Comments of the Center for Economic Justice
To the NCOIL Property Casualty Committee
Regarding Updates to the Credit Scoring Model

November 15, 2015

Background

The NCOIL Model Act Regarding Use of Credit Information in Personal Lines is NCOIL's most successful model law as measured by the number of states adopting the model or a close variation. Even though the federal Fair Credit Reporting Act (FCRA) authorizes and regulates the use of consumer credit information by insurers, lenders and others, ***the NCOIL model recognizes state regulation of insurance and provides some additional consumer protections.***

One of the reasons that NCOIL developed a model law regarding insurers' use of consumer credit information is that the information was the first large database of non-insurance personal consumer information utilized by insurers for underwriting, rating and pricing personal lines insurance. The existing statutes and regulations providing oversight of consumers' insurance data did not extend to non-insurance data sources, like consumer credit information.

Since NCOIL adopted its credit scoring model, there have not only been changes in credit scoring practices, but a tremendous growth by insurers in the use of other databases of non-insurance personal consumer information. Examples include the Carfax Vehicle Score, telematics and the variety of data available from data brokers, including web browsing activity, shopping activity, types of entertainment and more. So-called "alternative credit information" included in consumer reports by some consumer reporting agencies include payment history for home rent, utilities and telecom. Unless these data are provided by a consumer reporting agency subject to the FCRA, the consumer protections of the FCRA as well as those of the NCOIL model are missing. These protections include:

- Disclosure of the use of certain data by the insurer;
- Ability of the consumer to obtain the information used to review for accuracy;
- Ability of the consumer to challenge and correct false information;
- Notice to the consumer of an adverse action because of the use of the data;
- Ability for a consumer to take his/her data to another insurer;
- Opportunity to explain an extraordinary life circumstance to avoid unfair treatment

Credit Scoring Model Updates

During the debate over insurers' use of credit scoring, we heard time and again that credit scores measure a consumer's financial responsibility and, consequently, financially-responsible consumers should not be subsidizing insurance premiums for financially-irresponsible consumers.

During the financial crisis, the number of "financially-irresponsible" consumers skyrocketed as measured by those factors in credit scoring models with the greatest weight – delinquencies and public records, like foreclosures and bankruptcy.

At the beginning of the financial crisis, there were about 50 million outstanding mortgages, the majority of which were owned or insured by Fannie Mae or Freddie Mac. In January 2007, about 0.5% of Fannie and Freddie mortgages were seriously delinquent (90+ days) or in foreclosure. Three years later, the percentage of seriously delinquent or in foreclosure mortgages was over 4% for Freddie and over 5.5% for Fannie – an increase of millions of "financially-irresponsible borrowers."

According to data from the Federal Reserve Board, delinquency rates for residential mortgages increased from 2.03% at the end of the first quarter 2007 to 11.26% at the end of the first quarter 2010, representing an increase of about 4 million mortgages in delinquency. [1] According the FRB data, credit card delinquencies increased from 4% to 6.8% from 2007Q1 to 2009Q4, reflecting several million additional consumers with delinquencies showing up in credit reports.

In 2007, there were a total of 827, 396 bankruptcy filings. The number increased each year through 2010 when bankruptcies peaked at 1,561,008.[2] The number one cause of personal bankruptcy, by far, is medical debt.[3] According to a study by *the Atlantic*:

> Americans pay three times more for medical debt than they do for bank and credit-card debt combined, the report found. Nearly a fifth of us will hear from medical-debt collectors this year, and they'll gather $21 billion from us, collectively.

Putting aside the fundamental unfairness of charging consumers higher auto and home insurance rates because of reckless and abusive lending practices and because of medical costs that outstrip health insurance, the data on financial stress during the financial crisis should have led to significant deterioration in credit scores as millions more consumers became "financially irresponsible."

But TransUnion, a consumer reporting agency selling insurance credit scoring models, tells us that insurance credit scores were stable and improved slightly over the course of the financial crisis. If this is true, then what are insurance scores actually measuring – because it certainly is not "financial responsibility."

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[1] http://www.federalreserve.gov/releases/chargeoff/delallsa.htm
[2] http://www.creditslips.org/creditslips/2015/01/bankruptcies-down-12-in-2014-forecast-predicts-the-same-for-2015.html
[3] http://www.creditslips.org/creditslips/2015/01/bankruptcies-down-12-in-2014-forecast-predicts-the-same-for-2015.html

These questions about credit scoring take on greater significance after reviewing studies showing the average impact of a poor credit score varies widely by state[4] The 2014 InsuranceQuote study found that the impact credit score going from Excellent to Fair cause rates to increase in Arizona, the District of Columbia and Montana by 55%, 61% and 65%, respectively, while in New York, North Carolina and Wyoming, the increases were 11%, 13% and 18%, respectively.

The range if credit score impact is even greater for auto insurance, as the attached summary of the 2014 WalletHub study of average differences by state and by insurer of auto insurance rates between consumers with an excellent credit score and consumers with no credit. The average impact ranged from 18% in Vermont to 109% in Maine, 110% in Indiana and 114% in Wyoming. ***It seems illogical and arbitrary that the impact of a poor credit score varies by such a large range across states and that the impact can be so great.***

Given these data, CEJ suggests the following items for consideration by NCOIL to update the credit scoring model:

1. **Add a cap on the maximum impact of credit score on consumer's rates.** The cap might be set out in the model – the maximum difference in rates due to credit score, all other rating and underwriting factors constant, is 1.30, as measured by rate for the worst credit score divided by the rate for the best credit score. Or the model might delegate to the Commissioner the responsibility to establish a cap through a rulemaking proceeding, but subject to a maximum set out in the model.

2. **Prohibit a consumer's use of a credit freeze or security freeze as a negative factor in the scoring model.** As theft of personal consumer information has become more common and impacted tens of millions of consumers, the most effective method for consumers to protect themselves from identity theft is to employ a credit freeze, which locks the use of the credit information unless and until unlocked by the consumer. Consumers should not be penalized for utilizing the single most effective way to protect themselves from damage caused by a data breach.

3. **Prohibit identify theft as a negative factor in the scoring model.** Following on the discussion in 2, consumers who have been the victim of identity theft should not be penalized further.

4. **Strengthen the extraordinary life circumstances provision to ensure disclosure to consumers and to require regulators to collect data on insurer practices in this area.** The extraordinary life circumstances provision in Section 6 provide for credit scoring relief for a consumer who makes a written request to the insurer. This section provides no standards on how an insurer should disclose the life circumstance exception and no standards for how an insurer should consider and evaluate the individual's circumstances.

[4] http://www.insurancequotes.com/Media/Default/Blog-Images/credit-and-home-insurance-excellent-to-fair-large.jpg

Further, there is no provision for insurers reporting to regulators the number of life circumstance requests received and their disposition.

CEJ suggests that the life circumstances section be updated to require the Commissioner to engage in rulemaking to establish standards for disclosure of the life exception to consumers, reasonable evaluation of such requests by insurers and reporting of life circumstance activity to the Commissioner.

5. **Strengthen the protections related to medical debt.** As discussed above, medical debt is the biggest contributor key factors used in credit scores – payment history, public records. The NCOIL model admirably prohibits an insurer from using "Collection accounts with a medical industry code, if so identified on the consumer's credit report." The problem is that collection accounts for medical debt may not be identified as such in a credit report because the consumer paid the medical provider with a credit card or the debt was sold to a debt collector and the medical industry code was dropped. A further problem is that harmful information in the credit report short of a collection account – such as a delinquency – is permissible to use.

   CEJ suggests two updates. First, provide disclosure to the consumer in the adverse action notice that credit problems resulting from medical debt may not be considered by the insurer and, if the consumer's credit problem is a result of medical debt, the consumer should alert the insurer to that fact.

   Second, the prohibition in the model on consideration of medical debt collection should be expanded to any type of medical delinquency or collection. Simply stated, consumers should not be penalized with higher auto and homeowners insurance rates because of surprise balance billing or other medical debt issues. Medical debt problems do not reflect any type of behavior that warrants punishment with higher auto and homeowners insurance rates.

Other Big Data Issues

As mentioned above, the NCOIL credit scoring model was a response to insurers' use of non-insurance personal consumer information – information that was outside of the existing regulatory framework for personal insurance consumer information. But since NCOIL adopted the credit scoring model, insurers have turned to many other databases of non-insurance personal consumer information with the result that consumers do not have the protections that exist for insurers' use of consumer credit information and consumer insurance information. The need for consumer protections is even greater for these new databases used by insurers than with consumer credit information because for many of these new databases, consumers do not even have the protection of the federal FCRA.

To address this consumer protection gap, CEJ suggest the following additions to the NCOIL credit scoring model. While these additional databases may or may not include credit information, the same consumer protection issues and principles apply and extension of the model adopted in so many states is an efficient way to accomplish these consumer protection goals.

1. **Protections for Telematics Data.** Today, many insurers are collection data from consumers' vehicles and utilizing those data for pricing and, in some cases, claim settlement. Yet, consumer protections regarding ownership, use and transportability of those data are missing. Regarding telematics data, CEJ recommends the following:
    a. **Consumers Own Telematics Data Generated By Their Vehicles.** This seems straightforward, but it is an essential foundation for consumers being able to take their telematics data to other insurers in the same way consumers' claims history or credit information is available to all insurers seeking to write new business.
    b. **Require the Commissioner to establish data reporting standards and a statistical agent for the required reporting of telematics data by insurers to a repository that allows consumers to take those data to other insurers.** By establishing telematics data collection, the regulator can facilitate the telematics market.
    c. **Prohibit insurers from using telematics data for non-insurance purposes or selling telematics data to third parties.** Allstate's CEO has discussed the possibility of Allstate selling telematics data in the same way that Google sells web browsing data. This must be clearly and emphatically prohibited.
    d. **Require insurers to provide all of a consumer's telematics data maintained by the insurer to the consumer upon request.** This protection guards against asymmetric use of telematics data where, for example, the insurer might utilize the telematics data as evidence for denying a claim, but not provide the data to a consumer if the data assisted the consumer in settling the claim.

2. **Begin to Address Other Sources of Big Data in Insurance.** The following is a modest proposal to allow regulators, policymakers and the public to learn what types of data and data sources insurers are utilizing for what purposes. The general idea is that regulators would periodically issue this survey to insurers and prepare reports for the legislature and public, without identifying individual insurers, summarizing the sources and uses of new types of personal consumer information.

a. **Require the Commission to periodically, and no less than annually, issue a survey to personal lines insurers for a list of all types of personal consumer information used by the insurer, the sources of the data and the uses of the data.** The uses of the data would include marketing, underwriting, pricing, claims settlement, loss mitigation, payment plan eligibility, fraud detection and prevention.

b. **Require the Commissioner to periodically, and no less than annually, summarize the results of the survey in a public report to the Legislature.** The report shall not identify individual insurers.