Testimony of Mike Kreidler
Washington State Insurance Commissioner

Before the
United States House of Representatives
Oversight & Investigations Subcommittee of the Financial Services Committee

Regarding:
"Credit-based Insurance Scores: Are They Fair?"

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Chairman Watt, Ranking Member Miller, and members of the Committee, I thank you for the opportunity to testify here today on, “Credit-based Insurance Scores: Are They Fair?”

My name is Mike Kreidler, and I am the elected Insurance Commissioner for the State of Washington. I am also active in many of the committees of the National Association of Insurance Commissioners (the “NAIC”) related to the topic of today’s hearing.

Since my election as insurance commissioner, I have had concerns about credit scoring and the impact it has on consumers and the potential disparate impact on protected classes of people. I am not alone in my concerns. Credit scoring invokes more confusion and even outright anger from consumers than any other issue I’ve faced since taking office. Since it surfaced in the year 2000, my office has received nearly 5,000 calls from consumers about credit scoring. While there are a variety of issues that concern consumers, some of the more prevalent problems are:

- Consumers do not understand why their credit history should impact how much they pay for insurance rates;
- Each insurance company uses credit information differently; and
- Consumers’ insurance rates increased because of the use of credit scoring or a credit factor.

To address some of our concerns with credit scoring and how companies were using it, I proposed legislation back in 2002 that our state legislature enacted into law. At the time, it was one of the strongest laws regulating how credit scoring could be used and it set a national precedent. As of today, 48 states have joined Washington State and have enacted some level of regulation over this practice. While I favored an outright ban of credit scoring, I knew we wouldn’t succeed in that endeavor. With this in mind, we targeted the most unfair aspects of credit scoring in our legislation.

Under our state’s law, as of January 1, 2003, insurance companies cannot use credit history to cancel or non-renew a personal insurance policy (primarily auto and homeowners insurance). In addition, insurance companies cannot use the following six attributes of credit history to deny insurance coverage:

- The absence of credit history;
- The number of credit inquiries;
- Collection accounts identified as medical bills;
- The initial purchase or finance of a vehicle or house that adds a new loan to a person's existing credit history;
- The use of a particular type of credit card, debit card, or charge card; and
- The total available line of credit a person holds.

Additionally, after June 30, 2003, insurers cannot use the above attributes to set premiums with one exception. Insurers may use the absence of credit history to set premiums, if they provide statistical data that proves consumers without credit histories are more likely to file claims. Two other important consumer protections in the law are:

- Insurers must retroactively correct a premium if the company uses incorrect credit history for rating or underwriting; and
- Insurers must send enhanced "adverse action" notices to consumers so they know what items in their credit history are affecting insurance premiums and what they could do to improve their score.

While these consumer protections helped address some of the general problems with credit scoring, I'm still not satisfied we are doing enough. I believe that credit scoring unfairly discriminates against protected classes and the economically disadvantaged. Granted, insurance does discriminate when statistics can support charging different rates to people based on certain risk attributes. Anyone with a teenage driver in their household understands that. But it is our responsibility as regulators to ensure that credit scoring does not <u>unfairly discriminate</u> and harm protected classes of people.

Our 2002 law attempted to look at the unfair discrimination issue, and required a report back to the legislature. In 2003, we issued a report that looked at the effect of credit scoring on auto insurance and pricing. One of the key questions in our study was, "Does credit scoring discriminate against the poor and people of color?" Our report clearly suggested there was a potential negative impact as it found:

- Age was the most significant factor; and
- Income was the second most significant factor.

Unfortunately, due to our small sample size and small ethnic minority population, our results were inconclusive. We attempted to organize a comprehensive multi-state study to gather enough data to draw some valid conclusions, but when the Federal Trade Commission (FTC) was tasked with undertaking a similar study, the states decided to hold off and let the FTC conduct its study. We hoped it would result in a well-reasoned comprehensive study that would help answer the questions about unfair discrimination.

After three years of waiting, we finally have the FTC report. I believe the report confirms my suspicion that credit scoring has a disparate impact on protected classes. With regard to credit scores, the study indicated that "African-Americans and Hispanics are strongly over-represented in the lowest deciles and under-represented in the highest deciles." It seems to clear to me that credit scoring models will harm these classes of people. Yet, the FTC's report reached a conclusion that credit scoring is <u>not</u> a proxy for race. That seems counterintuitive to me.

Frankly, I'm disappointed with the FTC's report. As I stated earlier, we expected a comprehensive study with well-reasoned conclusions. I don't think the report lived up to those expectations. In particular, I'm disappointed because:

- The report failed to explain the disconnect between how a greater number of minority populations had lower credit scores, yet credit scoring was not a proxy for race;

- The report did not use complete data from more insurance companies; and

- The few insurers who did participate would not identify their data so it could be verified.

As we look at the future of credit scoring, it is worth noting again that 48 states have enacted some type of regulation of credit scoring. Some states have effectively banned credit scoring. Some states have adopted the National Conference of Insurance Legislators (NCOIL) model that says credit cannot be the “sole basis” for increasing insurance rates or taking underwriting action. Some states have landed somewhere in between. The reason for this regulation is that credit scoring is problematic. Consumers don’t understand it, companies can’t explain it well, and it appears it creates a disparate impact on protected classes of people.

I think it’s time to ask the question, “Should we allow credit scoring, even if it may be a valid indicator of risk, if it also has a disparate impact on protected classes?”

We answered this question correctly not that long ago. In 2002, the NAIC completed several multi-state examinations of companies that rated life insurance differently based on the race of the applicant. African-Americans were being charged higher rates because they had lower life expectancies. Actuarially, it was a “sound practice.” But the practice was appropriately stopped because of public policy and equal protection concerns.

If we banned credit scoring, similar to the life insurance example above, there would be an effect on rates. Some people’s rates would go up, and some would go down. Credit scoring doesn’t make insurance more affordable for everyone, it simply redistributes how much each of us pay for it.

The controversy doesn’t stop with credit scoring. Insurance companies found credit scores to be a useful risk assessment tool, and now they are looking for other factors in order to gain an advantage over their competitors. Now we are seeing models proposing to use education and occupation as factors in determining insurance rates. It seems to me that if credit scoring has a disparate impact on protected classes, allowing companies to consider other factors such as education and occupation may bring the same results.

Whether it is credit scoring, occupation, education, or any other new factor that insurance companies are developing or using, as regulators, we must be vigilant. Our country has a long history of civil justice and protecting the most vulnerable in our society. I’m afraid that these new tools- regardless of their intent or reliability- are moving us away from this history. Quite simply, business arguments are not a good enough reason to allow some factors to be considered, and we should hold companies to this higher standard.

In closing, I realize that effectively banning credit scoring would be difficult and perhaps not even practical, considering how far down the road we have gone in using this practice. But I do think we can do some things to protect consumers and protected classes from being harmed by credit scoring.

Here is what I suggest:

1) Restore "adverse action" notices. When a consumer's insurance rate is impacted by credit factors, the FACTA Act and many state laws require an "adverse action" notice to be sent to the consumer. Recently, the U.S. Supreme Court in *Safeco v. Burr* significantly altered the circumstances as to when consumers should receive an "adverse action notice." You should consider clarifying FACTA and restoring it to its original legislative intent.

2) Make "adverse action" notices more meaningful. Consider using language in FACTA similar to Washington State law that requires companies to disclose to consumers the top factors that impacted their credit score.

3) Require insurers to prove their models do not unfairly discriminate. If companies want to use credit or insurance scores, make the company prove that the models do not unfairly discriminate against protected classes.

Thank you for the opportunity to testify about this important issue, and I would be happy to answer any questions.