace in 2004, we learned that GEICO's rate-making practices are threaded through its use of up to four separate GEICO insurance companies – GEICO, GEICO General, GEICO Indemnity and GEICO Casualty. Using the trademark name of GEICO allows them to deceive consumers that there is only one entity offering them insurance. Drivers qualifying for GEICO's preferred insurance company receive the best (lowest) rates, while drivers who do not quality for GEICO's preferred company receive rates from one of GEICO's substandard insurance companies and pay substantially higher rates.

Having up to four separate companies to underwrite drivers and four distinct and separate rates associated with each company, GEICO is capable of charging drivers that possess the same rating variables and coverage completely different rates, based upon the "underwriting" variables of education level and professional occupation. Remember, factors such as driving record, geographic location and car type are taken into account only after a consumer is placed in one of GEICO's four companies through this process, as they are deemed "rating rules" not "underwriting rules."

Drivers who possess higher educational attainments and hold white collar occupations are provided eligibility into the preferred GEICO Company. Conversely, individuals without a 4-year degree and labeled as "blue collar," nonprofessional jobs typically are only offered insurance through one of GEICO's sub-standard affiliate companies and at significantly higher rates.

It should not be surprising to any layperson, let alone the insurance industry which is dependent on its ability to analyze statistical correlations, that educational attainment used in this fashion by GEICO serves as a proxy for a person's income. Simply stated, by employing underwriting rules in this fashion, GEICO can attract higher income drivers by providing them the lowest rates.

Source: U.S. Census 2006[13]

Measure	Some High School	High school graduate	Some college	Associate degree	Bachelor's Degree	Bachelor's degree or higher	Master's degree	Professional degree	Doctorate degree
Persons, age 25+ w/ earnings	$20,321	$26,505	$31,054	$35,009	$43,143	$49,303	$52,390	$82,473	$70,853

In addition to the use of education as a proxy for income, GEICO's rejection of what they term "blue collar workers" from its preferred affiliate companies can have significant racial impacts as well. It has been found that African-Americans and Hispanics are almost 60% more likely than Caucasians to have blue collar occupations in the United States.[14]

Our own comprehensive examination of GEICO's underwriting practices led us to conclude that the only homogeneous characteristic traits that appear common among GEICO's preferred occupational groups are the traditionally higher income levels associated with their selected occupations, further supporting our conclusion that a person's income is truly the driver of loss ratio correlation and profitability found by the GEICO Group of Companies. In fact, the most comprehensive study on occupational groups in relation to accident frequency indicate that

[13] Wikipedia. Updated July 7, 2008. "Income Inequality in the United States." http://en.wikipedia.org/wiki/Income_inequality_in_the_United_States (accessed on July 8, 2008).

[14] Office of Insurance Regulation. "In the matter of: The Use of Occupation and Education as Underwriting Factors to Determine Moto Vehicle Insurance Premiums." February 9, 2007. p. 5. http://www.floir.com/pdf/occtranscriptv1.pdf

drivers with the highest accident frequency are medical doctors and attorneys, individuals who are paradoxically placed in GEICO's most preferred affiliate company with the lowest rates.[15]

IMPACT OF GEICO'S UNDERWRITING METHOD

Table 1 (below) illustrates GEICO's vehicle distribution in Florida[16], where they insure over 1.2 million vehicles. This table supports that a business strategy of attracting higher-income highly educated, white collar professionals, using GEICO's underwriting practices, is successful. It is no surprise that 77% of its vehicles insured by GEICO Group of Companies in Florida are being insured in the preferred GEICO companies of GEICO/GEICO General while the less educated/blue collar class of drivers assigned to GEICO Casualty (their substandard affiliate) accounted for only 8.7% of their overall insured vehicles. Most importantly, although the lower income drivers insured in the substandard GEICO Casualty affiliate are likely to own less expensive vehicles and purchase lower coverage limits, the policyholders are charged an average of 57% higher premiums than the preferred affiliate policyholders. Charging such significantly higher rates to the less educated/blue collar workers shows that increasing rates in this manner can serve as a *de facto* manner of risk selection. If the business strategy by GEICO Group of Companies is to avoid lower income drivers unless they pay significantly higher rates, regardless of their driving records, then this certainly has been accomplished through the use of their multiple affiliates.

TABLE 1. GEICO MULTIPLE AFFILIATE DISTRIBUTION 2006 (FL)

Company	# of Insured Vehicles	% of portfolio	Average Annual Premium	% increase from GEICO preferred affiliate(s)
GEICO/GEICO General	990,262	77.6%	$ 938.70	
GEICO Indemnity	174,823	13.7%	$ 1,183.70	+26.1%
GEICO Casualty	110,613	8.7%	$ 1,474.90	+57.1%
Total	1,275,698	100.0%		

15 NBC5i.com. 2004. "Survey Results Limiting Dangerous Driving Habits with Occupation." http://www.nbc5i.com/news/2874252/detail.html (accessed July 9, 2008).

16 McCarty, Kevin M., March 2007. "Report of Commissioner: The Use of Occupation and Education as Underwriting/Rating Factors for Private Passenger Automobile Insurance." P. 12.

It should be noted that this GEICO Group of Companies portfolio vehicle distribution is not isolated to Florida, as New Jersey's GEICO affiliate company distribution numbers are strikingly similar. Table 2 (below) shows that the substandard GEICO affiliate in New Jersey constitutes a mere 7.3% of their total vehicle insured population, and the insured drivers are paying an astounding 103% more on average than those with GEICO's preferred affiliate drivers, who have advanced educational attainment and/or professional high paying occupations:

TABLE 2. GEICO MULTIPLE AFFILIATE DISTRIBUTION 2006 (NJ)

Company	# of Insured Vehicles	% of portfolio	Average Annual Premium	% increase from GEICO preferred affiliate(s)
GEICO/GEICO General	348,578	62.5%	$ 1,013.43	
GEICO Indemnity	168,074	30.2%	$ 1,431.97	+41.3%
GEICO Casualty	40,790	7.3%	$ 2,057.91	+103.1%
Total	557,442	100.0%		

Source: New Jersey Department of Banking and Insurance

GEICO'S USE OF INCOME FOR MILITARY PERSONNEL

Finally, it should be noted that GEICO's 2004 corporate documents[17] state that military personnel who "earn" less than a "pay grade of E-4" are considered "ineligible military" by GEICO. This term of "ineligible" relates to their inability to receive the preferred GEICO rates associated with the preferred GEICO affiliate unless they meet additional strict criteria not required by any other military personnel. All E-4 or below pay grades are enlisted military that earn less than $24,216 annually.[18] It is clear from the language contained in the corporate guidelines that the intent by GEICO's underwriting methodologies is to attract the higher income military personnel by offering them entrance into their preferred GEICO affiliate, while rejecting lower income military personnel. It should be understood that when an insurance company, such

[17] The GEICO Auto Group Computer Assisted Reunderwriting Guidelines. July 6, 2004. p. 41.

[18] The U.S. Army Info Site. "Army Ranks and Pay Grade." http://www.us-army-info.com/pages/ranks.html (accessed on July 7, 2008).

as GEICO Group of Companies, is permitted to use income discriminatory practices against our military personnel in this manner, it can be adopted by other industry competitors as well.

HOME OWNERSHIP STATUS CRITERIA

Liberty Mutual, Progressive, Allstate and a growing number of other multiple affiliate companies have adopted conditions which state an individual will not be eligible for their "preferred" affiliate company or their preferred tiers with their lowest rates if they do not own a home, regardless of their driving record. Keep in mind that this discount and eligibility is not given to individuals who purchase and combine their homeowners' policy with their auto insurance policy with the company. Instead, this is used as a pre-requisite to receiving the lowest rates with the company. It is clear from available U.S. Census data that lower income individuals are less likely to own a home than higher income individuals,[19] which is why this underwriting practice prevents lower income drivers from receiving the lowest rates regardless of their driving record.

NO NOTICE TO CONSUMERS OF ADVERSE DECISIONS

Another deceptive practice that these multiple affiliate group of companies adopt to effectively bypass any public scrutiny of its practice is their purposeful failure to notify applicants when they are rejected by the preferred affiliates. For example, applicants who apply online with GEICO.com, and are rejected by the preferred GEICO affiliate due to their educational attainment and occupation, will simply receive a quote with higher rates from the sub-standard GEICO affiliate bearing their familiar trademark GEICO name.

Further research also indicates that multiple affiliate companies such as Liberty Mutual, as well as Allstate, do not provide sufficient notice to consumers of their rejection of their preferred companies.

Although consumers are given notice of an insurance company's adverse decisions based upon their use of credit-based insurance scores through the notice requirements of the Federal Credit

19 Wikipedia. Updated on July 5, 2008. "Household income in the United States." http://en.wikipedia.org/wiki/Household_income_in_the_United_States (Accessed on July 11, 2008)

Reporting Act (FCRA), there is no notice requirement for individuals who have had adverse decisions made based upon their education level, occupation, or home ownership status.

CONCLUSION

It should be made abundantly clear that the use of underwriting factors such as education, occupation and home ownership status, which serve as proxies for a person's income when used in this fashion, far exceed the negative impact that the use of credit-based insurance scores has on the lower income and minority population in the United States.

Unlike factors such as age, use, and driving records, which are widely accepted factors used in auto insurance that provide equal opportunity for drivers to change or control, a person's ability to go to college, to obtain a high paying professional occupation, or own a home are clearly "socio-economic" factors which disadvantage minorities and those in lower income classes.

Unlike other traditional business industries, auto liability insurance is mandated in the vast majority of the states. If lower income drivers are not capable of affording car insurance they face fines and possible imprisonment. Therefore, a fundamental measurement of a healthy and successful insurance pooling mechanism is when an equal opportunity exists for individuals to control the affordability of their car insurance.

When a mandated insurance product, such as auto insurance, becomes unaffordable by any sizeable portion of the market, it is a signal that the system needs correction. With the proliferation of insurance models that use credit scores and other income-proxy mechanisms such as education, occupation and home ownership, the reported number of uninsured motorists has grown at an alarming pace.[20] This supports the notion that families at the bottom end of the income scale have very little disposable income, and every dollar spent on premiums for auto insurance represents money that could be spent on other essentials, such as food, shelter and health care. The difficulty lies in the fact that owning a car can be extremely important in terms of finding and holding down a job or providing an opportunity for a person to climb the economic ladder in our country. Undeniably, the grand inequity of permitting multiple affiliate

[20] Insurance Information Institute. 2008. "Compulsory Auto/Uninsured Motorists." http://www.iii.org/media/hottopics/insurance/compulsory (accessed May 18, 2008).

companies for auto insurance is that such a system results in charging the most for car insurance to those individuals who can afford it the least.

In conclusion, although the insurance industry may desire to maintain the freedom to compete and underwrite in any method it deems necessary, it is the ultimate responsibility of our country's legislative body to determine public policy. It is clear from the record that the industry has consistently exhibited willful blindness in adopting such income discriminatory practices in order to meet its desire for profits, which is why CURE auto insurance urges the legislature to draw the boundary of what constitutes fair grounds upon which our industry can compete and ban the existence of multiple affiliate companies.

Supplemental Information on Insurance Scoring

Requested by

United States House of Representatives
Financial Services Committee
Oversight & Investigations Subcommittee
Honorable Melvin L. Watt, Chairman
Honorable Gary G. Miller, Ranking Member

Lawrence S. Powell, Ph.D.

Research Fellow
The Independent Institute
100 Swan Way
Oakland, CA 94621-1428
www.independent.org

and

Whitbeck-Beyer Chair of Insurance and Financial Services
University of Arkansas-Little Rock
326 Reynolds Center
2801 S. University Avenue
Little Rock, AR 72204

lspowell@ualr.edu
501.773.7577

Measurement Error in the FTC Race Proxy Finding

Chairman Watt, Ranking Member Miller, and Members of the Subcommittee, it was my pleasure to share information with you about insurance scoring during the hearing on May 21, 2008. In response to Representative Waters' request, I offer the following explanation of my disagreement with the FTC finding that insurance scores display a proxy effect for race.

The FTC reports, with reservation, statistically significant race and ethnicity "proxy effects" within the predictive ability of insurance credit scores. I absolutely believe this finding is mathematically incorrect.

The FTC study also includes other findings contrary to insurance scores being proxies for race and ethnicity. They state "the relationship between scores and claims risk remains strong when controls for race, ethnicity, and neighborhood income are included in statistical models of risk." In addition, they find "tests also showed that scores predict insurance risk within racial and ethnic minority groups (*e.g.*, Hispanics with lower scores have higher estimated risk than Hispanics with higher scores). This within-group effect of scores is inconsistent with the theory that scores are solely a proxy for race and ethnicity." Collectively, the lack of objective confidence in the existence of race or ethnicity proxy effects, and the evidence inconsistent with a proxy effect, demonstrate that public policy should not be altered to address this weak finding.

The Race Proxy "Finding"

The FTC report claims to find statistically significant evidence that insurance scores include a "proxy effect" for race. To understand what they find, it is important to understand – at least a little bit – about what the analytical models they use actually test. The "Tweedie GLM" model used in the FTC report is a modified regression model. A regression model measures how much of the variation in a dependent variable (predicted loss) can be explained by variation in an independent variable (race, ethnicity, income, or credit score) while controlling for other independent or control variables (geographic location, age, driving record, etc.).

The authors define a race proxy effect as a change in expected losses due to using insurance scores in the model that cannot be explained by a factor other than race. To

test for the effect, they estimate predicted losses for individuals in the sample with and without insurance scores and explicit race and ethnicity controls in the model. Next, they compare predicted losses of each group (African Americans, Hispanics, Asians, and Non-Hispanic Whites) with and without insurance scores. This is reported in Column (a) of Table 7 from the FTC report (copied below). Column (b) shows the same percentage differences when race, ethnicity, and income are explicitly controlled for in the model. The results for African Americans in Column (a) is 10%, and in Column (b) it is 8.9%, a difference of 1.1%. Thus, **if all other aspects of the model were reliable**, one might conclude that, of the 10% difference in expected losses from using insurance scores 1.1% is attributable to race.

TABLE 7.
Change in Predicted Amount Paid on Claims from Using Credit-Based Insurance Scores Without and With Controls for Race, Ethnicity, and Income, by Race and Ethnicity

	Average Score Effect From Model Without Race, Ethnicity, and Income Controls (a)	Average Score Effect from Model With Race, Ethnicity, and Income Controls (b)
African Americans	10.0%	8.9%
Hispanics	4.2%	3.5%
Asians	- 4.9%	-4.8%
Non-Hispanic Whites	- 1.6%	-1.4%

Careful objective review of the FTC analysis leads me to conclude without reservation that flaws in the model render the race and ethnicity proxy findings invalid. The technical term for the flaw in the model is omitted variable bias. It is a form of measurement error in which one variable is not measured accurately and, as a result, its effect is attributed to another variable. Results from the FTC model suggest strongly that territorial risk is not measured adequately, and the incorrect finding of a "proxy effect" is actually attributable to this measurement error.

The territorial risk variable used in the FTC study is not the same as territorial risk controls used by insurance companies. The FTC created a national territorial risk variable, whereas insurers make rates within each state. Calculation of the variable is described in the report as follows:

> *Territorial Risk Variable*
> The five firms also submitted to EPIC data on earned ear years and claims on property damage liability policies by ZIP code for a three-year period from 2000 to 2002, for their full book of business. EPIC combined the data from the five firms to calculate ZIP-code level average property damage liability pure premiums (*i.e.*, average dollars paid out per year of coverage per car).[1] This is an improvement over the original Census-based population density measure that EPIC used in its report. The new ZIP code risk variable was included in the policy database EPIC forwarded to the FTC.

The zip codes were then ranked by quintile of property damage liability claims. The variables that enter the final model are a series of indicators of the zip code quintile.

Territorial risk is an important predietor of risk because it describes the area where insured automobiles are garaged and driven. However, territorial risk may differ for several reasons. There could be differences in claim frequency due to traffic density, propensity to litigate, moral hazard and fraud, the population that could be injured, or many other reasons. These differences cannot be measured adequately by simply grouping territories into national zip code quintiles.

Further evidence that measurement error in the territorial risk variable is responsible for the race proxy effect is found by comparing results across coverage categories. Because the territorial risk measure is calculated using property damage liability data, it should be most accurate when applied to property damage liability claims. In the Property Damage Liability Coverage column, there is not a statistically significant valid proxy finding. In the other three columns, the magnitude of the estimated proxy effect grows as the expected measurement error from using a territorial risk calculated with PDL claims grows. However, the FTC study reports the sum of the effect on all four types of coverage to arrive at the 1.1% effect for African Americans and the 0.7% effect for Hispanics.

[1] For ZIP codes with fewer than 3,000 property damage liability claims, data from surrounding ZIP codes were also used to calculate average pure premiums.

The differences in accuracy of the territorial risk measure across coverage types merrit further explanation. As mentioned above, the territory measure is a function of third party property damage liability (PDL) losses by zip code. It is then applied, with noted reservation in the study, to claims for bodily injury liability (BIL), and first party property damage claims referred to in the study as collision (COL) and comprehensive (COM).

PDL claims pay for damage to property owned by a third party that is damaged as a result of the insured driver's negligence. They provide the most accurate estimate of driving ability because they represent almost all potential BIL claims[2], and the majority of potential COL claims. They are also not subject to claiming behavior influences such as the impact of deductibles and moral hazard.

BIL claims pay for bodily injury to a third party resulting from the insured driver's negligence. Nearly all BIL losses also involve a PDL loss, but the amount of damage from a BIL loss is much harder to determine objectively because it may include damages for pain and suffering. This lack of objectivity is found to create large differences in claiming behavior across territories (Hoyt, Mustard and Powell, 2006; Cummins and Tennyson, 1996). Therefore, a measure of territorial risk derived from PDL losses will not be accurate when applied to BIL losses.

A similar problem exists for COL claims. COL claims pay for property damage to one's own vehicle when another party is not liable for the loss. A territorial risk measure derived from PDL claims will not accurately reflect COL claim risk for two reasons. First, while PDL and BIL coverage is mandatory for all drivers, COL is not. Because many drivers do not carry COL coverage, the measure will be biased by differences in this coverage across territories. Second, claiming behavior affects these losses because a deductible applies to each occurrence or claim.

Finally, COM claims pay for damage to an insured automobile from perils other than collision with another vehicle or object. Perils covered by COM include fire, earthquake, windstorm, larceny, and malicious mischief. Thus, as the FTC study implies, there is no reason to assume a territorial risk measure derived from PDL claims would

[2] One exception is an automobile versus pedestrian collision in which the injured party's property is not damaged. However, such claims represent only a small portion of BIL claims.

apply to COM claims. Nonetheless, the FTC study includes the race proxy finding estimated from COM claims in its conclusion.

The preceding discussion of differences across coverage type leaves little room for doubt that the estimates of a proxy effect, while still questionable, would be most accurate for PDL losses. The FTC report does not find a proxy effect for African Americans or Hispanics when analyzing PDL claims. However, the proxy effect finding presented in the FTC study represents the sum of the effects measured for PDL (proxy effect =0), BIL, COL, and COM, potentially leading readers to an incorrect conclusion. Table 1 shows that as the degree of expected measurement error from the territorial risk variable increases across coverage types, the estimated proxy effect increases, suggesting the effect is actually the result of measurement error in the territorial risk variable.

Table 1: Expected Measurement Error and Proxy Effect Findings by Coverage Type

	Property Damage Liability Coverage	Bodily Injury Liability Coverage	Collision Coverage	Comprehensive Coverage
Race and Ethnicity				
African American	0.93	1.29*	1.26*	1.46*
Hispanic	1.06	1.15	1.24*	1.36*
Asian	1.20*	1.15	1.33*	0.97
Non-Hispanic White	1	1	1	1
Expected Accuracy of Territorial Risk Measure	Plausible	Inadequate	Inadequate	None

Source: FTC Report Table 6 modified by the author

Note: * indicates statistical significance at the 5% confidence level.

Collectively, the lack of objective confidence in the existence of race or ethnicity proxy effects, and the evidence inconsistent with a proxy effect, demonstrate that public policy should not be altered to address this weak finding.

References

Cummins, J. David, and Sharon Tennyson, 1996. "Moral Hazard in Insurance Claiming: Evidence from Automobile Insurance." *Journal of Risk and Uncertainty* 12 (1996): 29-50.

Hoyt, Robert E., David B. Mustard, and Lawrence S. Powell, 2006. "The Effectiveness of State Legislation in Mitigating Moral Hazard: Evidence from Automobile Insurance," *Journal of Law and Economics,* v49 (October 2006): 427-450.

May 21, 2008

The Honorable Melvin L. Watt
Chairman
Oversight and Investigations Subcommittee
2129 Rayburn HOB
Washington, DC 20515

The Honorable Gary G. Miller
Ranking Minority Member
Oversight and Investigations Subcommittee
2129 Rayburn HOB
Washington, DC 20515

Dear Chairman Watt and Ranking Member Miller:

We fully endorse the statement of Charles Neeson submitted to the Subcommittee for the May 21, 2008, hearing entitled "The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance." Along with the Property Casualty Insurers Association, the undersigned trades strongly oppose passage of H.R. 5633 and H.R. 6062.

As outlined in Mr. Neeson's testimony the use of credit based insurance scores (CBIS) allows insurers to more accurately predict losses thus lowering rates and providing consumers more choice. Several studies have reached this conclusion, including the Federal Trade Commission's study on the use of CBIS in automobile products, the Arkansas Department of Insurance survey, and the Texas Department of Insurance.

Prohibiting or banning the use of CBIS would, as former Texas Commissioner Jose Montemayor stated, ". . . create[s] pricing and availability disruptions in a market. . . . Premiums would go up for a large number of policyholders if the collar on credit scoring (or any other risk variable for that matter) is set too narrow, because it would force an immediate price shock that would be unrelated to a change in risk."

Currently, in addition to provisions in the federal Fair Credit Reporting Act, the States comprehensively regulate the use of CBIS and they are subject to anti-discrimination provisions. In fact, most states have enacted or adopted limits on how an insurer can use CBIS. For example, most states prohibit the use of CBIS as a sole reason for denying, cancelling, or non-renewing a policy. States have also enacted numerous other consumer protections including enhanced notices, rerating upon error correction, restrictions on what kind of information can be considered and protections for consumers without credit histories.

CBIS are a regulated, effective, objectively verified and fair risk measurement tool. Banning or prohibiting their use would restrict consumer choice and eliminate the mechanism by which insurers provide discounts to the majority of consumers.

Regards,

American Insurance Association
Financial Services Roundtable
Independent Insurance Agents and Brokers of America
National Association of Mutual Insurance Companies
U.S. Chamber of Commerce

cc: The Honorable Barney Frank, Chairman, House Committee on Financial Services
The Honorable Spencer Bachus, Ranking Member, House Committee on Financial Services

STATEMENT FOR THE RECORD OF

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

AT THE HEARING ON

"THE IMPACT OF CREDIT BASED INSURANCE SCORES ON CONSUMERS "

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

HOUSE FINANCIAL SERVICES COMMITTEE

MAY 21, 2008

Founded in 1895, the National Association of Mutual Insurance Companies (NAMIC) is the largest full-service national trade association with more than 1,400 member companies that underwrite 43 percent ($196 billion) of the property/casualty insurance premium in the United States. NAMIC members account for 44 percent of the homeowners market, 38 percent of the automobile market, 39 percent of the workers' compensation market, and 31 percent of the commercial property and liability market. NAMIC benefits member companies through advocacy, public policy and member services.

NAMIC and its member companies strongly oppose attempts to impose broad sweeping prohibitions on legitimate and predictive underwriting tools, including credit-based insurance scores. The use of insurance scores in insurance underwriting has been studied extensively for a number of years both inside and outside the insurance industry. Every serious study of the issue has reached the same findings - there is a strong correlation between credit information and the probability of a loss. The same studies demonstrated that the use of credit enhanced the fairness of insurance underwriting by allowing insurers to offer coverage to more consumers, more accurately price policies and actually lower costs for the majority of insurance consumers.

Banning or limiting the use of any underwriting or rating factor which is known to be predictive of insurance losses leads to decreased coverage availability and higher insurance prices. History is littered with examples of how limitations on rating by geography, age of driver, or other factor have destroyed competitive markets and driven up prices. A ban on the use of insurance scores would be counterproductive and would harm, rather than benefit consumers.

H.R. 5633/H.R. 6062

H.R. 5633, the "Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008" would amend the Fair Credit Reporting Act (FCRA) empower the Federal Trade Commission to determine whether the use of credit-based insurance scores in any personal lines underwriting or rating decision results in racial or ethnic discrimination or represents a proxy or proxy effect for race or ethnicity. Based on the findings of the FTC the legislation would prohibit a consumer reporting agency from furnishing to any person, and any person from using or obtaining, a consumer report or consumer information for such use. The bill excludes information, such as property loss data and driving or medical histories obtained or derived from specified databases.

H.R. 6062, the "Personal Lines of Insurance Fairness Act of 2008" would amend the FCRA to remove certain personal lines of insurance from the definition of authorized business purpose, banning the use of credit-based insurance scores for personal lines coverage. Like H.R. 5633, information, such as property loss data and driving or medical histories obtained or derived from specified databases would be exempted from the prohibition.

NAMIC opposes both H.R. 5633 and H.R. 6062.

Insurer Use of Credit Information

The goal of insurance underwriting is to correlate rates for insurance policies as closely as possible with the actual cost of claims. Effective underwriting allows insurers to operate profitably and compete in the marketplace. Likewise appropriate underwriting ensures that consumers benefit by not subsidizing other policyholders who pose worse insurance risks, resulting in inappropriate cross-subsidization.

A full understanding of insurer use of credit-based information requires an understanding of the risk assessment process. Each insured presents a unique risk to the insurer. In order for the insurer to determine an accurate insurance rate to be charged, there must be an accurate assessment of the risk. The more accurate the risk assessment, the more accurate and fair will be the rate charged.

No single risk factor has yet been discovered which accurately measures the totality of risk represented by each insured. The state of today's science is that the most accurate risk assessment is achieved through a combination of risk factors. The addition of one such risk factor, credit-based insurance scores, has significantly increased the accuracy of the risk assessment process.

Insurance scoring systems utilize credit-based information and assign an "insurance" score. These scores calculate an overall total, in which positive factors offset negative factors. No single negative item will necessarily prevent a customer from receiving the best rates. Many customers, while not qualifying for the very best rate, through the use of credit-based insurance scores will qualify for a significantly better rate.

Since insurance scores are used in conjunction with other risk factors, it has been common for insurance score models to reflect only those risk factors not already included in an insurer's rating plan. The risk factors commonly included in the score are credit-related risk factors such as number of non-insurance inquiries, number of derogatory public records, ratio of total balances to total high

credit, age of oldest account, etc. Some insurance scores also include noncredit-related risk factors.

A credit-based insurance score, or scoring model, is typically created by testing the statistical relationship between each risk factor and insurance losses. Those credit-related and noncredit related factors which exhibit a weak correlation with insurance losses are discarded, or given low weight. Those risk factors which exhibit the highest degree of loss predictability are given the greatest statistical weight in the scoring model. The statistical analysis technique used to measure the correlation of each risk factor with insurance losses and to determine the weight to be given to each risk factor is usually a generalized linear model or some other regression method that provides for the simultaneous, multivariate analysis of all potential risk factors to be included in the score.

The use of credit-based information varies among insurers; however, no insurer uses the information as the sole determining factor. The FCRA and FACTA, specifically allow insurers to use credit information for rating and underwriting and insurers comply fully with the limits on the use of credit information imposed by the FCRA, including adverse action notice requirements, and state laws and regulations.

Insurers do not collect information regarding the income, ethnicity, race, religion, national origin or creed. Similarly, credit-based insurance scores do not consider characteristics such as race, ethnicity, gender, national origin, or income level. Insurers are blind to those demographic factors, the application of credit-based insurance scores are applied uniformly across these groups. Credit-based insurance scoring are but one tool that insurers utilize to differentiate among policyholders based on the level of risk they present. As an example, geography, age, sex and marital status are important risk factors reflected in the rating plans of most insurers that differentiate risks.

The use of credit information by insurers across the board has consistently been shown to increase availability of coverage and decrease the cost for most policyholders. Uncertainty about the adequacy of prices is the most important factor affecting coverage availability.

If an insurer is confident in the adequacy of its prices there is a strong economic incentive for the insurer to provide coverage whether or not it is a high-risk insured or a low-risk insured. The lowest risk in the market is unattractive to insurers if the rate is inadequate. Because credit-based insurance scores have contributed to the accuracy and adequacy of rates, there are now stronger economic incentives for insurers to provide coverage to all consumers, including high-risk insureds, improving availability of coverage outside state residual markets or high-risk pools.

When insurance scores are introduced into a rating plan the rates for some insureds will be lower and for some insureds the rates will be higher. The same is true for every other rate factor in the rating plan. Some argue that an insured receiving the higher rate is being harmed; however, if insurance scores are limited in the rating plan, insureds with good insurance scores are harmed because they would be charged a rate too high for the degree of risk they represent.

Even insureds with poor insurance scores that are charged higher rates may actually be receiving coverage at more affordable rates than would be available without insurance scores. Often high risks cannot find coverage in the regular market because of inadequate rates. Those high risks are often forced to find coverage at much higher rates in the state's residual market (e.g., assigned risk plan or FAIR plan). In most cases, prices in the regular market are lower, even though increased because of a poor insurance score, than are prices in the residual market.

Credit-based insurance scores have tended to replace underwriting decisions concerning eligibility for coverage and placement into one of several available rating programs. Traditionally, underwriting decisions have been a mixture of an underwriter's application of objective eligibility rules and subjective judgments. Credit-based insurance scores have allowed many insurers to more fully implement a mechanical underwriting system with the result that the need for personal intervention has been reduced, the underwriting process has become virtually instantaneous and more cost-effective, and the need for subjective judgments has been eliminated.

As a result of credit-based insurance scoring, many companies affirm that they are able to write more business with greater confidence, and that the vast majority of policyholders directly benefit realizing better rates and more choices in the marketplace.

Disparate Impact

A variety of factors differentiate the level of risk and impact underwriting decisions. The question is not whether a particular factor differentiates, but whether a policy or practice has the effect of disproportionately harming or excluding members of a group defined by race, ethnicity, disability, or gender—even though the challenged practice makes no reference to these characteristics, and even though the resulting adverse group impact was not intended.

During debate on the use of credit-based insurance scores the term "disparate impact" is often used inappropriately. Disparate-impact analysis was originally conceived as a legal theory for use in Title VII employment discrimination

lawsuits. The theory holds that a standard or practice is presumptively illegal if it has a disproportionate negative impact on members of a group defined by race, ethnicity, or sex—even though the challenged practice makes no reference to these characteristics, and the resulting adverse group impact was not intended by those who designed and implemented the practice. Significantly, however, defendants can rebut the presumption of unlawful discrimination by showing that the challenged practice is required by "business necessity." Disparate *treatment*, on the other hand, refers to situations in which a decision-maker intentionally discriminates against people *because of* their race, ethnicity, disability, or gender. It is hard to imagine *any* standard or criterion that does not affect different subgroups within the population differently. Only if each group had the same average age, educational background, geographic distribution, and countless other traits, would we expect each group to be affected in exactly the same way.

Courts have generally been reluctant to apply disparate-impact analysis to discrimination claims that don't involve employment. Moreover, in non-employment cases where it has been applied, courts have tended to depart from the onerous "compelling business necessity" defense familiar in Title VII cases. That defense requires defendants to show that the purpose behind the challenged practice is "sufficiently compelling to override any racial impact" and that "no acceptable alternative policies or practices [exist] which would better accomplish the business purpose advanced, or accomplish it equally well with a lesser differential racial impact."

In place of the business necessity test, courts have substituted a "legitimate business justification" standard in disparate-impact cases brought under the Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA). For example, in a case that challenged a housing community's numerical occupancy limits on disparate impact grounds, the U.S. Court of Appeals for the Tenth Circuit rejected plaintiff's argument in support of a compelling business necessity standard, declaring that "there is no requirement that the defendant establish a 'compelling need or necessity' for the challenged practice to pass muster since this degree of scrutiny would be almost impossible to satisfy."

The courts have increasingly come to recognize that serious economic problems would result if the Title VII version of the disparate impact doctrine became the template from which courts, legislatures, and administrative agencies reflexively construct disparate impact standards for other areas of commerce. Applying the disparate impact approach to claims of discrimination in the granting of credit, for example, presents special difficulties because the task of evaluating applications for credit differs significantly from that of selecting job candidates.

The casual use of the term disparate impact during discussion of credit-based insurance scores is inappropriate and policymakers and stakeholders should take care not to use the term out of its legitimate context. In the case of

discussions of the effect of insurance scores the term disparate impact is incorrect and inappropriate terminology.

Credit-Based Insurance Score Studies

In recent years, multiple national studies have confirmed that there is a strong relationship between credit-based insurance scores and risk of loss. The relevance of credit information to insurance loss potential has also been proven by the actual loss experience of insurance companies and the study findings were recently confirmed by the Federal Trade Commission.

In 2003, a study conducted by the University of Texas' Bureau of Business Research found a strong correlation between credit histories and both the size and frequency of insurance claims. The study looked at over 150,000 policies and matched credit information to claims history. The average loss per policy in the data examined was $695.00. Policyholders with the lowest credit-based insurance scores had an average loss of $918.00 compared to those with the highest scores that had an average loss of $588.00. Also in 2003, a study conducted by EPIC Actuaries, the largest and most comprehensive study ever undertaken; found that a consumer's credit-based insurance score is directly connected to that consumer's propensity for auto insurance loss. Even more significant, the EPIC study found that insurance scores are consistently among the most important rating variables used by insurers today. The EPIC study looked at a nationwide sample of 2.7 million automobile insurance policies and found that the propensity for loss decreased as the insurance score increased.

A two-part report published in December 2004 and January 2005 by the Texas Department of Insurance ("TDI") confirmed that insurance scoring based on credit information is correlated with risk. The TDI study clearly indicates that individuals with low scores have a higher risk of loss. The study also found that individuals with low scores also have more frequent losses. According to TDI, the "study provides definitive proof of a strong relationship between credit scores and claims experience." The report went on to note that "poor credit scores are associated with increased claims activity, while good credit scores are associated with fewer claims." TDI also concluded that that the variation in insurance loss costs explained by insurance scores remained high even when all other traditional classification factors were taken into account. The Department found that when used with other rating factors such as location, driving record, and claims history, credit-based insurance scores enables insurers to more accurately predict the potential for future claims and that the use of insurance scoring is not unfairly discriminatory.

Similar findings were confirmed by the Arkansas Department of Insurance. Beginning in 2005, the Arkansas Department of Insurance conducted a survey of

the effect of the state's NCOIL model based law on the use of credit-based insurance scores. In summary, the Department found that of the 2.6 million personal lines policies written of renewed in 2006 30 percent resulted in premium decreases, as opposed to only 9 percent showing a premium increase. Thus more than three times as many Arkansas policyholders saw a benefit. In the remaining 61 percent of policies, credit was a neutral factor and as a result those policyholders saw no effect on their premium.

The recently concluded multi-year study by the FTC confirms the findings of earlier studies. The FTC study, unprecedented in its nature and independence, puts to rest the arguments critics have lobbed at the insurance industry for years. The report found that credit-based insurance scores are effective predictors of risk under automobile policies, and their use may result in benefits for consumers. Specifically, the FTC found that "credit-based insurance scores appear to have little effect as a 'proxy' for membership in racial and ethnic groups in decisions related to insurance."

These studies provide conclusive evidence that credit-based insurance scores are highly predictive of loss and are not unfairly discriminatory.

State Action

To date, 48 states have taken some form of legislative or regulatory action on the use of credit-based insurance scores with Pennsylvania and Vermont the lone exceptions. In 2002, the National Conference of Insurance Legislators (NCOIL) adopted an insurance scoring model act. Passage of the model was the culmination of months of drafting and negotiating to create a proposal that was endorsed by all the national property/casualty trade associations and the agents associations, which is unprecedented. The model is fair, reasonable and strikes a good balance between consumers' rights and protecting the rights of insurers to utilize this information. Twenty-seven states have approved laws or regulations that either replicate the main provisions of the NCOIL model or address the underlying issues in some other way. The model contains "sole use" restrictions for both rating and underwriting and provides consumer disclosure in the form of initial disclosure that credit is being used and additional disclosure in the case of an adverse action. The model also addresses concerns expressed regarding consumer requests to be re-rated or re-underwritten if their credit situation changes. The model also effectively addresses thin files and extraordinary life circumstances.

No credible information has been presented to suggest that the current state laws and regulations are not working to effectively protect consumers. Passage

of H.R. 5633 or H.R. 6062 would unreasonably restrict the use of this underwriting tool and would negatively impact pricing and insurance availability.

Conclusion

One cannot determine the fairness of an underwriting practice by measuring its statistical impact on particular groups. The question that rightly concerns most Americans is whether the manner in which people are treated is fair, irrespective of the outcome. An inquiry that focused on how individuals are treated—rather than on statistical outcomes among groups—would pose three questions:

1. Is insurance scoring neutral on its face with respect to race, ethnicity, and income?
2. Is it applied neutrally?
3. Is the use of insurance scoring motivated by a desire to discriminate based on race, ethnicity, or income?

In the case of insurer use of credit-based insurance scores, every empirical study has concluded that the answer to questions one and two are yes and the answer to the third question is no. As a result, it is inappropriate to ban a fair and effective underwriting tool that benefits the majority of insurance consumers. Congress should acknowledge and respect the actions of the states in effectively regulating the business of insurance, including the use of credit-based insurance scores.

National Association of Mutual Insurance Companies
122 C Street, NW
Suite 450
Washington, D.C. 20001
202-628-1558
www.namic.org

Statement of Michael J. Miller and EPIC Consulting Regarding Credit-Based Insurance Scores

Introduction

My name is Michael J. Miller. I am a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I am Principal and Consulting Actuary with EPIC Consulting, LLC with a business address at 21253 N 825 East Road, Carlock, Illinois.

I have practiced as a professional actuary for over thirty years with a special emphasis on ratemaking for auto and homeowners insurance. In 2003 I co-authored a major study pertaining to credit-based insurance scores entitled "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity".

Ratemaking and Estimating Loss Propensity

The essence of insurance is the transfer of risk. There is no sharing of losses with other insureds. An insurance consumer eliminates risk by choosing the certainty of the insurance premium versus the uncertainty of suffering a severe financial loss.

The insurance premium is a combination of the insured's expected loss, a provision for the insurer's expected operational/administrative expenses, and a provision for profit. An insured's expected loss is a function of the probability of a claim occurring (i.e., claim frequency or likelihood) and the average cost of the claim once it occurs (i.e., claim severity). For example, if an insured's likelihood of an auto collision claim is 10% per year and the average cost of a collision claim is expected to be $1,000, the insured's expected loss is $100 per year (i.e., 10% x $1,000). Another insured with a claim likelihood of 12% and an expected claim cost of $1,000 would have an expected loss of $120 per year (i.e., 12% x $1,000). Since the expected loss is part of the calculated rate, the insurance premium charge for this second insured would be higher than the premium charge for the first insured because the expected loss for the second insured is higher.

An insured's expected loss is estimated based on a combination of several risk characteristics, or risk factors. Each risk factor has been found to measure and predict at least a portion of the total risk associated with each insured. For private passenger auto insurance, where the car is garaged and principally operated has been statistically shown to affect both the likelihood of claim occurrence and the cost of claims. Other important risk factors that are statistically correlated to the risk of auto insurance claims include the age, gender, marital status, and driving record of the drivers; annual mileage and how the car is used (i.e., pleasure, commuting, or business); and the make and model of the car.

No single risk factor has been found that measures or predicts the total risk. Typically, insurers rely on over twenty risk factors to accurately estimate an insured's likelihood of a claim and the expected loss. All risk factors work in combination to measure and predict the total risk. The EPIC Study of 2003 which I co-authored showed, and the Federal Trade Commission's Study of 2007 (i.e., FTC Study) confirmed, that credit-based insurance scores are strongly related to an insured's likelihood of claim occurrence and add significant accuracy to the risk assessment process. The strength of the statistical correlation is such that a credit-based insurance score is among the most important risk factors used by insurers to accurately estimate the probability of claim occurrence. The EPIC Study found that a credit-based insurance score was among the top three most important risk factors for each of the auto insurance coverages. No researcher has yet been able to find an alternative risk factor that could replace a credit-based insurance score as a predictor of claim likelihood without sacrificing a great deal of accuracy.

Causation

Sometimes I hear critics complain that it is inappropriate to use a risk factor such as a credit-based insurance score because it does not "cause" an insured to have an auto accident. If causation were a standard for the use of a specific risk factor, there would be no risk factors that could be used to predict and measure risk. While understanding the cause (e.g., inattention to driving, driving too fast, following too closely, etc.) of claim losses may be of interest when attempting to reduce losses, non-causal risk factors are the most practical and powerful predictors of the probability of an insurance loss.

The classical example of a relationship that is a cause-and-effect relationship is a home built in a river valley. Living in a river valley does not "cause" a flood. But there is a predictive relationship between the risk of a flood loss and the construction of a home in a flood plain. It would be foolish to presume there is no risk of a flood loss merely because the location of the home does not "cause" the flood.

Many other examples of risk factors can be cited that do not cause accidents to occur. Past traffic violations do not "cause" future insurance losses, but there is a predictive relationship between past driving records and future losses. An age of the driver is not the cause of an accident, but it is predictive of the likelihood of a future accident. No predictive risk factor used in the risk assessment process can be said to actually cause an auto accident.

Causality should not be the basis for allowing or disallowing the use of credit-based insurance scores just as it should not be the basis for allowing or disallowing all other risk factors. The basis for allowing the use of any risk factor should be the ability of the risk factor to significantly contribute to the accurate measurement of the propensity for insurance losses.

It has long been a tenet of risk assessment that financial stability/responsibility was related to risk for private passenger automobile insurance. However, the concepts of financial stability and responsibility have been heretofore difficult to translate into objective, measurable risk factors. Credit-based insurance scores offer for the first time the means of objectively measuring the relationship between financial responsibility and the propensity for insurance losses.

While it would be inconsistent with sound actuarial principles to require credit-based insurance scores to demonstrate a causal relationship, we could reasonably speculate that there are psychological factors that likely affect our adversity to risk and how we manage our personal lives. We could reasonably speculate that the results of these psychological tendencies can be observed in many aspects of our personal lives, including our credit history and insurance losses. Insurance scores seem to provide an objective means of measuring personal responsibility and its effect on insurance losses, even though we may never fully understand the psychology involved.

Unfairly Discriminatory Rates and Proxy Effect

Rate regulatory laws throughout the United States consistently require that insurance rates not be unfairly discriminatory. This rate standard has a history in insurance literature and rate regulation that goes back in time over 150 years.

Traditionally, insurance rates have been considered to be unfairly discriminatory if there are premium differences that do not correspond to differences in expected losses and expenses, or if there are differences in expected losses and expenses that are not reflected in premium differences. Because credit-based insurance scores provide an important and accurate measure of risk, it would be unfairly discriminatory to charge insurance premiums that ignored the differences in risk measured by these scores. Two insureds with significantly different insurance scores represent a significantly different risk of loss and as such it would be unfairly discriminatory to charge these two very different insureds the same premium.

In addition to studying the relationship of insurance scores and risk, the FTC also attempted to research the issue of the relationship between credit-based insurance scores and race, ethnicity, national origin, and income. The FTC attempted to determine if differences in credit-based insurance scores were correlated to differences in insurance risk or whether the scores were merely a proxy for race or household income.

The FTC concluded:

a. Credit-based insurance scores are effective predictors of risk under automobile policies.

b. Credit-based insurance scores appear to have little effect as a proxy for membership in racial and ethnic groups in decisions related to insurance (emphasis added).

The FTC's use of the term "little effect" left the door open for the possibility that credit-based insurance scores did have some proxy effect, no matter how small, with respect to race and ethnicity. Based on its analysis the FTC estimated the proxy effect for African Americans to be +1.1% and for Hispanics to be +0.7%.

The FTC measured its proxy effect by comparing the average predicted risk derived from a model without controls for race to the average predicted risk for each racial group derived from a model with controls for race. In order to have any confidence that the small 1.1% and 0.7% proxy effects on risk are accurate and have any significance, the FTC needed to precisely control its analyses for all known risk factors other than race. Unfortunately, the FTC simply did not have a database that was refined enough to accurately identify such a small proxy effect of 1.0% or less.

The FTC acknowledged "that the large differences in average risk on comprehensive coverage for Hispanics and African Americans should be treated with some caution, as the geographic risk variable in the FTC database is not a very effective control for geographic variation in risk on comprehensive coverage" (emphasis added). I was directly involved in designing the database from which data was used by the FTC, along with other data, to construct their study database. If asked I would have advised the FTC that the geographic risk variable was less than an ideal control for geographic variation in risk for the bodily injury coverage, as well as for the comprehensive coverage.

The way that the FTC grouped the data by age/gender/marital status, by tenure, by mileage, and by geography reduced the FTC's ability to accurately control its statistical analysis for all known risk factors. The FTC's problems with the traffic violations data also limited its ability to accurately measure a proxy effect. It is highly likely that the 1% and less proxy effect which the FTC ascribes to race would have disappeared entirely had the FTC been able to precisely and accurately control the analysis for all known risk factors.

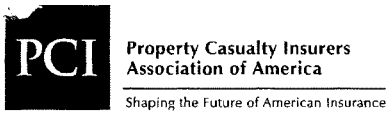
To support this contention I would draw the reader's attention to the calculation of the proxy effect for the property damage liability coverage. The data used to control for geographic risk for the property damage liability coverage was not ideal, but it was better data than for any other coverage. Where the FTC could adequately control for geographic risk the FTC found "very little difference in the impact of credit-based insurance scores on predicted risk based on whether the model included controls for membership in a protected class". In fact, the FTC found some evidence that inclusion of race in its model may be having an effect that was opposite a proxy effect for the property damage coverage (see FTC Study page 68). I suspect that if the FTC had been able to control for geographic risk as accurately for all

coverages ad it did for the property damage liability coverage, all hints of a proxy effect would have disappeared as was the case for the property damage coverage.

Conclusion

My primary criticism of the FTC Study is that readers were not properly warned as to the limitations of the data. The database was sufficiently refined to allow for general conclusions as to the ability of credit-based insurance scores to predict risk, both on an overall basis and within racial and income groups. The database was not sufficiently refined to allow for the measurement of a proxy effect that is as small as 1% or less.

In my opinion, the proper conclusion to be drawn from the FTC Study is that credit-based insurance scores are not proxies for race or income. Knowing someone's score provides no information, or even the basis for an educated guess, as to their race or income. If a small proxy effect does exist it is so small as to be unmeasurable by the FTC database. Surely the very small proxy effect hypothesized by the FTC, but not statistically proven, cannot invalidate an important risk factor that contributes significantly to the measurement of risk and benefits everyone by making insurance coverage more readily available.



The Use of Occupation and Education Factors in Automobile Insurance

In August of 2004, GEICO re-entered the state of New Jersey's insurance market after a 28 year absence. By the end of 2006, they had become the third largest auto insurer in the state. GEICO's rapid growth within its first two years in the New Jersey insurance market led the New Jersey Citizen Action (NJCA), a citizen watchdog organization, to charge that GEICO's use of occupation and education level was an unacceptable factor in insurance underwriting, and the use of these factors in rate setting was a proxy for race and occupation, having a negative impact on minorities and low-income drivers.

The issue was the subject of a hearing on June 12, 2006 in the New Jersey Senate Commerce Committee. Witnesses at the hearing included New Jersey Citizen Action (NJCA), New Jersey Citizens United Reciprocal Exchange (NJ CURE), GEICO, a variety of insurance trade organizations, and Department of Banking and Insurance Commissioner Steven Goldman.

On March 5th, a hearing was held on S-1714, a bill that would prohibit insurers from considering an applicant's occupation or education level. This bill was ultimately not released out of committee because of the possible unintended effects such legislation would have on the New Jersey auto insurance market. At that point, the New Jersey Department of Banking and Insurance decided it would meet with all parties to conduct an study of the issues raised by both sides.

In its analysis, which was published in April of 2008, the Department looked at the statutes and regulations of New Jersey, the statutes and regulations of other states and jurisdictions, the data and methodology of the NJCA report, GEICO's and other insurer filings in New Jersey, the findings of similar analyses conducted by Maryland and Florida regulators, census data, academic and government studies analyzing the effects of various insurance rating practices, and filings in a similar GEICO court case in Minnesota.

The Department's findings on New Jersey's statutes and regulations were supportive of an insurer's ability to use occupation and education level. Through the citation of statutory law and an analysis and comparison to other state laws, the Department wrote that "In summary, the Department's review of rating laws and regulations around the country confirms the Department's original understanding that occupation and education factors are widely permitted. They tend to be permitted because, as the Florida statute puts it, **the factors are 'actuarially measurable and credible and sufficiently related to actual or expected loss and expense experience of the group so as to assure that non-members of the group are not unfairly discriminated against.'"**[1] (Emphasis added).

The Department also analyzed New Jersey statutes, and found that the use of occupation and education level as rating factors was valid under state law. "Perhaps more importantly, **the Department has determined that the factors are, in fact, being applied by insurers in an objective, mathematical manner, with no knowledge of, or reference to, an individual applicant's race or income.**"[2] The Department further pointed out that **the use of occupation and education was actuarially valid and that the "Department is aware of no evidence of an interest by any auto insurer to measure race, income or any other characteristic by proxy**. (Emphasis added.)

---

[1] New Jersey Department of Banking and Insurance, *The Use of Occupation and Education Factors in Automobile Insurance*, April 2008
[2] Ibid.

The Department also analyzed the Maryland Insurance Administration (MIA) Conduct Report on GEICO, to determine whether the use of occupation and education levels violated Maryland State Code. The MIA found that the use of occupation and education level is reasonably objective, that occupation and education levels are predictors of loss, that occupation and education level risk characteristics meets the standards of risk classification, and that use of occupation and education level are not used as the sole decision to underwrite risk.

State of New Jersey
DEPARTMENT OF BANKING AND INSURANCE
PO BOX 325
TRENTON, NJ 08625-0325

JON S. CORZINE
Governor

TEL (609) 292-5360

STEVEN M. GOLDMAN
Commissioner

The Use of Occupation and Education Factors in Automobile Insurance

April 2008

Visit us on the Web at www.njdobi.org
New Jersey is an Equal Opportunity Employer • Printed on Recycled Paper and Recyclable

INTRODUCTION

Background

Occupation and educational attainment are two of more than one dozen commonly used factors for determining the price of auto insurance in most states, but the use of these factors has become a source of debate in New Jersey and some other jurisdictions, leading to a variety of analyses, public hearings and legislative initiatives.

In New Jersey and elsewhere, the practice of considering an insurance applicant's occupation or level of education is decades old; some insurers will only cover drivers who hold specified occupations, and in several states insurers charge less to applicants who have achieved certain educational goals.[1]

Not until 2004, however, had a company used occupation and education factors both simultaneously and on a wide scale in New Jersey. GEICO's national business model is based in part on the use of these factors, and the company, now the nation's fourth largest, extended that model to New Jersey when it re-entered the state in August 2004 after a 28 year absence. GEICO grew extraordinarily quickly in New Jersey while using this model, becoming the state's third largest auto insurer by the end of 2006.

GEICO's rapid growth and its use of these factors garnered public attention that year, and legislative concern about the company's use of the factors came to the forefront with a Senate Commerce Committee hearing on June 12. Witnesses

[1] "Membership" companies such as New Jersey Manufacturers Insurance Co., the state's largest auto insurer, require applicants to belong to specified occupations or trade organizations. Premium reductions for specified educational achievements are provided in New Jersey under the "Good Student Discount." California has some of the most restrictive rules on auto rating factors in the United States but nonetheless recognizes "academic standing" as a rating characteristic. See California Insurance Code, 10 CCR 2632.5(d). The California Insurance Department advises that it also permits separate rating systems for "affinity groups" that may be related to occupation.

included New Jersey Citizen Action (NJCA), a citizen watchdog organization; New Jersey Citizens United Reciprocal Exchange (NJ CURE), a New Jersey-based auto insurer that objects to the use of these factors; GEICO; a variety of insurance trade organizations; and Department of Banking and Insurance Commissioner Steven Goldman.[2]

In general, those who supported the ability to use these factors testified that a wide range of New Jersey consumers were benefiting from a 2003 package of auto insurance reforms that attracted new insurers to the State and thus prompted the growing use of the factors; that the ongoing use of the factors appeared to be contributing to increasing price competition and availability of coverage; that a regulatory change of course might jeopardize the market's substantial progress since 2003; that the factors appeared actuarially justified; and that the Department had no statutory or regulatory grounds upon which to deny their use.

Opponents of the use of these factors generally questioned the extent of the success of the 2003 auto reforms; questioned the role of these factors in implementing the reforms; questioned the actuarial basis for the factors; asserted that the factors were proxies for race and income or, at minimum, had a differential and negative effect on protected classes; asserted that the Department violated its own regulations by allowing their use; and asserted that, regulations aside, as a matter of policy the State should prohibit their use because of their impact on low-income and minority drivers.

Attention to the use of these factors was further heightened on February 28, 2007, when NJCA issued a report titled, ***Risky and Wrong: New Jersey Auto Insurance Rates for Lower Income and Minority Drivers, An Analysis of the Impact of GEICO's Use of Education and Occupation on the Price of Auto Insurance.***[3]

---

[2] Written testimonies are found in Attachment 1.
[3] See Attachment 2. Note that this attachment is the report as revised by NJCA on March 2.

The NJCA report expounded on the assertions that NJCA and other concerned parties had made in the preceding months, and sought to quantify the impact of education and occupation factors through an analysis of U.S. Census data and actual rates charged by GEICO. NJCA reported that GEICO charged dramatically higher rates to drivers with blue-collar occupations and less than a college degree, and that census data demonstrated that this practice was a proxy for race and class and had a differential effect on racial minorities and low-income drivers.

On March 5, following the release of the NJCA report but before the Department had an opportunity to analyze it, Department staff testified before the Commerce Committee on S-1714 (Gill/Vitale), a bill to prohibit insurers from considering an applicant's occupation or education.[4] The Department stated its specific concerns about the scope and potential unintended consequences of the proposed bill and reiterated its general concerns about changing course during a period of extensive progress in the auto insurance market.

The bill was not released by the Committee. However, the Department subsequently pledged to meet with NJCA and other groups to better understand their concerns, and to conduct an analysis of both the NJCA report and the issues raised by the sponsors and supporters of S-1714. The Department has done so. This document reports the Department's findings.

Process

As part of its analysis the Department examined:

- Statutes and regulations governing rating and acceptance decisions in New Jersey.
- Relevant statutes, regulations and practices of other jurisdictions.
- The data and methodology of NJCA's report.

[4] S-1714 is Attachment 3; the Department's testimony is Attachment 4.

- GEICO and other insurer rate filings with the Department.
- The findings of the Maryland and Florida insurance departments, two insurance regulators that have issued reports on this issue since the return of GEICO to New Jersey.
- Census data correlating race with occupation and education.
- Academic and government studies related to the potential differential effect of various insurer practices.
- Court filings in a pertinent class action lawsuit against GEICO in Minnesota.

In addition, the Department met with plaintiffs' counsel in the Minnesota case and conducted an independent, anonymous survey of GEICO's rates via the company's website.

In each instance, the goal was to establish facts about the use of these factors in New Jersey and across the country, to attempt to independently validate NJCA's findings (and where they could not be validated, to understand the methodological or other issues responsible for the difference) and to better understand various viewpoints on the issue of the possible differential effect of the use of education and occupation as factors in auto insurance.

RATE REGULATION AND THE USE OF OCCUPATION AND EDUCATION FACTORS IN NEW JERSEY AND OTHER STATES

New Jersey's statutory standard for the approval of automobile and other personal lines rating systems is set forth in N.J.S.A. 17:29A-7. That statute directs that:

> "If the Commissioner shall find that such rating-systems provide for, result in or produce rates that are not unreasonably high, and are not inadequate for the safeness and soundness of the insurer, and are not unfairly discriminatory between risks in this State involving the same hazards and expense elements, he shall approve such rates . . ."

This standard was originally adopted in New Jersey in 1944 and has continued in effect to date. It is similar to the general standard applicable in most United States jurisdictions since the 1940s.[5]

Since that time, New Jersey and many other states have amended their insurance rating laws in various fashions while maintaining the "not excessive, not inadequate, not unfairly discriminatory" standard as the fundamental criteria for insurance rates.

In New Jersey, the statutory criteria have been amended to include the following:

1. N.J.S.A. 17:29A-15.1 requires premium credits for various optional policy provisions required to be offered by New Jersey law;
2. N.J.S.A. 17:29A-36 requires uniform Statewide rating classifications; a 250% cap on the variation of base rates by class; a cap on the base class in any territory (since repealed but with the limitation that the resulting territorial rating differentials not be significantly disproportionate to those

[5] Enactment of insurance rating laws in all states were precipitated by the enactment of the McCarran-Ferguson Act, 15 USC 1101 et seq. which authorized the states broadly to regulate the business of insurance.

preexisting); and restrictions on the rating of automobiles with principal operators age sixty-five and over.

3. N.J.S.A. 17:29A-37, which requires flattening of taxes, licenses, fees and other expenses per insured automobile statewide; and
4. Various statutes enacted at different times that directed across-the board rate reductions upon enactment of changes in other laws.

While other states have modified their insurance rating laws in similar ways, either for general purposes or for automobile coverage in particular, few have directly addressed the use of occupation or education level as auto rating criteria. The absence of proactive statutory measures regarding such factors has therefore meant wide acceptance of their use under the bedrock "not excessive, not inadequate, not unfairly discriminatory" standard. [6]

Thus, at the time of its approval of the GEICO rating system in 2004, the Department understood that both occupation and education level were permitted as rating factors in most other jurisdictions, with only a small number of states having statutes or regulations that specifically addressed the issue in order to set forth conditions under which such factors could be used. [7] This group included Colorado and Pennsylvania.

The Department's understanding in 2004 is consistent with a finding by counsel for plaintiffs in a current, pertinent lawsuit against GEICO in Minnesota (discussed later in this report) that, in actual practice, GEICO uses occupation and education factors in essentially the same manner in forty-four jurisdictions.

In order to better understand how variations in state laws might affect the determination to permit the use of these rating criteria, or to regulate the manner in which they are used, the Department reviewed the auto insurance rating

[6] Under this standard, "unfairly discriminatory" means that the factors are not actuarially measurable and credible, and not sufficiently related to actual or expected loss and expense experience of the group.

[7] New Jersey is among the minority of states that impose specific statutory restrictions on the use of occupation as an acceptance criteria (as opposed to a rating criteria). These are discussed later in this report.

statutes of several other jurisdictions, starting with Colorado and Pennsylvania. The Department's findings are set forth below.

Colorado

Colorado's statute addressing insurance rates is set forth in the Colorado Revised Statutes at C.R.S. 10-1-101, a single paragraph that includes the standard:

> ". . . insurance rates shall not be excessive, inadequate or unfairly discriminatory."

Regulations promulgated by the Colorado Division of Insurance, found at 3 CCR 702-5, Section 5B limit insurers' action to refuse to write, cancel, nonrenew, increase premium, surcharge or reduce coverage. Section 5B.1 provides: "Basis for refusal to write a policy of automobile insurance (i.e., acceptance criteria):

a) Colorado law prohibits discrimination solely based on age, color, sex, national origin, residence, marital status or lawful occupation including military service". (emphasis added)

Section 5B.5.a provides a similar prohibition against refusing to renew.

On their face, these provisions appear to preclude the use of occupation in insurance acceptance decisions, though not in rating decisions. Personnel from the Colorado Division of Insurance confirmed that while these provisions prohibit the use of occupation as a reason to refuse an application or to nonrenew a policy, they do not prohibit the use of occupation in a rating system to reflect price differentials, so long as the differential is supported by adequate actuarial justification. Additionally, the Colorado Department advised that they have similarly required clear actuarial justification for any rating differences based upon education. Therefore, it appears that Colorado's use and application of its law and rules regarding these rating factors are similar to the New Jersey practice.

Pennsylvania

Pennsylvania statutes addressing this issue are set forth in its code at 40 P.S. 1171.5. Paragraph (a) of that statute defines "Unfair Methods of Competition" and "Unfair or Deceptive Acts or Practices" in the business of insurance to include:

> ". . . (7) unfairly discriminating by means of: . . . (iii) making or permitting any unfair discrimination between individuals of the same class and essentially the same hazard with regard to underwriting standards and practices or eligibility requirements by reason of race, religion, nationality or ethnic group, age, sex, family size, occupation, place of residence or marital status. The terms "underwriting standards and practices" or "eligibility rules" do not include the promulgation of rates if made or promulgated in accordance with the appropriate rate regulatory act of this commonwealth and regulations promulgated by the commissioner pursuant to such act." (emphasis added)

This statute appears to set a standard similar to the New Jersey practice which distinguishes acceptance criteria (whether coverage is provided) from rating criteria that determine price. According to the Pennsylvania Insurance Department, this reading is correct and neither this statute nor any other current provision of Pennsylvania insurance law would prohibit varying rates based on occupation if the insurer provided sufficient actuarial evidence supporting the differential.

Minnesota

Minnesota's statute at section 70A.04 sets forth the standard language that rates shall not be "excessive, inadequate or unfairly discriminatory," adding that an insurer shall not use rates to engage in unfair price competition. With respect to unfairly discriminatory rates, Subdivision 4 of the statute states that:

> "One rate is unfairly discriminatory in relation to another if it clearly fails to reflect equitably the difference in expected losses, expenses and the degree of risk. Rates are not unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors, or like expense factors but different loss exposures, so long as the rates reflect the differences with reasonable accuracy. Rates are not unfairly discriminatory if they attempt to spread risk broadly among persons insured under a group, franchise or blanket policy."

As noted in the Minnesota litigation referenced above, it appears that GEICO's use of occupation and level of education is permitted by this standard.

Florida

Florida statutes addressing automobile insurance rates are set forth in the Florida Statutes at section 627.0651. That statute contains the widely accepted standard to prohibit rates that are "excessive, inadequate, or unfairly discriminatory." Subparagraph (6) states: "one rate shall be deemed unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the difference in expected losses and expenses." Paragraph (7) states: "rates are not unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors, or like expense factors but different loss exposures, so long as rates reflect the differences with reasonable accuracy." Paragraph (8) states: "rates are not unfairly discriminatory if averaged broadly among members of a group; nor are rates unfairly discriminatory even though they are lower than rates for non-members of the group. However, such rates are unfairly discriminatory if they are not actuarially measurable and credible and sufficiently related to actual or expected loss and expense experience of the group so as to assure that non-members of the group are not unfairly discriminated against."

Based upon this statute, it appears that occupation and education factors are to be approved when loss experience is advanced to actuarially justify the rating differential, and legislative action would be required to implement a policy prohibiting the use of such factors. [8]

Michigan

Michigan's statute addressing rates for automobile and homeowners' insurance is set forth at Michigan Compiled Laws, section 500.2109 through 500.2111. That section includes the standard criteria that rates "shall not be excessive, inadequate or unfairly discriminatory" and defines unfairly discriminatory in paragraph (c) as follows:

> "A rate for coverages is unfairly discriminatory in relation to another rate for the same coverage if the differential between the rates is not reasonably justified by differences in losses, expenses, or both, or by differences in the uncertainty of loss, for the individuals or risks to which the rates apply."

Section 2111, however, sets forth with specificity a limited number of factors that may be used in automobile insurance rating. These factors do not include occupation or education level and thus these criteria are, on their face, prohibited. According to the Michigan Insurance Department, however, section 2110 of the Michigan statutes, enacted in 1997, permits auto insurers to establish and maintain premium discount plans utilizing factors in addition to those permitted by section 2111 "if the plan is consistent with the purposes of this act and reflects reasonably anticipated reductions in losses or expenses." The Michigan Insurance Department acknowledges that some insurers have used occupation and/or education level as the basis for discounts as permitted by that statute.

[8] Indeed, this was a conclusion of a March 2007 Florida Office of Insurance Regulation report on this issue, which report is discussed later in this document.

California

California's statutes concerning automobile insurance rating are set forth in the California Insurance Code, section 1861.02 which provides as follows:

> "(a) Rates and premiums for an automobile insurance policy, as described in subdivision (a) of Section 660, shall be determined by application of the following factors in decreasing order of importance:
>
> (1) The insured's driving safety record.
>
> (2) The number of miles he or she drives annually.
>
> (3) The number of years of driving experience the insured has had.
>
> (4) Those other factors that the commissioner may adopt by regulation and that have a substantial relationship to the risk of loss. The regulations shall set forth the respective weight to be given each factor in determining automobile rates and premiums. Notwithstanding any other provision of law, the use of any criterion without approval shall constitute unfair discrimination."

This California statute was adopted on initiative by voters as Proposition 103, Section 3, effective November 9, 1988. The California Commissioner's regulation setting forth rating factors is codified at 10 CCR 2632.5(d); these rating factors do not include occupation or education level. Subsection (d) 13 and (e), however, recognizes "academic standing" as a secondary driver characteristic and as a factor that may be combined with the three mandatory factors in order to rate an automobile insurance policy.

The California Insurance Department confirmed that based on the Proposition 103 law, occupation and education level are not currently used to rate auto insurance policies in that state. The reference to "academic standing" in the regulation is intended to permit the use of "good student discounts."

However, California also permits the use of "affinity groups" that provide separately rated auto insurance coverage to members of particular groups, which may be related to profession or occupation. The California Department advised that they review such programs to assure they are not being created simply to evade the prohibition in the law. As applied, rating of these affinity groups appears to be similar to the programs provided under New Jersey's rules. [9]

Massachusetts

Massachusetts statutes regulating insurance rating are set forth in the Annotated Laws of Massachusetts, Part 1, Title XXII, chapter 175E. Section 4 sets forth the standards for rates, directing that rates "not be excessive or inadequate . . . nor shall they be unfairly discriminatory." Although the balance of that section also includes other generally accepted insurance rating standards, section 5 of the statute authorizes the Massachusetts Commissioner to set rates required to be used by insurers upon a finding that competition is either insufficient or destructive. This finding has been made for the personal auto insurance market every year since 1977, and as a result all auto insurers in that state have used the same regulator-directed rating system for 30 years. The presently approved system uses a limited number of rating factors which do not include occupation or education level.

On October 5, 2007, the Massachusetts Commissioner proposed new rules (211 CMR 79.00) intended to bring competition and new entrants into the market, which currently consists of only nineteen companies. Most of the large national auto insurers do not write there and the major participants are "Massachusetts-only" companies. The new rules promulgate standards for insurers to file their own distinct rating systems. In section 79.05(11) the proposal sets forth a list of prohibited rating factors that include occupation and education. The prohibitions also include a number of factors that are used in most jurisdictions for auto

[9] NJAC 11:2-12 permits a discount from the insurer's standard rate to employees of particular employers or members of particular associations or organizations.

insurance rating such as sex, marital status and age (prohibited, but with an exception to allow special discounts for seniors).

According to the Massachusetts Department, action on the proposed rules is expected in the first quarter of 2008, after receipt and review of public comment, with an effective date later in the year.

In summary, the Department's review of rating laws and regulations around the country confirms the Department's original understanding that occupation and education factors are widely permitted. They tend to be permitted because, as the Florida statute puts it, the factors are "actuarially measurable and credible and sufficiently related to actual or expected loss and expense experience of the group so as to assure that non-members of the group are not unfairly discriminated against." California and Massachusetts are much more restrictive. However, in the few other cases where states proactively address the use of such factors, the general effect is to permit them under conditions not dissimilar to those already imposed in New Jersey.

ANALYSIS OF THE NEW JERSEY CITIZEN ACTION REPORT

New Jersey Citizen Action undertook a comprehensive review of the issue of occupation and education factors in automobile insurance, with a particular focus on the use of these factors by GEICO and an extensive investigation designed to determine the price impact of GEICO's rating system on applicants with varying levels of occupational and educational attainment.

However, the NJCA report contains several key assertions that, upon examination, appear to be unsupported. A foundational issue involves the assertion that the Department lacked the authority to permit the use of occupation and education factors. The Department also finds to be inadequately supported NJCA's claims that the factors are not actuarially justified;[10] that their use results in dramatically higher prices for certain classes of New Jersey drivers; that they are used by GEICO for marketing reasons not disclosed by the company; that they are used as proxies for race and income; and that the Department has exaggerated the positive impact of auto reforms and the linkage of these factors to improvements in the marketplace. Each of these NJCA assertions and the Department's responses are outlined below.

[10] As noted elsewhere in this document, insurance regulators in multiple other states have also found these factors to be actuarially justified.

NJCA Report: Department Lacked Authority to Approve GEICO Rating System

The use of occupation and education as rating or underwriting factors is prohibited by N.J.A.C. 11:3-19A, which states in part that "The placement of applicants and insureds at or within a tier and the movement of insureds between tiers shall be based on underwriting rules that...are mutually exclusive per tier, objective and not applied so as to violate any statute or regulation of the United States or the State of New Jersey." NJCA asserts that this rule is violated because "GEICO is using education and occupation in a manner that is not objective and in a manner that violates regulations of the United States and the state of New Jersey." (pp. 10-11)

While not part of its original report, NJCA made a related argument in a letter to the Commissioner dated June 6, 2007, so the letter is treated here as an addendum to the report. [11] *In that letter, NJCA asserted that the Department's approval of the GEICO rating system also violated N.J.A.C. 11:3-35, which lists prohibited underwriting rules including occupation.*

Department Finding

The regulations and the practical distinction between a set of acceptance criteria in a company's underwriting rules and a company's rating criteria appear to be the subject of general misunderstanding.

N.J.A.C. 11:3-35, by its own terms, does not apply to filings made after March 1, 1998. N.J.A.C. 11:3-35.1(c) states that "No private passenger automobile insurer shall make any filing pursuant to this subchapter after March 1, 1998." GEICO filed its rating system in August, 2004.

As applied by the Department to post–1998 rating systems, the acceptance criteria in a set of underwriting rules determine whether coverage will be provided

[11] See Attachment 5

at all. An insurer's rating system, in contrast, determines the price of coverage. The Department has consistently prohibited the use of occupation as an acceptance criteria (i.e., the offer of coverage or the refusal to offer coverage), except in the case of "membership" companies. But neither this nor any other regulation prohibits its use or the use of educational level in rating.

N.J.A.C. 11:3-35 was adopted as part of the implementation of the Fair Automobile Insurance Reform Act of 1990 (FAIRA). FAIRA established a legal requirement that insurers write business for all "eligible persons" (the "take-all-comers" law). The context for the requirement actually pre-dated FAIRA; prior rules prohibited use of occupation as a basis for canceling or non-renewing an auto insurance policy. The previous prohibition was unrelated to issues of race, creed or ethnicity, but instead arose from concerns about the availability of coverage for applicants in certain occupations that were perceived to generate more claims. These occupations included bartenders, entertainers and persons employed by race tracks. Other high profile occupations such as actors/actresses, professional athletes and politicians were perceived to represent "target defendants" more likely to be sued. Auto insurers in some other jurisdictions simply refused to write persons in these occupations, and so the rule was adopted to assure availability and continuity of coverage for such consumers in New Jersey.

FAIRA also restricted premium differentials to eligibility point surcharges in "standard/non-standard" rating systems. N.J.A.C. 11:3-35 was adopted to implement and enforce these provisions of FAIRA by requiring insurers to file acceptance criteria assuring that all "eligible persons" would be offered coverage.

In 1997 the Legislature significantly amended the automobile insurance laws, including repealing FAIRA's provisions establishing "standard/non-standard" rating systems, and substituted in their place "tier rating," which allowed insurers greater flexibility in the factors permitted to affect individual rates. The

Department implemented this new statute by adopting N.J.A.C. 11:3-19A, the regulation that NJCA cites in its report.

N.J.A.C. 11:3-19A established rules for the new tier rating systems. Occupation as a prohibited criteria was never transferred from N.J.A.C. 11:3-35 into this rule because tier rating involves pricing, not the ability to offer or deny coverage or a renewal of coverage (i.e., acceptance decisions). The applicability of N.J.A.C. 11:3-35 was thus limited to rating systems filed on or before March 1, 1998, because those were the only rating systems to which the provisions applied.

The 2003 automobile insurance reform laws began to phase out the "take-all-comers" requirement by permitting the use of underwriting rules with alternate acceptance criteria in order to exempt insurers that met specific growth targets from the obligation to cover all eligible persons. The Department's rules implementing those laws are set forth at N.J.A.C. 11:3-35A. Since these rules establish acceptance criteria standards (i.e., whether an applicant is able to obtain or retain coverage), the standards include a continued prohibition on the use of occupation or profession as an acceptance criteria.

As this background demonstrates, while the use of occupation or profession as an acceptance criteria has consistently been prohibited by the Department for non- "membership" insurers, the use of occupation or profession in rating (i.e., as part of the determination of the premium charged for coverage) has never been prohibited by any rule. In fact, the Department's "mass marketing" rules at N.J.A.C. 11:2-12 specifically permit the application of special price discounts for employees of particular employers, or for members of associations or organizations that may be based upon occupation, profession or education groups.

Since the enactment of FAIRA in 1990, many auto insurers have utilized a system of several separate companies in order to meet the requirement to write all eligible persons. The use of multiple companies to provide coverage to all

eligible persons has been consistently recognized by the Department as an acceptable rating system to satisfy the "take-all-comers" requirement within the group. The Department has prohibited certain acceptance criteria only when individual risks are being excluded from coverage, either initially or upon renewal; these standards have not been applied to rating systems that merely vary the price of coverage.

Since the approval of GEICO's rating system in 2004 was consistent with the statutes and rules then and currently in effect, the Department concludes that ordering its modification to exclude use of these factors would have been arbitrary and unable to withstand challenge.

With respect to NJCA's assertion that the use of the factors should be prohibited because it is "not objective" and violates U.S. law, the Department is unable to find support in the NJCA report or elsewhere for this conclusion. The footnote accompanying the assertion instead refers back to the Department regulation being quoted.

Perhaps more importantly, the Department has determined that the factors are, in fact, being applied by insurers in an objective, mathematical manner, with no knowledge of, or reference to, an individual applicant's race or income. Neither race nor income data is collected by New Jersey insurers (or, to the best of the Department's knowledge, by any other auto insurer in the country). Nor does GEICO in particular, as a predominately direct writer utilizing internet and telephone systems for its sales, come "face to face" with its applicants. All applicants with the same risk characteristics are treated in the same manner within each insurance company.

The impartial and consistent application of data that correlates losses to certain occupations and educational levels would seem clearly to constitute an "objective" use of that data, particularly since the data has been vetted by the Department, other regulators and the workings of the marketplace.

Additional support for the idea that the practice is well within insurance regulatory norms comes from the fact that it has been accepted in most other jurisdictions, as discussed previously in this report.

By way of confirmation, the Department also contacted the Maryland Insurance Administration (GEICO is domiciled in Maryland) to confirm usage of the model by GEICO in particular, and found that it generated no significant complaints.

NJCA Report: GEICO's Use of these Factors Results in the Exclusion of Certain Occupations and Levels of Education from GEICO's Best Company and Rating Tiers

"Contrary to GEICO's public representation, both a driver's education and occupation ***alone*** *can determine eligibility for one of GEICO's preferred companies, regardless of driving record." (p. 4)* (emphasis added)

"...GEICO fails to mention that drivers with lower education and nonprofessional jobs are denied access to the preferred company without notice and hence denied the lowest available rates." (p. 4)

Department Finding

This NJCA assertion appears to result from a methodological flaw that the Department found when attempting to replicate NJCA's findings on rate differentials. [12]

The Department conducted its own review of GEICO's acceptance criteria to determine if any risks were automatically excluded from GEICO's lowest-rated company (i.e., "preferred" company) and rating tier. DOBI determined that risks with a High School Diploma and Group 5 Occupation Class (the "least preferred" class) could in fact be eligible for the preferred company and rating tier.

With respect to the overall impact of GEICO's system on actual consumers in the market, the Department found that, for the 12-week period ending June 9, 2007, the preferred GEICO company wrote 4,417 policies (42.4%) where the named insured did not have a college degree, and 5,935 policies (56.9%) where the named insured was not placed in Occupation Classes 1 or 2 (the "most preferred" classes).

[12] This methodological flaw is discussed in more detail in the section on GEICO's rates.

For all companies combined, GEICO wrote 16,526 policies (63.2%) where the named insured did not have a college degree, and 19,481 policies (74.5%) where the named insured was not placed in Occupation Classes 1 or 2.

NJCA Report: The Factors Do Not Correlate to Risk

"There is no evidence that education or occupation – characteristic traits being used by GEICO to class drivers – correlate to risk." (p. 10)

"...demonstrating a correlation between education and occupation and corresponding loss ratios...does not constitute sound "actuarial loss data'." (p. 10)

"The industry fails to mention that the reason for this correlation is that education and occupation are simply proxies for income." (p. 10)

Department Finding

The Department finds NJCA's discussion of this issue to be contradictory and unclear. Department actuaries reviewed GEICO loss experience data and determined that the use of occupation and education was actuarially valid. The loss ratios are as follows: [13]

Occupation Group 1	0.849	High School or less	1.131
Occupation Group 2	0.837	Associate's Degree	1.027
Occupation Group 3	0.967	Bachelor's Degree	0.901
Occupation Group 4	1.047	Master's Degree	0.822
Occupation Group 5	1.257	Unknown	1.069
Student	1.084		
Military	1.040		

[13] This data was originally submitted to the Department in 2004 as proprietary and confidential. In September of 2006 GEICO authorized the Department to release the data in response to a legislative request for information about the issue. It has since been filed as an exhibit in a pending legal matter. Since it is directly relevant to the subject of this report and is no longer confidential, it is being reproduced here. Its reference should not be construed to indicate in any manner that the confidentiality of other proprietary information submitted to the Department by GEICO or any other insurer is deemed waived or otherwise compromised.

This information demonstrates that Occupation Groups 1 and 2 have better loss experience than the others, and that drivers with a Bachelor's or Master's degree are similarly less risky than the population generally. The differences are statistically significant and thus sufficient under current insurance statutes to be reflected in the rates charged to these driver groupings.

Based on this data, for example, individuals in Occupation Group 1 generate about 15% less claims than average drivers, while individuals in Occupation Group 5 generate greater than 25% more claims than average drivers. Similar results are documented in the loss ratios for groups with various levels of education.

It is unclear to the Department how the NJCA report concluded that this kind of data "does not constitute sound 'actuarial loss data'."

By way of confirmation, a Maryland Insurance Administration Market Conduct Examination report states: [14]

- GEICO has demonstrated that education and occupation are predictors of loss;
- GEICO's use of education and occupation as risk characteristics meets actuarial standards of practice and principles related to risk classification; and
- From an actuarial perspective, GEICO's use of education and occupation is reasonable.

Based on its review of testimony before the Senate Commerce Committee, and subsequent discussions with NJCA and others, the Department believes that the core issue here may be a desire that insurer rating systems be based on proven *causal* relationships between the factors used and losses incurred, instead of on statistical correlations.

[14] See Attachment 6.

While this may be appealing on an intuitive level, causation is ultimately not a meaningful or workable concept for insurance companies or regulators. This is because no currently used factors are proven to have causal relationships to losses, and seemingly commonsensical assumptions about causes are sometimes disproved mathematically. Having an accident this year does not *cause* a given driver to have another accident, yet it is typically reflected in the driver's rates based upon data that demonstrates a higher likelihood of future claims by insureds who have incurred past claims. Likewise with age, gender, marital status and other commonly accepted rating factors: none cause losses; they are simply statistically predictive of greater or lesser losses compared to all drivers combined.

Thus, as a predominately mathematical exercise, the assigning and pricing of risks is based on statistical correlations instead of on assumptions about causation, however logical they may seem. The more predictive those correlations are in practice, the more powerful and useful they are for the insurer.

Interestingly, some factors that intuitively seem most predictive are in practice less than ideal because of the infrequency of occurrence. For example, in New Jersey collision claims are made on average only once every 16 years. For comprehensive claims the period is 27 years. This is one of the reasons that insurers have searched for other correlations upon which to base their rates. Relying too heavily on accidents in the calculation of rates risks overcharging a customer who, statistically, is unlikely to have another accident for several years. Likewise, such over-reliance risks undercharging a customer who has not had an accident in several years but may have one soon. [15]

NJCA appears to believe that a "real" or "hidden" reason for the use of occupation and education factors is that they correlate with race and / or income,

[15] Indeed, the "standard/non-standard" rating systems created by FAIRA in 1990, which differentiated price primarily by surcharging those with accidents and motor vehicle violations, were criticized as unfairly penalizing minor transgressions. The statute was repealed in 1997.

and that race and / or income are what are in fact being measured here, but by proxy. The Department is aware of no evidence of an interest by any auto insurer to measure race, income or any other characteristic by proxy. But the argument does illustrate the fact that any given characteristic is part of a complex web of statistical correlations. One thing correlates with another which correlates with yet another, and so on. This reality and the thorny problems it raises are discussed later in this report with respect to the issue of differential effect.

NJCA Report: GEICO's Use of these Factors Results in Dramatically Higher Prices for Applicants with Certain Occupations or Levels of Education

A specific example based on a 51 yr-old female in Camden shows a rate difference from GEICO of 61% when education and occupation are varied. (p. 7)

GEICO's average rate quote for consumers without a Bachelor's Degree is 19% higher than for consumers with a Bachelor's Degree. (p. 8)

GEICO's average rate quote for consumers with a nonprofessional job is 27% higher than for consumers with a professional job. (p. 8)

GEICO's average rate quote for consumers with a Bachelor's Degree and a professional job is 38% lower than for all other consumers. (p. 8)

GEICO's average rate quote for consumers without a Bachelor's Degree and with a nonprofessional job is 22% higher than for all other consumers. (p. 8)

Department Finding

NJCA's findings are the result of a methodological flaw that results in an exaggeration of the differences in rates being quoted. NJCA used fictitious applicants without actual Social Security numbers and credit histories when requesting quotes from the GEICO website. The lack of actual credit information from a real applicant resulted in a large overweighting by GEICO's automated rating system of remaining factors such as occupation and education. This type of problem would arise in any case where insufficient or inaccurate information was provided to an insurance company by an applicant, regardless of whether or not the company used occupation or education factors. All auto insurers set prices based on a combination of factors; the removal of any one of the factors from the insurer's calculation would necessarily result in the remaining factors having an unexpectedly higher impact on the final price.

In addition, NJCA assumed that its drivers had no prior insurance (i.e., had been uninsured). That is an unlikely scenario for someone such as the 51 year old driver for whom NJCA got its most dramatic results.

DOBI compiled quotes based on a 51 yr-old female in Camden with the same characteristics as those selected for the NJCA study, except that DOBI varied the risk's prior insurance and credit histories. The results are as follows:

- For a driver with both prior insurance and a valid credit history, the impact of education and occupation combined was 8% ($524 v. $486 - both risks in GEICO);

- For a driver with a valid credit history but no prior insurance, the impact of education and occupation combined was 0% ($770 - both risks in GEICO Indemnity);

While the use of the factors clearly can result in more significant price differences than those above using this specific, fictional applicant, 19% was the largest difference that the Department found in its experiments with GEICO's online quote system using real drivers and varying both occupation and education level from the lowest to the highest categories.

With respect to the implications of GEICO's rating system for actual consumers shopping for insurance in New Jersey, it is worthwhile to note that prices also vary substantially between companies in the marketplace.

For example, a comparison of GEICO to six additional insurer groups for the risk discussed above, with prior insurance and a valid credit history, shows that four of the six insurers are significantly more expensive than GEICO despite GEICO's use of education and occupation as rating factors:

	GEICO	Insurer "A"	Insurer "B"	Insurer "C"	Insurer "D"	Insurer "E"	Insurer "F"
Prof. w/ Degree	$973	$1,792	$1,437	$1,541	$1,412	$1,000	$870
Non-Prof w/o Degree	$1,048	$1,792	$1,437	$1,541	$1,412	$1,000	$870

Thus, for actual consumers, GEICO's use of occupation and education rating factors results neither in dramatic rate differentials within GEICO nor in rates that make the insurance marketplace as a whole less affordable. On the contrary, as the following section describes, rates have generally fallen across the marketplace since the re-entry of GEICO in 2004 and the increase in competitive pressures to which that re-entry contributed.

NJCA Report: The 2003 Auto Reforms Have Failed to Create the Market Improvements Claimed by the Department and Others, and the Use of Occupation and Education was Not Part of Those Reforms

"...despite countless press releases, (the Department) and lawmakers have curiously failed to mention several key facts to the public regarding the condition of New Jersey's auto insurance market post (reform). First...the actual number of insurers writing auto insurance has decreased since 2003...Second, New Jersey continues to maintain the title for having the highest auto insurance rates in the country as of 2004. Third, the country-wide private passenger auto insurance marketplace has reported record profit levels since 2003, discrediting claims that (auto reform) was primarily responsible for the improved profits by auto insurers in New Jersey. Most importantly, the concerted effort to lure national auto insurers into New Jersey went beyond the scope of (the) original reforms and ultimately resulted in accommodations to the auto insurance industry at the price of consumer protections, in particular, protection for lower income individuals and racial minorities in New Jersey." (p. 5)

Department Finding

The NJCA report contains the following numbers of insurers: 2003 – 82; 2004 – 79; 2005 – 73; 2006 – 82; 2007 – 82.

DOBI has reviewed its records to determine that of the 82 insurers authorized for private passenger auto insurance in 2003, only 63 actually wrote private passenger automobiles; others wrote miscellaneous/specialty vehicles or motorcycles. Between 2003 and 2006, the number of insurers actually writing automobiles had increased to 69, a gain of six.

Since 2003, 13 new companies were licensed to write, and have begun writing private passenger automobiles. They are:

Company	Effective Date	Exposures as of 12/31/2006
Mercury Indemnity Company of America	8/14/2003	121,332
Government Employees Insurance Company	8/16/2004	387,121
GEICO Casualty Company	8/16/2004	36,689
GEICO Indemnity Company	8/16/2004	183,806
Esurance Insurance Company	3/29/2005	16,858
AMEX Assurance Company (transferred to IDS PC Ins Co)	7/1/2005	10,270
Progressive Garden State Insurance Company	9/30/2005	16,520
Progressive Freedom Insurance Company	9/30/2005	20,387
Drive New Jersey Insurance Company	9/30/2005	44,876
AIG Premier Insurance Company	3/1/2006	2,086
Unitrin Direct Insurance Company	4/18/2006	3,550
21st Century Insurance Company	10/8/2006	14,403
Personal Service Insurance Company	11/9/2006	1,111
13 Companies		859,009

NJCA is correct that New Jersey has consistently ranked first in national surveys of the average premium paid per vehicle. The Department does not share the conclusion, however, that the 2003 reforms have therefore failed to accomplish their goals.

First, the reforms were crafted in response to a crisis of availability, not affordability.[16] While the Department hoped for and expected downward pressure on premiums as a result of competition generated by the entrance of new insurance companies, the primary goal was to increase capital investment by insurers and thus the capacity and appetite to cover drivers who were then having difficulty finding coverage regardless of price.[17]

That the availability of coverage has risen dramatically since the reforms is beyond dispute. It is demonstrated by the more than 75% reduction since 2004 in the number of vehicles in the state's insurer of last resort, the Personal Automobile Insurance Plan (PAIP). PAIP insured 143,516 exposures in 2004. That number had dropped by more than 50% by the end of 2006, to 61,016 exposures. By the end of 2007, the figure had fallen by more than 50% again, to 29,285 exposures. Vastly improved market conditions are also reflected in the more than 50% reduction in auto related consumer complaints to the Department since 2004.

Second, premium reductions resulting from the competition spurred by new entrants and capital investment have, in fact, been substantial, and have resulted in a decline in the annual average premium paid in New Jersey.[18] In total, more than $1.2 billion has been returned to consumers in the form of dividends or rate reductions filed with the Department. That figure does not include savings consumers have presumably realized by switching to new entrants or other companies because of lower rates.

It is also an error to conclude that the relatively high premiums paid by New Jerseyans are, per se, an indication of a failure of the marketplace or reform. While the cost of insurance can certainly be problematic, particularly for lower income drivers, New Jersey's average premium figures are primarily reflective of two main circumstances that are largely beyond the control of insurers,

[16] See Attachment 7.
[17] See Attachment 8.
[18] See Attachment 9.

regulators and policymakers: 1) the high population and motor-vehicle density of New Jersey; and 2) the amount of coverage most New Jerseyans choose to buy.

Average premium figures measure both *rates charged by insurers* and the *coverage-level choices made by consumers*. In New Jersey, 87.5% of drivers choose at least $250,000 in Personal Injury Protection (i.e. medical benefits). This is the second highest level of medical coverage in the nation. And 82% choose at least $100,000/$300,000 split limits in bodily injury liability protection, roughly ten times the amount required by law.

New Jersey is consistently ranked as one of the nation's most affluent states. [19] It should be expected that residents with high levels of assets would choose to purchase high levels of insurance protection, and to drive vehicles that are more expensive to repair and replace, and thus more expensive to insure. Naturally, those choices would be reflected in the premiums that New Jersey drivers pay.

The Department is unsure how to respond to NJCA's assertion regarding the connection between reforms and insurer profitability in New Jersey, as the Department's interest in reform has always focused first on its role in expanding access to coverage and secondly on the ability of competition to put downward pressure on rates, thereby enhancing affordability. The Department notes, however, that after auto reform New Jersey fell sharply in national rankings of the most profitable states for auto insurers, to a mid point amongst the states. And National Association of Insurance Commissioners data shows that rates have dropped along with profits, suggesting that auto reform has been successful on more than one front. [20]

The Department agrees with NJCA that the 2003 statutory reforms are silent on the issue of occupation and education factors in auto insurance rating. But the

[19] U.S. Economic Census spreadsheet, Attachment 10
[20] See Attachment 11

Department does not share NJCA's inference that this silence should be construed to mean that such factors are prohibited.

As has already been demonstrated, these factors have long been utilized by insurers in New Jersey and most other jurisdictions. The 2003 reforms amended no statutory or regulatory provisions relevant to this matter. What the reforms did do -- primarily through a rationalization of rules regarding withdrawal from the market, excess profit, "Take-all-Comers" and rate filing process -- was make New Jersey more attractive to national carriers. When such carriers applied to enter the State, they did so with the business models that they were accustomed to using in other parts of the country. To the extent those models conformed with New Jersey statutes and regulations, they were approved by the Department. This is the connection of these factors to auto reform that the Department has cited.

The assertion that these market changes resulted in worsening conditions for consumers appears to the Department to be contrary to the evidence. The availability of coverage clearly increased. The price of coverage clearly decreased. And consumer complaints dropped precipitously.

NJCA Report: The Real Reason for Using the Factors is to Insure More Affluent Drivers to Whom the Insurer Can Sell More Profitable Products

"Higher income consumers have more profit potential for multi-line insurance companies. Private passenger automobile insurance typically yields small profit margins in comparison to homeowners', boat, life and umbrella insurance. With higher income households, a multi-line insurance company has the opportunity to reap larger profits because higher income households possess more assets to insure. Auto insurance in this fashion is being used simply as a "foot in the door" to sell other types of insurance." (p. 9)

Department Finding

GEICO does not write homeowners, boat or life insurance in New Jersey.

NJCA Report: the Factors are Proxies for Race and Income

"GEICO's use of education and occupation as rate-making factors results in discrimination against lower income people and minorities, because education and occupation are serving as proxies for race and class." (p. 11)

Department Finding

In this context the term "proxy" suggests a proactive decision to use one rating characteristic in place of another characteristic of similar predictive power in an effort to circumvent obstacles to using the "original" factor. The Department found no evidence that GEICO or other companies are using occupation and education factors in this manner.

The actuality that a "Factor X" used by an insurer correlates with losses, and that a "Factor Y" not used by an insurer may also correlates with losses, does not make "X" a proxy for "Y." In practice, a multitude of correlations exist, some known to the insurer and some not, some measurable by the insurer and some not, and some stronger than others. The insurer is interested in strong correlations that it can measure. The Department believes that is what is happening when insurers choose to use factors such as occupation and education.

A better understanding of the interplay of various correlations in a complex web of correlations – whether or not they are considered, known to, or measured by an insurer – may be worthwhile and could be the subject of academic analysis by scholars who specialize in this area. Such an analysis would be interesting, especially were it to provide more statistical detail of the impact of actual rating factors on actual customers.

While the Census data and analysis in this specific Department Finding is limited to correlations between racial categories and occupation and education levels, it

would be helpful for public policy deliberations on insurance rating factors in general to learn more about correlations involving rating factors other than occupation and education.

As it stands, the Census data points seen by the Department are not always specifically matched to the insurer criteria at issue in the present discussion, limiting the understanding of exact impacts. Thus, while general inferences about the impact of these factors on certain populations can be drawn with some confidence, the details are difficult to pin down.

To better understand what can currently be inferred, however, the Department conducted a review of New Jersey census data for the year 2000 on occupation and education levels, and on census data for the year 2002 on income in the United States by racial category. [21]

The occupation and education data indicates that most adults in New Jersey, regardless of race, have less than a Bachelors degree and work in non-professional occupations. However, with certain exceptions, non-Hispanic Whites are generally more likely than non-Whites to have Bachelors degrees or higher, or to work in professional occupations.

[21] For extensive relevant income data and analysis, see the Census report, *Income in the United States: 2002* in Attachment 12.

New Jersey
2000 US Census Data - % Bachelor's Degree or Higher by Race Category
Ages 20 Years and Over

	Bachelors or Higher	%	Less than Bachelors	%	Variance
White non-Hispanic	1,055,365	**38.4%**	1,693,380	**61.6%**	---
Hispanic	67,155	14.1%	408,480	85.9%	24.3%
Black non-Hispanic	92,965	19.9%	375,220	80.1%	18.5%
Asian non-Hispanic	159,470	66.2%	81,260	33.8%	-27.8%
NHOPI non-Hispanic	322	34.1%	623	65.9%	4.3%
AIAN non-Hispanic	1,294	23.9%	4,115	76.1%	14.5%
Black & White non-Hispanic	1,138	24.3%	3,550	75.7%	14.1%
Asian & White non-Hispanic	2,995	42.3%	4,085	57.7%	-3.9%
AIAN & White non-Hispanic	1,205	20.3%	4,735	79.7%	18.1%
AIAN & Black non-Hispanic	882	24.7%	2,690	75.3%	13.7%
Balance 2+ Races, non-Hispanic	13,670	28.4%	34,495	71.6%	10.0%
Sub-total All except White non-Hispanic	341,096	**27.1%**	919,253	**72.9%**	11.3%
New Jersey Total	1,396,461	34.8%	2,612,633	65.2%	

As shown above, 65.2% of all adults have less than a Bachelors Degree, compared with 61.6% of non-Hispanic Whites, 80.1% of non-Hispanic Blacks and 85.9% of Hispanics.

The largest discrepancy from the overall average is seen for non-Hispanic Asians, where only 33.8% have less than a Bachelors Degree. Asian is the only racial category in which a majority of members have attained a Bachelors degree or higher.

In summary, Asians are dramatically more likely than average to have attained a Bachelors Degree, Whites are slightly more likely than average, and Blacks and Hispanics are moderately less likely than average.

A similar pattern is found in the Census data on occupation:

New Jersey
2000 US Census Data - % Professional Occupation by Race Category

	Prof	%	Non-Prof	%	Variance
White non-Hispanic	1,074,825	**37.5%**	1,787,735	**62.5%**	---
Hispanic	77,600	15.2%	431,360	84.8%	22.3%
Black non-Hispanic	113,150	22.9%	380,305	77.1%	14.6%
Asian non-Hispanic	127,675	51.6%	119,835	48.4%	-14.0%
NHOPI non-Hispanic	325	32.7%	670	67.3%	4.9%
AIAN non-Hispanic	1,430	25.2%	4,255	74.8%	12.4%
Black & White non-Hispanic	1,184	22.1%	4,170	77.9%	15.4%
Asian & White non-Hispanic	2,665	34.3%	5,094	65.7%	3.2%
AIAN & White non-Hispanic	1,555	24.5%	4,795	75.5%	13.1%
AIAN & Black non-Hispanic	1,120	29.9%	2,620	70.1%	7.6%
Balance 2+ Races, non-Hispanic	11,490	22.6%	39,250	77.4%	14.9%
Sub-total All except White non-Hispanic	338,194	**25.4%**	992,354	**74.6%**	12.1%
New Jersey Total	1,413,025	33.7%	2,780,120	66.3%	

As shown above, 74.6% of all adults work in non-professional occupations, compared with 62.5% for non-Hispanic Whites, 77.1% of non-Hispanic Blacks and 84.8% for Hispanics.

Again, the largest discrepancy from the overall average is seen for non-Hispanic Asians, where only 48.4% work in non-professional occupations. Asian is the only racial category with a majority of members working in professional occupations.

In summary, Asians are much more likely than others to be working in a professional occupation, Whites are moderately more likely than average, and Blacks and Hispanics are moderately less likely than average.

From the results combined, it is reasonable to conclude that Asians are far more likely than the general populace to benefit from auto insurance rates that reward high educational and occupational attainments, Whites are slightly to moderately more likely than the general populace to benefit from such rates, and Blacks and Hispanics are moderately less likely than the general populace to benefit from such rates.

This also means, however, that each racial category includes a sizeable percentage of people who benefit from such rates, and a sizeable percentage who do not. It is because of this that NJCA appears to overstate its case that educational and occupational factors single out minorities as a group. The impact of these factors is by no means limited to any given racial category. In fact, the members of one minority group (Asian) are more likely than not to experience a positive impact from these factors. And the members of all other racial categories (*including Whites*) are *less likely* than not to experience a positive impact.

That NJCA appears to the Department to overstate the impact of these factors on minorities and non-professional workers does not, however, mean that NJCA's concern is without foundation.

The fact that drivers who belong to a minority racial group or have non-professional occupations are, on average, less likely than others to receive the best rates from an insurer that uses occupation and education rating factors means that these factors do indeed have a differential effect on racial minority and lower income drivers.

The Department looked to a variety of sources to try to better understand this issue. One source was the ongoing litigation, Amos, et al. v. GEICO, et al., a Minnesota case specifically challenging GEICO's use of occupation and education factors in auto insurance.

Amos, et al. v. GEICO, et al.

By Amended Complaint dated May 12, 2006 filed in the United Stated District Court in Minnesota (Civ. No. 06-1281), six African American GEICO policyholders sought declaratory, equitable and monetary relief to remedy the asserted racially discriminatory conduct of GEICO and its affiliate companies for using education level and occupation as auto insurance rating factors. Plaintiffs, for themselves and others similarly situated, allege that use of occupation and

education level in auto insurance rating violates 42 U.S.C.1981, the federal civil rights statute which prohibits the use of race in the making and enforcing of contracts.

Plaintiffs' Amended Complaint identifies themselves as four GEICO policyholders from Minnesota, one from Georgia and one from East Orange, New Jersey. Plaintiffs allege that GEICO's use of occupation and/or level of education to set auto policy rates discriminates against African American/black policyholders because of race.

In response to the complaint, GEICO filed a Motion to Dismiss on grounds that Plaintiffs' Amended Complaint does not allege intentional discrimination, as is required under the federal civil rights statute, but rather only alleges disparate impact, which it asserted is not actionable under that statute.

A hearing on the motion was held August 24, 2006 and a Magistrate Judge's written decision denying GEICO's motion was issued October 27, 2006 and later confirmed by court order. While not reaching the merits of plaintiffs' claims, the Magistrate Judge found that plaintiffs had adequately alleged a case of intentional discrimination under the federal civil rights law.

Besides reviewing various court documents filed in this case, Department personnel communicated by telephone with Plaintiffs' counsel and, on October 1, 2007, met with them.

Counsel stressed that the Minnesota litigation is an action brought under the Federal Civil Rights Law, which they believe GEICO's practice violates, and not under the insurance laws of any jurisdiction. They stated that the practice of using occupation and education level in auto insurance rating is not inconsistent with nor prohibited by the insurance laws in the approximately forty-four jurisdictions where GEICO utilizes the same method of evaluating education and occupation in auto insurance rating. Plaintiffs' counsel further noted that they

accepted insurance regulators' duty to administer the insurance laws as they exist in each jurisdiction, but believed that the practice is actionable as a violation of the federal Civil Rights Law.

The Minnesota litigation is currently in the discovery phase. Through discovery and continuing research, plaintiffs' counsel are developing their case for ultimate presentation to the Court. The Department will continue to monitor future developments in this case to evaluate the impact of the issues being litigated on public policy regarding auto insurance regulation.

Florida Office of Insurance Regulation Report

Another source of information on the impact on minorities of the use of education and occupation in rating is a Florida Office of Insurance Regulation (OIR) report issued in March, 2007, after a public hearing on February 9.

The hearing investigated the following eight questions:

I. Is there a correlation between Education/Occupation and Race/Income?
II. Is the insurance industry aware of such correlations between Education/Occupation and Race/Income?
III. Does the insurance industry believe its corporate responsibility extends to ensuring its policies do not negatively impact people due to race/income?
IV. Has the insurance industry researched the impact of its practices on Floridians as it relates to minority or low-income individuals?
V. Is there a correlation between education/occupation and loss ratios and or accident statistics?
VI. If it is determined that the use of education and occupation negatively impacts protected classes, what is the magnitude of the impact?
VII. If the FL Legislature does not change the laws, what will be the potential impact on the auto insurance industry?
VIII. If education and occupation were not allowed for underwriting factors, would the insurance industry still be competitive?

The OIR determined that there is a strong correlation between the factors in question, and that use of education and occupation would "negatively impact minorities." This conclusion is based on a review of US Census data revealing that higher percentages of White individuals are employed in management/professional occupations and have bachelors degrees. Data also shows that those employed in management/professional occupations have higher median incomes, and also that those with more education also have higher median incomes.

The industry denied knowing of any statistical correlations between education/occupation and race/income. All of the industry representatives (except for Eric Poe from NJ CURE) said that they did not review Census data, nor were they aware of anyone in their respective companies who did. The General Counsel for the OIR asserted that this was "willful blindness" by the industry.

OIR noted that much of the industry loss data is proprietary to individual insurers and could not be reviewed in the hearing process; most industry representatives alleged that supporting data is on file with OIR from past filings, and could be reviewed privately going forward. Some discussion occurred regarding a study conducted by Quality Planning Corporation (QP) demonstrating differences in accident frequency across various occupations. The QP study showed that students have by far the worst frequency, followed by doctors, lawyers, architects, and real estate brokers; farmers had the lowest frequency.

The QP study led to questioning of GEICO as to why doctors and lawyers are in GEICO's more preferred occupation classes, in apparent contradiction to the QP data. The main conclusion was that insurers review claim data, while the QP data simply measured accident involvement.

Industry representatives also stated that it is inappropriate to analyze occupation/education (or any rating variables) by themselves without analyzing the interaction between all rating characteristics via multivariate analysis.

OIR asserted that rate impacts varied up to 200% based on changes in occupation or education in some of the quotes obtained from the GEICO website. Liberty Mutual testified that occupation would not result in more than a 30% change (LM does not use education).

OIR acknowledged the assertion by various companies that the elimination of predictive variables adds risk to each policy written, and that increased risk is generally associated with higher prices. The level to which prices might rise due solely to the elimination of occupation and education was not quantified.

OIR also commented, however, that "all regulation implicitly limits freedom of insurance companies in exchange for a perceived societal benefit." Examples cited were standardized forms, prohibition of misleading advertising, and solvency requirements. OIR also noted that the life insurance market in Florida is "robust" despite the prohibition of race-based rating.

Maryland Insurance Administration Market Conduct Report on GEICO

The Maryland Insurance Administration (MIA) conducted a target market conduct examination of the GEICO Companies, focusing on whether the Companies' practice of using education and occupation as acceptance criteria is prohibited by Section 27-501(a) of the Insurance Article in Maryland statutes.

Section 25-501(a) provides:

> (a) In general. – (1) an insurer or insurance producer may not cancel or refuse to underwrite or renew a particular insurance risk or class of risk for a reason based wholly or partly on race, color, creed, sex, or blindness of an applicant or policyholder or for any arbitrary, capricious, or unfairly discriminatory reason; (2) Except as provided in this section, an insurer or insurance producer may not cancel or refuse to underwrite or renew a particular insurance risk or class of risk except by application of standards that are reasonably related to the insurer's economic and business purposes.

The Executive Summary states: "In general, the MIA found:

- GEICO's use of education and occupation as underwriting factors is reasonably objective;
- GEICO has demonstrated that education and occupation are predictors of loss;
- GEICO's use of education and occupation as risk characteristics meets actuarial standards of practice and principles related to risk classification;
- From an actuarial perspective, GEICO's use of education and occupation is reasonable;
- GEICO noted to the Administration that it does not use education or occupation to solely underwrite a risk, but the examiners identified a certain sub-class within an occupational group that was not eligible at initial application for the most preferred company based solely on

occupation This occupation sub-class, however, was eligible for the preferred company at renewal. GEICO has corrected this rule to ensure that no applicant is denied access to the preferred company based solely on occupation at the time of initial application.

- The Companies' use of education and occupation as underwriting factors is not in violation of Section 27-501(a) of the Insurance Article."

MIA contracted with an actuarial consultant, Merlino & Associates (M&A), who reviewed GEICO's use of education and occupation as they relate to actuarial principles and standards of practice. Based on a review of some of GEICO's confidential multi-variate analysis, M&A concluded that GEICO's use of these variables complies with actuarial principles and standards of practice. No study was conducted that included any data regarding race or income.

Federal Trade Commission Report on Credit-Based Insurance Scores

Another source of information regarding the issue of the effect by race or income on the basis of a rating factor is a July 2007 Federal Trade Commission (FTC) report to Congress, *Credit-Based Insurance Scores.* [22]

While not addressing the issue of occupation and education factors, the FTC report nonetheless delves into the use of a risk characteristic – credit history information – that the FTC found appears correlated to income and race.

The FTC first concluded that credit-based insurance scores are effective predictors of risk:

> "Using scores is likely to make the price of insurance conform more closely to the risk of loss that consumers pose, resulting, on average, in higher-risk consumers paying higher premiums and lower-risk consumers paying lower premiums. It has not been clearly established why scores are predictive of risk." (p. 82)

The FTC also concluded that the use of credit-based insurance scores appears to benefit consumers in general, though data in support of this conclusion was lacking in specificity:

> "Scores may permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums. However, little hard data was submitted or available to the FTC to quantify the magnitude of these potential benefits to consumers." (p. 82)

Importantly for the subject of the Department's analysis, the FTC also determined that credit-based insurance scores are distributed differently among racial and

[22] See Attachment 13.

ethnic groups, though the FTC report found that this fact does not necessarily make insurance scores a significant proxy for race or income:

> "The FTC's analysis revealed that the use of scores for consumers whose information was included in the FTC's database caused the average predicted risk for African Americans and Hispanics to increase by 10% and 4.2%, respectively. The Commission's analysis also showed that using the effects of scores on predicted risk that come from models that include controls for race, ethnicity, and income caused scores to increase the average predicted risk for African Americans and Hispanics by 8.9% and 3.5%, respectively. The difference between these two predictions for these two groups (1.1% and 0.7%, respectively) shows that a relatively small portion of the impact of scores on these groups comes from scores acting as a proxy for race, ethnicity, and income." (p. 82)

Of particular interest to the Department is the FTC's understanding of the concept of "proxy," as the FTC used that concept in coming to the conclusion above.

> "...the Commission analyzed whether scores predict risk within racial, ethnic, and income groups. <u>If scores do not predict risk within any group defined by race, ethnicity, and income, then the sole reason that scores predict risk in the general population would be because they act as a proxy for membership in different groups."</u> (p. 62) (Emphasis added).

In other words, for credit history to be a workable proxy for race or income under the FTC's standard, it would have to fail to be predictive of loss *within* a given racial or income group. The FTC, although focusing on credit history instead of occupation and education factors, finds that such data is predictive of loss whether or not the group being studied is one race, one income bracket or all races and income brackets combined. [23]

[23] It should be noted that the FTC report was not unanimous. A dissent (see Attachment 14) asserted that the report suffered from methodological problems and inadequate data, and that the proxy effect, while statistically small, should be a source of concern. On the other hand, the dissent supported the underlying conclusion that credit-history based insurance scores appear predictive of losses.

Whether the use of this type of data is desirable from a public policy point of view, however, remains an open question.

THE BROADER PROBLEM OF EFFECT BY RACE OR INCOME LEVEL

Analyzing the FTC report and the Census data that indicates correlations between occupation, education, income, and race sparked interest at the Department in understanding what other commonly used rating factors might have similar correlations.

In considering this question it became clear that many rating factors used here and nationwide can be assumed to have a differential effect.

For example, accidents are more common in urban centers (a fact presumably related to traffic density) and many New Jersey urban centers have higher-than-average populations of racial minorities and low-income citizens. Thus, higher-than-average accident rates are correlated with higher-than-average minority populations and lower-than-average incomes. Auto policies priced in part on accident history would, on average, charge more to minority and low-income customers because those customers would be more likely to have experienced an accident.

Likewise with rates based in part on claims under auto comprehensive (or "other than collision") coverages Urban centers have higher-than-average incidents of auto or contents theft, so residents in such areas are more likely than average to have had a car stolen and perhaps to file a claim that contributes to higher premiums. [24]

Related to the above is the premium savings that are typically offered to drivers who have garages in which to shelter their vehicles when not in use. Naturally, garages are far more common in suburbs than in urban centers.

[24] Insurers generally refer to these kinds of not-at-fault events as "occurrences" or "incidents" and have varying rules on how they are reflected in rates. Often, more than one such incident in a given period of time would have to occur before rates are affected.

Not surprisingly, rates based in part on the zip code in which a vehicle is kept (i.e. "territorial rating") would have a similar impact, even for drivers who have yet to file a claim.

Moving violations might be another rating factor that correlates with race and income. It appears plausible that lower income drivers would be less likely to expend the resources – such as hiring an attorney or taking a day off from work to attend a trial – to contest a ticket and seek a lessening of the violation that is recorded and ultimately seen by insurers. Thus, even a factor that intuitively appears highly correlated with driving behavior – and therefore seems particularly "fair" – may in fact disadvantage minority and low income drivers.

In summary, long-accepted rating factors such as accidents, comprehensive claims, territory and perhaps moving violations all may appear to correlate with higher-than-average minority populations and lower-than-average income levels. This would seem to complicate public-policy considerations involving potential responses to the problem of differential effect by race and income.

CONCLUSION

While occupation and education factors – and, indeed, several other factors with apparent differential effect – are permitted under current insurance statutes, public policy concerns about resulting socio-economic impacts may warrant a comprehensive analysis of potential different approaches to insurance company rating systems.

Because of its complexity, a full consideration of the issue, including by the Legislature, Administration, interested parties and the academic community, would be necessary to fully understand the impact of any proposed new approach on consumers, the insurance industry and by extension the State's economy.

The consequences of any regulatory change in New Jersey for the progress of the auto reforms of 2003, which continue to favorably unfold, is an important consideration. The Department hopes to continue to attract new companies – and thus new capital investment – to the State, further expanding the availability of coverage and improving price, service and product offerings. The predictability and stability of the regulatory system is of concern to potential new entrants to any marketplace.

The Department further notes the various indications, outlined in this report, that low-income and minority consumers are in fact benefiting from the marketplace improvements spurred by the current regulatory system. The potential for unintended, negative consequences from regulatory changes on these consumers must likewise be considered.

To briefly summarize the conclusions of this report:

- The Department's various approvals of automobile insurance rating systems employing occupation and education factors, including the 2004

approval of GEICO's rating system, are consistent with New Jersey statutes and regulations then and currently in effect. The Department has had no legal basis on which to disapprove such filings, and disapprovals would have been unlikely to withstand legal challenge.

- GEICO's rating system expanded but by no means introduced the use of occupation and education factors in automobile insurance in New Jersey. The occupation and educational attainment of applicants has had an impact on premium and company placement in this State for decades, both through the existence of membership companies with special acceptance criteria and rates for eligible groups (typically members of a specific profession or trade association); and through the long standing practice of providing "Good Student Discounts."
- The use of such factors is likewise common throughout the United States. The large majority of states approve such factors (so long as they are actuarially supported) under the ubiquitous, half-century-old regulatory standard that rates be neither excessive, inadequate nor unfairly discriminatory between risks involving the same hazards. In practice, this has meant approval of these factors in general (and GEICO's use of them in particular) in at least 44 jurisdictions.
- Few states proactively address the use of occupation or education in their insurance statutes or regulations. In practice, those states that do have such provisions nonetheless generally approve the use of occupation and education factors in one form or another.
- Across the country and in New Jersey, where insurance regulators have examined the issue they have found that such factors are predictive of losses and are thus actuarially justified to support pricing differences.
- The re-entry of GEICO into New Jersey after a 28 year absence, as well as the entry of other new insurers and the resulting increase in competition for New Jersey consumers, was made possible by a package of regulatory reforms in 2003 that resolved an insurance availability crisis, prompted widespread rate reductions and greatly increased consumers' satisfaction with auto insurers.

- The use of these factors naturally results in lower premiums for some customers than for others. However, the difference is not as large as that portrayed in a February, 2007 report issued by citizen watchdog group New Jersey Citizen Action (NJCA). That report contained methodological flaws that exaggerated occupation and education rating differentials and led to the incorrect conclusion that drivers with blue-collar jobs and low educational attainment were ineligible for the best rating tiers and placement in preferred companies. In actuality, these factors are just two of many, and other characteristics are also important for determining rate and company placement.
- An analysis of the rates of multiple insurers demonstrates that the use of these factors has not created higher overall premiums for drivers with lesser occupational and educational attainment. Indeed, GEICO's New Jersey rates for these consumers are often lower than the rates of competing companies where such factors are not used.
- Allowing insurers to use a wider variety of rating factors has contributed to overall improvement in the marketplace for many kinds of drivers and in all regions of the State.
- The Department found no evidence that such factors are used as a proxy for race or income. U.S. Census data and common sense indicate that, on average, these factors have a differential effect on low-income and minority drivers, in that such drivers are less likely than average to have professional jobs and college degrees. However, such groups are not singled out, as the range of education and occupation is great in every category. For example, most Whites would fail to qualify for the best possible rates. Still, on average, minority and low-income drivers are less likely than White drivers and drivers with professional occupations to benefit from the lowest rates available from a company that uses occupation and education factors.
- It is problematical, from an insurance regulatory perspective, to "pick and choose" between all of the factors with the potential for differential effect on the basis of race or income. This is especially the case because all of

these factors are equally permitted by current insurance statutes. Because there is no actuarial basis or regulatory theory under which an insurance regulator could reasonably discern between "acceptable" factors with a differential effect and "unacceptable" factors with a differential effect, the question is ill-suited for resolution by the Department.

Further examination of the impact of the use of a variety of rating factors on the affordability of auto insurance may be appropriate. If that determination is made the Department will be a willing and active participant in that evaluation.

○