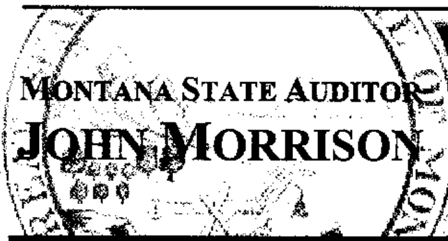

Protecting Montana's consumers through insurance and securities regulation

Testimony from John Morrison on Bill to Limit Credit Scoring

HB 41 – Sponsored by Rep. Bill Wilson

"When insurers engage in credit scoring, Montana families are harmed"

EXHIBIT 3
DATE 1-28-05
HB 41

What is credit scoring?

Credit scoring is a system creditors use to help determine whether to give you credit. For years, creditors have been using credit scoring systems to determine if you would be a good risk for credit cards and auto loans and mortgages – which makes sense in these applications. But credit scoring for insurance purposes is not appropriate – here's why. The use of credit scoring by the insurance industry is not only unfair, but it makes no sense because insurance is always paid in advance – there is no credit risk. If a consumer doesn't pay their insurance bill, they don't receive insurance – it's as simple as that, the insurance company is out nothing. It's not like a situation where someone is granted a loan and then doesn't make their payments – which is what credit scoring was designed to safeguard against.

Insurance Credit Scoring is Unreliable and Unfair

Despite the obvious 'disconnect' between credit risk and insurance, insurance companies attempt to justify the use of insurance credit scoring by claiming that there is a correlation between a consumer's financial responsibility and his or her risk of filing a claim. That argument fails for the following reasons:

1. A good credit history does not necessarily result in a good insurance credit score.

Insurance credit scores are not simply based on late payments or bankruptcies, but also on other factors unrelated to financial responsibility. These factors may include the length of time that credit has been established; the number of credit cards maintained; the length of time since the last account opened; and the number of inquiries. Moreover, the absence of positive credit information may lower a score just as much as the presence of negative information. Some models, for example, will lower a consumer's score if he or she does not have a home mortgage, regardless of how the individual has managed other credit accounts.

2. Insurance credit scores derive from a credit reporting system that is seriously flawed.

Insurance credit scores are based on credit reports that are often incomplete and inaccurate, which significantly undermines any potential value credit information may have as a predictor of future claims.

Credit Reports are Inaccurate and Incomplete

Studies consistently have documented inaccuracies in consumers' credit reports. In 2002 examination of credit scores completed by the Consumer Federation of America and the National Credit Reporting Association found that 20% of consumers with credit histories would likely be misclassified as "high risk." The study also found that information in credit reports varies dramatically among the different credit bureaus. Approximately one-third of the files had a range of 50 points or greater between credit bureaus.

In 2003, the Federal Reserve Board released a comprehensive study of information in almost 250,000 credit reports maintained by one of the three major national credit bureaus. The study found that information in the reports were incomplete and often contained duplicate information. Approximately 70% of consumers had at least one credit account in their file that did not list the account's credit limit. Credit limit information is used to determine the level of a consumer's credit utilization (i.e., the consumer is using $1000 of his potential available credit of $9,000), a factor often used in credit scoring. Without credit limit information, some models use the consumer's "high balance" amount to determine credit utilization, which can have the effect of lowering the consumer's score. The report also noted a problem with duplicate reporting of collections and public records. Many of these items relate to one event, but are reported twice: once when the collection is initiated and yet another time when the collection is paid. According to the report, duplicate reporting of negative information could "significantly affect" a consumer's score.

Process for Correcting Inaccuracies in Credit Reports is Deficient
Consumers face great difficulty in correcting inaccurate information on their credit reports. The federal Fair Credit Reporting Act establishes a process by which consumers may report errors and the credit bureau must investigate to ensure the accuracy of the data. This dispute system, however, simply does not work adequately.

Credit bureaus receive a significant amount of consumer complaints about inaccurate data. One credit bureau, Experian, receives, on average, twenty five to thirty thousand consumer letters each day, the majority of which are disputes. On top of that, staffers are required to answer 100 complaint calls per day, providing them with only 3-4 minutes for each call.

Once the credit bureaus receive documentation from consumers who dispute inaccuracies, they often fail to forward the information to the creditors. Instead an "investigator" simply translates the information detailed in the consumer's written dispute to a two-digit code representing the general nature of the dispute, and that code gets transmitted to the creditor. The creditor never gets to see the documentation the consumer provided. As a result, most consumer disputes end up being verified against consumers.

Given these practices, consumers are left having to sue the credit bureaus to force them to remove inaccurate data.

Corporate Database Sharing Creates Unregulated 'De-facto Credit Bureaus'
Consumers have no right to ensure the accuracy of the information that corporations may compile about them and use to develop insurance credit scores.

Under the federal Fair Credit Reporting Act (FCRA) consumers have the right to review, dispute and correct information maintained in their credit reports. The definition of credit report under the FCRA, however, does not include the sharing of information among corporate affiliates. This loophole puts consumers at serious risks because some corporate affiliates are pooling the information they have about consumers and creating their own internal 'de facto credit bureau'.

If insurance companies are sharing consumer information to create internal insurance credit scores, the FCRA will not apply, and consumers will not be able to access that information and ensure its accuracy.

Identity theft compounds the problem of utilizing credit history to determine insurance rates.
Theft of financial identity is one of the fastest growing crimes, and consumers spend hundreds of hours and dollars trying to clear their name. Many victims report great difficulty in getting creditors and the credit bureaus to believe them and remove the accounts the thieves have established in their name. For victims of identity theft, the use of insurance credit scoring only victimizes them further.

In sum, the credit reporting industry is seriously flawed. Consumer complaints to the Federal Trade Commission about the three major credit bureaus increased by 75% last year, from 8,331 in 2001 to 14,557 in 2002. The State of Montana should not allow insurers to use this faulty system for rating and underwriting purposes.

3. Any alleged correlation between credit scores and risk of loss is insufficient to justify the use of insurance credit scoring.

Insurance companies claim that there is a correlation between a consumer's score and the chance that he or she will file a future insurance claim. Insurance companies, however, have failed to demonstrate a relationship between credit history and expected losses independent of other risk factors. In fact, the University of Texas Bureau of Business Research study, which many insurers cite as validating the correlation, actually demonstrates that credit history is merely a proxy for other risk factors that are already considered by insurers. The study examined policies issued ***before*** the insurers used credit history to underwrite and categorize consumers into the standard and nonstandard markets. The study found that on average insurance credit scores were higher in the standard market than in the nonstandard market. This result indicates that some other underwriting factor or factors that insurers use must correlate with credit. Consequently, insurance credit scoring may be a double counting of other risk factors that results in excessive rates.

Insurance companies have refused to release publicly their credit scoring models, preventing an independent, public review of the actuarial soundness of their claim. We know that traditional credit scoring correlates to race and income, Many believe that insurance credit scores likely would have the same results. Insurers bear the burden of demonstrating that their insurance rates are not unfairly discriminatory. By failing to publicly disclose all the factors use to determine insurance credit scores, insurers have failed to meet this burden.

<u>The outcry from Montana consumers over the unfairness of insurance credit scoring</u>
The Montana State Auditor's Office has received hundreds of complaints from Montana insurance consumers and insurance producers who are concerned about the practice of using credit to determine premium rates. Consumers are worried because their insurance rates increase and insurance producers lose customers when insurance companies use credit to adversely rate their customers.

On the State Auditor's Office website, there is a page where consumers are asked to share concerns about credit scoring and express their support for reforming our current credit scoring law. Since October 2001, 154 people have left their names, email addresses and comments on this page.

In addition, the State Auditor's Office received over 500 calls last year from Montana consumers who were upset about the adverse affects that credit scoring has had on their insurance. However, under current law, Policyholder Services is not able to provide much assistance to most of these calls.

Here are a few examples of the complaints we receive on credit scoring:

Summary of Credit Scoring Complaints received by the State Auditor's Office

- A couple from Martin City had their insurance cancelled on their house, due to adverse credit information regarding the disabled wife's medical bills.
- A woman from Helena had her auto insurance premiums rise 56% in a six-month period even though she had no claims or changes in her driving record. The reason was due to a lowering of her credit score.
- Another consumer from Anaconda was denied lower auto insurance coverage due to her credit score. She had a history of no accidents or prior insurance claims.
- A couple from Deer Lodge had their auto insurance premiums increase dramatically. The reason is that they pay their bills in cash, and have been told by their insurance company they are a bad risk because they have no credit.
- A man from Whitefish had an increase in his premiums even though he had no claims in the previous twelve years. He believed the reporting agency was not correct in their information. His insurance representative said they would not do another re-calculation using the correct score "because another inquiry would hurt the score worse." Thus, he was stuck with higher premiums.
- There are many more stories in our files and on our consumer comment section of our website.

Conclusion – Take action to protect Montanans

Credit scoring is a practice that is unfair and possibly discriminatory. In addition, insurers' expenses in developing and implementing insurance credit scoring models may raise rates for all consumers. Finally, insurance credit scoring cannot help prevent risk loss, as can discounts for good driving or the installation of home security systems. I am urging this committee to take action to protect Montana consumers and restrict the practice of insurance credit scoring.

I am urging a yes vote on HB 41.

Thank you.