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On Behalf of the Center for Economic Justice
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Proposed Model Law Regulating Insurers' Use of Consumer Credit Information in Personal Lines Insurance

Thank you for the opportunity to testify before the Property Casualty Committee today. And as requested, I will direct my comments towards the proposed model law. I do want to preface my comments with a statement of our position on insurance credit scoring. We oppose it and strongly believe the practice should be prohibited. I would like to go into some of the reasons for that position and hope that one of the committee members might ask me a question following my prepared testimony.

With regard to the proposed model law regulating insurers' use of consumer credit information, there are three overriding reactions. First, our thanks to the legislators and agents who have worked diligently to address the many problems associated with insurance credit scoring. The models before NCOIL are clearly an improvement over the current market practice.

Second, we are struck by the how many restrictions and prescriptions are necessary for the use of credit as an underwriting or rating factor. Given the tremendous regulatory resources necessary to enforce the proposed model and given the many concerns with credit scoring reflected in the model, one would think that there are some powerful reasons for allowing insurers to use insurance credit scoring. But, in fact, there are no such powerful reasons. All the industry has is an alleged correlation. Surely that cannot be enough to justify the use of insurance scoring.

Third, the proposed model – or any statute or regulation attempting the things in the proposed model – will not benefit consumers because of lack of enforcement. Some of the provisions are simply unenforceable, while others would require a commitment of regulatory resources that legislators will be unable to provide.

Regarding the three proposals – the proposed model, the proposed substitute and Representative Eiland's amendments – the proposed substitute generally improves upon the proposed model with some notable exceptions. And Representative Eiland's proposed amendments are much needed, although some fine-tuning is necessary.

I will work down section by section from the proposed substitute.

The changed title is an improvement. I suggest adding Insurers' Use of Consumer Credit Information to the title and the purpose. The revised purpose better captures the broader intent of the model.

Personal Insurance might be defined as a personal auto or residential property or personal inland marine insurance policy.

The definition of adverse action is slightly lacking because it seems to revolve around change from a current situation instead of an offer from the insurer of something other than most favorable provisions because of credit information. We suggest the following definition.

> Any action by the insurer to offer a consumer other than the most favorable price, terms of coverage, rating tier, payment plan or other feature of the personal auto or residential property insurance policy upon initial application or renewal by the consumer.

Throughout the model, the actions of insurers are generally described as underwriting and rating. For clarity and completeness, we suggest inclusion of tier selection, terms of coverage and payment plan eligibility to go along with underwriting and rating.

The definition of credit information is somewhat circular. The key word in the concept is credit and that is also the key word in the definition. Credit information should be defined as any information from a consumer credit report as defined by the FCRA and then add specific exemptions for purposes of the model for things like CLUE and MVR.

The original definition of credit report is much better than the proposed definition. The definition of insurance score should describe the purposes as underwriting, tier selection, rating, terms of coverage, pay plan eligibility.

Section 5

This section describes various prohibitions regarding underwriting and rating risks. To this list should added tier selection and determining terms of coverage. This section should also include a provision prohibiting the use of consumer credit information to condition pay plan eligibility. The use of insurance scores for pay plan eligibility is illogical, unnecessary and contrary to public policy. It is illogical because the scoring models are purportedly developed to predict claims and not payments. Insurers go to great lengths to distinguish insurance scoring from credit scoring. It is unnecessary because insurers are never in a position to offer coverage without payment. It is contrary to public policy because the availability of payment plans is essential for insurance availability.

Subsection A prohibits the use of several types of information / consumer characteristics. However, the information in credit reports could easily be correlated with these prohibited characteristics. In fact, an econometrician could easily develop a scoring model that predicts income, race, gender or age based upon information in the credit reports. It is of limited value to prohibit consideration of certain factors if there are easily available proxies for those factors.

Further, what is the public policy for prohibiting consideration of these factors? And why doesn't that same public policy apply to credit scoring itself?

Subsections B and C prohibit use of credit as the sole factor for an adverse action and specifically defines tier placement not to be cancellation, denial or nonrenewable. First, prohibiting something as the sole factor is not meaningful. An insurer could use, for example, credit and vehicles valued at less than $50,000 to avoid the prohibition literally but not

substantively. Second, where is the consumer protection if the insurers' use of credit results in an offer for very high cost insurance is the worst rate tier with no pay plan? This subsection allows insurers to effectively decline coverage without literally doing so. And it worsens the current situation by purporting to provide consumers with protections that, in fact, do not exist.

Subsection D attempts to prohibit adverse actions based upon absence of a credit card. Again, the "sole" language enables an insurer to effectively avoid the prohibition. For example, an insurer could deny coverage if there was no credit card and a vehicle valued at less than $50,000.

In Subsection E, paragraph 1 removes the substance of restriction because regulators are unable to perform independent review of the studies presented by insurers. Credit is unique in this regard because regulators collect data on other underwriting and rating characteristics through designated statistical agents and authorized statistical plans. See the discussion below for a requirement on data collection that would allow regulators to perform the type of independent review envisioned by this section. In addition, this section envisions yet additional work and necessary resources for regulators. We fear the likely result from overtaxed regulators will be routine approval of restrictions based upon thin credit files.

Subsection F seems to provide a very big window for new business credit reviews. We found Subsection G confusing and could not figure out the exact intent.

The restrictions in Subsection H are very good. We again raise the issue of how difficult enforcement will be for state regulators. Private lawsuits are the logical means of enforcing these provisions. Again, we ask what are the benefits of credit scoring that warrant the use of an underwriting and rating factor that elicits such restrictions and concerns? A simple correlation is not sufficient benefit to either consumers or the insurance system.

The dispute resolution in Section 6 is excellent and we support it.

Section 7 deals with initial notification regarding use of credit information. We support Representative Eiland's proposed amendments. These amendments go to the heart of informing a consumer how credit is used in the underwriting, rating, and tiering process. The type of information suggested by Representative Eiland informs consumer in a manner that encourages consumers to engage in less risky behavior and, consequently, to reduce overall claim costs.

Section 8 provides for adverse action notification. Such notification must be strengthened to better inform consumers of the precise aspects of their credit reports. For example, compare the difference between a consumer being uprated and told the reason was two at-fault claims versus being told the reason was too many retail accounts. The first reason is specific and understandably related to claim costs. The second reason is non-specific and not understandably related to claim costs. The standard industry explanations are inadequate.

The consumer disclosure requirements in the Fair Credit Reporting – and those in the proposed credit insurance model are based upon the notion that an error in the credit report wrongly resulting in an adverse action against the consumer will be the incorrect presence of some negative information in the credit report. For example, if a consumer is denied a loan or

insurance coverage because of a recent bankruptcy, then the consumer is entitled to review the credit history to see if a bankruptcy has been incorrectly reported. Then the consumer can correct the false information and reverse the adverse action.

This consumer disclosure framework is wholly inadequate for insurance scoring because a consumer's insurance score is determined as much – if not more – by the presence or absence of positive factors as it is by the presence or absence of negative factors. A consumer's credit score can be low (i.e., bad) even if there are no negative factors, such as bankruptcies, public records, delinquencies or late payments. A poor insurance score can arise from the absence of certain types of credit (e.g., no real estate-secured loan), the types of credit (e.g., loans from a finance company lead to a lower score than the same loan from a bank and a retail credit card leads to a lower score than a bank credit card), and/or the absence of credit activity or credit information (e.g., a consumer typically pays in cash, has only one credit card or uses financial institutions that don't report payment activity to credit bureaus, such as check-cashing, payday lending and/or rent-to-own businesses).

With insurance scoring, the traditional form of FCRA adverse action disclosure is insufficient because; one, most consumers don't know their credit history is used for underwriting and/or rating; two, even if consumer did know their credit history was being used, the insurer typically does not explain how it is being used or what aspects of the credit report led to the adverse action; and, three, even if the insurer provided the specific reasons, the consumer is unable to determine if information that could have helped the score is missing. Consequently, adverse action and other credit-related disclosure requirements for insurers must be far broader than those set out in the FCRA.

The trade secret exemption to public disclosure in Section 9B is far too broad. It closes much of what is open today. There is no evidence that public disclosure of what insurers do with credit information has harmed any insurer or vendor.

We also recommend the following language for data collection:

> Data Collection and Independent Regulatory Analysis. The Commissioner shall direct statistical agents to collect insurer-specific premium, exposure and loss data broken out by raw credit score and credit score category assigned to consumer in addition to other data categories required in approved statistical plans. As soon as such data are available to perform an actuarially credible and/or statistically significant analysis, the Commissioner shall perform an analysis of the correlation of credit information to frequency and severity of claims and to other underwriting and rating factors both permitted and prohibited.

Section 10 provides for indemnification of agents and insurers. We are unclear of how this section will work. What happens if a bunch of consumers are overcharged because of faulty calculations? Do they have any recourse?

Thanks for the opportunity to comment on the proposed model.