USE OF CREDIT INFORMATION BEYOND LENDING: ISSUES AND REFORM PROPOSALS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

MAY 12, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–134

U.S. GOVERNMENT PRINTING OFFICE

58–044 PDF WASHINGTON : 2010

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

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WEDNESDAY, MAY 12, 2010

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

USE OF CREDIT INFORMATION BEYOND LENDING: ISSUES AND REFORM PROPOSALS

Wednesday, May 12, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Watt, Moore of Kansas, Waters, Hinojosa, McCarthy of New York, Baca, Green, Scott, Cleaver, Ellison, Klein, Foster, Speier; Hensarling, Royce, Capito, Garrett, Neugebauer, Price, Marchant, Lee, Paulsen, and Lance.

Also present: Representatives Kilroy, Manzullo, and Cohen.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Good morning and thanks to all of the witnesses for agreeing to appear before the subcommittee today.

Today's hearing will examine the impact that the use of credit reports and information has on consumers outside of the traditional use for lending and credit purposes. We will examine the use of credit-based insurance scores, where the medical debt is predictive of a person's chances of defaulting, and finally, whether or not a consumer's credit information should be used to determine their employability.

We will be limiting opening statements to 10 minutes per side, but without objection, all members' opening statements will be made a part of the record.

We may have members who wish to attend but do not sit on the subcommittee. As they join us, I will offer an unanimous consent motion for each to sit with the subcommittee and for them to ask questions when time allows.

I yield myself 5 minutes for my opening statement.

This morning's hearing is about the use of credit information in areas such as insurance underwriting and employment purposes. We will hear about important yet complex and often opaque processes concerning credit board insurance and insurance scores in the first panel.

In the second panel, we will hear about issues that are equally important to a vast number of consumers—the little known or understood use of credit information for hiring and even firing decisions, and the effect medical debt has on one's consumer report, even after you paid the medical debt off.

When legislators or regulators attempt to fully grasp an issue such as credit-based insurance scores, they see a complex system laden with ever-changing computer applications and models, but it is precisely this complexity that should make us here in Congress delve further into an issue that affects every single American who owns or rents a house, a car, has insurance, has a job or is looking for a job, or is likely to incur medical debt.

Do most consumers know that their car or homeowner's insurance rates may go up due to their credit score? Do they know that if one of their medical bills goes to a collection agency and they pay it in full and settle it, it will still affect their credit report for up to 7 years?

Do people realize that even in these tough economic times, pre-employment consumer credit checks are increasingly widespread, trapping many people in the cycle of debt that makes it harder for them to pay off their debts and harder for them to get the job that would allow them to pay off the debt?

I wonder—when you go to State Farm or Allstate or GEICO to get your insurance and they have a credit score, and that credit score was negative, so they are going to charge you more for your insurance, do they send you a note in the mail telling you that you are going to pay more for that insurance?

I think these are all very important questions that the American public should know. Indeed, the current system facilitates the denial of employment to those who have bad debt, even though bad debt oftentimes results from the denial of employment, a vicious cycle. You cannot get a job, so you get a bad credit score. You have a bad credit score, so you cannot get a job.

I wonder who is most likely to be affected, especially in these economic times. What? Extend unemployment compensation? What about the national debt?

I have a way maybe we could settle unemployment compensation, how about letting somebody get a job and prove who they are without some mysterious number coming out of a black box somewhere where nobody knows about it.

That is why the subcommittee is holding this hearing, the second so far this year on the issue of credit reports, credit scores, and their impact on consumers.

We will look at reports and studies about the predictive nature of insurance scores and traditional scores among other things. As we do so, we also need to look at the basic guiding principles of equity, fairness and transparency.

Some have contended that there is no disparate treatment of minorities in credit-based insurance scores. Some will say that even if there is a disparate impact on some groups, the system still does not need to be changed.

The question of how predictive a credit-based insurance score is on an insured's likelihood to file a claim is important, as it is the predictive value of traditional credit scores used for credit granting.

As long as there continue to be disparities in the outcomes of the current system for racial and ethnic groups and along class and geographical lines, I believe the system needs strenuous oversight and may need fundamental change.

How to correct the disparities in the system with this disproportionately negative impact on minorities and low-income groups while maintaining the core framework of credit information as a risk management tool is a challenge we should take on.

For example, on issues like the use of credit information for developing insurance pricing and the inclusion of medical debt collection in determining a consumer's risk of default, I have doubts as to whether there are biased uses of data.

The Equal Employment Opportunity Commission, the Federal Reserve, the Brookings Institution, the Federal Trade Commission, and the Texas Department of Insurance have all found that racial disparities between African Americans, Latinos and Whites in credit scores exist, and we will see this has wide ranging implications beyond simply obtaining consumer credit.

Defending a system where decisions such as determining car insurance rates or even something as vital as to whether or not to hire someone is based on something that has shown to possess a degree of bias is difficult, to say the least.

I welcome the testimony this morning of those who believe the system works, and of those who believe the system needs to be changed to work in a more equitable, fair, and transparent fashion.

In the same spirit of transparency, I am making it clear at the outset that I side with the latter group. I do not think you need any sort of score to predict that, from my point of view.

In order to persuade this committee not to move forward on legislation that would strongly limit what we believe to be unfair practices, the industry witnesses before us must prove to me that not only are the practices we call into question scientifically predictive, but more importantly, they are fair and equitable to all Americans.

The ranking member, Mr. Hensarling, is recognized.

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you for calling this hearing.

As we all know, last week we were greeted with more bad economic news in our Nation as unemployment ticked up yet again to 9.9 percent. Again, unemployment remains mired at a generational high.

Since the President asked for and the Congress passed the stimulus bill, approximately 3 million of our fellow countrymen have now lost their jobs. There are countless stories of hardship, and countless stories of suffering. We know that the underemployment rate hovers around 17 to 18 percent of our country.

By any historical standard, we should already be out of this recession. We should have robust GDP growth. We should have robust employment growth. Unfortunately, we do not.

I believe, as do many, that the reckless spending, the enormous debt and deficit that has been brought up on us by this Congress, by this Administration, the serial bailouts, the government takeovers, and legislation passed that ultimately restricts access to credit have all contributed to the fact that we are still mired at almost double digit unemployment.

I believe the Administration and Congress are holding back our economic recovery, an economy that wants to recover. Economies work on reverse gravity. What goes down must come up Yet, this recovery has been the most tepid and languishing recovery in the modern economic era. I did not even mention the impact of the high cost of the new health care bill and the threat of a national energy tax.

As I talk to small business people in the 5th Congressional District of Texas, as I talk to investors, as I talk to bankers, as I talk to Fortune 500 CEOs, I hear the same message over and over, and that is, "I am not willing to expand my business and create more jobs today. I do not know what the health care costs are going to be for my employees. I do not know what the energy costs might be associated with cap and trade. I do not know what my tax bill is going to be as tax relief expires at year's end, and I do not know how my Nation is going to pay for all of this debt."

More taxes. More inflation. Given this backdrop, I would hope that any legislation that this subcommittee or full committee considers, that we would consider jobs to be job number one for our committees.

I feel we are considering at least three more policy ideas that are going to further harm job creation in America by restricting access to credit. All of the ideas before us are either going to prohibit accurate data from going into a credit file or prohibit the use of accurate data that may be in a credit file. To many of us, this all has the distinct odor of government censorship and even the faint whiff of Orwellian thought control.

The bottom line is, thinner credit files are going to erode risk-based pricing of these products, which in turn is going to lead to less available credit and more expensive credit, at a time again when our Nation is mired in almost double digit unemployment.

Should credit scores be used in insurance underwriting? Are they predictive? I have seen a number of studies that claim they are but most importantly, I suppose those who are using them find them to be predictive.

I believe they have an incentive to get it right. Otherwise, they would ultimately lose money and they would have to fold up shop. Those who get it wrong ultimately go out of business. Maybe one insurance company feels those who wear blue ties are riskier than those who do not. I do not know. I do not know if that is predictive. It is not logical, but maybe it is. One company may decide to use it and another one may choose not to use it.

Information about discharged medical bills. There are a lot of setbacks that one can have in their life that ultimately impact their credit: divorce; unemployment; a medical bill.

At the same time, are they predictive? If they are predictive, if we do not allow that information in, ultimately small businesses, many of which are organized as sole proprietorships—

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. HENSARLING. In that case, Mr. Chairman, I will stop there.

Chairman GUTIERREZ. I am going to ask unanimous consent that Ms. Kilroy be allowed to sit in this hearing, and grant her 2 minutes for an opening statement. Hearing no objection, it is so ordered.

Ms. KILROY. Thank you, Mr. Chairman. Thank you for your leadership in this important issue. I thank the witnesses for their time here today. I am interested in what you have to say, particularly about medical debt and the impact it has on the credit scores for millions of Americans, and their ability to get an affordable home loan or car loan, long after they have paid their medical debt.

I ask for unanimous consent to enter into the record a letter written to me from my constituent, Julia Mueller of Columbus, Ohio.

She is a responsible young adult, a college student. She pays her credit cards on time. She purchased health insurance. She checked with them before she was going to have an expensive procedure to see if it would be covered. She was assured it was. That was her understanding until the bills came and her insurance company denied coverage. She ended up in a year-long dispute with them on that. It was eventually resolved, but it destroyed her credit score. Now, she is worried about her ability after college to buy a car, and to buy a house. I worry it might even affect her ability to get a job.

I introduced the Medical Debt Relief Act to help hard-working Americans like Julia who play by the rules, pay or settle their medical debts, yet find their credit scores adversely affected for years to come.

Today, we are taking an important step in the right direction to deal with this important issue. I want to tell Julia when she writes to me that, "I am fiscally responsible and I would like to be treated that way," and that is what we are aiming to do here today.

Thank you, Mr. Chairman. I yield back my time.

Chairman GUTIERREZ. The gentlelady yields back the balance of her time. Mr. Price of Georgia is recognized for 2 minutes.

Mr. PRICE. Thank you, Mr. Chairman. Mr. Chairman, if the past 2 years have taught us anything, it is that risk is unavoidable and ever present.

In order for the economy to work, businesses must be able to price their products for the risk that they incur. Risk-based pricing is especially important when trying to determine the reliability of the insured and the exposure of job creators.

Credit-based insurance scores have proven to be the most predictive factor in determining the likelihood of a consumer filing a claim. This risk model enables insurers to more accurately underwrite and price for risk, and when this is done well, everyone wins.

Democrats want you to believe that everyone should not be judged by their past actions. However, it is the American way to pull one's self up by working hard and making responsible decisions. What makes risk-based pricing and insurance scores important is the ability for people to improve their scores and lower their rates by paying their bills on time and taking responsibility for their financial decisions.

What would happen if there was no risk pricing? Everyone would get the same price regardless of how much an insurer has to pay to cover a claim. This would result in significant and dramatic increases in rates to virtually all Americans, less credit available, more expensive credit, and more job destruction.

This is clearly not the most wise avenue. I look forward to the testimony and hopefully our response in wisdom. I yield back.

Chairman GUTIERREZ. Mr. Green is recognized for 2 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing.

Mr. Chairman, I am concerned about credit-based insurance scores, especially as they relate to employment. It is very difficult to be poor. It is very expensive to be poor. In poor neighborhoods, goods cost more. In poor neighborhoods, you find that unemployment is obviously higher for any number of reasons. It is very difficult to be poor.

When you are poor and you need a job, and it is difficult to get a job because of credit scores, it seems that we compound the problem. I am very concerned about how we approach credit scoring with reference to employing people, especially people who are poor.

I look forward to hearing from the witnesses and I look forward to solutions such that poor people will not find that they are being invidiously discriminated against.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman GUTIERREZ. The gentleman yields back the balance of his time. I ask unanimous consent that Mr. Manzullo be allowed to sit on the subcommittee, and hearing no objection, I recognize him for 1½ minutes.

Mr. MANZULLO. Thank you, Mr. Chairman. There is a distinction between people who incur medical debt and those who go out and charge vacations and consumer items. I practiced law for 22 years and have been through probably 1,000 bankruptcies.

In several of those cases, the people I put into bankruptcy either exhausted their insurance or had no insurance and they filed bankruptcy not because they wanted to, not because they did anything intentionally, but simply because they could not pay off their medical bills.

I talked to two colleagues of mine in Rockford, Illinois, who specialize in bankruptcy. The two of them have been through 30,000 bankruptcies together. One had the record for credit card debt, $140,000.

Mr. Chairman, it was all medical expenses. We have to draw a distinction here between people who because of their spendthrift outrageous uncreditworthy conduct go out and buy things just because they want them, and people who are caught up, especially today, without insurance or lack of insurance or many times very high deductibles, co-pays, etc.

I am a sponsor of this bill because it is the right thing to do, especially with so many credit card companies, the case that my wife and I had on a simple $150 coat that was put on layaway, it took us 4 years to clear that. It was not until I threatened a lawsuit under the Fair Credit Reporting Act that the credit companies finally backed off on it.

Credit card reporting companies do a job and I understand what they are doing, but for people who are the unfortunate victims—

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. MANZULLO. They should not have to suffer the consequences.

Chairman GUTIERREZ. My friend, Mr. Watt, is recognized for a minute.

Mr. WATT. Thank you, Mr. Chairman. I may not even take a minute. I just wanted to applaud your continuing effort to shed some light in this area, an area that a number of us started looking at during the last term of Congress and found some very disturbing things, like credit scores determine your automobile insurance rates. I never could quite figure out why somebody's credit had anything to do with their driving record or how somebody's credit had anything to do with the insurance rates that they paid on their homeowner's insurance.

There are a lot of disconnects here, and we need more information about this so we can make some good judgments and possibly do some legislation in this area. I think that is why this hearing is so important, and I applaud the chairman for the hearing. Thank you.

Chairman GUTIERREZ. I thank the gentleman. Mr. Garrett of New Jersey is recognized for 2 minutes.

Mr. GARRETT. I thank the chairman, and I thank the ranking member, and I thank the members of the panel who are here.

Credit information has obviously become an essential and valuable tool in allowing various market participants to more accurately price for the risk.

One of the areas we are examining today is how this information is used by property casualty insurance companies in determining the premiums they charge to their clients. There have been numerous actuarial reports that have studied this. By using consumer-based insurance or CBIS, in determining premium rates for P&C lines, insurance companies are basically more able to accurately price for the risk of the consumer and the rates have significantly decreased for a broad majority of the policyholders.

Credit scores are really just one of a number of different data points that insurers consider when determining a consumer's premium.

If we were to now limit or restrict certain types of information from being used to allow insurers to more accurately price for risk, two things are going to happen: One, more people will pay higher premiums; and two, fewer people will be able to purchase insurance. Neither of these things are good.

In the wake of the recent financial crisis, instead of looking for ways to decrease credit availability and the accurate pricing of risk, I believe Congress should be considering policies that will help expand credit for consumers and small businesses and lower the cost of credit and insurance premiums for the majority of Americans.

With our current unemployment rate around 10 percent, we really must work on initiatives to expand economic opportunities for all Americans, not ways for the government to micro-manage our Nation's small businesses and risk trying to restrict the aggregate price of risk.

With that, I yield back the balance of my time.

Chairman GUTIERREZ. Last for our side, we have Congresswoman Maloney for 30 seconds.

Mrs. MALONEY. Thank you, Mr. Chairman. First, I want to welcome Mr. Wilson. LexisNexis is headquartered in the district I represent and I am very proud to represent his company which is so valuable to our country. The number of consumer complaints related to credit scores have been going up, and I look forward to his testimony and others on how we can better move forward in a way that is fair to consumers and fair to business. Thank you.

Chairman GUTIERREZ. We have two panels this morning. The first panel will focus on the use of credit information for insurance underwriting and ratings, and the second panel will focus on the use of credit information in other areas such as employment.

The first panel consists of three witnesses. First, the honorable Michael T. McRaith, director of the Illinois Department of Insurance, on behalf of the National Association of Insurance Commissioners. I welcome Mr. McRaith here from Illinois. He is doing a great job out in the State of Illinois. I am happy to have him here.

Then, we have Mr. David Snyder, the vice president and associate general counsel of the American Insurance Association.

Our third witness is going to be introduced by Mr. Price of Georgia.

Mr. PRICE. Thank you, Mr. Chairman. Mr. Wilson is a constituent and I want to welcome him to our panel today. Mr. Wilson serves as the director of analytics for the Insurance Data Services Group at LexisNexis Risk Solutions. He joined Equifax in 1983, and his early experience included roles as a marketing analyst and as a field operations manager for electric gas and telephone utility customers, and he then served as manager of strategic planning and research before moving to Equifax Insurance Services in New Product Development. He has worked extensively on the development and introduction of the first credit scoring models, and has a wealth of knowledge in this area.

In his current role with LexisNexis, he continues to support insurance risk scoring models and manages a team of statisticians and modelers, holds a B.A. in marketing from Oglethorpe, a grand university down in Georgia, and an MBA from Mercer University, another great education institution in Georgia.

We want to welcome Mr. Wilson.

Chairman GUTIERREZ. You are welcome here. We are going to start with the gentleman from Illinois, Mr. McRaith. You are recognized for 5 minutes. There is a clock there. It is green at the start of your 5 minutes. When there is a minute left, it will turn yellow. When you see it turning yellow, you have a minute left. A minute can last quite a while. When you see it turn red, I will tap. Five seconds later, we hope you will wrap it up.

Please, Mr. McRaith, you are recognized for 5 minutes.

STATEMENT OF MICHAEL T. McRAITH, DIRECTOR, ILLINOIS DEPARTMENT OF INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Mr. MCRAITH. Thank you. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, thank you for inviting me to testify. I am Michael McRaith, director of Insurance in Illinois, and I serve as chairman of the Property and Casualty Committee for the National Association of Insurance Commissioners.

Today, I offer the views of my fellow regulators on behalf of the NAIC. Thank you for your attention to the use of credit information in personal lines insurance.

H.R. 5633, introduced and sponsored by the chairman last year, coincided with our own effort to scrutinize the use of insurance scores. As regulators, we do not fashion public policy. Those decisions are made by Congress and State legislatures.

States view insurance scores from different perspectives. Some States have banned the use of credit information, others impose rate bans or prohibit use on renewal or allow only if credit information would reduce premium. Still others require only that credit not be the sole basis for an insurer's decision.

In Illinois, unlike most States, our law requires only that insurers consider extraordinary life events and does not even recognize military deployment as an extraordinary event.

In Illinois, an older gentleman from a small town wrote that he had paid cash for everything his whole life, car, farm land, etc. His handwritten note explained that he bought car insurance before the law required, never ate fancy meals or bought pricey clothes. He even added that he had been married 47 years to the same woman, but confronted a greater than 20 percent premium increase due to his thin file.

Illinois law should be improved.

For the NAIC, we applaud this committee's desire to move past the rhetoric of interested parties and toward a fully informed approach. To that same end, the NAIC held public hearings in 2009. Interested parties, insurers, actuaries, and insurance score vendors argued that insurance scores allow for more accurate underwriting and rating.

Consumer representatives argued that credit-based insurance scores have a disparate impact on members of protected classes and are premised upon irrelevant if not inaccurate information.

We heard in great length about the studies that support both positions. In our own States, insurers sell homeowner insurance in urban neighborhoods where homeowners were previously stretched to find affordable coverage. Insurers argue that credit-based insurance scores have facilitated that market change.

Studies also indicate that individuals of racial and ethnic minority heritage are overrepresented in low credit score categories and that credit-based insurance scores discriminate on the basis of that heritage.

Our national focus has turned. Rather than engage in that circular debate, we have undertaken a two-pronged strategy to assist policymakers.

First, we are developing a standardized data call or detailed interrogatories for personal lines auto companies. This data call will target the impact of different factors upon rates paid by consumers: gender; marital status; age; and credit score, among others.

This data will enable Congress and the States to measure the consumer and market impact of one State's law versus another's.

Second, the NAIC is developing a model law to bring insurance score vendors within insurance regulator oversight.

One panelist indicates in written testimony that those vendors are already subject to State regulator oversight, an assertion with which we largely agree.

However, those same vendors argued the exact opposite before the NAIC, and we intend to eliminate the ambiguity.

As digital information expands insurer access to consumer specific details, insurance regulators remain vigilant in protecting consumers against potentially abusive underwriting and rating practices.

We are watchful for any underwriting or rating formula that may constitute a proxy for race, gender or other protected characteristics. Insurance must function as insurance.

For the NAIC, we appreciate the chance to assist this subcommittee and pledge our continued support of your efforts. With our two-pronged approach, State regulators intend to offer reliable, fact-based information for Congress and the States. As our data call and model law development conclude, we will deliver the results to this committee and to Congress.

Thank you for your attention. I look forward to your questions.

[The prepared statement of Mr. McRaith can be found on page 81 of the appendix.]

Chairman GUTIERREZ. Thank you so much.

Mr. Snyder, you are recognized for 5 minutes, sir.

STATEMENT OF DAVID F. SNYDER, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION

Mr. SNYDER. Good morning. Chairman Gutierrez, Ranking Member Hensarling, Mr. Price, and members of the subcommittee, my name is Dave Snyder, and I am vice president and associate general counsel for the American Insurance Association.

In the midst of the financial turmoil and its related chaos, the U.S. property and casualty insurance sector is stable, secure, and strong. There are good reasons for this.

We, you and the States never lost sight of our fundamental shared goals, reduce risk where possible, accurately assess and assume the remaining risk, and provide effective coverage to the American people.

As a result, auto and homeowner's insurance markets are by every measure financially sound, competitive, and affordable. Claims are being paid daily by solvent companies. The market is very competitive by any measure and insurance is taking less of a bite out of household incomes than in the past.

This is good for the economy because this maximized competition forces prices down to the lowest feasible level so people have money to spend on other things.

Insurance scoring has played a major role in creating this positive market for all concerned. By empowering more effective risk assessment and pricing, the majority of the population pays less. Insurance is more available and more people can receive reasonably priced coverage, instead of being relegated to the high-risk pools, because insurers have a cost-effective tool to assess and price for risk, giving them the certainty they need to provide coverage to nearly everyone.

You have asked us to address certain issues relating to insurance scoring. In summary, it is race and income blind, and has repeatedly been proven to be an accurate predictor of risk, indeed, one of the most accurate.

The States have actively regulated it and insurance commissioners have full access to all the information they desire.

In response to your request for recommendations, we suggest that all States adopt the National Conference of Insurance Legislators' model law.

Second, the States should make sure they capture and analyze all of the credit complaints they can and communicate with insurance companies about them, individually, and any trends.

We note, for example, from Director McRaith's testimony, that the rate of complaints under the existing system for credit-based insurance scores is about 1 complaint out of every 1.5 million policies issued or renewed.

In addition, we all need to work together more effectively on financial literacy to help the American people understand how insurance scores are used by insurance companies to provide them with coverage.

There is one other recommendation we did not emphasize in our written statement, that is to make it more possible to innovate on a pilot basis. For example, to introduce more direct measures of driving performance, such as the ability to assess risk, based not only on mileage, but how, when, and where those miles were driven.

One other factor in the strength of the personal lines insurance market is that we have collectively reduced risk. Thanks to your leadership and that of safety groups, the insurance industry, and the States, far fewer Americans are injured and killed on our highways than ever would have been expected.

Using fatality rates of 1964, last year alone, we have collectively saved 120,000 lives and prevented millions of injuries. This has created a solid foundation of the healthy auto insurance system we have today.

The insurance industry is focused on building safety as never before through advocacy of smoke detector laws and codes requiring sprinklers and disaster resistant buildings, and the eminent opening of a building construction test center with wind turbines powerful enough to test the structural integrity of buildings.

We hope to see a pattern of positive change similar to that which we helped bring about in auto safety with your cooperation and assistance.

Thank you for inviting me to speak with you today. I would be pleased to answer any questions you may have.

[The prepared statement of Mr. Snyder can be found on page 147 of the appendix.]

Chairman GUTIERREZ. Mr. Wilson, you are now recognized for 5 minutes, sir.

STATEMENT OF JOHN WILSON, DIRECTOR, ANALYTICS, LEXISNEXIS RISK SOLUTIONS

Mr. WILSON. Good morning. My name is John Wilson, and I am director of analytics for the Insurance Data Services Group at LexisNexis Risk Solutions.

LexisNexis provides technology and information that helps businesses, government agencies, and other organizations reduce fraud and mitigate risks.

In our Insurance Data Services Group, we provide a variety of products and services to support the insurance industry, including credit-based insurance scores.

In my remarks today, I will focus specifically on how our insurance scores are developed, utilized, and regulated.

Credit-based insurance scores have long been used by insurance underwriters and actuaries to more accurately assess risk for auto and homeowner's insurance policies. Insurance scores provide an objective, effective, and consistent tool that insurers use with other information such as driving histories and prior claims to better predict the likelihood of future claims and the cost of those claims.

Deriving an insurance score follows a straightforward process. A carrier compiles historical policy experience, including earned premiums and incurred losses, on a selected population of risks.

LexisNexis then works with the credit bureau to match that policy experience to the historical consumer credit from the particular point in time to which the policy performance data pertains. Then, using regression techniques, we identify the credit variables that taken together provide the best representation of the observed loss ratio performance.

Most credit variables can be grouped into one of five primary areas: one, how long you have had accounts established; two, the number and type of accounts that you hold; three, indications of recent activity, including inquiries and new account openings; four, the degree of utilization on your accounts; and five, payment history.

The relevant weight of each of these areas can vary depending on the line of business being modeled but for any specific model, the insurance regulator is given access to the individual variable descriptions, bins, and point assignments.

Insurance scores do not consider factors such as race, religion, national origin, gender, marital status, age, sexual orientation, address, income, occupation, disability or education. Also, inquiries made for account review or promotional or insurance purposes are not used in calculating insurance scores. We also exclude medical collections.

It is important to note that while LexisNexis provides insurance scores, we are not an insurance company. We are not involved in insurer rate setting determinations or rate decisions with respect to groups of individuals or individual consumers.

LexisNexis is also not a consumer credit bureau, and we do not make credit decisions. Our role is to supply information to the insurance carriers to assist them in making underwriting decisions.

The credit-based insurance scoring process is currently regulated at multiple levels. LexisNexis is considered a consumer reporting agency under the Federal Fair Credit Reporting Act and its State analogues.

As required by that Act, LexisNexis provides consumers upon request with access to all the information in the consumer's file at the time of the request. We have also set up a process by which any consumer may order a copy of their insurance score via our Choicetrust.com Web site.

Additionally, because insurance is regulated at the State level, LexisNexis must conform its models to specific State statutes, regulations, and guidelines relative to insurance scoring.

Most States have adopted regulations based on the model law on insurance scoring developed by the National Conference of Insurance Legislators.

Pursuant to State requirements, a third party vendor like LexisNexis must file its model for review with State insurance departments. In many States, carriers are required to include the LexisNexis model filing materials in their rate filing. In other States, a carrier may be allowed to reference the LexisNexis model once it has been filed.

Finally, the insurer must gain approval of its rate filing that may include an insurance scoring component.

As a result, LexisNexis works on an ongoing basis with State departments of insurance to explain our models and to create State-approved scoring solutions for our insurance customers.

In addition, LexisNexis provides two consumer Web sites, Choicetrust.com and Consumerdisclosure.com, to make information about our insurance scores and processes more readily accessible to consumers and to other interested individuals.

In conclusion, credit-based insurance scores provide an objective, effective, and consistent tool that insurers use with other information to better predict the likelihood of future claims and the cost of those claims.

There are existing Federal and State regulation and approval processes that provide comprehensive oversight by individual State departments of insurance over insurance scores, insurance score developers, and the use of insurance scores.

LexisNexis works cooperatively with State insurance commissioners and their staffs in seeking approval for our scoring models.

I appreciate the opportunity to provide the subcommittee with information on insurance scoring, and I am happy to answer any questions you may have.

[The prepared statement of Mr. Wilson can be found on page 180 of the appendix.]

Chairman GUTIERREZ. Thank you so much. I welcome all of you here. I know there are a lot of questions because I can see that quite a number of members have shown up this morning.

Let me just take a couple of minutes, and then I will allow members to ask questions. I will just make some general comments.

If someone has cancer and they become very ill and they do not have health insurance, they are likely to suffer great economic harm, and that is going to affect their credit score.

Let me ask you, if someone becomes ill, is it more likely they are going to drive quickly, get into an accident, or drive erratically if they become ill? Their credit score, as we know, is going to be affected.

Each of you answer the question, please, from left to right. Mr. McRaith?

Mr. MCRAITH. Mr. Chairman, first of all, let me say and also in reply to Congresswoman Kilroy's concern about medical expenses, we are aware that two-thirds of all personal bankruptcies are based on medical costs. Three-quarters of those people filed even though they had health insurance. It is a significant problem.

Different States have adopted different approaches to dealing with an extraordinary life event like medical expenses as you have described, and allowing—

Chairman GUTIERREZ. If you use my credit score, a deteriorating credit score, is it more likely I am going to cause the insurance company additional liability?

Mr. MCRAITH. To answer that question, I do not know the answer to that. I am not sure that anyone has explained directly the nexus between credit score and driving.

Chairman GUTIERREZ. Mr. Snyder? Am I more likely to survive cancer and have incredible debt? Is my house more likely to have a fire?

Mr. SNYDER. Mr. Chairman, the answer to that is no. That is why we have supported language in the National Conference of Insurance Legislators' model that removes collection accounts with a medical industry code. That is what was done first, and then this past summer, the National Conference of Insurance Legislators tightened that up even more with our support.

It removes the consideration of negative factors resulting from a serious illness or injury.

Chairman GUTIERREZ. Just for the record, just so it is clear to all the members of this committee, you are coming here representing who? Just so we have it for the record. You are representing the American insurance industry?

Mr. SNYDER. Yes, sir.

Chairman GUTIERREZ. Thank you. Mr. Wilson, you provide them with the information, so what do you think?

Mr. WILSON. We have not tried to study the specific question that you have asked. We also agree that medical collections should not be used in our scores.

Chairman GUTIERREZ. But they are used in scores.

Mr. WILSON. They are not.

Chairman GUTIERREZ. In your credit report, they are. If someone fails to pay a medical bill, it has a derogatory impact on my credit report, which is going to have a derogatory impact on my credit score.

Mr. WILSON. I am not going to—

Chairman GUTIERREZ. You cannot. It shows up. In other words, Mr. Wilson, if someone does have difficulty paying a hospital bill and it goes to a collection agency, does that show up on the individual's credit report?

Mr. WILSON. It will show up on the credit report.

Chairman GUTIERREZ. Does it have a derogatory effect on their credit score?

Mr. WILSON. It is not used in our scores.

Chairman GUTIERREZ. It is not used in your scores, but it is used in their credit reports.

Mr. WILSON. It is on the credit report.

Chairman GUTIERREZ. Thank you. It is used on the credit report. Everybody has witnesses here. I do not think Mr. Wilson is too upset at me asking him the questions.

What we are trying to get at here is how is it that people who have an accident, who have an illness, in the end are not deprived of insurance even though they had no way of dealing with this and maybe it does not have anything to do with them.

Let me ask, if I am employed and I become unemployed and cannot pay my bills because I have become unemployed, does that mean I am more likely to have an accident or fire in my house? Mr. Wilson?

Mr. WILSON. Again, the scoring models that do look at delinquent payments which would potentially be a result of having lost a job show that those delinquencies are in fact indicative of greater risk of claim filing.

Chairman GUTIERREZ. Therefore, I would pay more in health care insurance? I am sorry. Therefore, I would pay more in car or home insurance?

Mr. WILSON. You could; yes.

Chairman GUTIERREZ. I would.

Mr. WILSON. Not every carrier uses credit scoring and the weights—

Chairman GUTIERREZ. Thank you. My time has expired.

Mr. SNYDER. Mr. Chairman, if I might, just to provide a further response to that, the extraordinary life circumstances language added to the National Conference of Insurance Legislators' model specifically excludes the use of loss of employment for a period of 3 months or more if it results from involuntary termination.

Yes, that is a factor which we are trying to work with consistent with your question.

Chairman GUTIERREZ. Thank you.

Mr. McRaith. Mr. Chairman, if I could add—

Chairman GUTIERREZ. I am sorry. I ask unanimous consent for 10 more seconds. Mr. McRaith, please?

Mr. MCRAITH. They cannot both be true; if medical loss expenses are not considered, then there would be no reason to have an extraordinary life exception. Also, the so-called NCOIL model has been adopted in different States in different variations, as I said.

The State of Illinois, for example, only requires that the company consider such an event.

Chairman GUTIERREZ. Thank you.

I recognize Mr. Price for 5 minutes.

Mr. PRICE. This is a remarkably important topic and I think there is a lot of misinformation that is going into the debate, and there is a lot of hyperbole that occurs. I am hopeful that throughout the question period in this hearing, we will be able to sort out some of that.

Mr. Wilson, you mentioned in your testimony that the main variables, the primary areas where credit variables are looked at are: length of time of an account; number and type of credit accounts;

indications of recent activity; the degree of utilization; and payment practices.

In your next statement, "Insurance scores do not consider factors such as race, religion, national origin, gender, marital status, age, sexual orientation, address, income, occupation, disability or education."

Given that, why do you think there is all this misinformation about what goes into a credit score?

Mr. WILSON. I do think some of the comments that were introductory to this session are accurate, that not every consumer has a clear understanding of all of the details of credit reports, credit scoring, or how these things are used in making decisions about them.

I do think we have tried to be out there making information available to consumers. We developed training programs for continuing education credits for agents, insurance agents, because they are very often the first line of answering questions about these things.

Mr. PRICE. Providing a score, you are not an insurance company, you are not a credit bureau, you do not provide credit, you provide information?

Mr. WILSON. Right.

Mr. PRICE. There is a lot of information that goes into the rationale for why a consumer might be excluded from gaining credit. I would be interested in the opinion of the panel on if we as a Congress determine we ought to exclude certain things from being considered, is it possible that would actually harm consumers as opposed to helping consumers, Mr. Wilson? Mr. Snyder?

Mr. SNYDER. Mr. Price, the FTC estimated that 59 percent of the people pay less as a result of credit-based insurance scores. Frankly, in public testimony given by companies in the States, the numbers are really much higher for many companies.

We would envision first of all a very negative effect on the vast majority of policyholders directly. Secondly, it would deprive the market of a critical tool that has allowed the market to evolve much more toward objective underwriting individually tailored to each risk, which in turn is giving the companies the confidence to write virtually everybody.

Under the old system that was sort of pass/fail, you were either very good, normal or you were relegated to the high cost assigned risk plans.

Now, because of the tool that is capable of individual accurate and objective risk assessment, insurance companies are pretty much able to write anyone who comes to them, which has resulted in the shrinkage to historic lows of these high risk pools, so there are a number of harms that would come, some directly, to the majority of policyholders, and then indirectly to a market as a whole resulting in less competition and potentially less availability of insurance.

Mr. PRICE. And higher costs? Less availability and higher costs.

Mr. SNYDER. And higher costs.

Mr. PRICE. Mr. McRaith, do you agree with that?

Mr. MCRAITH. Congressman, we should always be concerned about unintended consequences and certainly the pricing of one risk in a company's pool affects the pricing of another risk in that same pool.

However, we should not accept as gospel that 60 percent of people benefit from the use of credit-based insurance scores because we do not know what the baseline is.

Mr. PRICE. Do you dispute that number?

Mr. MCRAITH. What I am saying is, I described earlier our effort with the data call to collect information from insurance companies. One is to get behind the rhetoric which argues that a certain percentage of consumers benefit from the use of credit-based insurance scores. We do not know when we hear the word "benefit," what is the starting point. We do not know what the baseline is. That is what we intend to find out. We will report back to you.

Mr. PRICE. Mr. Wilson, do you have any comments?

Mr. WILSON. No.

Mr. PRICE. In the remaining seconds, what factors did Congress rely on when examining and endorsing the non-lending uses of credit information while amending the Fair Credit Reporting Act in 1996 and the FACT Act in 2003?

Mr. Snyder?

Mr. SNYDER. Congress continued the ability of insurers to use credit information for insurance underwriting, and that has long been the case. Congress continued that through the recent amendments.

The recent amendments also made the whole credit scoring system better. Frankly, we have a major interest in making sure that scores are accurate and that people have access to their credit history and the ability to correct any issues that may exist.

I think the Congress improved all of that through the most recent amendments, but did maintain the long-standing ability on the part of insurers to use credit for underwriting subject to Federal law under the Fair Credit Reporting Act, and all that implies as well as being currently State regulated, all the State regulation that applies as well.

Mr. PRICE. Thank you, Mr. Chairman.

Chairman GUTIERREZ. The time of the gentleman has expired. Mr. Watt, you are recognized for 5 minutes, sir.

Mr. WATT. Thank you, Mr. Chairman. I want to try to make a distinction here between causation and correlation. I take it, Mr. Wilson, you are in the nexus business. That is the correlation business. What you are saying is, there is a correlation between somebody's credit score and these factors that impact driving insurance rates and homeowner's insurance rates.

I am not clear whether you are prepared to assert to me that there is some causal connection between those things as opposed to a correlation between those things.

Let me ask the question directly: Are you prepared to assert to me that if I have a low credit score, that will cause me to be a worse driver?

Mr. WILSON. No.

Mr. WATT. Are you prepared to assert to me that if I have a low credit score, that is likely to cause me to have a fire at my house?

Mr. WILSON. I am not saying it is causal.

Mr. WATT. You are saying that the correlation factor makes it more likely that I will be a bad driver; right? That is what the nexus is in your LexisNexis, I take it. Is that right?

Mr. WILSON. I am not actually familiar with what the nexus in our LexisNexis—

Mr. WATT. Do not waste my time on hyperbole. Let's talk about insurance, not LexisNexis. I am sorry. I got you off track. You are saying there is a correlation.

We have made it explicitly clear that if there is a correlation between race and bad driving or race and more likelihood that I will have a fire, that is prohibited; right? You cannot take that into account. There is no question about that.

If you find some substitute for race that correlates in the same way, has the same impact, would you think it would be appropriate to use that as a factor and then turn around and say well, no, we are not considering race at all, we are just considering this correlation factor that we have out here?

Mr. WILSON. You are giving me a hypothetical.

Mr. WATT. No, I am just asking you a question. Would you think it would be appropriate to do that?

Mr. WILSON. If you could find a pure proxy, you should not be able to use it; yes.

Mr. WATT. Okay. What about you, Mr. McRaith? I assume you would not think it would be appropriate to do that.

Mr. MCRAITH. It is absolutely fair to say, Congressman, that the States have taken different approaches to this subject. If one factor were identified to be a proxy, I believe all States would be opposed to that.

Mr. SNYDER. Mr. Watt, if I might add that—

Mr. WATT. I am not sure I asked you anything, Mr. Snyder. You are welcome to add something.

Mr. SNYDER. Thank you, sir. The FTC did conclude that credit-based insurance scoring is not serving as a proxy for race.

Mr. WATT. I read that study. We had a hearing about that study. It did not exactly say that. I understand you want to get that in the record. Maybe we ought to put that study in the record. We had it in the record last year when we had a hearing about this. That is not exactly what it says.

It says kind of there is the same kind of correlation that you are talking about as legitimate here for credit-based scoring between this and race. You want to use it on one side and say we like the correlation on one side and we are going to use it, and on the other side, we do not like the correlation, so we want to say no, no, we should not be using correlations here.

Is there not a strong correlation between these factors and race? That requires either a yes or no answer. Is there a strong correlation or is there not?

Mr. SNYDER. It found that it was not a proxy for race.

Mr. WATT. I heard that. That is what you testified to earlier. That is not the question I asked. I want to know, is there a strong correlation, not whether there is a proxy. I do not think anybody in here knows what "proxy" means.

Tell us, is there a strong correlation or not?

Chairman GUTIERREZ. The time of the gentleman has expired. Answer the question.

Mr. SNYDER. It found that there were larger percentages in various demographic groups with lower credit scores than other groups. It also found that within these groups—

Chairman GUTIERREZ. Your time has expired.

Mr. WATT. Can I just get him to answer my question, Mr. Chairman?

Chairman GUTIERREZ. I tried. We will come back around.

Mr. WATT. I just want to know whether there is a strong correlation or not. That is a simple question. It is not a trick.

Chairman GUTIERREZ. Mr. Marchant, you are recognized for 5 minutes, sir.

Mr. MARCHANT. Thank you. Mr. Wilson, talk to us about the relationship you have with your customer. Your customer is an insurance underwriter, salesman, company?

Mr. WILSON. Right. Our primary customer is the underwriting department and/or the actuarial department in the personal lines property casualty industries.

Mr. MARCHANT. Is a major consideration—would the insurance company come to you regardless of whether there was credit being extended to the customer to purchase the product?

Mr. WILSON. Yes. The credit scoring used by insurance companies is generally not a part of say premium finance decisions. It is a risk indication.

Mr. MARCHANT. The credit history that you are looking at has nothing to do with the fact as to whether the insurance company is going to get paid for the product they are selling?

Mr. WILSON. Right. It is not about payment of premium.

Mr. MARCHANT. It is purely a historical fact that gets plugged into the fact of what they pay for insurance actually; right?

Mr. WILSON. Right. The credit factors or the score in conjunction with driving record, in conjunction with coverage amounts, in conjunction with prior losses, it all goes into the underwriting or rating of the policy.

Mr. MARCHANT. If a customer comes to the insurance company and says, I want this kind of coverage and I am going to pay cash, the companies still go through the same process, and if your information taints that customer, even though they are planning to pay cash or pay for it other than with that company, it still taints that customer or has the potential to taint them?

Mr. WILSON. Right. If the carrier does use credit scores as part of their rating, then it would be used even if the consumer were paying cash for their premium.

Mr. MARCHANT. This is the complaint that I get from my constituents the most. They feel that because they have had bad credit or they have had a car repossessed or they paid their last insurance policy and their premiums were slow, they feel like when they apply for more insurance, the reason why their insurance—the rate has been raised is because there is a direct correlation between the late payments on a previous policy.

You are saying it is the late payments on any kind of credit they may have?

Mr. WILSON. That is right.

Mr. MARCHANT. Not specifically on that product, on the insurance itself?

Mr. WILSON. On the premiums; right.

Mr. MARCHANT. You give the report to them, but it is up to the underwriting department to make its own decision based on your report, how much they weigh each of those things?

Mr. WILSON. That is correct.

Mr. MARCHANT. What is your experience in that weighing process? Is it pretty reliable if you have a very low credit score that you are going to pay more for your insurance?

Mr. WILSON. These scores have been tested not only by independent parties like actuaries and the Federal Government and the Texas Department of Insurance, but also by carriers themselves.

Carriers would not use these tools if they did not work well for them. There is a great deal of variation, however, in the weight that individual carriers assign to credit score in their overall rating programs.

Mr. MARCHANT. Mr. Snyder, in your particular instance, would a driving record be a significant factor in your information that you gave to an underwriter that bought your service?

Mr. SNYDER. Absolutely. Auto insurance rating generally involves not only credit information but the age of the driver, the prior driving experience, the make and model of the vehicle, and on and on. The ultimate underwriting and rating decision is based upon many factors, only one of which is credit.

Chairman GUTIERREZ. The time of the gentleman has expired. Mr. Moore is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

Our Oversight and Investigations Subcommittee held the first in a series of hearings last week on the topic of the end of excess, a broad look at lessons learned from the crisis.

I believe that one lesson from the financial crisis is we need to go back to living within our means and that is true for our government, for financial firms, for businesses, families, and individuals.

Mr. Snyder, I agree with the point you make in your testimony that we need to increase financial literacy, which will be the focus of one of our subcommittee hearings in our lessons learned series.

We need to teach personal finance to our students in high school and college, ensuring that our young people are fully empowered to make sound financial decisions.

Mr. Snyder, as we think about credit scores, how can we encourage individuals to regularly review their credit report, correct any misinformation, and learn how to build their credit scores?

Mr. SNYDER. Thank you. It is a message which we try to repeat on Web sites. Attached to my testimony is some information where we talk about what goes into an insurance score and the need to stay on top of it. There are adverse action notices that make that point as well. I know the credit industry is doing a lot.

Frankly, we look forward to increased cooperation with the Congress and the States on improving financial literacy. We have done some work on our own. We would like to work collaboratively to see what we can do to raise the level of financial literacy for everyone in this country.

Mr. MOORE OF KANSAS. Mr. McRaith or Mr. Wilson, do either of you have any comments?

Mr. MCRAITH. Financial literacy is important for all sectors of consumer finance. Insurance in particular can be very confusing to the average family, the average small business. States are committed to helping consumers understand how their insurance policies are underwritten, how they are priced, and providing whatever direct consumer assistance we can.

Mr. MOORE OF KANSAS. Mr. Wilson?

Mr. WILSON. I would agree with the gentleman.

Mr. MOORE OF KANSAS. Mr. McRaith, in your experience as a State regulator, how accurate are these credit scores? Do they get abused in how are they used by insurance firms? Do credit scores assign reasonable value if one is comparing medical debt to excessive spending habits, and do insurance firms focus more on credit scores or the inputs that provide the credit scores? What is your view?

Mr. MCRAITH. Congressman, in fact, we understand a broad range. What one company does and the weights that one company might assign to one factor like a credit score might be significantly different from another company.

Of course, different States have different parameters. There is a wide variation. I think one State estimates a variance of credit score affecting a rate from 7 percent up to the high double digits. That indicates that companies use this one factor of credit scores in a way that—companies use them differently based on their proprietary or pricing formula.

Medical expenses and the debt associated with medical expenses frequently is a problem for consumers. State law varies with respect to whether consumers can be penalized for that or what is the recourse the consumer might have in the event that consumer is penalized for medical debt.

It is inaccurate to say that companies do not consider medical debt as part of a credit score. It is also inaccurate to say that all States allow medical debt to be exempted as an extraordinary life event. Some States do. Some States do not.

Mr. MOORE OF KANSAS. Do either of the other witnesses have a comment? Mr. Snyder?

Mr. SNYDER. Yes, sir. With regard to the latest point, we support the enactment of the National Conference of Insurance Legislators' model, including extraordinary life circumstances, including the provision on use of serious injury or serious illness with the individual or family member.

Mr. MOORE OF KANSAS. Thank you.

Mr. WILSON. I think I would just add that even in States that have not adopted an NCOIL model or an NCOIL-like model, we still do not consider medically coded collection items in our scoring.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. I yield back my time.

Chairman GUTIERREZ. The gentleman yields back the balance of his time. Congressman Lance, you are recognized for 5 minutes, sir.

Mr. LANCE. Thank you, Mr. Chairman. Good morning to you all.

Commissioner McRaith, if credit-based insurance scores were not used by insurers as one factor out of many for setting premiums, what other factors, in your opinion, would be more heavily weighted and what would be the likely effect on rates?

Mr. MCRAITH. Congressman, the availability of data to any one insurance company at this point is so expansive, it is impossible to determine exactly what or to conclude what factors would replace a credit score. Some companies are using all of the sub-components of a credit score right now for pricing and not relying solely upon a credit score in and of itself.

What we expect is that eliminating one rating factor will shift costs. There are some people who might pay more. Others might pay less. When you affect the price of one person in a risk pool, you are going to also affect someone else in that same pool.

Mr. LANCE. That is obviously my point, and whether that would be fair to others where the risk would be shifted is obviously a question of great concern.

Mr. Snyder, do you have an opinion on that?

Mr. SNYDER. I would agree with the comments of Director McRaith on the potential impact on people paying more as a result.

Mr. LANCE. Mr. Snyder, could you move your microphone closer?

Mr. SNYDER. Yes. I would just indicate my agreement with the comments Director McRaith just made, that if some people pay less, many more people will pay more.

Mr. LANCE. From your experience, what might be those factors if we were to eliminate this factor?

Mr. SNYDER. Well, in one sense it might force the industry to go back to larger classifications and rely more on those, such as territory and other factors which themselves were controversial.

With the addition of credit-based insurance scores, you have added a degree of objectivity and individual tailoring that did not exist before, and it allows both not only accurate rating and underwriting of individuals but has improved availability in the market because the confidence companies have that they have the ability to price every risk and therefore, many more risks are being written in the voluntary market.

Mr. LANCE. Credit scores are individual. I recognize a once-in-a-lifetime situation should be excluded. Credit scores are individual in a way that geographical territory is not and may be bitterly unfair to those who live within the territory, and actually in my judgment may be extremely harmful to those whom we are trying to help.

Mr. Wilson, your thoughts?

Mr. WILSON. That is certainly a possibility. There are only so many factors that have been demonstrated to have a correlation with expected loss costs, and insurance companies do try to use them as effectively as they can to write risks.

Mr. LANCE. What would your view be on a risk based upon territory?

Mr. WILSON. Territory has been demonstrated to be strongly indicative, but as you know, it is broad, and one of the benefits as we saw it for credit scoring is it was individual.

Mr. LANCE. Yes. It is my observation that in several other areas, unrelated to the discussion this morning, Congress has inappropriately tried to pressure those. Fannie Mae and Freddie Mac certainly come to mind.

I trust as we move forward on this issue that we do not engage in the type of behavior in which Congress was certainly guilty regarding that matter.

I yield back the balance of my time. Thank you, Mr. Chairman.

Chairman GUTIERREZ. The gentleman yields back the balance of his time. Congressman Hinojosa is recognized for 5 minutes.

Mr. HINOJOSA. Thank you, Mr. Chairman. Chairman Gutierrez, I want to thank you for holding this important hearing on a very important issue, consumer credit.

I commend my colleague, Congresswoman Mary Jo Kilroy, for introducing H.R. 3421, the Medical Debt Relief Act of 2009. The intent of her legislation is admirable. I agree with her that medical debt should be removed from credit reports 30 days after that debt has been repaid or settled, and that it not continue to hurt the credit rating of that individual, having gone through so many difficulties with sickness.

I am concerned about one issue involving credit reporting agencies. They buy and sell information from virtually all adult residents in the United States. For a long time, we have been encouraging them to provide credit reports in languages other than English, especially Spanish.

Mr. Chairman, I would ask that each credit reporting agency provide in writing their proposals to provide credit reports in languages other than English or that we at least have an opportunity to debate that.

I would like to ask my question to Mr. Snyder. I am interested in legislation that would require that every adult American citizen 21 years or older receive a free credit score on an annual basis.

Would the American Insurance Association support such legislation?

Mr. SNYDER. I think we would. We are interested in having both transparency in the process as well as accuracy in credit scoring. I have not checked with my other colleagues in that industry. Perhaps they have a view of that. I certainly think anything that makes the process more transparent as the Congress has done recently is something worthy of very serious consideration.

Mr. HINOJOSA. I am glad to hear you say that.

Mr. McRaith, do lenders or insurance lenders pay for the credit reports they obtain from the credit reporting agencies?

Mr. MCRAITH. Insurance companies typically will contract with a vendor that will provide or develop the insurance score on which the underwriting decisions and pricing are determined by that insurance company.

Some of the larger companies have their own independent proprietary insurance scoring formula.

Mr. HINOJOSA. I see. Mr. Chairman, with that, I yield back.

Chairman GUTIERREZ. The gentleman yields back. Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to go back to one of the things that seems to be a common theme, and I do not want to put words in people's mouth, but that the credit scores are used in part of the underwriting process.

What is not standardized is some companies put more weight on that credit score than others.

If I am a company and I am competing for business, if I am overly penalizing people for their credit scores and using that as a higher rate, I am probably losing business because I would say I would be pricing myself out of the market.

Is that a reasonable assumption?

Mr. SNYDER. Yes, sir; that is.

Mr. NEUGEBAUER. Basically, the checks and balances of how that information is being used is in the marketplace today; right?

Mr. SNYDER. Yes, there are many checks and balances in the marketplace, and the additional check and balance of detailed regulation at the State level.

Mr. MCRAITH. I would add, Congressman, that the companies pursued the profitable risks, and if in fact credit-based insurance scores identify prospectively less profitable risks, the pricing might be geared towards reducing the likelihood of that less profitable risk from enrolling with that company.

Mr. NEUGEBAUER. Which is probably prudent business, wouldn't you say?

Mr. MCRAITH. I would say that is the business judgment of the company; absolutely.

Mr. NEUGEBAUER. What we want is these companies—I do not want to do business with an insurance company that is broke. Do you?

Mr. MCRAITH. No, that is exactly right. We want financially strong companies able to deliver on the promises they make to consumers.

Mr. NEUGEBAUER. I think one of my colleagues asked the question and I want to rephrase it just a little bit, is it fair to say that because of the underwriting tools, credit report being one of them, and other information, that people can actually effectively lower their insurance costs by good behavior?

Mr. SNYDER. Yes, absolutely. The system very much rewards that behavior, not only on the road but in terms of responsible management of credit.

Mr. NEUGEBAUER. Mr. Wilson, any reflection on that?

Mr. WILSON. I would agree. You do have the opportunity to modify your profile, your risk profile, and therefore become a better risk.

Mr. NEUGEBAUER. We have gotten into the business around here it seems like that we kind of are trying to get government to pick the winners and losers. We do it with legislation that hand-ties a process that works and rewards good behavior where people who pay their bills, drive safely, demonstrate certain characteristics that they are responsible, and they get to reap the benefit from that.

It seems to me if we go in and sterilize that system, basically it becomes harder to determine who is the higher risk or the more profitable, so what happens is in order for a company to counteract that, I guess they just raise everybody's rates.

Would that be a fair assumption?

Mr. MCRAITH. I think it would in fact pricing, Congressman. As I mentioned in my opening statement, we see homeowner insurance companies, for example, offering insurance in neighborhoods where previously it would have been very difficult for them to price a homeowner policy.

Having said that, actuarial justification is not in and of itself a sufficient reason to allow a rating factor to be used.

In our examples over time, I will not bore you with it right now, actuarially justified factors that Congress or the States later determine should be prohibited.

Mr. NEUGEBAUER. Should we be careful as we go down that road?

Mr. MCRAITH. I think those are the public policy questions, of course, that Congress and the State legislatures answer every day.

Mr. NEUGEBAUER. One of the things that I think about is I know there are different insurance products, for example, they ask you if you are a smoker. If you are not a smoker, there is a discount. There must be a reason actuarially that non-smokers get a discount.

Would you agree with that?

Mr. MCRAITH. Absolutely. The one example that I recall, Congressman, is several years ago, there were life insurance companies charging higher premiums to African-American enrollees because their life expectancy was shorter. The country and States determined that was inappropriate.

I am not disagreeing with you. I think we want companies to be accurately pricing their products and financially strong. All I am pointing out is that actuarial justification in and of itself is not sufficient.

Chairman GUTIERREZ. The time of the gentleman has expired. The gentlelady from New York is recognized for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I thank you for having this hearing. I thank the panelists for their information.

We know that some individuals do not have traditional credit reports. Some have alternative reports that are created by items such as rental payments and utilities, to create a credit history. Those kinds of reports typically are different than a traditional credit report in underwriting.

For all of you, the current economic downturn has resulted in financial struggles for many of our constituents. As a result, they have seen their credit reports negatively impacted, even though they have had a good history from the past.

How could this affect an individual's ability to renew their insurance? I will throw that out to all of you.

Mr. SNYDER. Thank you. Lending scores and insurance scores are very different. We have included some materials in our statement from FICO, which is one of the major modelers, indicating they have not seen an overall pattern of insurance scores declining.

It is because of the different make-up of the scores. You have heard no doubt and read newspaper articles about lending scores. That has not been the case with insurance scores. They continue to be very stable over time, and they continue to reflect differences in risk.

Insurers also have the ability to adjust their rating tier so that if you have an overall decline in the economy, you can understand that across-the-board, so you have not had the impact on insurance scores that has occurred with regard to lending scores that you might otherwise assume would be occurring.

Mrs. MCCARTHY OF NEW YORK. Just a follow-up question, so many homes have actually de-valued in their worth, and yet they are continuing with basically—I just thought of this when you were speaking. My homeowner's insurance basically has gone up even though my home value has gone down. Are you seeing a trend like that across the Nation?

Mr. MCRAITH. Congresswoman, we have seen homeowner insurance premiums increase. We perceive that not to be a reflection of the value of the house necessarily, more a reflection of the economic challenges.

Investment portfolios of insurance companies, of course, did not provide the return they had been seeing over the years, and as a result, we expect premiums increased for many companies to reflect the decrease in portfolio return.

Mrs. MCCARTHY OF NEW YORK. It has nothing to do with basically—to rebuild the home would be lower, but you are still paying a higher price.

Mr. MCRAITH. Right. In fact, one question that I have heard with some frequency is, since construction costs are less now because construction workers are generally less expensive, why is the cost of my premium not declining as well?

Again, the premiums are not necessarily tied to the value of the home or the cost of replacing that home. They are connected with that but not directly and solely connected with that.

I would also add in terms of the question that you asked Mr. Snyder earlier, we do have that concern and have explored that question. For example, many credit card limits decreased through no act or fault of the consumer as a result of our recent financial challenges nationally. That affects the credit ratio for that individual consumer.

Does that then affect the insurance score? That remains to be an open question and we have heard conclusions on both sides of that question.

However, our effort, as I mentioned earlier, is to provide Congress with more fact-based information and reply to some of those questions, and we expect to have that survey done by the end of this year.

Mrs. MCCARTHY OF NEW YORK. Thank you. Mr. Wilson?

Mr. WILSON. Yes. I guess I would note that we also track information on our insurance applicants' scores, and while we have seen some adverse changes as an example, a slight increase in delinquency rates and in some cases, as Mr. McRaith mentioned, a reduction in the limits on credit cards, we have also seen some positive changes.

We have seen fewer inquiries, fewer recent account openings. We have also seen many consumers are actually paying down their revolving indebtedness. That, I think, has tempered the changes in the scores.

Chairman GUTIERREZ. The time of the gentlelady has expired. Mr. Royce, you are recognized for 5 minutes, sir.

Mr. ROYCE. Thank you, Mr. Chairman.

Instead of dealing in the abstract, I would like to focus on a few facts here. I come from California. In California, we continually rank among the highest rates for auto insurance in the country. A study just came out, again, California is in the top five, as we always are. Despite the fact that many safe drivers in California have decades of driving experience and clean driving records, they are also paying the highest insurance premiums in the Nation.

My home State also happens to ban the use of credit scores for insurance. I was going to ask Mr. Snyder, is there a correlation between the fact that the insurance rates are so high and the banning of credit scores?

Mr. SNYDER. We think there is. California has an unique and incredibly restricted rating system. According to economist David Appel, that cost California consumers $10 billion throughout the 1990's because loss costs, which we were pleased to participate in, for example, through highway safety, anti-fraud measures declined dramatically.

The entire State played a role in that, and we were there to support it.

Because the regulatory system was so rigid, companies were not able to respond as rapidly as they would in a free market to those declining costs, and the difference calculated just during one decade was the cost to California consumers of about $10 billion.

We think there are huge subsidies within the system as a result of that strict rating regime that is in place. We also think it would fail any cost/benefit analysis and is grossly inefficient—a totally unique system with major negatives about it.

Mr. ROYCE. It seems that the essence of this issue when you get down to it is whether or not a credit score has a predictive value when it comes to auto insurance scoring. I know study after study, and I think you mentioned the FTC study, they all conclude that a credit score has a strong predictive value and is a net benefit to the market.

The result, I think, in that study, said the use of credit scores produce a situation where 59 percent of policyholders pay less as a result of that use.

What happens when we remove this risk indicator? Is there a viable alternative out there to credit scores that you can think of that is as good?

Mr. SNYDER. Right now, no. That was actually confirmed in the FTC study. The fear would be if you eliminated an individual objective factor like credit scores, they would be forced to go back to larger risk classifications or more reliance on larger risk classifications in the past, such as territory and other factors like that.

I think what the FTC concluded is there was not another factor out there that was able to assure the same predictiveness as we currently have.

I think that would be the fear, that we would have a system less accurate, actually less fair, and one relying on larger classifications rather than on the more individual risk classification.

Mr. ROYCE. The FTC concludes that risk-based pricing benefits the majority of market participants. The observation I would make is that if there is a flaw in the marketplace in terms of anti-competitive pricing or the availability of insurance, we should look at the fragmented antiquated regulatory model that exists in the United States that is unlike that anywhere else in the world, where we have this regulatory model overseeing the industry where we have 50 different markets instead of one national market, and I think recent estimates put that cost of the fragmented State-based system at $14 billion in higher premiums every year for consumers.

If we could focus instead on enhancing competition, instead of unnecessarily limiting tools in the marketplace, it would be much better for the consumer, although I am sure many of our elected State insurance commissioners would have to find other things to focus on.

It would certainly move us into a national market for insurance. It would certainly not only reduce the costs but produce a much more competitive industry, especially when you look at what Europe is doing right now as it goes to one market for all of Europe for insurance.

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. ROYCE. Thank you, Mr. Chairman.

Chairman GUTIERREZ. You are very welcome. Congressman Baca, you are recognized for 5 minutes, sir.

Mr. BACA. Thank you very much, Mr. Chairman. I thank you and the ranking member for your leadership on this issue which is important to a lot of us, especially as we represent diverse groups of individuals within our communities.

I am concerned from both aspects that it impacts everyone but also how it impacts many minorities as we look at the credit rating. I heard a lot of you talk about it when Congressman Moore said we needed more financial literacy.

The problem is on this literacy, where does it go and what kind of outreach are we doing in making sure that when we target it, the different diversities, that they are actually aware of the credit scores that they are going to get, and if they get it, when do they know they are getting a credit score?

Right now, as we look at its impact, it is not only on the automobile but also as we look at the health bill that is coming before us.

Maybe any one of you three can explain that, and since no one has clearly explained the casual connection between credit scores and insurance risks, are customers at least made aware of the credit scores that are used when they purchase that coverage?

Is there an adjustment during any period of time to their rates they are getting because they may have improved or something may not have been accurate during that period of time that the credit report went out, but yet you underwrote your insurance policy or health coverage, which means they are paying a higher premium.

Another question: I am going to try to get all my questions in all at once. What effect does it have on our seniors? A lot of our seniors right now, when you look at their credit ratings, a lot of them get their checks once a month, there are adjustments in there, and then the ratings are there.

Do we have any studies on the impact on a lot of our seniors? What are their rates compared to someone elses?

How are we doing it in terms of geographical areas on the credit scores? People who live within certain geographical areas get a higher score versus individuals who do not live in those geographical areas, based on the high risk? Therefore, their premiums are a lot higher, yet their income does not change, but they are being impacted.

When does the insurance company review the credit scores, after the initial purpose, or do they make adjustments in the ratings at one period or another, so this way the rates can also be lowered?

If there are two individuals who get a credit score, husband and wife, say one or the other gets a higher score than the other. How is it underwritten, based on whom? The higher score or the lower score, or is there an adjustment in between?

All three of you can tackle all of these questions.

Mr. MCRAITH. I will do my best to answer them quickly. Congressman, first of all, in terms of financial literacy, the States are committed to improving the literacy of consumers.

Mr. BACA. States are committed, but do we know that they are really doing that? In a lot of minority areas, do they really know they have gotten a credit score based on their automobile or their health bill that will be coming up right now because we are saying we want to make it affordable, but "affordable" means you have to have a good score as well. If you do not have a good score, you are going to be paying a higher premium on that health coverage.

Mr. MCRAITH. We absolutely have to do it better than we are doing it right now. I think this hearing illustrates all the reasons for that.

I would point out I am not sure knowledge of the impact of a credit score affects whether someone is able to pay their medical expenses. Literacy is one component. It is not necessarily going to put the dollars in someone's pocket to help them pay during a difficult time in their lives.

Mr. BACA. No, but if a score is given, that means their premiums are higher. That makes a big difference based on if you have a fixed income as a senior, that impacts me, because today I have to decide whether I pay for groceries, pay my rent or pay for my insurance policy.

Mr. MCRAITH. That is exactly right. That gets to your last question, the impact on seniors and other people with fixed incomes. We also hear from the disabled community, of course. They are on fixed incomes.

Under Illinois law and under many States' laws, individuals who do not have credit records are to be treated as "neutral." What exactly "neutral" means varies from State to State. It largely means they do not get a benefit of a great credit history and they do not get penalized for having a negative credit history.

By and large, that is how people on fixed incomes are treated.

Mr. BACA. But that is not a standardized process or procedure that is used in other States. It is only in Illinois.

Mr. MCRAITH. No, that is generally the practice across the country, not in every State, but it is generally the practice.

In terms of geography and credit scores, I believe different studies have shown that different parts of your district, for example, will generally have higher credit scores. Again, we have heard today higher credit scores result in lower insurance premiums.

Chairman GUTIERREZ. The time of the gentleman has expired. Congressman Hensarling, you are recognized for 5 minutes, sir.

Mr. HENSARLING. That was quick, Mr. Chairman.

Chairman GUTIERREZ. A triangle has three corners. Five minutes has those many seconds, unfortunately.

Mr. HENSARLING. Thank you, Mr. Chairman. I did not know we would be getting a geometry lesson here as well.

I will beg the forgiveness of our witnesses. I missed your testimony trying to straddle two meetings. I am one of the Republican appointees to the President's Fiscal Responsibility Commission. We have our work cut out for us. I was attending some of those proceedings. We may cover some ground that has already been covered and I apologize to you about that.

I guess the central question I have with regards to the use of credit scores in insurance ratings, clearly, there are those who feel this is predictive. Otherwise, I do not understand why they would be using it, but particularly as I look at the incredibly high unemployment rate that remains in our country, how important is it to small insurers and small businesses that they be able to use credit-based insurance scores?

In your dealings in the marketplace, again, your observation, how important is it to small businesses and small insurers?

Why don't we start with you, Mr. Snyder?

Mr. SNYDER. I think it is very important. I think the use of credit-based insurance scores in the personal lines of insurance has proven to be very important for the market. It has allowed a degree of objective and individually tailored decision making that more accurately assesses risk than was possible before.

The risk assessment is good in and of itself because how else would you price an insurance product but to reflect the risk within that product, and the danger of moving away from that, I think we have seen perhaps too much of in other sectors.

Secondly, it has had an overall positive availability impact on the market for personal lines. That would be true if you are an individual.

In commercial lines, credit information has long been used because everyone understands that one of the first things that is reduced is maintenance of critical equipment and other things like that, and that leads to safety issues, which in turn leads to increased insurance risks.

I think it is important up and down the line in terms of assessing for risk and then pricing for risk.

Mr. HENSARLING. How many years of history do we have now to observe as far as the use of credit scores in our credit-based insurance scores?

Mr. SNYDER. In personal lines, about 15 years or so.

Mr. MCRAITH. 1993.

Mr. HENSARLING. Thank you. It is a fairly substantial time period. Mr. McRaith?

Mr. MCRAITH. Just to build on Mr. Snyder's comment, Illinois has more insurance companies competing for personal lines insurance than any other State. We have seen some of those smaller companies able to compete because of their ability to accurately price. They state the reason they can accurately price is the credit-based insurance scores.

Mr. HENSARLING. I personally have not seen it, has not come across my desk, have there been any studies that would indicate kind of the overall economic impact that is derived from credit-based insurance scores? Is there something like that out there that has crossed your desks?

Mr. SNYDER. There is some data. Professor Powell may have some data which we can provide to you. He testified previously before Congress last session.

We have a report that proves the reverse, which is we have very good data about California where credit-based insurance scores have not been permitted, that loss costs went down dramatically, but because of the absence of free market pricing, the prices that were actually charged in the market lagged the downturn in loss costs, because companies simply could not go through the very elaborate process that you have to go through there.

I think there is strong evidence—

Mr. HENSARLING. What happened in California?

Mr. SNYDER. What happened in California is that you have a situation with massive cross subsidies, a very inefficient system with a huge overhead cost, and for many years and I think now, overall prices that would be lower if the free market were permitted.

Mr. HENSARLING. If we were to somehow restrict the use of credit scores in insurance pricing, what you see in California, would you predict might spread nationwide?

Mr. SNYDER. I think that is right.

Chairman GUTIERREZ. The time of the gentleman has expired. Congresswoman Waters is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I was just going over some information with my staff. I want to thank you for holding this hearing. I wish that we could get at some of the information that is so desperately needed to try and understand how decisions are made to determine insurance rates, and what is taken into consideration.

From everything that I can gather, there may be 500 different variables that are taken into consideration. We just do not know and understand what that is all about.

I am told that all kinds of studies are done, including studies about your Zodiac sign.

Let me just raise the question: How many variables are taken into consideration by members of the Association for determining insurance rates? I will address that question to Mr. David Snyder, who is the vice president and associate general counsel for the American Insurance Association.

Mr. SNYDER. Thank you, Ms. Waters. That will differ from insurer to insurer. There are dozens of variables that are considered. Many different credit variables, as well as other variables, such as prior loss experience. In automobile insurance, make and model of car. In homeowner's insurance, prior loss experience, proximity to a fire station, and on and on.

The whole effort is to try to combine these factors, to be as accurate as possible in predicting future risk of loss and therefore, pricing for it.

Ms. WATERS. Do you think it would be helpful to set some standards so that people can have a good understanding about what is taken into consideration no matter what insurance company you go to, rather than having all of these variables that are not identified in any insurance policy that I know of, to tell people how the decision was made?

Should we have some standards?

Mr. SNYDER. There are general legal standards, but to encourage competition in the market, the models and the variables are all subject to insurance commissioner review on a State by State basis. That is the system that has been followed, general legal standards, and then allowing the companies to innovate and experiment, and subject to both legal standards and actuarial standards.

Ms. WATERS. Have members of your Association done their own studies? There is not one, two, three, four or five studies every year done by the Association or do they all do different studies?

Mr. SNYDER. For anti-trust reasons, the Association cannot discuss how individual companies do their business. I am very aware they are constantly reviewing their data, constantly reviewing their factors, constantly subject to insurance commissioner review on their models and programs and the factors used in them.

Ms. WATERS. What is the difference between defending the fact that they all use variables unknown and different for competitive purposes and the question that I just asked about the studies? Do you know something about that? You can talk about that but you cannot talk about the studies. What is the difference?

Mr. SNYDER. I can talk about generally from published reports what the companies have said in the media, but they do not share with us—

Ms. WATERS. Any of the companies using the Zodiac study?

Mr. SNYDER. Excuse me?

Ms. WATERS. Are any of the companies in your Association using the Zodiac study?

Mr. SNYDER. Using which study, ma'am? I am sorry.

Ms. WATERS. Zodiac.

Mr. SNYDER. Zodiac study?

Ms. WATERS. Yes. Are you aware of that?

Mr. SNYDER. I am not aware of it.

Ms. WATERS. Never heard of it?

Mr. SNYDER. I have not.

Ms. WATERS. Thank you. Do you believe that given the way decisions are made by insurance companies to charge or to not insure—is the Association satisfied that your companies in the Association are acting in the best interest of the consumers?

Mr. SNYDER. Yes, so far as we know.

Ms. WATERS. Do you know of any changes that you would recommend that should be taking place to have them do a better job of acting on behalf of the consumers?

Mr. SNYDER. The answer is I cannot recommend to them how they do their business.

Ms. WATERS. Can you recommend to us?

Mr. SNYDER. What we do support is reasonable regulation and their ability to innovate and compete in the market.

Ms. WATERS. Mr. McRaith, you represent the National Association of Insurance Commissioners. You must hear from commissioners all over the country about the problems they have with whatever regulation they may be responsible for in their States.

Have you heard any of your commissioners complaining about loops or gaps in their oversight responsibilities—

Chairman GUTIERREZ. The time of the gentlelady has expired.

Ms. WATERS. —that could be closed?

Chairman GUTIERREZ. Answer the question. Ten seconds, please, Mr. McRaith.

Mr. MCRAITH. As you would expect, Congresswoman, there is a wide variety of viewpoints among regulators across the country on the use of credit-based insurance scores.

Chairman GUTIERREZ. Mr. Green, you are recognized for 5 minutes, sir.

Mr. GREEN. Thank you, Mr. Chairman. Thank you to the witnesses.

Let's first review some intelligence that I have received. The intelligence indicates that credit-based insurance scores are not, "n-o-t," held out as being predictive of an individual's likelihood to have an automobile accident or experience damage to their home. True or false?

Mr. WILSON. Right. Scores are—

Mr. GREEN. If you would, just true or false. If this is true, would you kindly raise your hand, please?

[No response.]

Mr. GREEN. Nobody agrees this is true?

Mr. MCRAITH. I am sorry. The question is?

Mr. GREEN. I will read it again. Credit-based insurance scores are not, "n-o-t," held out as being predictive of an individual's likelihood to have an automobile accident or experience damage to their home. Is this true?

Mr. SNYDER. They are predictive of making a claim.

Mr. GREEN. Is it true that they do not predict that a person is likely to have an accident?

Mr. WILSON. Models perform for groups of individuals rather than for individuals.

Mr. GREEN. Do you know whether it is predictive of whether a person will have an accident? I am not hearing you say yes or no. I do not know.

Mr. SNYDER. It is predictive of having an accident and making a claim; yes.

Mr. GREEN. A credit score can predict whether a person will have an accident?

Mr. MCRAITH. It is my understanding, Congressman, that a credit score indicates a likelihood of submitting a claim.

Mr. GREEN. I am not there yet. I am talking about the likelihood of having an accident, which I thought was going to be the easy question, by the way.

Let me ask again: Will a credit score predict whether a person will have an accident?

Mr. MCRAITH. I have not seen any study that indicates that to be true.

Mr. GREEN. Your answer is yes or no?

Mr. MCRAITH. I would love to answer your question, Congressman. I simply do not know whether that is true or not.

Mr. GREEN. You do not know whether a credit score will predict the likelihood of having an accident?

Mr. MCRAITH. You have probably read—

Mr. GREEN. Let's move on. Let's go to Mr. Snyder. Mr. Snyder, do you know the answer? Is it yes, no, or you do not know?

Mr. SNYDER. My answer would be the same as Director McRaith, which is the studies indicate the greater likelihood of submitting a claim.

Mr. GREEN. I am not there yet. I want to talk about accidents. Do credit scores predict whether people will have accidents?

Mr. SNYDER. They predict insurance risks including accidents and claims.

Mr. GREEN. They predict accidents? Okay. Let's go to Mr. Wilson. Do they predict accidents, Mr. Wilson?

Mr. WILSON. They are correlated with accidents.

Mr. GREEN. Credit scores will predict whether a person is going to have an accident?

Mr. SNYDER. It measures—

Mr. GREEN. Excuse me. Mr. Wilson has the floor right now. I am sorry.

Mr. WILSON. I would agree it measures the likelihood. Models perform for groups of individuals.

Mr. GREEN. Credit scores predict the likelihood of a person having an accident? That seems to be where you all are.

Mr. MCRAITH. I cannot agree with that. I do not know that is true. What I know is it indicates the likelihood of a claim to an insurance company.

Mr. GREEN. If this is what you believe, I see what the problem is. This is a real problem for us. If you believe that a credit score is likely to predict that a person is going to have an accident, what is the correlation between the credit score and the likelihood of an accident?

My thought was you would all say no, it is not likely to predict this, that it is likely to predict whether a person will file a claim. That is what I thought you would say. Now you have completely revamped my thinking, given that you seem to think that a credit score can predict whether a person will have an accident.

Mr. Wilson, I will give you one more chance. Are you sure that a credit score can predict the likelihood of having an accident?

Mr. WILSON. For an individual?

Mr. GREEN. Yes.

Mr. WILSON. Again, models perform for—

Mr. GREEN. Is your answer yes or no? Sometimes when you finish, I do not know whether you said yes or no. Maybe your answer is, "I do not know."

Mr. WILSON. I do not think I know.

Mr. GREEN. Okay. You do not know. Let's go to our next expert, Mr. Snyder. Again?

Mr. SNYDER. It predicts the likelihood of having a claim and you are not going to have a claim for certain types of auto policies unless you are in an accident.

Mr. GREEN. Does it predict the likelihood of having an accident, is the question.

Mr. SNYDER. It predicts a likelihood of accident involvement.

Mr. GREEN. You are not going to answer the question. It is a simple question. Is it likely to predict that you are going to have an accident?

Here is what my intelligence tells me. It is likely to predict that you will file a claim. That is what it is likely to predict. That seems kind of reasonable when you think about it. If that is the case and it predicts whether you are likely to file a claim, then the question becomes this, or maybe the statement is this, that the fact that one is likely to use one's credit—pardon me—one's insurance, if you have an accident, then that says to me you have a lot of people who are poor, who can barely pay for their insurance. They have an accident. I can tell you without having a study that they are likely to use their insurance, and they are likely to want to take advantage of something they paid for.

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. GREEN. Thank you, Mr. Chairman. I yield back.

Chairman GUTIERREZ. Mr. Cleaver, you are recognized for 5 minutes, sir.

Mr. CLEAVER. Thank you, Mr. Chairman.

I am interested in the extraordinary life circumstances and whether or not the three of you agree that extraordinary life circumstances should be taken into consideration with regard to an individual's credit score.

Mr. MCRAITH. Yes.

Mr. WILSON. Yes.

Mr. CLEAVER. It does not exist. Who is taking that into consideration?

Mr. MCRAITH. Certain State laws require that a company, an insurance company, consider an extraordinary life event if the insured, the policyholder, reports and submits that to the insurance company.

Mr. CLEAVER. California and Hawaii.

Mr. MCRAITH. California and Hawaii prohibit the use of credit-based insurance scores. Some States, like Illinois, for example, require that the insurance company review and consider an extraordinary life event. Some States require that the insurance company actually make a reasonable exception to the rate due to an extraordinary life circumstance.

Mr. CLEAVER. That is where I am. That is where I am going.

Mr. SNYDER. Sir, the National Conference of Insurance Legislators recently amended its law to include specific provisions on extraordinary life circumstances. This was done fairly recently. Some States have already enacted it this past legislative session and it is something we support for all States.

Mr. CLEAVER. All of you support that?

Mr. WILSON. Yes.

Mr. CLEAVER. I have a friend who is in the hospital now suffering from cancer. Last summer, he ate a cheeseburger. I have concluded that cheeseburgers cause cancer.

I know someone who had two automobile accidents, so therefore, automobile accidents cause bad credit.

Point out the illogic in that. Either one, the hamburgers or the accidents.

Mr. MCRAITH. Congressman, as a Chicago Cubs fan, I think it is true the Cubs have not won the World Series since Theodore Roosevelt was President. Until he comes back, we are not expecting a victory.

Mr. CLEAVER. Yes. I agree. We are in the age of deniers. We will deny everything.

On a credit score, and this goes back to Mr. Watt's questions earlier, in my hometown, Kansas City, Missouri, some of us protested years ago because the newspaper, in the real estate section, in identifying the location, would always say, "East of Trust."

Trust in Kansas City has been unfortunately and painfully the Mason-Dixon line separating the African-American and Latino communities from the majority community. They eventually stopped doing that because they realized that they were sending subliminal information, maybe not even so subliminal.

On a credit score, is not the address of the individual listed?

Mr. WILSON. It is on the credit report. It is not used in scoring.

Mr. CLEAVER. You just made the point I am trying to make. It is on the report. Mr. Watt was saying can that be a proxy, a substitute. I am saying if it is on the score, is it not also logical that it gives some additional information about the individual?

Mr. MCRAITH. Yes.

Mr. CLEAVER. Thank you. Mr. Snyder?

Mr. SNYDER. As the gentleman indicated, the address is not included in the score that we use.

Mr. CLEAVER. Yes, I said that at the beginning. The gentleman said it, but I said that at the beginning.

The question was and I apologize, is it not very likely that is some additional information that is being given about the individual, more than the numbers?

Mr. WILSON. Many—

Mr. CLEAVER. No, I want Mr. Snyder to answer, please. Excuse me.

Mr. SNYDER. Certainly no demographic information. No other information than the number.

Mr. CLEAVER. You just said the address is on there.

Mr. SNYDER. I heard the gentleman say it was not.

Mr. CLEAVER. It is not? That is unbelievable. You are saying—

Chairman GUTIERREZ. The time of the gentleman has expired. Ms. Kilroy, you are recognized for 5 minutes.

Ms. KILROY. Thank you, Mr. Chairman.

Chairman GUTIERREZ. You are very welcome.

Ms. KILROY. Thanks again to the witnesses for their input here this morning.

I wanted to bring up an issue that a constituent and friend and actually former Member of Congress brought up to me, Robert Samansky, who spent a great deal of his personal time over the last 6 months working with my staff and our committee staff to understand and analyze the way credit-based insurance scores are being used and explained to insurance consumers.

He was not able to be here with us this morning. I am going to follow up, Mr. Wilson, with some written questions for you regarding his specific circumstances. I hope you will be able to provide me with some answers. Thank you for that.

There is a disparity between his overall excellent credit record and his Choice Point credit-based insurance score. I have looked at his materials. I do not understand it.

Could you explain to me how someone with an exemplary overall credit score could end up with a mediocre credit-based insurance score?

Mr. WILSON. Sure. One of the key considerations is the target that is being modeled. A credit score for financial purposes is generally targeting the likelihood or the odds of someone going delinquent on a loan payment in the next 2 years.

The bank has a pool of loans. They know who has gone delinquent and who has not gone delinquent. They model for that. The credit characteristics that are most correlated with loan delinquency come into that model.

By contrast, an insurance company is going to look at loss ratio for a pool of policyholders. They will use the correlation between the credit factors and the observed loss ratio to produce a rank ordering.

Because the target is different, the credit characteristics and their weights are different.

Ms. KILROY. What kind of—

Mr. MCRAITH. Congresswoman, to answer your question more directly, if your friend is older than a certain age, he is likely to see his premiums increase. A credit-based insurance score is not solely based on credit. There are many other factors that are considered as well, including the age of the driver.

Ms. KILROY. When Mr. Wilson suggested earlier that age was not taken into account?

Mr. WILSON. Age is not used in our scores.

Ms. KILROY. It does come into play later on, is that what you are saying?

Mr. WILSON. Yes.

Ms. KILROY. The answer that he got from his insurance company was it was based on his credit score and they gave him some reason codes, again, I have to say I do not see the correlation.

You mentioned earlier you wanted to be transparent and we want to get behind some of the rhetoric on credit-based insurance scores. I am still kind of stuck here. It is pretty opaque to me. There is a lot of rhetoric out there in terms of how this happens.

Mr. MCRAITH. Yes, I would agree, Congresswoman. I would say it is possible that both sides can be right, that credit scores—credit-based insurance scores are predictive. It is also possible that they might have a disparate impact on racial and ethnic minorities. Both of those could be true.

Ms. KILROY. You mentioned earlier, Mr. McRaith, about the large number of medical bankruptcies in this country, and that is certainly true. My bill is really not focused on that really significant problem.

My bill is focused very narrowly on people who actually paid their medical debt. They might have had some confusion with the large number of bills.

Let me give you another example of a lawyer in my community. Her daughter was in a significant accident. They life-flighted her to a hospital. She had a grocery bag full of bills as a result.

She worked with her insurance company and paid everything off and never heard anything again until years later, about 5 years later, she went to get a loan to do an addition on her home and discovered her credit score was dinged because of a $100 co-pay on that medical life flight that they had never billed her for, that the municipality had never billed her for, but somehow it had gone to collection. That collection effort never came to her.

Mr. MCRAITH. Those are real problems that people and families all over the country face every day. The States, I think, are trying to impose some requirement that insurance companies acknowledge that exceptional, extraordinary life event.

Ms. KILROY. Even if it is not an exceptional, extraordinary life event, if somebody has paid their medical debt, do you think it is reasonable to have that disparaging comment removed from their credit score?

Mr. MCRAITH. In my opinion, I think it is reasonable to have it removed. I think it is unreasonable for it to remain.

Ms. KILROY. Thank you very much.

Chairman GUTIERREZ. The time of the gentlelady has expired.

I thank you all very, very much. We have a second panel, and I thank the first panel. I am being a little biased, I thank Mr. McRaith from Illinois. Thank you for all the fine work you do for the citizens of Illinois. Thank you for your testimony.

We are going to go quickly to the second panel, in which we will continue to show the fairness of the Democrats. We had two industry people and one person for the consumer. Now we are going to have two industry and two consumer witnesses.

Thank you. We would ask everybody to please end their conversations and have a seat.

We are going to introduce these wonderful witnesses and go to our second panel. The second panel consists of four witnesses: Ms. Chi Chi Wu, staff attorney, National Consumer Law Center; Mr. Mark Rukavina, executive director, The Access Project; Mr. Stuart K. Pratt, president and CEO of Consumer Data Industry Association—and someone who knows his way around here; and Ms. Anne Fortney, partner, Hudson Cook LLP, another person who knows her way here.

You are all welcome. We are going to give 5 minutes to Ms. Chi Chi Wu. Please, you have 5 minutes.

STATEMENT OF CHI CHI WU, STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. WU. Mr. Chairman, Representative Hensarling, and members of the subcommittee, thank you very much for inviting me here today. I am testifying on behalf of the low-income clients of the National Consumer Law Center. And, Mr. Chairman, thank you for holding this hearing about the use of credit reports in areas beyond lending, such as employment and insurance. And we also thank you for inviting us to speak about the need to fix a scrivener's error in the Fair Credit Reporting Act.

The use of credit reports in employment is a growing practice, with nearly half of employers involved in it. It's a practice that is harmful and unfair to American workers. For that reason, we strongly support H.R. 3149, and we thank Chairman Gutierrez and Congressman Steve Cohen for introducing it. This bill would restrict the use of credit reports in employment to only those positions for which it is truly warranted, such as those requiring national security or FDIC-mandated clearance.

We oppose the unfettered use of credit histories and support H.R. 3149 for a number of reasons. The first and foremost is the profound absurdity of the practice. Considering credit histories in hiring creates a vicious Catch-22 for job applicants. A worker loses her job, and is likely to fall behind on her bills due to lack of income. She can't rebuild her credit history if she doesn't have a job, and she can't get a job if she has bad credit. Commentators have called this a financial death spiral, as unemployment leads to worse credit records, which, in turn, make it harder for the worker to get a job.

Second, the use of credit histories in hiring discriminates against African-American and Latino job applicants. We have heard how study after study has documented, as a group, these groups have lower credit scores, including the FTC study that did find the disparities in credit scoring. These are groups that have been disproportionately affected by predatory credit practices, such as the marketing of subprime mortgages and auto loans and, as a result, have suffered higher foreclosure rates, all of which have damaged their credit histories.

The Equal Employment Opportunity Commission has expressed concerns over the use of credit histories in employment, and recently sued one company over the practice.

Third, there is no evidence that credit history predicts job performance. The sole study on this issue has concluded there isn't even a correlation. Even industry representatives have admitted, "At this point we don't have any research to show any statistical correlation between what's in somebody's credit report and their job performance, or likelihood to commit fraud."

Finally, as we have testified here before, the consumer reporting system suffers from high rates of inaccuracy, rates that are unacceptable for purposes as important as employment. And the estimates range from 3 percent, which is the industry estimate, to 12 percent, from the FTC studies, to 37 percent in an online survey.

In an environment with 10 percent unemployment, a 3 percent error rate in credit reports affects 6 million American workers, and it's not acceptable. And, remember, a consumer who has an error in her credit report, and is able to fix it—which is very difficult—can reapply for credit. But very few employers are going to voluntarily hold up a hiring process for one or more months to allow an applicant to correct an error in the credit report.

The issue at stake is whether workers are fairly judged on their ability to perform a job, or whether they're discriminated against because of their credit history. Oregon recently signed a bill into law restricting this practice. Other States are considering it, and Congress should do the same and pass H.R. 3149.

The second issue I want to talk about is a scrivener's error. The amendments of 2003 may have inadvertently deprived consumers of a 30-year-old pre-existing right they had to enforce the FCRA's adverse action notice requirement. This is the notice given when credit or insurance or employment is denied, based on an unfavorable credit report. That was intended to limit the remedies for a totally new notice—the risk-based pricing notice—at 1681m(h). However, due to ambiguous drafting, a number of courts have interpreted this limitation to apply to the entirety of section 1681m of the FCRA, including the pre-existing adverse action notice.

Congress can easily and should fix the scrivener's error, because it was never part of the legislative bargain struck by FACTA. In fact, FACTA's legislative history indicates that Congress had absolutely no intention of abolishing any private enforcement of the adverse action notice requirement, and an uncodified section specifically states that nothing in FACTA "shall be construed to affect any liability under section 616 or 617 of the Fair Credit Reporting Act"—that is the private enforcement provisions—"that existed on the day before the date of the enactment of this act."

And there is more evidence that Congress didn't intentionally abolish the private enforcement. If it had done so, the banking and credit industry would have trumpeted that change. In fact, the industry has never made that claim, with only the American Banker noting that FACTA perhaps inadvertently eliminated the existing right of consumers and State officials to sue for violations of the adverse action provisions. Even 4 years later, in a hearing before the full committee, my fellow testifiers today declined to claim that FACTA had intentionally abolished this private remedy.

Now, despite the clear legislative history, several dozen courts have, unfortunately, held that FACTA abolished this private remedy, depriving hundreds of consumers of their rights. We think that the documented cases are perhaps only the tip of the iceberg, so we assume that customers' damage has—

Chairman GUTIERREZ. The time of the gentlelady has expired.

Ms. WU. We thank you for the opportunity to testify, and look forward to your questions.

[The prepared statement of Ms. Wu can be found on page 186 of the appendix.]

Chairman GUTIERREZ. Let me describe it once again. You get the green light at 5 minutes to start. When you get to the yellow light, you have a minute. Time yourself.

Mr. Mark Rukavina, you are recognized for 5 minutes, sir.

STATEMENT OF MARK RUKAVINA, EXECUTIVE DIRECTOR, THE ACCESS PROJECT

Mr. RUKAVINA. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, I thank you for the opportunity to address the committee today. My name is Mark Rukavina, and I am executive director of the Access Project. We work nationally on health care issues, and have since 1998. And our research played an instrumental role in revealing the problem of medical debt.

Medical debt is money owed for any type of medical service or product. That money may be owed directly to the provider of the service, or to an agent of the provider, such as a collection agency. In my testimony today, I would like to discuss the use of medical debt in assessing one's creditworthiness. And more detailed information is found in my written testimony.

First, some background on medical debt. Data gathered by the Commonwealth Fund found that during 2007, the most recent year for which data are available: 49 million working-aged Americans and 7 million elderly adults had medical debt or medical bills that they were paying off over time; and 28 million working-aged adults were contacted by collection agencies for medical bills.

What makes medical bills unique? Few Americans understand that nearly two-thirds of the people who have medical debt had insurance at the time of the incident for which they owe money. While insurance provides protection, patients still have out-of-pocket obligations that they must pay.

Americans are often confused by their health insurance coverage. One national study found that nearly 40 percent of Americans did not understand their medical bills or the explanation of benefits. They did not know what service they were supposed to pay for, the amount they owed, or whether that amount was correct. Nearly one-third let a medical bill go to collection, and one in six did not know whether they should pay their health care provider or their insurance company.

Given this, it is not surprising when claims that are not promptly paid get sent to collection. The confusion regarding medical claims payment also carries over to credit reports. Many Americans mistakenly believe that unpaid medical bills have no influence over a credit score. The lack of clarity may stem from statements made by industry representatives. Testimony from the previous panel was an example of this.

However, in recent testimony before this committee, a VantageScore representative said that their score does not factor medical debt into the calculation of a consumer's credit score. Following that hearing, a letter was sent to the committee to clarify that this only applies when that medical debt is reported directly by a health care provider. They also clarified that they include all collection accounts, including those related to medical debt, when calculating a credit score.

Given this, it is important to understand how most medical data appear on people's reports. According to Experian, data provided directly by medical providers accounts for only 7/100ths of one percent of the data that they gather. TransUnion states that medical debts are not typically reported unless they become delinquent and are assigned to collections.

So, here are the facts. Forty percent of Americans are confused by medical bills. Consumers and some credit scoring agencies appear confused as to whether medical data are used in calculating credit scores. Medical data can only drag down one's score. I say this because medical debts that are paid off directly to providers aren't used in calculating one's score. Medical accounts are only included on credit reports if they are deemed delinquent and sent to collection. This system is stacked against consumers, and penalizes those who experience illness.

Even when proper action is taken, and one pays off a medical bill, the Fair Credit Reporting Act allows for this bill to remain on a person's report for up to 7 years. This leads me to question the predicted value of medical accounts, which has also been questioned by some of those in the financial service industry. Some lenders disregard them when reviewing loan applications.

A study published in the Federal Reserve Bulletin found that nearly one-third of Americans with a credit file have a collection account on their credit report. The study found that more than half of the accounts in collection are medical accounts. It went on to state that, "some credit evaluators report that they remove collection accounts related to medical services from credit evaluations because such accounts often involve disputes with insurance companies over liability for the accounts or because the account may not indicate future performance on loans."

It is estimated that in 2008, Americans spent $277 billion in out-of-pocket costs. This resulted from millions of invoiced medical bills. Millions of Americans had bills sent to collection as the result of a lengthy insurance claim adjudication process or confusion due to numerous bills generated from one visit to a hospital. Those who paid their bills in full are often very surprised when they learn that despite such actions, the bills continue to plague them and peg them as poor credit risks.

Such data errors harm consumers, and these inaccuracies in credit reports slow America's economic recovery. H.R. 3421 addresses this problem, it corrects these errors on credit reports. Specifically, it would require—

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. RUKAVINA. —that only those medical accounts that have been paid or fully settled be removed from a credit report within a certain period of time.

[The prepared statement of Mr. Rukavina can be found on page 137 of the appendix.]

Chairman GUTIERREZ. Thank you.

Mr. RUKAVINA. Thank you.

Chairman GUTIERREZ. Mr. Pratt, you are recognized for 5 minutes.

STATEMENT OF STUART K. PRATT, PRESIDENT AND CEO, CONSUMER DATA INDUSTRY ASSOCIATION

Mr. PRATT. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, thank you for this opportunity to testify. I will highlight just a few points in my oral remarks.

First, preserving a full and complete credit history is imperative. A central pillar of the credit reporting system is that it is full-file. And this means the database contains both positive and negative information about a consumer's management of his or her debts. The FCRA balances this fundamental idea that all accurate and predictive data is available for risk management, with the requirement that data that is considered adverse be deleted, generally, within 7 years.

Congress recognized that a system that allows for the accumulation of payment history spanning decades is inherently fair for consumers. Because there is a positive payment history, any adverse data resulting from hardship or even mismanagement is set into this context. Credit reports are the bridge of data for us, as consumers, in an impersonal marketplace. Credit reports tell our story, a story of hard work, good values, and even times of trial.

Credit reports are the basis for building fair and unbiased risk management tools, such as credit scores. Credit scores remove the risk of bias and mere opinion. Race and gender, for example, are no longer barriers to accessing loans and other services.

It is for these reasons that we remain very concerned with H.R. 3149's proposal that the 7-year period for reporting paid medical debts reported by collection agencies be changed to a 30-day period.

Consider the following: Maintaining stability of the system of data is essential. We all understand, better than ever, the importance of safe and sound underwriting. Removing accurate predictive data is not the right step. It's not the right direction.

Some may misunderstand the nature of the 7-year period. It does not begin on the date of the final payment or settlement. This seven-year period is running throughout the period of time that the account is on the file prior to payment.

Data is regularly evaluated for predictive qualities. Prematurely removing even a paid debt which was delinquent removes even the possibility of considering how these data help ensure fair and also safe and sound decisions. We support the FCRA's current approach to adverse data. We urge the committee to consult with users of data about the consequences of deleting any data, since it isn't merely an issue for the consumer reporting agency, but ultimately it's an issue for users who manage risk.

Let me now turn to the uses of credit reports for employment. While credit scores are not provided by our members for employment purposes, credit reports are used, and this permissible purpose should be maintained. H.R. 3149 proposes to place a significant limitation on the use of credit reports. We understand the desire to ensure consumers are getting jobs they need during this period of high unemployment. But it is our view that credit histories do not serve as an impediment.

Following are some important points to consider: First, employers' use of any criterion for employment is highly regulated. Employers must determine whether or not the use of a credit history is appropriate for a given position. The FCRA, in fact, requires the employer to certify that it will not use data in violation of any applicable Federal or State equal employment opportunity law or regulation.

The Society for Human Resources Management surveyed its members. They found, for example, that their members use credit checks for positions that have fiduciary or financial responsibilities, for executive positions, CFOs, or for positions where employees have access to a customer's assets, corporate secrets, and technology platforms, including access to sensitive personal information. And I think these uses make sense.

While media counts might lead readers to think differently, background screening products only include a credit check in about 15 percent of the cases. In other words, 85 percent of the time, a credit report is not used in the employment decision.

The Association of Certified Fraud Examiners, however, has reviewed occupational fraud, and it found two top red flags exhibited by perpetrators of fraud were: living beyond one's means; and experiencing financial difficulties.

Finally, there seems to be a view that credit checks serve as a final yes or no for an employer. This is not the case. Employers use applications, testing, interviews, resume data, and many other data points. The credit check is used where it makes sense. Preserving this appropriate use under the current law is the right policy outcome.

Thank you for this opportunity to testify, and we look forward to your questions.

[The prepared statement of Mr. Pratt can be found on page 115 of the appendix.]

Chairman GUTIERREZ. Ms. Fortney?

STATEMENT OF ANNE P. FORTNEY, PARTNER, HUDSON COOK, LLP

Ms. FORTNEY. Thank you. I am Anne Fortney, a partner in the Washington, D.C., office of the Hudson Cook law firm. I appreciate the opportunity to appear before you again today.

My testimony draws on many years of consumer protection practice in both the private and the public sectors, including service at the Federal Trade Commission. I believe my depth of experience enables me to comment upon legislation from the perspective of consumers, as well as the consumer financial services industry.

I am aware that credit information is used as a factor in predicting risk other than consumers' default on credit obligations, such as when it is used in insurance and employment purposes. Credit information is used in conjunction with other empirical information for these purposes, because it has been proven to be a reliable tool in predicting risk.

While some may question the use of credit histories in employment situations, there are times when that information is essential to a prospective employer or licensor. In fact, to protect consumers, many States require credit information in evaluating applicants for mortgage loan originator licenses.

As the Fair Credit Reporting Act recognizes, it is critical that consumer reports used for employment decisions be accurate. To that end, the law requires notice to a consumer before any adverse action based on a consumer report is taken. As a result, an employment decision is not made until the consumer is alerted to negative information in the report, and has the opportunity to correct any inaccurate information.

A consumer will also receive notice if the consumer report information formed a basis for the denial of employment, or for another decision that affects the consumer, once employed.

My previous testimony before this subcommittee addressed the use of medical debt collection information in credit histories. As others have testified, this information is a predictive characteristic in credit scoring systems. For that reason, its use benefits consumers, as well as creditors and others that rely upon that information.

In 2003, Congress enacted FCRA subsection 615(h)(8), which eliminated a consumer's private right of action for all violations occurring under section 615. Since then, litigants across the country have argued about whether Congress intended to eliminate this private right of action, or whether there was a so-called scrivener's error that led to this result.

Some critics complain that there was no legislative history evidencing the congressional intent to achieve this result. However, the lack of legislative history is irrelevant. Because of the haste with which Congress deliberated and enacted the amendments to the FCRA at the end of 2003, there is a dearth of legislative history on any of the provisions.

Moreover, some claim that the placement of the private right of action exclusion within this subsection is indicative of the congressional intent to limit its application to that particular subsection. However, that claim is not supported by anything in the legislative record.

At this point in time, rather than trying to discern what Congress may or may not have intended more than 6 years ago, I believe the appropriate inquiry is whether Congress should now reinstate a private right of action.

Based upon my experience with the FCRA, and my participation as an expert witness in class action litigation arising under this subsection, I do not believe that there is any measurable benefit for consumers in reinstating a private right of action for its violations. There is no indication that consumer report users routinely fail to comply with the section 615 adverse action notice requirements since the elimination of the private right of action.

The National Consumer Law Center's written testimony mentions 44 cases in which it claims to have alleged consumer reports users' failure to give an adverse action notice. In fact, virtually all those cases involved a different allegation, usually that creditors gave consumers a notice, as required, but the notice was not clear and conspicuous.

In other words, the section 615 claim in those cases was that, although consumers received the proper notice, it was not in the proper type size. The courts rightly saw those claims as blatant attempts to extract huge statutory damages in class action suits where there was no consumer harm.

There is no indication that the Federal agency or State attorneys general administrative enforcement of section 615 is inadequate. At the same time, as described in my written statement, history shows that the only persons who stand to benefit from the reinstatement of a private right of action under section 615 are those lawyers who can pursue class action litigation, unless Congress also implements appropriate limits on class action liability. Otherwise, consumers will ultimately be the ones who bear the cost of litigation in the form of increased credit and insurance rates.

Thank you for the opportunity to testify. I will be glad to answer your questions.

[The prepared statement of Ms. Fortney can be found on page 67 of the appendix.]

Chairman GUTIERREZ. I thank the gentlelady for being with us once again here. We are going to go right into the questions.

First, I would like to ask unanimous consent that Mr. Cohen of Tennessee be allowed to sit in at this hearing, and when his turn comes, be allowed to ask questions. Hearing no objection, it is so ordered. And we welcome Mr. Cohen here, to this hearing.

So, Mr. Pratt, large amounts of debt and living beyond your means, huh? So I guess Madoff would have done really well. He would be like your stellar candidate, right? Multi-millionaires like Mr. Skilling at Enron, all of—I mean I can go through—Bolski? I guess they would all be just fine. But someone who is poor—in other words, if you're poor, you're likely to live beyond your means, right?

Mr. PRATT. [No response.]

Chairman GUTIERREZ. It's tough. So you're likely to have a propensity to be a criminal, right? No? What did you say? You said that you were going to judge people's character, right? You judge people's character, given your credit scores, right? It's a judgement of people's character and their integrity.

Do you really think you can judge people's character and integrity, that you have the right to do that, or the ability to do that, to judge people's character? Do you feel comfortable doing that?

Mr. PRATT. If I could respond—

Chairman GUTIERREZ. Yes, I'm waiting.

Mr. PRATT. Thank you, sir. Two things. No, somebody who is poor is not inherently somebody with bad character. As a big brother with Big Brothers and Sisters, I worked with a mother who—

Chairman GUTIERREZ. One of your—

Mr. PRATT. —had three jobs, Congressman, and who worked very hard and paid her bills, and—

Chairman GUTIERREZ. Excuse me. One of your members is Experian, one of the big three credit bureaus. And it touts "employment insight" reports as providing insight into "an applicant's integrity and responsibility towards his or her financial obligation." An applicant's integrity. It's easy to see a potential employer rejecting an applicant with negative credit information in his or her credit report, particularly when it is sold as providing insight into an applicant's integrity. So—

Mr. PRATT. This—

Chairman GUTIERREZ. —one of your members is actually judging people's integrity based on credit information?

Mr. PRATT. No, to the contrary. An employer uses lots of different data to make a final hiring decision.

Chairman GUTIERREZ. No, but they—

Mr. PRATT. And it's possible—

Chairman GUTIERREZ. They will use one of your clients in order—

Mr. PRATT. They could—

Chairman GUTIERREZ. —to get that information.

Mr. PRATT. They could use—

Chairman GUTIERREZ. Okay. Is it or is it not true that Experian touts, "employment insight," and they are one of the members of your group?

Mr. PRATT. Yes, they are. Yes, sir.

Chairman GUTIERREZ. And I picked it right out of their information. It says, "into an applicant's integrity and responsibility towards his or her financial obligation." Integrity and responsibility in character.

You know, I find it astonishing that someone could predict or claim to predict, especially working men and women, their integrity and their responsibility is based on that.

Ms. Chi Chi Wu, let me just ask you a question. You talked about a spiral. Could you talk about, "I have bad credit, therefore I am denied a job?" Tell me how that works.

Ms. WU. Well, it's very simple, and it's actually exactly as you described it in your opening statement. If you lose your job, you're not going to be able to pay your bills. You're going to fall behind on your credit card bills, maybe your mortgage, maybe your auto loan. Then you try to get a job. A potential employer runs a credit check and denies you a job. If you have bad credit, you can't get the job. And without income, you can't fix or improve your credit. So, it's just a vicious Catch-22.

And it's societal, as well. That affects your ability to both build assets, your children's—what you could pass down to your children, and there are racial disparities. You know, the evidence cited that certain minority groups have lower credit scores, as a group. That—if credit scores are supposed to be an accurate translation of credit reports, what the industry claims it does, then you're talking about a huge disparate impact on these groups.

And, you know, people don't start off at the same places. So a poor person who loses their job is less likely to have the assets to repay those bills than someone with more means and maybe a little savings when they lose their job. So it just makes things worse.

Chairman GUTIERREZ. Thank you. I just want to make sure that we have from Mr. Pratt's testimony—I have it here, you introduced it to us—"The Association of Certified Fraud Examiners reviewed occupational fraud between early 2006 and early 2008, and found that the top 2 red flag warnings exhibited by perpetrators leading up to the fraud were instances where the fraudster was living beyond his or her financial means—present in 39 percent of all cases with the median loss of $250,000—or experienced financial difficulties—present in 35 percent."

So, if you have a financial difficulty, and if you get sick, as has already been testified, most of the financial difficulties, the majority of financial difficulties, can be related to illness and lack of health care insurance, then you are probably going to be a thief. And your integrity is going to be questioned, and you get to do that. And I just think—

Mr. PRATT. To the—

Chairman GUTIERREZ. I don't have any more time. My time has expired. Mr. Hensarling, you are recognized for 5 minutes, sir.

Mr. HENSARLING. Thank you, Mr. Chairman. Mr. Pratt, if you would like to respond to the chairman's comments, I will give you that opportunity.

Mr. PRATT. Thank you. A couple of things. First of all, credit scores are not used—I just want to make that clear—I understand the credit history is used, but not credit scores. So that's an irrelevant discussion. Credit scores are not used in employment.

An employer wants to know, when they look at a credit report, what caused the problem in the credit report. Employers are smart, and they want to hire good people. That's why they use resumes, and that's why they use other types of tests of your qualifications. And that's why a credit report is not a single determining factor in whether or not you get the job.

And if you show some financial distress over the last couple of years, employers are smart enough, because it's a credit history, which shows the full history of your hard work. It shows, by that band of difficulty is correlating very closely with the circumstances we have had in this country, with unemployment. So, an employer is not going to simply flip that application aside, particularly when they have a qualified person.

The other very important point—and I keep coming back to this—is credit reports are not being used across the whole spectrum for every kind of job. If you're stocking a shelf, a credit report is probably not being used. If you're entering the construction trades, a credit report is probably not being used. It's being used, based on the surveys from the Society for Human Resources Management, as you would expect, if you are a CFO, and you have fiduciary responsibilities, if you have access to cash, a small business owner may want to know that.

And, by the way, small business owners are some of the ones who do want to use a credit history as part of the review process. But that's why they have interviews, Mr. Hensarling. They have interviews to learn more about why you are qualified for the job, and why you should be the one hired for the job.

Mr. HENSARLING. But, Mr. Pratt, ultimately it is your clients who decide how they wish to use this information. You are simply observing in the marketplace that most will use it as a part of an interview process.

I have to admit I have had a number of different jobs, everything from bussing tables to serving in Congress. And every job I had to go through a job interview. The one for Congress was particularly grueling and took a year.

Mr. PRATT. Right.

Mr. HENSARLING. So, what you're saying is, this may be part of a hiring decision. I must admit, as I listen to this debate—and it is a little bit like Groundhog Day—I suppose a lot of these issues get recycled—but I continue to be struck by the mindset that Americans need congressional approval in deciding what the criteria is they're going to use to make a hiring decision.

I continue to be struck at this current that is anti-freedom that says that you have to have congressional approval in your decision to offer credit. You know, I have read the Constitution, and I don't see where there is a constitutional right to force my neighbor to lend me money. I do not see that in the Constitution.

Again, and so what I see here, in my opinion—and I know the proponents—I don't question anybody's motives or intentions, I know their intentions are good. But at the end of the day, what I see, frankly, are efforts to censor credit files. This is a form of government censorship, to tell Americans that there is information that their Congress will disallow them to have because they're not trusted with that information, and that somehow it is the responsibility and the burden of the small business person or the guy who is trying to do a little store credit in the furniture store in Mineola, Texas, that somehow they have to justify to the government their exercise of freedom, as opposed to their government justifying restricting their freedom. You know, the default position ought to be freedom. And so I simply don't understand this current of thought.

Ms. Wu, you talk about having a discriminatory impact in hiring decisions. But if there are two people who are applying for a job, and if the employer wishes to use a credit score as the decision-making factor and you deny him that, and the person who had the bad credit score, be it his fault, somebody else's fault, nobody's fault, but if you deny that opportunity, why aren't you discriminating against the person who had the good credit record?

And he is denied the job, and yet you would somehow deny that information from going into the file and essentially de facto discriminating against the person with the good credit record. How do you justify that?

Ms. WU. I mean, employers don't have unfettered discretion to have all the criteria they want. We do have equal employment opportunity laws. And one of those is that—

Mr. HENSARLING. And is the Obama Administration not enforcing those?

Ms. WU. And the practices that have a disparate impact are prohibited. And we think that the use of credit histories—

Mr. HENSARLING. Is the Obama Administration enforcing those laws or not?

Ms. WU. The Equal Opportunity—

Chairman GUTIERREZ. The time of the gentleman has expired.

Ms. WU. —Commission is looking into this.

Chairman GUTIERREZ. Thank you. Mr. Green, you are recognized.

Mr. GREEN. Thank you, Mr. Chairman. I would like to associate myself with the comments of the Chair. And I would also like to ask this panel the same question that I asked a previous panel, with reference to whether or not one's credit score is predictive of one's likelihood to have an accident. We will start with Ms. Wu.

Ms. WU. I don't think one's credit score has anything to do with whether one is likely to have—

Mr. GREEN. Do you know of any study based on empirical evidence that supports this claim?

Ms. WU. Not that I am aware of. I am not an insurance expert, but not—

Mr. GREEN. All right. Well, let's go to the next person, please.

Mr. RUKAVINA. I am not an expert in this area. I am not aware of any studies that indicate that there is a correlation.

Mr. GREEN. The next, please?

Mr. PRATT. I would be happy to provide you an answer in writing.

Mr. GREEN. Thank you very much. I look forward to your answer in writing. But as for now, do you know of any studies that indicate that one's credit score is predictive of one's likelihood to have an accident?

Mr. PRATT. I have staff who have read those studies. I personally have not. So I really truly need to—

Mr. GREEN. I appreciate—

Mr. PRATT. —at least do the right thing and consult with them first. That's all.

Mr. GREEN. Thank you. Ma'am?

Ms. FORTNEY. I am not an expert in this area, but I have worked with insurance companies. I know that an insurance score, which often includes a credit score component—is likely to predict the likelihood that somebody will file a claim, which means it's likely to predict they will have an accident.

Mr. GREEN. Well, let's examine that statement. The likelihood that you will file a claim is indicative of the likelihood that you will have an accident?

Ms. FORTNEY. Well, yes.

Mr. GREEN. How is that?

Ms. FORTNEY. Well—

Mr. GREEN. An accident.

Ms. FORTNEY. I am talking about an accident. And the question is, when there is an accident, the insurance company learns about it because a claim is filed. What the insurance company is trying to predict is the likelihood that a claim will be filed. That's what they're insuring against.

Mr. GREEN. I understand. But your indication is that the likelihood of filing a claim is indicative of how I drive, whether I am going to have good driving habits, whether I am going to stop at stop signs, whether I am going to speed, whether I am going to drive recklessly. The likelihood that I will file a claim is indicative of how I will drive?

Ms. FORTNEY. What I said is that if you don't have an accident, you won't file a claim.

Mr. GREEN. Oh. Well, I understand. But see, what I can extrapolate from what you are saying is this: The likelihood of filing a claim is based upon the likelihood of your having had an accident, that there is some correlation between the accident and the claim.

But my question goes to the likely—being—predicting whether or not you will have the accident itself. That's the question. Can one's credit score predict whether one will have an accident?

Ms. FORTNEY. I think we disagree. I think it's the same thing.

Mr. GREEN. Well, okay. I don't see the logic in what you say. I will accept what you say, but I am hoping that you can help me with some logic, as opposed to just a statement. Because it's easy to say things, but where it the logic to support the notion that one's credit score is predictive of whether one will have an accident? I don't see it.

And I am asking for empirical evidence. Do you have empirical evidence to support this premise? Let's not go to the claims, because if your bills are behind, if you have poor credit and your bills are behind, you haven't managed your affairs well, you have an accident. There is a good likelihood you will use your insurance. So that means there is a good likelihood that you will file a claim. But does it predict that you will have the accident that causes you to file the claim? That's the question.

Ms. FORTNEY. Well, again, I don't know of any studies on that point. What I said, however, is that the insurance companies are pricing according to the likelihood you will file a claim after having had an accident. That is how credit—

Mr. GREEN. Well, let's examine that. These will be my last seconds.

The likelihood that you are going to file a claim. So, do the insurance companies want people who have accidents to—do they want to do business with them? Simply because you will now file a claim, you had an accident—that's what insurance is for, to be there when you have the accident—so if you—there is a likelihood that you're going to file a claim, even though you may not be at fault, then there is some means by which you are viewed as negative, and therefore, you will pay more?

Ms. FORTNEY. The nature of insurance is that people who pose a higher risk of whatever they're insuring against—in this case, claims—will pay more.

Mr. GREEN. But they are insuring against now the filing of claims. You see, it's not the accident. We have escaped the accident. You have—thin lines of distinction have to be made. So now we are saying that they don't want to insure you simply because you filed the claim. Not because you had the accident, because you're likely to file a claim.

I see that my time has expired, Mr. Chairman. I yield back.

Chairman GUTIERREZ. The gentleman yields back. The gentlelady from California.

Ms. WATERS. Thank you very much, Mr. Chairman. I have no questions. I simply want to thank this panel for being here, and to say that I am focused on working with you and your legislation.

We know who the insurance companies are. We know what they do. And for the commissioners who are in bed with them, we just need some laws that are going to deal with this issue.

I yield my time back to you. Thank you.

Chairman GUTIERREZ. I thank the gentlelady. I guess the claim—because I think when we go back through the record, we are going to find that even the insurance representatives keep going back to the likelihood of filing a claim.

I have a feeling that I think I know the answer to that, and that is if you make more money, you are probably less likely to file a claim. That is to say, let's say you have insurance on your house. You burn something, right? Cause some damage. You are probably more likely to just take care of it yourself, given your extra income and your income status than filing a claim, because you do not want your insurance premiums to increase.

Somebody bangs into your car. You are likely to take care of it.

You are less likely to take care of it and file a claim if you make less money. It is really about the likelihood of a claim, I think, more. We are going to delve into this.

Given the fact—I think Mr. Green—they keep using the words "likelihood of claim." Not likelihood of having an accident, the likelihood of filing a claim.

I think we have to look at that. I would like to say our purpose here is not to deny people access to information, but correct information, accurate information, information that truly reflects who they are.

I want people to get good information but I do not want people to get bad information. I think we do have a responsibility. As a matter of fact, the Equal Opportunity Commission has gone and said that using information from credit reports for employment is discriminatory. They are leading actions against that. People are doing that.

It is interesting that Mr. Pratt represents three of the people who do the credit industry, and here are the credit bureaus. Equifax decided last year to stop selling it. They said no, we are not going to do that any more.

Do you know why, Mr. Pratt, they decided to stop selling it for employment purposes?

Mr. PRATT. I am not aware they have.

Chairman GUTIERREZ. You should ask them and come back and let us know. Again, I do not know. We are going to ask them because it says, "Equifax is no longer selling credit reports for employment screening." It says, "used to determine eligibility, and while it is perfectly legal under the Fair Credit Reporting, the company seems to have proactively decided that selling reports to employers was not worth the trouble."

In other words, they see trouble on the horizon with this, probably due to discriminatory actions that might or might not take place.

We are going to ask them as part of our process. We are going to ask them to come here. I think it is an interesting question. If there are three credit bureaus and one of them does not want to go through the trouble, I would like to know what the "trouble" is.

It is not about denying people information. It is just correct information. I would encourage everyone here on this panel and anyone listening, since through Congress and a law which we on this side of the aisle advocated, you now get your credit report once a year. It does not give you your credit score, only the credit report. The credit score is still a little more murky, but you get your credit report.

Listen, go get one. When you see the mistakes that are in your credit, that is what we want. It is almost as though we depart from the premise that the credit bureaus are somehow, I do not know, omnipotent, they do not create any errors or mistakes.

I would like to just ask one last question and that is I want to go back very, very quickly to Mr. Rukavina. They told us earlier that if I am sick, that it is put in my credit report but does not have an impact on my credit score. Just elaborate very quickly on that.

Mr. RUKAVINA. It is my understanding that collection accounts go into the credit history portion of a credit score and that following a hearing before this subcommittee, it was clarified that medical accounts in collection are used as a factor in determining credit scores.

What is confusing to me as a consumer and wearing my policy hat is why medical accounts are treated differently based on who furnishes the data to the consumer reporting agencies. I am curious as to whether other data are treated in a similar fashion, depending on who furnishes it.

Chairman GUTIERREZ. I thank you. Ms. Kilroy, you are recognized for 5 minutes.

Ms. KILROY. Thank you, Mr. Chairman. Thank you to the panelists. Ms. Fortney, you stated that you believed that medical debt is predictive in determining an individual's credit worth?

Ms. FORTNEY. I believe I said medical debt collection information. It is my understanding that is the information that is used in credit scoring, as witnesses testified at the last hearing.

Ms. KILROY. Witnesses when they testified at the last hearing—I ask unanimous consent to enter into the record a May 3rd letter from VantageScore to me.

You believe it is appropriate that we consider medical debt differently depending on where the information is coming from? Is that what you are telling us?

Ms. FORTNEY. No. What I am saying is in credit scoring systems, as I recall, I think it was the witness from Fair Isaac that testified, in a credit scoring system, the credit scoring models they have developed, they used collection information including medical debt collection information in the development of those models because that information has been found to be predictive in the models that are predicting credit risk.

Ms. KILROY. You disagree with VantageScore which stated categorically that, "We do not believe medical debt will contribute to predictive performance?"

Ms. FORTNEY. I have not seen that letter. I would like to see it before I comment on it.

Ms. KILROY. Would you agree or disagree with the statement?

Ms. FORTNEY. What is that statement again?

Ms. KILROY. Do you agree or disagree that medical debt will contribute to predictive performance?

Ms. FORTNEY. What I understand and what I have said is we are talking about collection information. That statement refers to medical debt alone without discussing whether that medical debt information is limited to collection information.

Ms. KILROY. Mr. Rukavina, you talked about the confusion and inconsistency in medical debt reporting. You have taken a look, as I understand, at some medical debt studies. Have you seen when taking a look at or talking to either lenders or others an impact that medical debt, including paid medical debt, may have on a person's ability to obtain, say, a home loan?

Mr. RUKAVINA. We have talked with people from the lending industry who have been confused by the credit scores of individuals, that they feel are quite good credit risks, and when they look at the credit report, find there are oftentimes several either zero balance medical accounts that are in collection or medical accounts that have a very small balance in collection.

This to us, based on our experience, indicates oftentimes not a problem in terms of credit, but a problem regarding the health care billing system and frankly, the insurance adjudication process.

These bills are then sent to collection and we have been told by some in the collection industry that a significant number of people whom they contact pay off those bills promptly.

We believe they are doing the right thing by paying their bills, which is advised by those in the credit scoring industry, that is something people should do. We believe they are doing that.

In spite of those bills having a zero balance, they continue to drag down people's credit scores. We have worked with some in the industry who have run people's credit history through a credit score simulator and have found that by removing medical trade lines in collection, people's credit scores have increased by 50 to 100 points. These are for medical accounts that have a zero balance due.

Ms. KILROY. Would you agree that hurting people's credit scores with paid medical debt for the 7-year period could have an adverse effect on America's economic recovery and people's ability to get a loan, buy a car, buy a house?

Mr. RUKAVINA. I would absolutely agree.

Ms. KILROY. Thank you. I yield back.

Chairman GUTIERREZ. The gentlelady yields back. We have an unanimous consent request.

Mr. HENSARLING. Thank you, Mr. Chairman. I ask unanimous consent that a statement by the Independent Insurance Agents and Brokers of America be entered into the record.

Chairman GUTIERREZ. Without objection, it is so ordered.

The insurance agents apparently got to both of us. Mr. Cohen, you are recognized for 5 minutes.

Mr. COHEN. Thank you, Mr. Chairman. I appreciate you allowing me to participate in this panel and for your co-sponsorship of the bill that we have introduced on credit reports, which I think is extremely important.

First, I would like to ask Mr. Pratt and Ms. Fortney if you can help us. It has been reported that at a recent legislative hearing in Oregon, TransUnion Director of State Government Relations Eric Rosenberg said, "At this point, we do not have any research to show any statistical correlation between what is in somebody's credit report and their job performance or their likelihood to commit fraud."

Are you all familiar with that statement?

Mr. PRATT. I am.

Mr. COHEN. Do you concur or not concur?

Mr. PRATT. I do not because—

Mr. COHEN. Do you have statistical or empirical evidence?

Mr. PRATT. I would be happy to keep going. I do not because we really need the employers here. It is the employers who make the decision as to when to make a decision based on—

Mr. COHEN. Thank you, sir. I got an answer and I have heard it before. You do not have any data to discredit Mr. Rosenberg, and Mr. Rosenberg does not have anything to support any reports or any information to support the credit reports.

We are kind of going in a circle, kind of a Catch-22, just like the persons—

Mr. PRATT. Not really, because it is similar to asking us whether a creditor effectively uses a credit report for a lending decision. You have to have the creditor here in order to answer that question because they are the one that is going to be able to explain how they use the data, whether they include medical debts or do not include medical debts.

I think that is very important.

Mr. COHEN. Mr. Pratt, I have a limited amount of time, and I am not going to go through this because the question was statistical correlation and there is none.

Let me ask you this. Would you agree—Mr. Hensarling said we should have freedom and this works against freedom. At one time, that same argument was used about discrimination laws on race and gender and other areas, disability.

Would you agree that we should have laws that do not allow for discrimination based on race and gender? Would you agree with that?

Mr. PRATT. We have those laws.

Mr. COHEN. You agree they should be on the books; right?

Mr. PRATT. Those laws are on the books.

Mr. COHEN. Do you agree they are good things?

Mr. PRATT. And they work well.

Mr. COHEN. You agree they are good things?

Mr. PRATT. Sure.

Mr. COHEN. And if something operates in practice to make it de facto or in its application a racial barrier and a racial discrimination, then we should cure that as well, should we not, sir?

Mr. PRATT. If that is proven.

Mr. COHEN. Yes, sir. Is it a fact that because of Jim Crow laws and slavery and years and years of oppression against African Americans, would you agree that it is more likely that African Americans would have less opportunities to have inherited wealth and accumulate inherited wealth from property or previous jobs or stocks or other bonds and investments of ancestors who might have owned land or had cotton companies or shipping companies or whatever, that they would be less likely to have accumulated wealth that could help them through hard times?

Would you agree that is a fact? Do you think African Americans have equal amounts of wealth stored up, even though they were slaves for 400 years and suffered under Jim Crow for 100 years subsequent to that, Mr. Pratt, would you agree with that or disagree?

Mr. PRATT. I just do not know.

Mr. COHEN. Obviously, you do not know. I will tell you it is a fact. Anybody would know it is a fact. We had 400 years of slavery and 100 years of Jim Crow as distinguished from another group who had property, who owned slaves, who sold slaves, who had discriminatory practices where they could have advantages and they could get credit and they could get loans. They owned the insurance companies and the banks and the credit bureaus, so they had the wealth.

When they lose their job or they have a difficult financial time, they have mama or daddy or grand-daddy's money to fall back on. Their credit scores are good.

Yet when you look at the credit scores, you say that credit score indicates whether they do good work and have hard values. I submit to you good work and hard values is not a constant.

If you have money to fall back on, resources, because of family wealth, you submit that shows because your credit report is good that you have good work habits and hard values, that credit history equals hard work.

That is not necessarily true. Credit history shows you have family sometimes and you have support from years and years of opportunity that was denied others, and the fact is the Equal Employment Opportunity Commission has sued certain people over the practice of using credit reports because they believe it has an effect, it is a racial barrier, and there are racial disparities, and it should be pursued.

I think it should be, too. I think what you are talking about is a world where all is equal. If you do statistics, Ms. Fortney, you are great on statistics, I think you were thinking about fraud and not accidents.

Mr. Green was talking about accidents. There is no way to predict accidents. Maybe a few people might not file claims because they can afford it. You are submitting people who have bad histories might commit fraud, have an accident, which really is not an accident, so they can make a report and get some money. I think that is what you are alluding to.

Mr. Hensarling talking about discriminating against the person who does not have a good credit rating, you do not discriminate against him, you let that person, he or she operate against the other person on an equal basis, and the employer can choose them on who can do the best job.

Mr. Pratt, you said a lot of jobs do not use credit reports. If that is the case, would you agree that maybe we should pass a bill to make sure that those jobs that you concur where they do not use credit reports now, like skills, etc., that there should not be the permission to use credit reports?

Could you sit down with us and come up with those particular industries?

Chairman GUTIERREZ. Answer the question and then we will finish up.

Mr. PRATT. I think the laws today respond directly. We cannot discriminate. We cannot unintentionally discriminate. I think the way the FCRA works today, employers know they have responsibilities to decide when it is appropriate to use a credit report.

I do not think I have seen enough to know precisely when to choose yes or no.

Chairman GUTIERREZ. The time of the gentleman has expired. Thank you, Mr. Pratt.

Mr. COHEN. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Congresswoman Kilroy, you have a couple of documents for which you would like unanimous consent to be entered into the record?

Ms. KILROY. Yes. Letters of support.

Chairman GUTIERREZ. We have letters of support. Without objection, it is so ordered.

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

This subcommittee meeting is now adjourned.

[Whereupon, at 12:58 p.m., the hearing was adjourned.]

A P P E N D I X

May 12, 2010

Statement by Congressman Luis V. Gutierrez, Chairman, House Financial Services Subcommittee on Financial Institutions and Consumer Credit Hearing

"Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010

This morning's hearing is about the use of credit information in areas such as insurance underwriting and employment purposes. We will hear about important yet complex and often opaque processes concerning credit based insurance and insurance scores in the first panel, and in the second panel we will hear about the equally important and –to a vast number of consumers- little known or understood uses of credit information for hiring and firing decisions, and the effect medical debt has on one's consumer report, even after it's paid off.

When legislators or regulators attempt to fully grasp an issue such as credit based insurance scores, they see a complex system, laden with algorithms and ever-changing computer applications and models. But it is precisely this complexity that should make us here in the Congress delve further into an issue that affects every single American who owns or rents a house, a car, has insurance, has a job or is looking for a job, or is likely to incur medical debt.

Do most consumers know that their car or homeowner's insurance rates may go up due to their credit score? Do they know that if one of their medical bills goes to a collection agency and they pay it in full or settle it, it will still affect their credit report for up to 7 years? Do people realize that, even in these tough economic times, pre-employment consumer credit checks are increasingly widespread, trapping many people in a cycle of debt that makes it harder to pay off their debts and harder for them to get the job that would allow them to pay off their debts? Indeed, the current system facilitates the denial of employment to those who have bad debt, even though bad debt often times results from . . .the denial of employment.

That is why this subcommittee is holding this hearing, the second so far this year on the issue of credit reports, credit scores and their impact on consumers. We will look at reports and studies about the predictive nature of insurance scores and traditional scores, among other things. But as we do so, we also need to look at the basic guiding principles of equity, fairness and transparency.

Some may contend that there is no disparate treatment of minorities in credit based insurance scores. Some will say that, even if there is a disparate impact on some groups, the system still doesn't need to be changed. The question of how predictive a credit based insurance score is of an insured's likelihood to file a claim is important, as is the predictive value of traditional credit scores used for credit granting. But as long as there continue to be disparities in the outcomes of the current system for racial and ethnic groups and along class or geographic lines, I believe that the system needs strenuous oversight and may need fundamental change. How to correct the disparities in the system -with its disproportionately negative impact on minorities and low-income groups- while maintaining the core framework of credit information as a risk management tool, is the challenge we should take on.

For example, issues like the use of credit information for developing insurance pricing and the inclusion of medical debt collections in determining a consumer's risk of default, I have doubts as to whether these are bias-free uses of data: The Equal Employment Opportunity Commission, the Federal Reserve, the Brookings Institution, the Federal Trade Commission and the Texas Department of Insurance have all found that racial disparities between African Americans, Latinos and whites in credit scoring exist and, as we will see, this has wide-ranging implications beyond simply obtaining consumer credit.

Defending a system where decisions such as determining car insurance rates or even something as vital as whether or not to hire someone that are based on something that has been shown to possess a degree of bias -

- that is difficult, to say the least. But I welcome the testimony this morning of those who believe the system works, and of those who believe the system needs to be changed to work in a more equitable, fair and transparent fashion. In this same spirit of transparency, I'm making it clear at the outset that I side with this latter group. I don't think you needed any sort of score or algorithm to *predict that.*

In order to persuade this committee from moving forward on legislation that would strongly limit what we believe to be unfair practices, the industry witnesses before us must prove to me that not only are the practices we call into question scientifically predictive, but more importantly, that they are fair and equitable to all Americans.

Opening Statement of the

Honorable Maxine Waters, D-35th CA

Committee on Financial Services

Hearing on "Use of Credit Information Beyond Lending: Issues and Reform Proposals"

Wednesday, May 12, 2010

2128 Rayburn House Office Building

10 a.m.

Thank you, Mr. Chairman.

I am very concerned about the non-lending use of credit scores, particularly the use of credit scores in setting rates for car and homeowners' insurance. Frankly, I don't think that a person's credit score has any bearing on whether or not they are more likely to be in a car accident or to have their home burglarized, but insurance companies are using credit scores in this way. This is why I worked on legislation in the last Congress—with Reps. Gutierrez, Watt, and Frank—to ban the use of credit scores to set insurance rates. I plan to reintroduce this legislation soon.

I am also concerned about the use of credit scores to determine employment decisions. There are serious questions about whether or not credit scores are fair and sometimes events that are beyond the control of consumers negatively impact their credit score.

For example, last year, when this Committee marked up the Credit Card Bill of Rights, I was prepared to offer an amendment to ban the phenomenon of credit card companies lowering the credit limits of borrowers based on where they shop. While I didn't offer that particular amendment, I did offer an amendment that required the Federal Reserve to study this practice because when a credit line is lowered, that negatively impacts the consumer's credit score.

But in the current environment, a consumer who had their credit line and then their credit score lowered—through no fault of their own—could lose out on a job that they would have otherwise qualified for. This is bad policy in the best of economic times; in the current recession it makes even less sense.

Furthermore, sometimes credit scores just aren't accurate. Some consumers that identify errors on their credit reports—which can in turn impact their credit score—have a hard time getting that negative information removed. Moreover, consumers that receive loan modifications can see their score drop by 100 points, even though they are making their newly modified mortgage payments on time. Given the problems with accurate credit reporting, it is simply unfair for a person to be denied employment because of a low score.

I hope that our two panels of witnesses can shed some light on the issues I've just mentioned. I also hope that our witnesses can inform us about whether or not credit scores are a proxy for race and if so, what impact that is having on the ability of minority consumers to obtain credit.

Thank you, Mr. Chairman. I yield back the balance of my time.

PREPARED STATEMENT OF

ANNE P. FORTNEY
HUDSON COOK, LLP

Use of Credit Information Beyond Lending: Issues and Reform Proposals

Before the

SUBCOMMITTEE
ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
HOUSE COMMITTEE ON FINANCIAL SERVICES

Washington, DC

Wednesday, May 12, 2010

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, I am Anne Fortney. I am a partner in the Washington, DC office of the Hudson Cook law firm. My practice concentrates on compliance issues under the federal and state consumer protection laws, primarily for the consumer financial services industry. I appreciate the opportunity to appear before you to discuss the use of credit information beyond lending and issues related to this use.

Background and Experience

I have practiced law for more than 40 years. After a couple of years in private practice, I joined the Federal Trade Commission ("FTC") where I served as an attorney-advisor to Commissioner Mary Gardiner Jones and as a staff attorney in the Division of Marketing Practices. I first began working on consumer financial services matters when I was in the Washington, DC legal office of the JC Penney Company in the late 70's and early 80's – a time when Penney was one of the largest credit card issuers in the country. My principal responsibilities involved legislative and regulatory issues affecting Penney's credit card operations.

I returned to the FTC in 1982, as the Associate Director for Credit Practices. In that capacity, I directed the nationwide enforcement of the consumer financial services laws with respect to finance companies and other creditors within the FTC's jurisdiction. I was also responsible for the development of the FTC's Commentary on the Fair Credit Reporting Act ("FCRA"), the final version of which was published after I had left the Commission. I have been in practice since 1986, concentrating in consumer financial services law compliance, regulation and litigation. From time to time I serve as an expert witness in litigation involving the FCRA and related consumer protection laws.

Thus, my testimony draws on many years of consumer protection practice, in both the public and private sectors. I believe my depth of experience in this regard enables me to comment upon legislation from the perspective of consumers, as well as the industry.

Non-Lenders' Use of Credit Information

Although most of my practice involves creditors and consumer reporting agencies, I am aware that under certain circumstances, credit information is used as a factor in predicting risk other than consumers' default on credit obligations. For example, financial institutions use credit information along with other empirical data in considering consumers' applications for checking and other deposit accounts. As others will testify, this information has also been proven to be a valuable factor in property and casualty insurance underwriting. In addition, credit information may be useful, and under certain circumstances essential, to employers when screening prospective employees or in monitoring suspicious activity. Landlords and property managers use credit information as a factor in evaluating rental applications. In each of these instances, these non-creditors use credit information in conjunction with other information because it has been proven to be a useful and reliable tool in predicting the user's risk associated with a transaction or other relationship with a consumer. In my experience, non-creditors do not use credit information alone in making these risk assessments. Rather, credit information is used as one factor along with other empirical information.

There are two important considerations resulting from the fact that credit information is rarely the only factor in a non-credit transaction. The first is that a consumer's credit history is considered only to the extent that it is valuable in making the risk assessment in question. The second consideration is that the removal of, or non-empirical restriction on, the use of credit information necessarily renders less accurate a non-creditor's prediction of risk. The elimination or reduction of credit information will, therefore, diminish the ability of the non-creditor to assess risk and the resulting decisions will be less efficient and less fair for consumers. For example, if an insurer cannot use credit information as a factor in assessing risk in the case of property or casualty insurance, the insurer's ability to price effectively for risk will be diminished. The inevitable result will be higher premiums for most consumers and less availability of insurance for marginal insurance risks. It is important to keep in mind that when credit information plays a role in insurance availability and pricing, a consumer who is denied insurance or who is required to pay a premium increase will receive a notice and have the opportunity to ensure that information in the consumer report is accurate.

Employment screenings, including screenings that use credit reports, are an important tool used by businesses to ensure employee safety and avoid employee theft.[1] If an employer cannot use credit information in those circumstances where that information has been proven to be valuable, then a consumer who is the stronger candidate based on background and experience for a job may lose a position to a less reliable applicant. If employers cannot use credit information as a factor in assessing potential fraud or other misconduct, then the employer will run the risk of loss that otherwise could have been avoided. In some cases, that risk could directly harm other

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[1] *An Acxiom White Paper: Background Screening for Retail Employment - Where Privacy Meets Best Practices*, 2007, available at: http://www.acxiom.com/SiteCollectionDocuments/Resources/White%20Papers/AISS_White_Paper__Retail.pdf. ("Ten percent of all applicants for employment have criminal background information that could affect hiring decisions." *See also*, http://risk.lexisnexis.com/screen-applicants (Statistics posted by Lexis-Nexis show that more than 30% of all employment applicants provide false information on their resumes, according to the Society of Human Resource Managers.)

consumers, and the employer could be accused of being negligent for failing to use a readily available screening tool like credit reports. In fact, many states have decided that applicants for a mortgage loan originator license must authorize the release of a credit score so that the state can determine if the applicant poses a risk that will harm consumers. Although there is debate about whether the states should mandate the release of credit information, the fact is that the state regulators believe credit report information is an important assessment tool that will help the state decide whether an individual should be approved for licensing and thus for employment, as a mortgage loan originator.[2]

The FCRA recognizes that it is critical that consumer reports used for employment decisions must be accurate to be predictive. To that end, the FCRA imposes two notice requirements so that the employment decision is not made until the consumer is alerted to negative information and has the opportunity to correct negative inaccurate information. The consumer will also receive a notice if the information in the consumer report formed the basis for the denial of employment or a promotion.

Unless there are compelling public policy reasons dictating the elimination or reduction of the use of credit information in these circumstances, the use should continue to be permitted.

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[2] Starting in 2010, NMLS intends to provide functionality within the system to process independent credit reports from a consumer reporting agency for the purpose of obtaining or maintaining a license in one or more jurisdictions. *See* http://mortgage.nationwidelicensingsystem.org/profreq/credit/Pages/default.aspx. Examples of states that require authorization for release of credit reports include: California, Illinois, Iowa, North Carolina, Pennsylvania, and Texas. These states were identified by a search of the NMLS website, and there are other states that have the same requirement as well.

The use of credit information in property and casualty insurance has recently been challenged in the courts on the basis of an alleged disparate impact on certain protected minority groups. While the ultimate resolution of those challenges should be left to the courts, it is important to understand that the existence of a disparate impact on a protected group would not, standing alone, constitute a violation of the Fair Housing Act or the Equal Credit Opportunity Act. Once such a disparate impact is proven, the burden shifts to the defendant to show a legitimate business reason for the use of a policy or practice that caused the disparate impact. If the defendant can show a legitimate business need for such a policy or practice, the burden then shifts back to the plaintiff to show that there is a less discriminatory means of achieving the same result. Thus, an allegation of a disparate impact alone does not mean that there is, or is not, a violation of the fair lending laws. The process is more complicated, in large part because the courts have recognized that both credit and insurance underwriting involve complicated processes. In addition, the creditor or insurer bears the risk of loss in the underwriting process, and the elimination of any predictive information will impair the risk underwriting process.

Because of the demonstrated public value in the use of credit information as a factor in non-credit determinations, any legislative consideration of the use should not be based on isolated and unverified anecdotes. These kinds of stories may make for good media copy, but they do not reflect an informed assessment of the benefits to society as a whole resulting from the use of this information. Similarly, consumers' concerns regarding the non-transparency of the uses of this information should not be the basis for any legislative action. The users of credit information, not consumers, are in the best position to assess the ultimate risk of loss and are, therefore, uniquely entitled to determine the value of the information.

Medical Debt Collection Information

My previous testimony before this Subcommittee addressed the use of medical debt collection information in credit histories. As others have testified, this information is a predictive characteristic in credit scoring systems. For that reason, its use benefits consumers, as well as creditors and others that rely upon that information. Because the use results in more predictive and thus reliable risk prediction, the users are able to more accurately predict risk in pricing for credit or insurance or making other informed decisions that benefit consumers in the form of lower prices and/or increased availability of services.

Legislation pending in Congress would restrict the use of medical debt information in credit reports. That legislation is premised on unfounded assumptions and inaccurate statements. For example, the findings and purposes section of H.R. 3421 states: "Medical debt is unique because, unlike consumer debt, Americans don't get to choose when accidents happen or when their genetic traits will catch up to their health profiles." To the extent this sentence means that medical debt is unique because it cannot be avoided, the sentence is inaccurate. Medical debts are no different from many other causes of default or delinquency over which consumers have no control – such as death of a spouse, divorce, or job-loss due to lay-off. Moreover, contrary to the findings in H.R. 3421, medical debt collection issues do not affect all consumers, only those that are unable to pay their medical debts or reach agreement with their medical providers as to a payment plan. In addition, H.R. 3421 states that "medical debt collections are more likely to be in dispute, inconsistently reported, and of questionable value in predicting future performance because it is atypical and non predictive." This sentence is attributed to "credit evaluators" without further clarification. This anonymous attribution is puzzling particularly because it is contradicted by the testimony of witnesses, including credit score model developers, before this Subcommittee. Moreover, to the extent that a consumer disputes a medical collection debt or any other debt that is furnished to a consumer reporting agency, the consumer has adequate rights and procedures under the Fair Credit Reporting Act to dispute that debt and have it corrected if it is inaccurate or incomplete.

Additional "findings" in H.R. 3421 are irrelevant. These include the statement that "medical debt that has been completely paid off or settled can significantly damage a consumer's credit score for years." This statement does not explain why medical debt should be treated differently from any other debt which is paid or settled and which can also affect a consumer's credit score. The following statement: "consumers can be denied credit or pay higher rates when buying a home or obtaining a credit card" does not explain why this result is relevant in the case of medical debt, as opposed to other forms of consumer debt. Similarly, statements about the use of collection agencies to collect medical debts or the number of consumers who have medical debts do not provide a factual basis as to why it is in the public interest to eliminate from consideration by creditors, other credit report users, information that has been proven to have a predictive value in credit scoring and other credit risk assessments. Lacking any empirical basis for the preferential treatment of medical collection debt, H.R. 3421 would impair credit scoring and other credit evaluation systems without any countervailing public benefit.

FCRA Private Right of Action for Section 615 Violations

Section 615 of the FCRA imposes requirements on users of consumer reports that are designed to protect consumers from identity theft and its consequences, and notice requirements to help educate consumers about information included in consumer reports and the effect of that information on the user. Users who fail to follow the requirements of Section 615 face administrative enforcement actions by the FTC, the federal financial institutions regulatory agencies and state attorneys general.

In 2003 as part of the FACT Acts amendments, Congress enacted FCRA § 615(h)(8), which eliminated a consumer's private right of action for all violations occurring under Section 615. Since the enactment of this provision more than six years ago, litigants across the country have argued about whether Congress intended to eliminate a private right of action for provisions that existed in Section 615 before the FACT Act amendments, or whether there was a "scrivener's error" that led to this result. There have been at least 68 reported opinions addressing this issue, and virtually all the courts have concluded that Congress eliminated the private right of action for *all* provisions found in Section 615.[3] Thus, there is little doubt as to the effect of this change: There is no private right of action for any violation of FCRA Section 615.

Some critics of this result complain that there was no legislative history evidencing the Congressional intent to achieve this result. However, the lack of legislative history is irrelevant. Because of the haste with which Congress deliberated and enacted the FACT Act amendments to the FCRA, there is a dearth of legislative history on ***any*** of the provisions. Moreover, a claim that the placement of the exclusion

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[3] *See*, e.g. *Perry v. First Nat'l Bank*, 459 F.2d 816, 822-823 (7th Circuit (Ill.) 2006); *Banga v. Allstate Ins. Co.*, 2009 U.S. Dist. LEXIS 86619 *11 - *12 (E.D. Cal., Sept. 22, 2009).

with Section 615(h)(8) is indicative of Congress' intent to limit its application to the particular subsection is not supported by anything in the legislative record, and there other are other examples of misplaced provisions added by the FACT Act, such as the credit and debit card number truncation requirement which was inexplicably placed in Section 605 (Requirements Relating to Information Contained in Consumer Reports). The credit and debit card truncation provision has no relevance whatsoever to the section where it was placed by the FACT Act.

At this point in time, rather than trying to discern what Congress may or may not have intended six years ago, I believe that the appropriate inquiry is whether Congress should now entertain amending Section 615 to reinstate a private right of action for certain subsections. Recent history weighs against amending the FCRA to revisit the issue.

Some of the provisions in Section 615 clearly never extended private rights of action, such as the provisions adding in the FACT Act amendments that require the federal agencies to promulgate the red flags rule and the risk-based pricing rule. As far as I am aware, there is no suggestion that a private right of action should be allowed for these rules' requirements. What must now be considered is whether extending a private right of action to consumers enhances the other protections found in Section 615 in any way. Based upon my more than 30 years experience in working with the FCRA, and my participation as an expert witness in litigation related to issues arising under Subsection 615(a), I do not believe that there is any measurable benefit to consumers.

First, it has been my experience that most users of consumer reports comply with the law, even in the absence of a private right of action. In the credit context, creditors who use consumer reports and other information bearing upon creditworthiness give adverse action notices to consumers in writing, even though they could lawfully give the notice orally or electronically under Subsections 615(a) and (b). In fact, most creditors include their FCRA adverse action notices as part of their adverse action notices required under the ECOA and Regulation B. The model FCRA adverse action notice language was added by the Federal Reserve Board to the sample ECOA adverse action notice forms found in Appendix C to Regulation B.[4] Thus, in the credit context, consumers receive protection under both the ECOA and the FCRA.

Second, there are significant negative, and perhaps unintended, consequences that will undoubtedly result if a private right of action is added to Section 615, particularly to Subsection 615(a). The nationwide class action litigation brought against the insurance industry from 2000 through 2009 illustrates that the burden of litigation can vastly overshadow any benefit to consumers. This litigation was predicated on an FTC staff opinion letter written by a junior staff attorney, who relied on incorrect legislative history, in reaching a conclusion that was unsupported by the language of the FCRA. The litigation involved many large property and casualty insurance companies in this country. After years of protracted and extremely expensive litigation, two of these cases, involving Safeco and GEICO, reached the United States Supreme Court. In a unanimous opinion, the Court rejected the FTC staff interpretation that had engendered the litigation.[5]

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[4] *See,* Form C-1, Form C-2, Form C-3, Form C-4, and Form C-5.

[5] *Safeco Ins. Co. of America v. Burr* and *GEICO General Ins. Co. v. Edo*, 551 U.S. 47, 70 (2007).

While these insurance companies were thus vindicated, the outcome came at enormous cost. At the same time, many other insurance companies had chosen to settle prior to the Supreme Court's ruling rather than face the prospect of potentially ruinous liability. As a result, those companies paid statutory damages to some customers who, according to the Supreme Court's ruling in GEICO, would have been entitled to no recovery at all. No public policy supports such a windfall.

Finally, one major insurance company gave its customers the notice as required under the FTC staff lawyer's interpretation, but was forced to defend a class action challenging the *content* of its notice. In reliance on advice of legal counsel, the company tried to craft a portion of the notice, which was sent to about 94% of its customers, in a manner that was meaningful and accurate. Ultimately, that insurance company was vindicated by a unanimous jury verdict in its favor, but only after facing the prospect of statutory damages in the billions of dollars and incurring enormous legal fees and other costs in its defense. In not one of these cases could any consumer demonstrate harm.

If Congress amends the FCRA to add a private right of action under Subsections 615 other than Subsection 615(h), the only persons who stand to benefit are those lawyers who can assemble a class and pursue class action litigation, unless Congress also implements limits on class action liability. Otherwise, consumers will ultimately be the ones who bear the cost of litigation in the form of increased credit and insurance rates.

Thus, adding a private right of action under Subsection 615(a) will do nothing more than encourage frivolous litigation. History has demonstrated that fact. There is nothing for individual consumers to gain by allowing consumers to sue directly on policies and procedures or subjective beliefs about what should and should not be in notices and how they should be given.

Similar policy reasons apply to the other provisions of Section 615. The threat of administrative enforcement is significant. The FTC has substantial authority to ensure that users of consumer report information have the proper tools in place to protect and educate consumers. The FTC actively pursues complaints to ensure that consumers are protected and that the users of consumer report information comply with all aspects of the FCRA. In addition, The Federal Deposit Insurance Company, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Office of Thrift Supervision, the National Credit Union Administrator, the Surface Transportation Board, the Secretary of Transportation, the Secretary of Agriculture all have examination and enforcement authority over entities that they regulate. Any gap in regulation can be filled by state attorneys general. Section 621 allows for robust enforcement of the FCRA.

The elimination of the private right of action for Section 615 violations has not precluded consumers alleging violations of the FCRA from bringing private actions. Generally, the provisions for which consumers can sue for willful violations are those that involve a fundamental breach of consumer privacy or an abdication of responsibilities with respect to consumer disputes as to the accuracy or completeness of information in a consumer report. For example, consumers can seek statutory penalties for a willful violation against someone who obtains their consumer reports without a purpose that is specifically permitted under the FCRA. This may occur when someone obtains a report on an ex-spouse during a divorce proceeding or when a car salesman obtains the report for use in negotiating the price of a car even though the consumer is not planning to finance the purchase.

Someone who obtains a consumer report in an attempt to commit identity theft may also be subject to statutory damages for a willful violation. Creditors and insurers that do not have a permissible purpose to obtain prescreened lists from consumer reporting agencies may also face statutory damages for willful violations.

Similarly, if a creditor or other company that furnishes consumer report information to a consumer reporting agency ignores consumers' disputes as to the accuracy or completeness of the information in the consumer report based on that information, the furnisher may be subject to statutory damages for a willful violation. Statutory penalties for willful violations may also be available to users of consumer reports that fail to dispose of consumer report information in a proper manner and thereby create a risk of identity theft for consumers whose information is involved in the reports.

Finally, Section 615 is not the only portion of the FCRA for which there is no private right of action. Subsection 623(a) is also limited to administrative enforcement. There are valid policy reasons for limiting private rights of action under these FCRA provisions.

Thank you for the opportunity to testify. I will be glad to answer your questions.

Testimony of
Michael T. McRaith, Illinois Insurance Commissioner
National Association of Insurance Commissioners

Before the
Subcommittee on Financial Institutions and Consumer Credit
Of the
House Committee on Financial Services

Regarding:
"Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010
Room 2128
Rayburn House Office Building

Michael T. McRaith
Illinois Insurance Commissioner
National Association of Insurance Commissioners

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, thank you for the opportunity to testify on the use of credit-based insurance scores in the provision of personal lines of insurance.

My name is Michael McRaith, and I am the Director of Insurance for the State of Illinois. I am also the chair of the Property & Casualty Insurance Committee of the National Association of Insurance Commissioners (NAIC), and I am representing that organization today. Today I will address the use of credit-based insurance scores and the NAIC's continuing effort to provide reliable information to policymakers on this topic.

INTRODUCTION

Consumer protection has been, is, and will remain the first priority for state insurance regulators. In that capacity, we enforce the laws enacted and regulations promulgated within our respective states.

In my testimony, I will describe the role of credit-based insurance scores in the State of Illinois today. I also will report on actions undertaken by the NAIC to collect data and further elucidate the role of credit-based insurance scores and the impact on personal lines insurance.

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

The use of credit-based insurance scoring forces an examination of the fundamental purpose of insurance, and the acceptability of factors used to underwrite, or assess, an individual risk and to classify and price, or rate, an individual risk. Proponents argue that credit-based insurance scores are predictive of an insured's future claims experience, and are a necessary tool for underwriting and/or rating. Substantial evidence supports this claim. Opponents argue that the use of a credit-based insurance score discriminates against lower income individuals and those within protected classes.

A significant number of studies support both sides of the debate. For example, in 2004-2005, the Texas Department of Insurance ("TDI") studied the use of credit in underwriting. The TDI study indicated that credit scores are widely used by insurers but only in connection with other criteria such as driving record. The study also noted that the impact of a credit score on the ultimate price of insurance varied significantly among insurers, and even among products offered by an individual insurer. The TDI study also reported that certain segments of the population are disproportionately represented in the lower tiers of credit scores and, therefore, are disproportionately and negatively impacted by the use of credit in underwriting.

Alaska, Florida and Hawaii, among others, as well as the Federal Trade Commission, have also reviewed the impact of credit scores upon personal lines consumers.

Proponents of credit scores emphasize that insurers' use of credit-based insurance scores streamlines the underwriting process for a significant number of consumers and benefits a majority of consumers. In short, the arguments remain unsettled: (1) use of credit-based insurance scores adversely impact people in protected classes, or (2) use of credit-based insurance scores allows for more accurate pricing, thus allowing more consumers to receive reasonable offers.

The public policy questions involved with credit-based insurance scores raise broader implications that extend beyond the insurance sector, and beyond the scope of this hearing. If, in fact, both proponents and opponents are correct, then policymakers must evaluate all relevant factors and provide appropriate guidance to regulators.

For years, insurance regulators have heard arguments and rhetoric, if not diatribe, on both sides of this public policy question. Distinct from the public policy debate, regulators are presently investigating the components of an insurance score, the extent to which any one rating factor affects a consumer, whether consumers have an appropriate understanding of the credit factors that affect a particular insurance policy, and whether insurance score vendors should be subject to enhanced transparency or supervision.

Forty-eight states have taken some form of legislative or regulatory action to address the use of credit scores for insurance. Exhibit A, attached hereto, is a Table identifying state laws relative to credit-based insurance scores. Typically states will not allow credit-based insurance scores to be used as the sole basis for increasing rates or denying, cancelling or non-renewing policies. Other states prohibit credit-based insurance scores being used as the sole basis in underwriting or rating decisions. Some states require insurers to notify applicants or insureds that adverse credit-related decisions have been taken regarding pending applications or existing coverage based on the consumer's credit score. Four states effectively have banned the use of credit information in classification and price-setting processes.

A number of credit characteristics are utilized in developing a credit-based insurance score. Sophisticated mathematical models incorporate different weights in using these credit characteristics to come up with a numerical score. According to some, there are approximately 450 variables obtainable from a credit file and perhaps 10 to 50 are used in developing credit-based insurance scores models. Among the credit-related variables used in credit-based insurance scores are data such as: payment history, bankruptcies, amount of credit utilized, numbers and types of accounts, length of credit history, outstanding debt amounts, debt ratios, age of accounts, new applications for credit, and types of credit in use. Insurance regulators understand that credit score providers utilize a number of these variables, but the formula appears to differ between companies and even between products within a company.

An additional question is whether consumers have a way of registering complaints or problems with the use of credit information for insurance purposes. Consumers report issues or complaints about the use of credit based insurance scores both directly to state insurance regulators, or through the NAIC's Consumer Information Source (CIS). CIS allows a consumer to file a complaint through the NAIC, and research the complaint history of any insurance company. In 2008, consumers reported 86 complaints with credit scoring through CIS, and in 2009 that rose to 157 complaints.

Illinois Law -- One State's Approach

Illinois law allows insurers to use credit information to underwrite and rate an insurance policy. Exhibit B, 215 ILCS 157/1, *et seq.* Illinois law does not restrict the extent to which credit information can impact a premium. Insurers may consider typical credit-related items, including bankruptcy, number and frequency of late payments, home ownership, and how much is owed compared to how much credit is available.

In Illinois, an insurer is required to inform the consumer at the time of application that credit information may be considered by the insurer. If the credit information causes an insurer to take an "adverse action" against the consumer, then the insurer must notify the consumer. An "adverse action" can include not offering the "best rate," not providing a discount, demanding a higher rate, or denying, canceling or non-renewing the policy. In other words, insurers have broad discretion about the use and impact of credit information.

While Illinois law prohibits an insurer from taking an adverse action due to a consumer not having a credit history, the law does not require that consumer to be treated favorably. Illinois law requires only that the treatment of that individual be "actuarially justified." Nothing defines or outlines the definition of a "good" credit score, and Illinois has recently experienced insurers raising the credit score threshold for favorable treatment, thereby increasing premiums for many insureds.

Illinois law nominally recognizes that an insured may experience an "extraordinary life event." 215 ILCS 157/22. However, insurers are only obligated to "review and consider" whether the event justifies an exception to a premium increase.

NAIC Public Hearing on Insurance Companies' Use of Credit Scoring, April 30, 2009

As aforementioned, the scope and use of credit based insurance scores has been addressed by 48 states. Since the complexity of insurance underwriting and pricing has evolved, insurance regulators work to understand and better illuminate the multiple factors that affect an insurance credit score other than the credit component. The NAIC held a public hearing on April 30, 2009 to explore insurance companies' use of credit scoring. Testimony was received on the following issues: (1) how credit scores are developed and used; (2) data quality in credit reports and actuarial standards; (3) how insurers develop and use credit-based insurance scores; and (4) the consumer perspectives on the use of credit-based insurance scores. The hearing included various opinions that largely repeated the rhetoric and talking points of the various interested parties. We heard from consumer representatives, credit scoring agencies, actuaries and industry representatives. We also developed an expansive written record through the hearing which, along with an audio record, is available on the NAIC web site at NAIC.org.

The findings from the NAIC's public hearing highlighted the need for enhanced understanding both of the underwriting and pricing factors considered by an insurer and the weight attributed to each factor. While regulators know that several factors may determine one's eligibility and coverage costs, state regulators work to keep pace with the insurance industry regarding the weight attributed to each insurance score component. In addition to credit score, regulators know and monitor the relative weight of other factors, including: occupation, education, marital status, income, loss history, lapse in coverage, gender, age and territory, among others.

In addition, insurance regulators have also determined that the insurance score vendors should fall within the insurance regulatory penumbra. While some dispute exists as to whether those vendors are currently subject to insurance regulatory oversight, regulators recognize the important role these vendors play in the business of personal lines insurance.

Insurance score vendors offer a product that impacts a consumer's eligibility and the price a consumer may pay. These vendors avoid transparency and may be unregulated with regard to the information provided by the vendors and relied upon by insurers.

Concerns also exist because a substantial percentage of credit reports contain erroneous information, and credit scores may be adversely impacted by factors totally beyond the consumer's control. For example, the recent banking crisis may have resulted in the reduction of available credit for a consumer, even though the consumer has an excellent payment history. This, of course, increases the credit ratio and reduces that consumer's credit score.

Credit-based insurance scores were first introduced into the insurance industry in 1993, but many consumers remain unaware of the impact of those scores. Some regulators share concern about whether consumers comprehend the use of credit scores and the potential impact of a credit score on an insurance premium. Consumer understanding of coverage eligibility is often limited, just as an understanding of classification and pricing can be limited.

Even credit-related notices received from an insurer pursuant to state law can be confusing. For example, Illinois law requires written notice of any "adverse action" taken against a consumer due to a credit score. This notice, although meaningful to some, merely inspires more questions in many. Consumers often are surprised to learn that auto or home insurance rates may increase due to a credit score.

Throughout 2009, the NAIC collected written and oral testimony from interested parties on the topic of credit-based insurance scores. The rhetoric became predictable and uninformative. Since the question is ultimately a public policy question, insurance regulators, acting in coordinated manner through the NAIC, have undertaken a comprehensive review of all factors involved with personal lines underwriting and rating.

With the explosion of digitized information and electronic communication, insurance scores have become even more sophisticated and dependent upon more discrete pieces of information. We must be vigilant to assure consumers are not rated and priced into increasingly small silos that reduce both the insurance function and consumer benefit.

Consumers will benefit if policymakers and consumers better understand the factors that determine rates and coverage, including the weight given a credit score by a personal lines insurer,. For that reason, we applaud this distinguished Committee's inquiry into this subject matter.

NAIC's State-based Data Call

The NAIC is developing a voluntary data call for states to issue to personal lines auto carriers operating within the borders of that state. The data call will allow regulators to obtain information from insurance companies regarding the development of an insurance score and the range of premium differences among consumers based on the insurance scores. Also, for the first time, the data call will allow states to compare the impact of one state's law regarding insurance scores versus another state's law, and allow policymakers to move forward in a fully-informed manner.

The South Carolina Department of Insurance recently conducted a less formal survey in order to gain insight on how insurers used the insurance scores for pricing of auto and home insurance policies. South Carolina Director Scott Richardson reported that discounts for home insurance ranged from 7.6 percent to 51 percent, and that surcharges ranged from 1 percent to 86 percent. For auto insurance, the discounts were as high as 36 percent, and the surcharges ranged from 12 percent to 99 percent. In Illinois, the same range appears likely.

To protect consumers, regulators continue to monitor, if not approve, the technology and formula used for the development of rates, the variables involved with the determination of an insurance score, and the weight assigned to each variable The results of the NAIC's broader multi-state data call will be compiled, evaluated and published to inform policymakers about actual consumer impacts.

Need for Legislative Authority – State Involvement

Insurance companies claim that the factors considered when determining an insurance score are proprietary and therefore can't be disclosed to regulators. This is false. Consumer protection requires an intimate familiarity with company underwriting, classification and pricing practices -- information which allows regulators to monitor for anti-competitive or discriminatory activity. For states like Illinois, with little rate approval authority, this is especially true. As insurance regulators, we receive and preserve confidential, proprietary information of consumers and companies hundreds of times a day -- personal lines underwriting and pricing information is not different.

The NAIC's multi-state data call, to be issued within the next 75 days and completed, aggregated and reported by the end of 2010, will afford policymakers in Congress and the states the opportunity to compare state laws and consumer impact. The NAIC is committed to providing the data and expertise in support of this Committee's important work.

Insurance score vendors should also be regulated. While the issue of whether these vendors are currently regulated may be debated, it is indisputable that insurance score vendors must fall within state insurance regulator oversight. For that reason, the NAIC intends to develop a model law prior to the end of 2010.

CONCLUSION

Insurers' use of credit scoring for underwriting and rating generates significant rhetoric. Consumer protection requires that legislators and regulators fully comprehend the use by insurers of insurance scores when determining personal lines eligibility and rates. The ongoing, fast-paced evolution of the calculation and reliance upon insurance scores warrants insurance regulator attention. State insurance regulators, through the NAIC, are developing data to support and inform the discussions within Congress and state legislatures.

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 look forward to answering your questions.

EXHIBIT A

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

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 (5/08)	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 (5/08)	§§ 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 (5/08)	§ 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 (5/08)	§§ 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 (5/08)	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 (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
CT (5/08)	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 (5/08)	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 (5/08)	No provision		
FL (5/08)	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)

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
GA (5/08)	§§ 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 (5/08)	§ 431:10C-207	Auto	Insurer shall not base standard or rating plan upon a person's credit bureau rating.
ID (5/08)	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 (5/08)	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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

5/08

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
IN (5/08)	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 (5/08)	§ 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 (5/08)	§§ 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 (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
LA (5/08)	§ 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 (5/08)	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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
MD (5/08)	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 (5/08)	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 (5/08)	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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
MN (5/08)	§ 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 (5/08)	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 (5/08)	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 (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NE (5/08)	§ 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 5/08)	§§ 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 (5/08)	§ 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 (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NM (5/08)	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 (5/08)	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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
NC (5/08)	§ 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 (5/08)	§§ 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 (5/08)	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 (5/08)	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)

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
OR (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
PA (5/08)	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 (5/08)	§ 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 (5/08)	§ 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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
SD (5/08)	Bulletin 2002-3	Personal lines property and casualty	May not use credit information as the sole rating factor.
TN (5/08)	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 (5/08)	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.

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
UT (5/08)	§ 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 (5/08)	No provision		
VI (5/08)	No provision.		
VA (5/08)	§§ 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)

USE OF CREDIT REPORTS/SCORING IN UNDERWRITING

STATE	REFERENCE	LINE OF BUSINESS	SUMMARY OF PROVISIONS
WA (5/08)	§ 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 (5/08)	§ 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 (5/08)	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 (5/08)	§ 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.

EXHIBIT B

INSURANCE
(215 ILCS 157/) Use of Credit Information in Personal Insurance Act.

(215 ILCS 157/1)
Sec. 1. Short title. This Act may be cited as the Use of Credit Information in Personal Insurance Act.

(215 ILCS 157/5)
Sec. 5. Purpose. The purpose of this Act is to regulate the use of credit information for personal insurance so that consumers are afforded certain protections with respect to the use of that information.

(215 ILCS 157/10)
Sec. 10. Scope. This Act applies to personal insurance and not to commercial insurance. For purposes of this Act, "personal insurance" means private passenger automobile, homeowners, motorcycle, mobile-homeowners and non-commercial dwelling fire insurance policies, and boat, personal watercraft, snowmobile, and recreational vehicle polices. Such policies must be individually underwritten for personal, family, or household use. No other type of insurance shall be included as personal insurance for the purpose of this Act.

(215 ILCS 157/15)
Sec. 15. Definitions. For the purposes of this Act, these defined words have the following meanings:

"Adverse action" means a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of personal insurance.

"Affiliate" means any company that controls, is controlled by, or is under common control with another company.

"Applicant" means an individual who has applied to be covered by a personal insurance policy with an insurer.

"Consumer" means an insured or an applicant for a personal insurance policy whose credit information is used or whose insurance score is calculated in the underwriting or rating of a personal insurance policy.

"Consumer reporting agency" means any person that, for monetary fees or dues or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

"Credit information" means any credit-related information derived from a credit report, found on a credit report itself, or provided on an application for personal insurance. Information that is not credit-related shall not be considered "credit information," regardless of whether it is contained in a credit report or in an application or is used to calculate an insurance score.

"Credit report" means any written, oral, or other communication of information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, or credit capacity, that is used or expected to be used or collected in whole or in part for the purpose of serving as a factor to determine personal insurance premiums, eligibility for coverage, or tier placement.

"Department" means the Department of Insurance.

"Insurance score" means a number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of an individual applicant or insured.

(215 ILCS 157/20)

Sec. 20. Use of credit information.

(a) An insurer authorized to do business in this State that uses credit information to underwrite or rate risks shall not:

(1) Use an insurance score that is calculated using income, gender, address, ethnic group, religion, marital status, or nationality of the consumer as a factor.

(2) Deny, cancel, or nonrenew a policy of personal insurance solely on the basis of credit information, without consideration of any other applicable underwriting factor independent of credit information and not expressly prohibited by item (1). An insurer shall not be considered to have denied, cancelled, or nonrenewed a policy if coverage is available through an affiliate. If an insurer denies, cancels, or does not renew a policy of personal insurance based on credit information, it must provide the affected party with a notice as described in Section 35 of this Act and an opportunity for the affected party to explain its credit information under the procedures outlined in Section 22 of this Act.

(3) Base an insured's renewal rates for personal insurance solely upon credit information, without consideration of any other applicable factor independent of credit information. An insurer shall not be considered to have based rates solely on credit information if coverage is available in a different tier of the same insurer.

(4) Take an adverse action against a consumer solely because he or she does not have a credit card account, without consideration of any other applicable factor independent of credit information.

(5) Consider an absence of credit information or an inability to calculate an insurance score in underwriting or rating personal insurance, unless the insurer does one of the following:

(A) Treats the consumer as otherwise filed with the Department, if the insurer presents information that such an absence or inability relates to the risk for the insurer and submits a filing certification form signed by an officer for the insurer certifying that such treatment is actuarially justified.

(B) Treats the consumer as if the applicant or insured had neutral credit information, as defined by the insurer.

(C) Excludes the use of credit information as a factor and uses only other underwriting criteria.

(6) Take an adverse action against a consumer based on credit information, unless an insurer obtains and uses a credit report issued or an insurance score calculated within 90 days from the date the policy is first written or renewal is issued.

(7) (Blank).

(8) Use the following as a negative factor in any insurance scoring methodology or in reviewing credit information for the purpose of underwriting or rating a policy of personal insurance:

(A) Credit inquiries not initiated by the consumer or inquiries requested by the consumer for his or her own credit information.

(B) Inquiries relating to insurance coverage, if so identified on a consumer's credit report.

(C) Collection accounts with a medical industry code, if so identified on the consumer's credit report.

(D) Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within 30 days of one another, unless only one inquiry is considered.

(E) Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within 30 days of one another, unless only one inquiry is considered.

(b) An insurer authorized to do business in this State that uses credit information to underwrite or rate risks shall, at annual renewal upon the request of an insured or an insured's agent, re-underwrite and re-rate the insured's personal insurance policy based on a current credit report or insurance score unless one of the following applies:

(1) The insurer's treatment of the consumer is otherwise approved by the Department.

(2) The insured is in the most favorably priced tier of the insurer, within a group of affiliated insurers.

(3) Credit information was not used for underwriting or rating the insured when the personal insurance policy was initially written.

(4) The insurer reevaluates the insured at least every 36 months after a personal insurance policy is issued based on underwriting or rating factors other than credit information.

(5) The insurer has recalculated an insurance score or obtained an updated credit report of a consumer in the previous 12-month period.

An insurer that uses credit information to underwrite or rate risks may obtain current credit information upon the renewal of a personal insurance policy when renewal occurs more frequently than every 36 months if consistent with the insurer's underwriting guidelines.

(215 ILCS 157/22)

Sec. 22. Extraordinary life events.

(a) An insurer authorized to do business in this State that uses credit information to underwrite or rate risks shall review and consider an exception to the risk score based upon extraordinary life events after receiving a written and signed notification from the applicant or insured explaining how the applicant or insured believes the extraordinary life event adversely impacts the applicant's or insured's insurance risk score.

(b) For the purposes of this Section, "extraordinary life event" means the following:

(1) a catastrophic illness or injury to an applicant or insured or an immediate family member of an applicant or insured;

(2) the death of a spouse, child, or parent of an applicant or insured;

(3) involuntary loss of employment for a period of 3 months or more by an applicant or insured;

(4) identity theft of an applicant or insured; or

(5) dissolution of marriage of an applicant or insured.

(215 ILCS 157/25)

Sec. 25. Dispute resolution and error correction. If it is determined through the dispute resolution process set forth in the federal Fair Credit Reporting Act, 15 U.S.C. 1681i(a)(5), that the credit information of a current insured was incorrect or incomplete and if the insurer receives notice of that determination from either the consumer reporting agency or from the insured, the insurer shall re-underwrite and re-rate the consumer within 30 days after receiving the notice. After re-underwriting or re-rating the insured, the insurer shall make any adjustments necessary, consistent with its underwriting and rating guidelines. If an insurer determines that the insured has overpaid premium, the insurer shall refund to the insured the amount of overpayment calculated back to the shorter of either the last 12 months of coverage or the actual policy period.

(215 ILCS 157/30)

Sec. 30. Initial notification.

(a) If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or its agent shall disclose, either on the insurance application or at the time the insurance application is taken, that it may obtain credit information in connection with the application. The disclosure shall be either written or provided to an applicant in the same medium as the application for insurance. The insurer need not provide the disclosure statement required under this Section to any insured on a renewal policy, if the consumer has previously been provided a disclosure statement.

(b) Use of the following example disclosure statement constitutes compliance with this Section: "In connection with this application for insurance, we may review your credit report or obtain or use a credit-based insurance score based on the information contained in that credit report. We may use a third party in connection with the development of your insurance score.".

(215 ILCS 157/35)

Sec. 35. Adverse action notification. If an insurer takes an adverse action based upon credit information, the insurer must meet all of the notice requirements of this Section. The insurer shall:

(1) Provide notification to the consumer that an adverse action has been taken, in accordance with the requirements of the federal Fair Credit Reporting Act, 15 U.S.C. 1681m(a).

(2) Provide notification to the consumer explaining the reason for the adverse action. The reasons must be provided in sufficiently clear and specific language so that a person can identify the basis for the insurer's decision to take an adverse action. The notification shall include a description of up to 4 factors that were the primary influences

of the adverse action. The use of generalized terms such as "poor credit history", "poor credit rating", or "poor insurance score" does not meet the explanation requirements of this Section. Standardized credit explanations provided by consumer reporting agencies or other third party vendors are deemed to comply with this Section.

(215 ILCS 157/40)
Sec. 40. Filing.
(a) Insurers that use insurance scores to underwrite and rate risks must file their scoring models (or other scoring processes) with the Department. A third party may file scoring models on behalf of insurers. A filing that includes insurance scoring may include loss experience justifying the use of credit information.
(b) Any filing relating to credit information is considered to be a trade secret under the Illinois Trade Secrets Act.

(215 ILCS 157/45)
Sec. 45. Enforcement; rates not regulated.
(a) The Department shall enforce the provisions of this Act pursuant to the enforcement powers granted to it under the Illinois Insurance Code. The Department may promulgate rules necessary to enforce and administer this Act.
(b) Nothing contained in this Act shall be construed to empower the Department to regulate or set the rates of any insurer pursuant to this Act.

(215 ILCS 157/50)
Sec. 50. Sale of policy term information by consumer reporting agency.
(a) No consumer reporting agency shall provide or sell data or lists that include any information that in whole or in part was submitted in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. Such information includes, but is not limited to, the expiration dates of an insurance policy or any other information that may identify time periods during which a consumer's insurance may expire and the terms and conditions of the consumer's insurance coverage.
(b) The restrictions provided in subsection (a) of this Section do not apply to data or lists the consumer reporting agency supplies to the insurance agent or producer from whom information was received, the insurer on whose behalf the agent or producer acted, or the insurer's affiliates or holding companies.
(c) Nothing in this Section shall be construed to restrict any insurer from being able to obtain a claims history report or a motor vehicle report.

(215 ILCS 157/55)
Sec. 55. Severability. If any Section, paragraph, sentence, clause, phrase, or part of this Act is declared invalid due to an interpretation of or a future change in the federal Fair Credit Reporting Act, the remaining Sections, paragraphs, sentences, clauses, phrases, or parts thereof shall be in no manner affected thereby but shall remain in full force and effect.

(215 ILCS 157/95)
Sec. 95. The Illinois Insurance Code is amended by repealing Section 155.38.

(215 ILCS 157/99)
Sec. 99. Effective date. This Act takes effect on October 1, 2003.

CDIA
CONSUMER DATA INDUSTRY ASSOCIATION
Empowering Economic Opportunity

STATEMENT OF

STUART K. PRATT

CONSUMER DATA INDUSTRY ASSOCIATION

WASHINGTON DC

BEFORE THE

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

House of Representatives

ON

"Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010

Chairman Gutierrez, Ranking Member Hensarling and members of the committee, thank you for this opportunity to testify. For the record, my name is Stuart K. Pratt and I am president and CEO of the Consumer Data Industry Association.[1] In your letter of invitation, you have asked me to address particular issues and questions regarding the use of "credit scores and reports." Below you will find both some background on the Fair Credit Reporting Act and our responses to the Committee's letter.

Background – Fair Credit Reporting Act (*§* 15 U.S.C. 1681 *et seq.*)

When Congress enacted the original Fair Credit Reporting Act it created a law with a broad range of rights for consumer and which also limits the uses for which consumer reports may be used.[2] The law also regulates the actions of consumer reporting agencies which produce consumer reports, users of consumer reports and suppliers of data to consumer reporting agencies.[3] In both 1996 and again in 2003 the FCRA has been materially amended. It is an up-to-date and effective consumer protection statute enforced by the Federal Trade Commission, state attorneys general, consumers and federal bank agencies.

In drafting the FCRA, Congress recognized that there are many legitimate uses for

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[1] CDIA is an international trade association representing more than 220 of the nation's leading consumer data companies providing credit and mortgage reporting services, fraud prevention and risk-management technologies, identity management and verification tools, tenant and employment screening services, check fraud prevention and verification systems and collections services. CDIA's members' products are used more than 9 billion times a year.

[2] See Appendix I for the FTC's Consumer Rights Notice.

[3] See Appendix II for the FTC's description of the duties of users of consumer reports. Also, note that the FTC and federal bank agencies have issued new rules regarding the accuracy and integrity of the data supplied to consumer reporting agencies. These rules become effective in July of 2010.

consumer reports. Consumer reports of all types are designed to help end users to both identify risks and to manage these risks. Through the multiplicity of recent Congressional hearings regarding the leading causes of our economic crisis, it is clear that where risks are not identified and are not managed, the consequences are severe and unrelenting. Congress, when enacting the FCRA, was prescient in recognizing both that there are many types of data which can help assess risks and in recognizing that these data should be available for uses all across the U.S. economy. These decisions have stood the test of time and no country enjoys such a robust system of data used for risk management and ensuring fairness in the marketplace.

The permitted uses of consumer reports, called permissible purposes, are found in Section 604 of the Act. Below is the statutory language for Section 604(a) which enumerates purposes for which a consumer report may be provided by a consumer reporting agency:

§ 604. Permissible purposes of consumer reports *[15 U.S.C. § 1681b]*

(a) In general. Subject to subsection (c), any consumer reporting agency may furnish a consumer report under the following circumstances and no other:

(1) In response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury.
(2) In accordance with the written instructions of the consumer to whom it relates.
(3) To a person which it has reason to believe
(A) intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer; or
(B) intends to use the information for employment purposes; or
(C) intends to use the information in connection with the underwriting of insurance involving the consumer; or
(D) intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status; or
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(E) intends to use the information, as a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation; or
(F) otherwise has a legitimate business need for the information
(i) in connection with a business transaction that is initiated by the consumer; or
(ii) to review an account to determine whether the consumer continues to meet the terms of the account.
(4) In response to a request by the head of a State or local child support enforcement agency (or a State or local government official authorized by the head of such an agency), if the person making the request certifies to the consumer reporting agency that
(A) the consumer report is needed for the purpose of establishing an individual's capacity to make child support payments or determining the appropriate level of such payments;
(B) the paternity of the consumer for the child to which the obligation relates has been established or acknowledged by the consumer in accordance with State laws under which the obligation arises (if required by those laws);
(C) the person has provided at least 10 days' prior notice to the consumer whose report is requested, by certified or registered mail to the last known address of the consumer, that the report will be requested; and
(D) the consumer report will be kept confidential, will be used solely for a purpose described in subparagraph (A), and will not be used in connection with any other civil, administrative, or criminal proceeding, or for any other purpose.
(5) To an agency administering a State plan under Section 454 of the Social Security Act (42 U.S.C. § 654) for use to set an initial or modified child support award.

With this background in mind I will now respond to questions and requests outlined in the Committee's letter of invitation.

Committee Question 1 - Discuss ways that non-lenders may use credit information contained in an individual's consumer report under the FCRA to determine whether to do business with someone and how much to charge them.

Users of consumer reports are in the best position to respond to this request. As described above in the general background on the FCRA, there are multiple appropriate uses for consumer reports by non-lenders.

One type of non-lender business which uses consumer reports to manage risk is the insurance industry. This same hearing includes a panel which will cover the topic of credit scores developed for insurance underwriting and the use of credit histories, thus there is no need for me to duplicate the information provided by this panel.

There are many other U.S. businesses which must manage and price for risk. For example, landlords, utilities and telecommunications companies use data from various types of consumer reporting agencies in order to determine a consumer's ability and willingness to pay for services. In some cases the consumer report is used to price for risk and in some cases the data also contributes to a user's decision about whether or not an upfront deposit is necessary.

Detailed descriptions of precisely how the data is used, including the use of credit scores, would be best obtained from the users themselves.

Committee Question 2 - Discuss the use of consumer reports for employment purposes under FCRA and what impact, if any, this use may have on the ability of the unemployed to re-enter the workforce. Please review any legislative proposals on this matter, including H.R. 3149, the "Equal Employment for All Act."

Since the original enactment of the FCRA, Section 604(a)(3)(B) has permited the use of a consumer report for an employment purpose. In 1996, Section 604(b) was added and this section established new duties for users of consumer reports issued for an employment purpose. The FTC described these new duties as follows:

> *"If information from a CRA is used for employment purposes, the user has specific duties, which are set forth in Section 604(b) of the FCRA. The user must:*
>
> > *Make a clear and conspicuous written disclosure to the consumer before the report is obtained, in a document that consists solely of the disclosure, that a consumer report may be obtained.*
> >
> > *Obtain prior written authorization from the consumer.*
> >
> > *Certify to the CRA that the above steps have been followed, that the information being obtained will not be used in violation of any federal or state equal opportunity law or regulation, and that, if any adverse action is to be taken based on the consumer report, a copy of the report and a summary of the consumer's rights will be provided to the consumer.*
>
> *Before taking an adverse action, provide a copy of the report to the consumer as well as the summary of the consumer's rights. (The user should receive this summary from the CRA, because Section 604(b)(1)(B) of the FCRA requires CRAs to provide a copy of the summary with each consumer report obtained for employment purposes.) "*

With the above context in mind, and before I turn to the practice of using credit histories for employment purposes, let me first clarify that credit scores are not sold by our members for employment purposes. Below you will find a more fulsome discussion of our views regarding the use of credit histories by employers.

<u>Checking credit is done responsibly, and is not in and of itself a barrier to employment</u>

Employers may check credit history as part of a background check to help them determine whether a prospective employee is a possible risk to the financial health of a business or to their customers. Employers use credit checks as part of a background check very responsibly, and prohibiting their use in assessing employees makes employers, other employees and customers more vulnerable to fraud and identity theft.

Credit checks are only used in about 15% of all background checks, and when they are used they are used primarily for positions that have fiduciary and financial responsibility or for executive positions, or for positions that have access to confidential or proprietary information. Further, employers look for lawsuits, judgments and accounts in collection, NOT late payments (which, according to a study by the Society for Human Resource Management, did not even make the list of things employers consider).[4]

Finally, the vast majority of employers do not use credit as a "yes or no" proposition, but to provide prospective employees with the opportunity to explain their circumstances.

<u>When employers check credit, they review several years of history, not a "snap-shot" of the current situation</u>

When looking at credit as part of a background check, employers do not limit their examination to a recent "snap-shot" look at a person's credit, but in fact most tend to look at a 6-year window or longer.[5] This is significant, because it enables employers to see beyond possible short-term problems caused by this current climate of economic uncertainty, and it gives potential employees

[4] http://www.shrm.org/Research/SurveyFindings/Articles/Pages/BackgroundChecking.aspx
[5] http://www.shrm.org/Research/SurveyFindings/Articles/Pages/BackgroundChecking.aspx

the ability to demonstrate a long-term, stable payment history, and any difficulties caused by current conditions can be saved by many years of prior positive credit history.

Personal financial health can be an indictor of potential employee fraud

The Association of Certified Fraud Examiners (ACFE) reviewed occupational fraud between early-2006 and early-2008, and found that the top two red flag warnings exhibited by perpetrators leading up to the fraud were instances where the fraudster was living beyond his or her financial means (present in 39% of all cases, with a median loss of $250,000) or experiencing financial difficulties (present in 34% of all cases with a median loss of $111,000).[6]

That is not to say that all financial difficulties will or could lead to fraud; however, it is simply wrong for Congress to undercut fraud prevention by outlawing use of information that shows a correlation between past behavior and future fraud.

Checking credit of potential employees protects companies, particularly small businesses, from fraud.

Employee theft accounts for more than $15 billion annually, and companies lose a median of 5% of their annual revenue to employee fraud, which is expected to rise further.[7]

[6] http://www.acfe.com/documents/2008-rttn.pdf
[7] http://www.acfe.com/occupational-fraud/occupational-fraud.asp

Small businesses, in particular, are vulnerable to financial fraud. For example, according to the Association of Certified Fraud Examiners, the median loss suffered by organizations with fewer than 100 employees was $190,000 per incident. This was higher than the median loss in even the largest organizations. Small businesses have fewer internal controls on the back end once they have hired someone to control fraud if it occurs internally.

Committee Question 3 - Discuss what impact information on medical debt collections in an individual's consumer report can have on their creditworthiness. Please review any legislative proposals on this matter, including H.R. 3149, the "Equal Employment for All Act."

How medical debts are reported to nationwide consumer credit reporting agencies:

Medical services providers (e.g., hospitals, ambulance services, doctors) generally do not report data directly to consumer credit reporting agencies. Where a medical services provider's account with a patient is delinquent, it may choose to use a third-party collection agency to help with the recovery of the outstanding debt. Third-party debt collection agencies do typically report the accounts for which they are attempting to collect to a consumer credit reporting agency. By way of background, FCRA Sections 604(g), 605(a) and 623(a)(9) all ensure that the particulars of medical treatment information is not conveyed to a user of consumer reports.

Credit scores and medical debts:

The committee question regarding the impact of information regarding medical debt in an individual's consumer report is very difficult to answer and ultimately the impact is going to depend on the consumer's particular credit report. Further, as testimony from this committee's March 24, 2010 hearing indicated, lenders who use are ultimately the ones who determine what weights they want assigned to various factors, and some lenders may choose to count and weight different types of debts in different ways.

The difficulty in responding to the committee's question is compounded by the fact that there is no one credit score in the marketplace and users often design their own scores and always ultimately control their own underwriting outcomes. By way of background different scores may put different weights on different factors, including paid medical debt. For example, scores may be designed to predict risk relative to different types of products or to predict different credit behaviors. As a result of this, various scores, even ones designed by the same developer, may weight data in a consumer's credit file differently. While each score weights various data differently, each may be highly predictive of the future risk that they are seeking to predict.

Building on the previous points, one score developer may develop a score that does not consider any third-party collection agency accounts at all, but another credit score may consider third-party collection agency accounts to be highly predictive. Another credit score may not consider third-party collection agency accounts that are medically-related, but does consider all other third-party collection agency accounts as important and predictive.[8] In any of the scenarios just discussed, score developers may also conclude that the predictive strength of a given data element, such as a third-party medical collection account, may become less predictive of future risk as a factor of time, but the rate of decline in the predictive strength of the data element may vary between scores. As stated above, even a single score developer may reach any of the previous conclusions depending on what type of risk behavior the score is designed to predict or the product for which the score is designed, etc.

As the above discussion suggests, credit score developers and ultimately lenders which underwrite the loan are not monolithic in their use of data and data that was not important in the past may be found to be important going forward. Lenders, for example, update their credit scorecards over time and may, after running additional tests, determine that previously unused data may now be highly predictive. Thus a lender scorecard may change incrementally over time, and consider different data as a result of testing, in order to ensure that it remains predictive.

In other words, in some types of lending decisions, lenders may disregard paid medical debt, but in others lenders may find that it is highly predictive, and eliminating access to that data across the board could have a serious detrimental effect on lending decisions. The impact of making decisions less predictive through the removal of accurate data is significant – it will reduce credit availability and increase cost for consumers.

[8] For example, as the testimony from the hearing demonstrated, "VantageScore does not factor medical debt into the calculation of a consumer's VantageScore credit score."
http://www.house.gov/apps/list/hearing/financialsvcs_dem/burns_testimony.pdf

It is because of the discussion above that CDIA continues to urge extreme caution in changing the current standard for the deletion of accurate but adverse information contained in a consumer's credit report file.

Conclusion

In conclusion it is our view that:

- The FCRA has been the focus of extensive oversight by the Congress. It has been materially amended. This is a law that is both current and effective.
- The uses of consumer reports have been regularly included in Congress' review of the FCRA. These uses are fair and consumers are protected by the FCRA.
- Users of consumer reports are regulated by other laws and regulations that protect consumers such as the Equal Credit Opportunity Act or the Equal Employment Opportunity Commission guidelines and application of the Civil Rights Act. How a consumer report is used to manage risk is always dictated by the laws that govern the users themselves. Laws such as the ones discussed above, ensure outcomes are fair, just as the FCRA ensures that the uses of data are fair.
- Requiring the removal of any accurate and predictive data is the wrong policy outcome. Our members' systems are used to help businesses manage risk and we can ill afford to take away data which can inform a user's decisions. There is no doubt that we all want a fair marketplace in which to do business, and part of ensuring this fairness is to ensure that risks are being identified and managed.

- Ultimately without a full inquiry into the user's views regarding removal of accurate data, it would be premature to change current law and further restrict the flow of data for risk management. Consumer reporting agency databases are designed for a wide range of permitted uses, and while one particular industry sector may not use a particular data type, another may consider the presence of such data to be essential to their risk management process. It is best to preserve the data in the system and to allow users to determine which data is most important to them, product by product, industry by industry.

I hope the above information has been responsive and I thank you again for this opportunity to testify.

Appendix I

FTC Summary of Consumer Rights – Fair Credit Reporting Act

A Summary of Your Rights Under the Fair Credit Reporting Act
The federal Fair Credit Reporting Act (FCRA) promotes the accuracy, fairness, and privacy of
information in the files of consumer reporting agencies. There are many types of consumer reporting
agencies, including credit bureaus and specialty agencies (such as agencies that sell information about
check writing histories, medical records, and rental history records). Here is a summary of your major
rights under the FCRA. **For more information, including information about additional rights, go
to www.ftc.gov/credit or write to: Consumer Response Center, Room 130-A, Federal Trade
Commission, 600 Pennsylvania Ave. N.W., Washington, D.C. 20580.**

C **You must be told if information in your file has been used against you.** Anyone who uses
a credit report or another type of consumer report to deny your application for credit,
insurance, or employment – or to take another adverse action against you – must tell you, and
must give you the name, address, and phone number of the agency that provided the information.

C **You have the right to know what is in your file.** You may request and obtain all the information about you in the files of a consumer reporting agency (your "file disclosure").
You will be required to provide proper identification, which may include your Social Security
number. In many cases, the disclosure will be free. You are entitled to a free file disclosure if:

C a person has taken adverse action against you because of information in your credit report;

C you are the victim of identify theft and place a fraud alert in your file;

C your file contains inaccurate information as a result of fraud;

C you are on public assistance;

C you are unemployed but expect to apply for employment within 60 days.

In addition, by September 2005 all consumers will be entitled to one free disclosure every 12
months upon request from each nationwide credit bureau and from nationwide specialty
consumer reporting agencies. See www.ftc.gov/credit for additional information.

C **You have the right to ask for a credit score.** Credit scores are numerical summaries of your
credit-worthiness based on information from credit bureaus. You may request a credit score

from consumer reporting agencies that create scores or distribute scores used in residential real
property loans, but you will have to pay for it. In some mortgage transactions, you will receive
credit score information for free from the mortgage lender.

C **You have the right to dispute incomplete or inaccurate information.** If you identify information in your file that is incomplete or inaccurate, and report it to the consumer reporting
agency, the agency must investigate unless your dispute is frivolous. See www.ftc.gov/credit
for an explanation of dispute procedures.

C **Consumer reporting agencies must correct or delete inaccurate, incomplete, or unverifiable information.** Inaccurate, incomplete or unverifiable information must be removed or corrected, usually within 30 days. However, a consumer reporting agency may
continue to report information it has verified as accurate.

C **Consumer reporting agencies may not report outdated negative information.** In most
cases, a consumer reporting agency may not report negative information that is more than seven years old, or bankruptcies that are more than 10 years old.

C **Access to your file is limited.** A consumer reporting agency may provide information about
you only to people with a valid need -- usually to consider an application with a creditor, insurer, employer, landlord, or other business. The FCRA specifies those with a valid need for
access.

C **You must give your consent for reports to be provided to employers.** A consumer reporting agency may not give out information about you to your employer, or a potential employer, without your written consent given to the employer. Written consent generally is
not required in the trucking industry. For more information, go to www.ftc.gov/credit.

C **You may limit "prescreened" offers of credit and insurance you get based on information
in your credit report.** Unsolicited "prescreened" offers for credit and insurance must include
a toll-free phone number you can call if you choose to remove your name and address from the
lists these offers are based on. You may opt-out with the nationwide credit bureaus at 1-888-5-OPTOUT (1-888-567-8688).

C **You may seek damages from violators.** If a consumer reporting agency, or, in some cases, a
user of consumer reports or a furnisher of information to a consumer reporting agency violates
the FCRA, you may be able to sue in state or federal court.

C **Identity theft victims and active duty military personnel have additional rights.** For more information, visit www.ftc.gov/credit.

States may enforce the FCRA, and many states have their own consumer reporting laws. In
some cases, you may have more rights under state law. For more information, contact your
state or local consumer protection agency or your state Attorney General. Federal enforcers
are:

TYPE OF BUSINESS: CONTACT:

Consumer reporting agencies, creditors and others not listed below Federal Trade Commission: Consumer Response Center - FCRA
Washington, DC 20580 1-877-382-4357
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 Consumer Help (FRCH)
P O Box 1200
Minneapolis, MN 55480
Telephone: 888-851-1920
Website Address: www.federalreserveconsumerhelp.gov
Email Address: ConsumerHelp@FederalReserve.gov
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 Complaints
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 703-519-4600
State-chartered banks that are not members of the Federal Reserve System
Federal Deposit Insurance Corporation
Consumer Response Center, 2345 Grand Avenue, Suite 100
Kansas City, Missouri 64108-2638 1-877-275-3342
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

Appendix II

NOTICE TO USERS OF CONSUMER REPORTS: OBLIGATIONS OF USERS UNDER THE FCRA

The federal Fair Credit Reporting Act (FCRA) requires that this notice be provided to inform users of consumer reports of their legal obligations. State law may impose additional requirements. This first section of this summary sets forth the responsibilities imposed by the FCRA on all users of consumer reports. The subsequent sections discuss the duties of users of reports that contain specific types of information, or that are used for certain purposes, and the legal consequences of violations. The FCRA, 15 U.S.C. 1681-1681u, is set forth in full at the Federal Trade Commission's Internet web site (*http://www.ftc.gov*).

I. OBLIGATIONS OF ALL USERS OF CONSUMER REPORTS

A. Users Must Have a Permissible Purpose

Congress has limited the use of consumer reports to protect consumers' privacy. All users must have a permissible purpose under the FCRA to obtain a consumer report. Section 604 of the FCRA contains a list of the permissible purposes under the law. These are:

- As ordered by a court or a federal grand jury subpoena. *Section 604(a)(1)*
- As instructed by the consumer in writing. *Section 604(a)(2)*
- For the extension of credit as a result of an application from a consumer, or the review or collection of a consumer's account. *Section 604(a)(3)(A)*
- For employment purposes, including hiring and promotion decisions, where the consumer has given written permission. *Sections 604(a)(3)(B) and 604(b)*
- For the underwriting of insurance as a result of an application from a consumer. *Section 604(a)(3)(C)*
- When there is a legitimate business need, in connection with a business transaction that is initiated by the consumer. *Section 604(a)(3)(F)(i)*
- To review a consumer's account to determine whether the consumer continues to meet the terms of the account. *Section 604(a)(3)(F)(ii)*
- To determine a consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status. *Section 604(a)(3)(D)*

- For use by a potential investor or servicer, or current insurer, in a valuation or assessment of the credit or prepayment risks associated with an existing credit obligation. *Section 604(a)(3)(E)*

- For use by state and local officials in connection with the determination of child support payments, or modifications and enforcement thereof. *Sections 604(a)(4) and 604(a)(5)*

In addition, creditors and insurers may obtain certain consumer report information for the purpose of making unsolicited offers of credit or insurance. The particular obligations of users of this "prescreened" information are described in Section V below.

B. <u>Users Must Provide Certifications</u>

Section 604(f) of the FCRA prohibits any person from obtaining a consumer report from a consumer reporting agency (CRA) unless the person has certified to the CRA (by a general or specific certification, as appropriate) the permissible purpose(s) for which the report is being obtained and certifies that the report will not be used for any other purpose.

C. <u>Users Must Notify Consumers When Adverse Actions Are Taken</u>

The term "adverse action" is defined very broadly by Section 603 of the FCRA. "Adverse actions" include all business, credit, and employment actions affecting consumers that can be considered to have a negative impact -- such as unfavorably changing credit or contract terms or conditions, denying or canceling credit or insurance, offering credit on less favorable terms than requested, or denying employment or promotion.

1. Adverse Actions Based on Information Obtained From a CRA

If a user takes any type of adverse action that is based at least in part on information contained in a consumer report, the user is required by Section 615(a) of the FCRA to notify the consumer. The notification may be done in writing, orally, or by electronic means. It must include the following:

> The name, address, and telephone number of the CRA (including a toll-free telephone number, if it is a nationwide CRA) that provided the report.
>
> A statement that the CRA did not make the adverse decision and is not able to explain why the decision was made.
>
> A statement setting forth the consumer's right to obtain a free disclosure of the consumer's file from the CRA if the consumer requests the report within 60 days.
>
> A statement setting forth the consumer's right to dispute directly with the CRA the accuracy or completeness of any information provided by the CRA.

2. Adverse Actions Based on Information Obtained From Third Parties Who Are Not Consumer Reporting Agencies

If a person denies (or increases the charge for) credit for personal, family, or household purposes based either wholly or partly upon information from a person other than a CRA, and the information is the type of consumer information covered by the FCRA, Section 615(b)(1) of the FCRA requires that the user clearly and accurately disclose to the consumer his or her right to obtain disclosure of the nature of the information that was relied upon by making a written request within 60 days of notification. The user must provide the disclosure within a reasonable period of time following the consumer's written request.

3. Adverse Actions Based on Information Obtained From Affiliates

If a person takes an adverse action involving insurance, employment, or a credit transaction initiated by the consumer, based on information of the type covered by the FCRA, and this information was obtained from an entity affiliated with the user of the information by common ownership or control, Section 615(b)(2) requires the user to notify the consumer of the adverse action. The notification must inform the consumer that he or she may obtain a disclosure of the nature of the information relied upon by making a written request within 60 days of receiving the adverse action notice. If the consumer makes such a request, the user must disclose the nature of the information not later than 30 days after receiving the request. (Information that is obtained directly from an affiliated entity relating solely to its transactions or experiences with the consumer, and information from a consumer report obtained from an affiliate are not covered by Section 615(b)(2).)

II. OBLIGATIONS OF USERS WHEN CONSUMER REPORTS ARE OBTAINED FOR EMPLOYMENT PURPOSES

If information from a CRA is used for employment purposes, the user has specific duties, which are set forth in Section 604(b) of the FCRA. The user must:

> Make a clear and conspicuous written disclosure to the consumer before the report is obtained, in a document that consists solely of the disclosure, that a consumer report may be obtained.
>
> Obtain prior written authorization from the consumer.
>
> Certify to the CRA that the above steps have been followed, that the information being obtained will not be used in violation of any federal or state equal opportunity law or regulation, and that, if any adverse action is to be taken based on the consumer report, a copy of the report and a summary of the consumer's rights will be provided to the consumer.

Before taking an adverse action, provide a copy of the report to the consumer as well as the summary of the consumer's rights. (The user should receive this summary from the CRA, because Section 604(b)(1)(B) of the FCRA requires CRAs to provide a copy of the summary with each consumer report obtained for employment purposes.)

III. OBLIGATIONS OF USERS OF INVESTIGATIVE CONSUMER REPORTS

Investigative consumer reports are a special type of consumer report in which information about a consumer's character, general reputation, personal characteristics, and mode of living is obtained through personal interviews. Consumers who are the subjects of such reports are given special rights under the FCRA. If a user intends to obtain an investigative consumer report, Section 606 of the FCRA requires the following:

> The user must disclose to the consumer that an investigative consumer report may be obtained. This must be done in a written disclosure that is mailed, or otherwise delivered, to the consumer not later than three days after the date on which the report was first requested. The disclosure must include a statement informing the consumer of his or her right to request additional disclosures of the nature and scope of the investigation as described below, and must include the summary of consumer rights required by Section 609 of the FCRA. (The user should be able to obtain a copy of the notice of consumer rights from the CRA that provided the consumer report.)
>
> The user must certify to the CRA that the disclosures set forth above have been made and that the user will make the disclosure described below.
>
> Upon the written request of a consumer made within a reasonable period of time after the disclosures required above, the user must make a complete disclosure of the nature and scope of the investigation that was requested. This must be made in a written statement that is mailed, or otherwise delivered, to the consumer no later than five days after the date on which the request was received from the consumer or the report was first requested, whichever is later in time.

IV. OBLIGATIONS OF USERS OF CONSUMER REPORTS CONTAINING MEDICAL INFORMATION

Section 604(g) of the FCRA prohibits consumer reporting agencies from providing consumer reports that contain medical information for employment purposes, or in connection with credit or insurance transactions, without the specific prior consent of the consumer who is the subject of the report. In the case of medical information being sought for employment purposes, the consumer must explicitly consent to the release of the medical information in addition to authorizing the obtaining of a consumer report generally.

V. OBLIGATIONS OF USERS OF "PRESCREENED" LISTS

The FCRA permits creditors and insurers to obtain limited consumer report information for use in connection with unsolicited offers of credit or insurance under certain circumstances. *Sections 603(l), 604(c), 604(e), and 615(d)* This practice is known as "prescreening" and typically involves obtaining a list of consumers from a CRA who meet certain preestablished criteria. If any person intends to use prescreened lists, that person must (1) before the offer is made, establish the criteria that will be relied upon to make the offer and to grant credit or insurance, and (2) maintain such criteria on file for a three-year period beginning on the date on which the offer is made to each consumer. In addition, any user must provide with each written solicitation a clear and conspicuous statement that:

> Information contained in a consumer's CRA file was used in connection with the transaction.
>
> The consumer received the offer because he or she satisfied the criteria for credit worthiness or insurability used to screen for the offer.
>
> Credit or insurance may not be extended if, after the consumer responds, it is determined that the consumer does not meet the criteria used for screening or any applicable criteria bearing on credit worthiness or insurability, or the consumer does not furnish required collateral.

The consumer may prohibit the use of information in his or her file in connection with future prescreened offers of credit or insurance by contacting the notification system established by the CRA that provided the report. This statement must include the address and toll-free telephone number of the appropriate notification system.

VI. OBLIGATIONS OF RESELLERS

Section 607(e) of the FCRA requires any person who obtains a consumer report for resale to take the following steps:

> Disclose the identity of the end-user to the source CRA.
>
> Identify to the source CRA each permissible purpose for which the report will be furnished to the end-user.
>
> Establish and follow reasonable procedures to ensure that reports are resold only for permissible purposes, including procedures to obtain:

(1) the identity of all end-users;

(2) certifications from all users of each purpose for which reports will be used; and

(3) certifications that reports will not be used for any purpose other than the purpose(s) specified to the reseller. Resellers must make reasonable efforts to verify this information before selling the report.

VII. LIABILITY FOR VIOLATIONS OF THE FCRA

Failure to comply with the FCRA can result in state or federal enforcement actions, as well as private lawsuits. *Sections 616, 617, and 621.* In addition, any person who knowingly and willfully obtains a consumer report under false pretenses may face criminal prosecution. *Section 619*

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STATEMENT OF

MARK RUKAVINA

THE ACCESS PROJECT

WASHINGTON, D.C.

BEFORE THE

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

House of Representatives

ON

"Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010

I appreciate the opportunity to speak before this committee today, thank you. My name is Mark Rukavina, and I am the executive director of The Access Project. I will focus my comments on issues related to medical debt and the use of medical accounts in assessing an individual's creditworthiness.

The Access Project is a national resource center that conducts research and provides policy analysis to local organizations seeking to improve access to health care. Since our inception in 1998, The Access Project has worked in partnership with the Heller School at Brandeis University in Massachusetts. In our work we have undertaken numerous research and policy analysis projects and have produced reports on subjects relating to health care access barriers.

One of the barriers uncovered by our work is that of medical debt. Medical debt is money owed for any type of medical service or product. The money may be owed directly to the provider of the service or to an agent of the provider, such as a collection agency. The Access Project's work has documented and examined the problem of medical debt and its consequences. Through our research, and that of others, we have learned that the problem is widespread and that it has diverse consequences.

Prevalence of Medical Debt

During calendar year 2007, the most recent year for which data are available, 72 million (41%) non-elderly Americans adults reported medical bill problems or had medical debt or bills they were paying off over time. The medical bill problems afflicting people included experiencing times when they had difficulty or were unable to pay bills, being contacted by a collection agency for unpaid bills, or significantly changing their lives in order to pay medical bills. Forty-nine million American adults under the age of 65 (28%), and an additional 7 million elderly adults (19%) had medical debt or bills they were paying off over time. Nearly two-thirds of those with medical debt had insurance at the time that care was provided.[1] Each year, millions of Americans who experience medical billing problems go on to then experience credit problems. In 2007, 28 million working age adults were contacted by collection agencies for unpaid medical bills.[2]

Unpaid Medical Bills and Third Party Payment

In America, affordable health care has been elusive. The problem of unaffordable healthcare bills has stung uninsured and insured Americans alike. Americans who are uninsured, even for a part of the year, report higher rates of medical debt than those with insurance. It is expected that this problem will be addressed once the Patient Protection and Affordable Care Act is fully implemented and the number of uninsured Americans decreases dramatically.

However, simply having insurance is not enough. Insured individuals with inadequate coverage experience medical bill problems or medical debt at more than twice the rate for those with comprehensive insurance coverage.[3] Nearly half of the people contacted by collection agencies for unpaid medical bills were insured with no gaps in coverage. More than one-quarter (28%) of insured Americans said their doctor charged more than what their insurance carrier would pay for the procedure. One-third (34%) of all those with insurance reported that they had to contact their insurance company because the insurer did not pay a bill promptly or had denied payment for a claim.[4]

For Americans with health insurance coverage, confusion reigns supreme. One study of consumers nationwide found that nearly 40 percent of Americans did not understand their medical bills or explanation of benefits statements. They did not know what services they were paying for, the amount they owed, or if that amount was correct. Nearly one-third (31 %) of respondents let a medical bill go to a collection agency in the previous year. One in six (16%) did not understand the description of procedures they received yet most rarely or never contacted their providers to ask questions or get clarification on a bill. A similar number (17 %) did not know whether they should pay the provider or insurance company.[5]

Many insured people are surprised when they receive calls from collection agencies seeking payment on a medical bill. However, each and every day, millions of patients in the U.S. sign release and consent forms with language similar to the following: *I understand that my insurance company may not pay 100% of the amount of the medical claim and I may be responsible for any and all amounts not payable by my insurance company.* Across the nation, when claims are not paid promptly, they are sent to collection. The question for today's hearing is whether medical accounts are of predictive value when assessing an individual's creditworthiness.

Reporting Medical Debt

The confusion regarding medical bills carries over to credit reports. Many people mistakenly believe that unpaid medical bills have no influence over one's credit score. This lack of clarity may stem from statements that have been made by representatives from credit reporting and credit scoring agencies. For example, in recent testimony before this Committee, a representative from VantageScore made the following statement: "VantageScore does not factor medical debt into the calculation of a consumer's VantageScore credit score."[6] A representative from TransUnion, at the same hearing said, "We share the view of many that the medical payments system in our country has much room for improvement. We also acknowledge the fact that some scoring models, such as *VantageScore* and our own insurance scoring model do not consider paid medical collections, ...[7]

A letter from VantageScore sent after the Committee hearing clarifies that "The VantageScore algorithm does not utilize medical payment data in generating consumer scores, when the reporting comes directly from the medical provider." The letter than continues saying that "the VantageScore algorithm does include all collections trades when generating a score, including third-party collections activities related to medical debt."[8]

According to the representatives of the credit reporting agencies, hospitals, doctors and medical providers rarely report payment information to the credit bureaus. "Accounts reported by medical businesses account for only .07 percent of our data," according to

Maxine Sweet, Experian's vice president of public education. TransUnion spokesman Steven Katz said "These types of debts are not typically reported unless they become delinquent and are assigned to collections."[9] Once assigned to collection, whether the result of an inefficient healthcare billing systems or a patient's unwillingness to pay, the account will be considered a major derogatory account.

The current credit reporting system serves to penalize people with medical debt. If a bill is owed directly to a healthcare provider and paid off in a timely manner, it is not reflected in most score algorithms since few healthcare providers report to the consumer reporting agencies. If, for any reason, it is turned over to a collection agency, it is reported as a derogatory account. Even when the consumer takes the proper action of paying off the medical bill, it tarnishes their report and consumer reporting agencies may include it on a credit report for up to seven years in spite of having a balance due of zero.[10]

The Predictive Value of Medical Accounts

The predictive value of medical accounts on credit reports has been questioned by some working in financial services.[11] Given the unpredictable and an atypical nature of medical debt, many lenders disregard it when reviewing loan applications. "Our experience has been that medical debt isn't generally reflective of a borrower's ability or willingness to repay," said public-policy director David Beck of Self Help of Durham, N.C.[12]

Many lenders have discovered that disregarding medical debt often gives a better picture of a potential borrower's creditworthiness. Some have found that if other accounts are current, a medical debt or outstanding medical bill is not a good predictor of creditworthiness.

According to a study on credit report accuracy published in the Federal Reserve Bulletin, nearly one-third of Americans with a credit file have a record of a collection account on their credit report. The study found that more than half of accounts in collection are medical accounts. It reported that *"some credit evaluators report that they remove collection accounts related to medical services from credit evaluations because such accounts often involve disputes with insurance companies over liability for the accounts or because the accounts may not indicate future performance on loans."* By using a simulation to correct potential data errors, the researchers found that nearly 80% of those with medical collection data would have experienced an increase in scores if these accounts were not factors in the scoring algorithm.[13]

It is estimated that during calendar year 2008, Americans spent $277 billion on out-of-pocket health care expenses. This is over and above the cost of insurance premiums. No doubt, a portion of this amount was used to pay off medical bills inappropriately sent to collection. Analysis of collection accounts done several years ago found that 85% of medical accounts in collection originally had balances due amounting to $500 or less.[14] Accounts with small balances due that are sent to collection have a disproportionate effect on a credit score. It is inappropriate to factor into a score algorithm medical accounts that were sent to collection as result of a lengthy insurance claim adjudication process or confusion due to numerous bills being generated from one visit to a hospital. Such erroneous data harm consumers. These accounts, even when promptly paid off, remain on a credit report as derogatory accounts.

Based on direct service work done through The Access Project's Medical Debt Resolution Program, we believe that credit scores are wrongly lowered by medical accounts on credit reports with a balance due of zero. Some of our clients qualify for a provider's charity care policy but learn that they qualify for free care after the account was sent to collection and included on their credit report. For other clients who have done the right thing and paid their bills in full, they are surprised that such action continues to plague them and pegs them as credit risks. Such inaccuracies in credit reports slow America's economic recovery.

A mortgage originator in Texas, Rodney Anderson of Supreme Lending, has seen the detrimental effects of these errors firsthand. He was frustrated as he observed clients who were looking to purchase or refinance homes but were deemed risky because of medical accounts on their credit reports. Ironically, Mr. Anderson found that for a number of his clients, these medical accounts were paid in full. Because they had been sent to collection – though subsequently paid in full – his client's credit scores were lowered.

Using the services of a credit score simulation service, Mr. Anderson re-ran scores for clients after removing zero-balance medical accounts. The credit scores of some of his clients increased by 50 to 100 points after being recalculated by the simulation service. What he found exposed an injustice with the current credit scoring algorithm. He showed that medical accounts on credit reports can destroy credit even after being paid in full. This is simply wrong.

Recommendations

The widespread problem of medical debt places the people who experience it at a disadvantage in the health care and financial service arenas. Representative Mary Jo Kilroy has introduced HR3421 to address this problem. This legislation would correct what we perceive as errors on people's credit reports. Specifically, HR3421 would require that medical accounts that have been fully paid or settled be removed from a credit report within a specified timeframe. This would put an end to the practice of penalizing hardworking Americans who have had medical bills sent to collection but then pay them off in full.

On behalf of the estimated 31 million Americans who have collection accounts associated with medical bills on their credit reports, thank you for the opportunity to testify today.

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[1]S. Collins et al, *Losing Ground: How the Loss of Adequate Health Insurance Is Burdening Working Families*, Commonwealth Fund, August 2008.

[2] Ibid.

[3] M. M. Doty et al, *Seeing Red: The Growing Burden of Medical Bills and Debt Faced by U.S. Families*, The Commonwealth Fund, August 2008.

[4] Collins, *Losing Ground.*

[5]http://about.intuit.com/about_intuit/press_room/press_release/articles/2010/AmericansConfusedAboutMedicalStatements.html.

[6] Barrett Burns, President and Chief Executive Officer, VantageScore Solutions, LLC, Testimony before the Subcommittee on Financial Institutions & Consumer Credit Committee on Financial Services United States House of Representatives, Hearing on "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and Their Impact on Consumers" March 24, 2010.

[7] Chet Wiermanski,, Global Chief Scientist, Analytic and Decision Systems, TransUnion LLC, Testimony before the Subcommittee on Financial Institutions & Consumer Credit Committee on Financial Services United States House of Representatives, Hearing on "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and Their Impact on Consumers" March 24, 2010.

[8] Letter from Barrett Burns, President and Chief Executive Officer, VantageScore Solutions, LLC, to Rep Mary Jo Kilroy, May 3, 2010.

[9] C. Prater, *15 Tips For Paying High Medical Bills Negotiate Before Using Credit Cards To Finance Medical Expenses*, CreditCards.com (http://www.creditcards.com/credit-card-news/medical-bill-payment-tips-1266.php.)

[10]The Fair Credit Reporting Act at www.ftc.gov/os/statutes/fcradoc.pdf.

[11] R. Seifert, *Home Sick: How Medical Debt Undermines Housing Security*, The Access Project, 2005. (See page 22 – "Fair Isaac and Company (FICO), a major credit scoring organization, considers medical debt to be "atypical and non-predictive" of overall credit worthiness.")

[12]http://articles.moneycentral.msn.com/Banking/YourCreditRating/WhyMedicalDebtsShouldntCount.aspx?page=2.

[13] R. Avery et al, *Credit Report Accuracy and Access to Credit*, Federal Reserve Bulletin, Summer 2004.

[14] R. Avery et al, *An Overview of Consumer Data and Credit Reporting*, Federal Reserve Bulletin, Summer 2003.

United States House of Representatives

Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on "Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010

Testimony of David F. Snyder, Vice President and Associate General Counsel
American Insurance Association

United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on "Use of Credit Information Beyond Lending: Issues and Reform Proposals"

May 12, 2010

Testimony of David F. Snyder, Vice President and Associate General Counsel
American Insurance Association

Thank you, Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee. My name is Dave Snyder. I am Vice President and Associate General Counsel of the American Insurance Association, a national trade association whose property and casualty insurance company members write business, including personal automobile and homeowners insurance, in every U.S. jurisdiction and throughout the world. Our members range from large multinational insurers writing in dozens of countries to smaller insurers writing in a few states.

The Personal Lines Insurance Market Is Financially Sound, Competitive And Stable, Partly As A Result of Credit Based Insurance Scoring.

The personal lines insurance market is functioning well by every measure, including the especially important attributes of affordability and availability. This good performance in the 2000s through today corresponds with the widespread use of credit-based insurance scoring ("insurance scoring"). An estimated 90% of personal lines insurers now employ insurance scoring, usually a combination of credit and other risk related information, such as prior accidents and violations and make and model of vehicle for auto insurance and prior losses and proximity to a fire station for homeowners insurance. These scores are used for risk assessment and pricing, through underwriting and rating, subject to applicable law.

Insurance scoring has contributed to favorable personal lines markets in several ways. First, it provides an objective, cost effective risk measurement tool that adds to the predictive power of other factors. Insurance scoring consistently
ranked among the top two or three most important risk factors for all components of auto insurance coverage – bodily injury liability, personal injury protection, medical payments, property damage liability, collision and comprehensive – according to the June 2003 EPIC Actuaries comprehensive analysis of 2.7 million auto insurance policies. Second, by providing a comparative and quantitative measure for each risk, it has allowed insurers to move toward pricing which is much more tailored to individual risk, replacing the old system that relied exclusively on large group classifications, such as geographic territory or age. Third, it has encouraged insurers to write more coverage because they have more confidence that they are able to accurately predict and price

for all levels of risk. Fourth, insurance scoring has supported pricing systems in which the majority of people pay less.

Auto Insurance

Auto insurance is comparatively affordable, actually costing 17.4% less in 2007 as a percentage of median family income than it did in 1993 (1.10% versus 1.41%). Over the time period from 1995-2009, the average cost of auto insurance increased less than gasoline, vehicle maintenance and repair, and motor vehicle body work. In addition, insurers' profits for this line of business are very modest: an average underwriting loss of .7% from 1999-2008 and an average 7.5% return on net worth, according to NAIC data.

Auto insurance is also readily available. A good measure of availability is the number of cars written in residual markets, state mandated insurance pools, for people unable to purchase insurance in the voluntary market. These pools are at or near historic lows, insuring just 1.11% of the total personal auto market. The residual market as a percentage of the total market declined by 72.28%, from 1994-2006. In addition, the percentage of people estimated to be uninsured has dropped from 16.3% in 1989 to 13.8% in 2007. A commonly used measure of concentration, the Herfindahl-Hirschman Index (HHI), yields a score of 333, meaning the auto insurance market is not concentrated. This is an indicator of the competitiveness of the market.

Homeowners Insurance

Homeowners insurance is also comparatively affordable -- its increase in the Producer Price Index from 2000-2009 was 17.2%, which was lower than housing (28%), housing rentals (35.3%), electricity (50%), and energy (55%). Insurers lost an average 3.4% from 1999-2008 and had an average return on net worth of 4.6% for their homeowners business, according to the NAIC.

Homeowners insurance is also comparatively available. In most states, the residual market is less than 1% of the total market. Only five states have residual markets of more than 3%. And the HHI of 386 for homeowners insurance also indicates a very competitive market.

Insurance Scoring Has Been Heavily Studied. These Studies Validate The Predictive Nature Of The Tool And Its Value To The Market.

Few insurance issues have received more scrutiny or been more thoroughly studied by federal and state government, the private sector and academia, than insurance scoring. Attachment 1 to this statement provides some highlights from these studies. In general, they demonstrate that insurance scoring adds to the accuracy of risk prediction, does not use information such as race or religion, and has benefited the market.

Consistent with these other studies, the Federal Trade Commission (FTC) study of auto insurance concluded that: insurance scoring has strong predictive value and has helped the market; impermissible factors are not used; there is not a readily available substitute; and the majority of policyholders pay less (59%) as a result of it use.

Insurers have and continue to fully cooperate in all of the government studies and provided both extensive data and actuarial expertise as requested by the FTC for its auto study. And, the nine insurers served with formal requests from the FTC for data in connection with the on-going homeowners study, have provided millions of records for the FTC's analysis, without contest.

Insurance Scoring Is Subject To Extensive Federal And State Oversight And Regulation.

The federal Fair Credit Reporting Act, as amended, expressly allows insurers to use credit information. That use, however, is subject to many federal regulatory provisions, including that adverse action notices be provided as required by law. In addition, the sources of credit information insurers use are heavily regulated.

States have general, long-standing regulatory provisions that apply to insurance scoring. For example, virtually every state requires that rates not be "excessive, inadequate or unfairly discriminatory" and states have anti-discrimination provisions banning actions based on race, religion or national origin. To assure compliance with these laws, many states require the filing of rates, have the authority to approve them in advance or to disapprove them after a review, have nearly unlimited access to information and have at their disposal a full range of penalties.

States have added specific laws relating to insurance scoring to their pre-existing insurance statutes and regulations. Generally, the new laws follow the National Conference of Insurance legislators (NCOIL) model law which requires upfront disclosures and more detailed adverse action notices, prohibits the use of certain information, requires prompt remedy in case of incorrect information and prohibits sole basis use. The NCOIL model and state laws based on it, usually apply to new business and renewals and assure full access by regulators to all aspects of insurance scoring. See Attachment 2 for the NCOIL model law.

Recently, the NCOIL model has been amended to provide for exceptions based on extraordinary life circumstances in order to address some particular scenarios recently highlighted in state hearings. This change is consistent with the basic approach of the states to allow insurance scoring, while focusing on consumer protections.

As previously indicated, the personal lines insurance market is highly competitive with stable rates and wide availability of products. To the best of our knowledge, insurance scoring complaints continue to be a tiny fraction of personal lines transactions, even in the context of adverse action notices and mandatory disclosures.

Specific Issues Raised In Connection With This Hearing

In its letter of invitation, the Subcommittee asked that we provide suggestions on how to improve oversight regarding insurance scoring. AIA is pleased to provide the following observations and suggestions of future actions that might be taken to assure that favorable markets are maintained, and that consumers continue to benefit from the use of insurance scoring.

The development and components of insurance scores

Insurance scoring models are created either by vendors or by individual insurers, are subject to extensive regulatory oversight and differ from lending scores. One widely used vendor's explanation of its model and components is provided as Attachment 3. Individual insurers may use those or other similar credit attributes in their models, subject to regulation.

Existing supervisory frameworks to assure consumer protection

As summarized above, the states have long standing laws and related regulatory authority to assure risk assessment accuracy and non-discrimination. Most states have added further regulatory authority and specific mandates relating to insurance scoring, similar to the NCOIL model. Implied in this issue is the question of the level of access regulators have to scoring models. The answer is that they have access to everything—including the models, the credit attributes, the algorithms and the impacts on premium. This information may be in filings, in response to inquiries from regulators, or both.

Proposals for improving state regulation and consumer understanding

We recommend adoption of the provisions of the NCOIL model law by states that have not yet done so. The NCOIL model has been repeatedly validated through legislative and administrative proceedings and day to day application, has been implemented in more than one half of the states, and has helped achieve positive consumer and market related objectives. Expanding its use would contribute to both effective and efficient regulation.

We recommend that state regulators' complaint systems be able to break out and analyze scoring related matters. Regulators potentially have the most valuable and precise source to determine whether there is a problem with insurance scoring or with any other factor – consumer complaints. This complaint data could be especially useful as an indicator of any issues, because of the insurance scoring notice/disclosure system, including "adverse action notices.", that highlights the use of credit for consumers and thereby helps to bring forth any complaints that may be .

Good complaint data can give a clear indication of the magnitude of a problem. If a particular state's current complaint data systems do not identify complaints arising out of insurance scoring, then the complaint data systems could be changed to do so. These complaint numbers should then be put into context, by looking at them as a percentage of personal lines policies issued and renewed.

If remedial action is needed, regulators could then work with insurers on responses that address the identified issues but that do not do collateral damage to the market and policyholders. We have offered cooperation in this regard and continue to do so. Today the states and the NAIC collect complaint data. Industry has suggested that this system be enhanced by adding a code to capture whether a consumer's concern is credit-related. Thus far, this suggestion has not gained traction.

We recommend continued public and private sector efforts to improve financial literacy and specifically the understanding of insurance scoring. Financial literacy is a challenge that goes far beyond insurance scoring and even insurance. Recognizing the importance of consumer information as it relates to insurance scoring, insurance groups, companies and vendors have developed and made available specific information on insurance scoring. This information is disseminated in print, on CDs and on web sites and sometimes in a language other than English. Insurance department information sources, including websites, could be reviewed to make sure that insurance scoring is explained so consumers can better understand their scores. Attachment 4 contains examples of information AIA has published in English and Spanish.

Conclusion

AIA wishes to continue to work with the states and Congress to maintain the financial strength, affordability and competitiveness of the personal lines insurance market, which has come about at least in part because of the presence of insurance scoring, a non-discriminatory, objective and accurate rating and underwriting tool. We all have a major stake in making sure favorable personal lines insurance market conditions continue and we are committed to working with you to that end.

ATTACHMENT I

American Insurance Association

CONCLUSIONS FROM MAJOR CREDIT-BASED INSURANCE SCORING STUDIES

- **"...91% of consumers either received a discount for credit or it had no effect on their premium"** and **"for those policies in which credit played some role in determining the final premium, those receiving a decrease outnumbered those who received an increase by 3.33 to 1."**
  Source: "Use and Impact of Credit in Personal Lines Insurance Premiums Pursuant to Ark. Code Ann. §23-67-415"; A report to the Legislative Council and the Senate and House Committees on Insurance & Commerce of the Arkansas General Assembly by the Arkansas Insurance Dept. July 2007. The Arkansas Insurance Dept. examined approximately 1.8 million auto and nearly 500,000 homeowners policies. Arkansas enacted the National Conference of Insurance Legislators Model Act on Credit in 2003.

- **"Credit-based 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."** and **"Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that many be passed on to consumers in the form of lower premiums."** Also, when scoring is used **"...more consumers (59%) would be predicted to have a decrease in their premiums than an increase (41%)."**
  Source: "Credit-based Insurance Scores: Impacts on Consumers of Automobile Insurance," A Report to Congress by the Federal Trade Commission, July 2007. The FTC examined more than two million insurance policies.

- **"A survey of Oregon insurers indicates that nearly 60 percent of personal auto policyholders...pay lower rates than they would if credit information was not used. In addition, many insurers report writing policies that they would not have written had they not had access to credit information."**
  Source: "The Use of Credit Information by Insurers," ECONorthwest, October 2006. This study was commissioned during the November 2006 elections when Oregon voters were asked to consider a statewide ballot initiative (Measure 42) that would have banned insurer use of credit. The measure was defeated with citizens voting more than 2-1 (65.6% to 34.4%) against it, rejecting "mass subsidization."

- **"These results** [impact of using credit information] **corroborate the insurance industry's contention that the majority of policyholders benefit from the use of credit scoring."**
  Source: "Report on the Use of Consumer Credit and Loss Underwriting Systems," Nevada Dept. of Business & Industry, Division of Insurance, July 2005. Insurers representing 60% of the auto and homeowners market were surveyed for this report.

- **As part of the Michigan insurance industry's successful legal efforts to stop a regulatory ban on credit, multiple companies reported in lawsuit filings that a ban would produce premium increases up to 68% for both auto and homeowner policies, with individual rates rising hundreds of dollars.**
  Source: In the case of *Insurance Institute of Mich., et. al. v Commissioner of the Office of Financial and Insurance Services*, (2005) Case #05-156-CZ, Barry County (MI) Circuit Court. There the Judge issued a clear and definitive opinion saying in part credit "clearly shows an actual effect on losses and expenses" (Judge's emphasis). The case is now on appeal (#262385).

- **"For both personal auto liability and homeowners, credit score was related to claim experience even after considering other commonly used rating variables. This means that credit score provides insurers with additional predictive information distinct from other rating variables. By using credit score, insurers can better classify and rate risks based on differences in claim experience."** Also, **"[C]redit scoring...is not unfairly discriminatory...because credit scoring is not based on race, nor is it a precise indicator of one's race."**
  Source: "Use of Credit Information by Insurers in Texas: The Multivariate Analysis," Supplemental Report to the 79th Legislature by Texas Department of Insurance (TDI), January 2005. The study analyzed scores and rating factors for over two million auto and homeowners insurance policies in Texas.

- **"...the lowest range of insurance scores produce indicated pure premiums 33% above average and the highest range of insurance scores produce indicated pure premiums 19% below average."**; and **"...insurance scores significantly increase the accuracy of the risk assessment process."**
  Source: "The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity," EPIC Actuaries, LLC, June 2003. The EPIC study reviewed more than 2.7 million auto policies.

- **"The correlation between credit score and relative loss ratio is .95, which is extremely high and statistically significant. The lower a named insured's credit score, the higher the probability that the insured will incur losses on an automobile insurance policy, and the higher the expected loss on the policy."**
  Source: "A Statistical Analysis of the Relationship Between Credit History and Insurance Losses," University of Texas Bureau of Business Research at the McCombs School of Business, March 2003.

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ATTACHMENT 2

NCOIL

National Conference of Insurance Legislators

...for the states

MODEL ACT REGARDING USE OF CREDIT INFORMATION IN PERSONAL INSURANCE

Adopted by the Property-Casualty Insurance and Executive Committees on November 22, 2002.
Readopted by the Property-Casualty Insurance Committee on November 17, 2005, and Executive Committee on November 19, 2005.
Amended on July 12, 2009, to expand on extraordinary life circumstances provisions.

Table of Contents

Section 1. Short Title

This Act may be called the *Model Act Regarding Use of Credit Information in Personal Insurance.*

Section 2. Purpose

The purpose of this Act is to regulate the use of credit information for personal insurance, so that consumers are afforded certain protections with respect to the use of such information.

Section 3. Scope

This Act applies to personal insurance and not to commercial insurance. For purposes of this Act, "personal insurance" means private passenger automobile, homeowners, motorcycle, mobile-homeowners and non-commercial dwelling fire insurance policies [and boat, personal watercraft, snowmobile and recreational vehicle polices]. Such policies must be individually underwritten for personal, family or household use. No other type of insurance shall be included as personal insurance for the purpose of this Act.

Section 4. Definitions

For the purposes of this Act, these defined words have the following meaning:

A. Adverse Action—A denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of personal insurance.

B. Affiliate—Any company that controls, is controlled by, or is under common control with another company.

C. Applicant—An individual who has applied to be covered by a personal insurance policy with an insurer.

D. Consumer—An insured whose credit information is used or whose insurance score is calculated in the underwriting or rating of a personal insurance policy or an applicant for such a policy.

E. Consumer Reporting Agency—Any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

F. Credit Information—Any credit-related information derived from a credit report, found on a credit report itself, or provided on an application for personal insurance. Information that is not credit-related shall not be considered "credit information," regardless of whether it is contained in a credit report or in an application, or is used to calculate an insurance score.

G. Credit Report—Any written, oral, or other communication of information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing or credit capacity which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor to determine personal insurance premiums, eligibility for coverage, or tier placement.

H. Insurance Score—A number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of an individual applicant or insured.

Section 5. Use of Credit Information

An insurer authorized to do business in *[insert State]* that uses credit information to underwrite or rate risks, shall not:

A. Use an insurance score that is calculated using income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the consumer as a factor.

B. Deny, cancel or non-renew a policy of personal insurance solely on the basis of credit information, without consideration of any other applicable underwriting factor independent of credit information and not expressly prohibited by Section 5(A).

Drafting Note: This subsection prohibits an insurer from refusing to insure an applicant, insured, or other individual seeking insurance coverage because the person's insurance score fails to meet or exceed a minimum numeric threshold, unless one or more other applicable underwriting factors independent of credit information are considered.

C. Base an insured's renewal rates for personal insurance solely upon credit information, without consideration of any other applicable factor independent of credit information.

D. Take an adverse action against a consumer solely because he or she does not have a credit card account, without consideration of any other applicable factor independent of credit information.

E. Consider an absence of credit information or an inability to calculate an insurance score in underwriting or rating personal insurance, unless the insurer does one of the following:

1. Treats the consumer as otherwise approved by the Insurance Commissioner/ Supervisor/Director, if the insurer presents information that such an absence or inability relates to the risk for the insurer.

2. Treats the consumer as if the applicant or insured had neutral credit information, as defined by the insurer.

3. Excludes the use of credit information as a factor and use only other underwriting criteria.

F. Take an adverse action against a consumer based on credit information, unless an insurer obtains and uses a credit report issued or an insurance score calculated within 90 days from the date the policy is first written or renewal is issued.

G. Use credit information unless not later than every 36 months following the last time that the insurer obtained current credit information for the insured, the insurer recalculates the insurance score or obtains an updated credit report. Regardless of the requirements of this subsection:

1. At annual renewal, upon the request of a consumer or the consumer's agent, the insurer shall re-underwrite and re-rate the policy based upon a current credit report or insurance score. An insurer need not recalculate the insurance score or obtain the updated credit report of a consumer more frequently than once in a twelve-month period.

2. The insurer shall have the discretion to obtain current credit information upon any renewal before the 36 months, if consistent with its underwriting guidelines.

3. No insurer need obtain current credit information for an insured, despite the requirements of subsection (G)(1), if one of the following applies:

   (a) The insurer is treating the consumer as otherwise approved by the Commissioner.

   (b) The insured is in the most favorably-priced tier of the insurer, within a group of affiliated insurers. However, the insurer shall have the discretion to order such report, if consistent with its underwriting guidelines.

   (c) Credit was not used for underwriting or rating such insured when the policy was initially written. However, the insurer shall have the discretion to use credit for underwriting or rating such insured upon renewal, if consistent with its underwriting guidelines.

   (d) The insurer re-evaluates the insured beginning no later than 36 months after inception and thereafter based upon other underwriting or rating factors, excluding credit information.

H. Use the following as a negative factor in any insurance scoring methodology or in reviewing credit information for the purpose of underwriting or rating a policy of personal insurance:

1. Credit inquiries not initiated by the consumer or inquiries requested by the consumer for his or her own credit information.

2. Inquiries relating to insurance coverage, if so identified on a consumer's credit report.

3. Collection accounts with a medical industry code, if so identified on the consumer's credit report.

4. Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within 30 days of one another, unless only one inquiry is considered.

5. Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within 30 days of one another, unless only one inquiry is considered.

Section 6. Extraordinary Life Circumstances

A. Notwithstanding any other law or regulation, an insurer that uses credit information shall, on written request from an applicant for insurance coverage or an insured, provide reasonable exceptions to the insurer's rates, rating classifications, company or tier placement, or underwriting rules or guidelines for a consumer who has experienced and whose credit information has been directly influenced by any of the following events:

1. Catastrophic event, as declared by the federal or state government

2. Serious illness or injury, or serious illness or injury to an immediate family member

3. Death of a spouse, child, or parent

4. Divorce or involuntary interruption of legally-owed alimony or support payments

5. Identity theft

6. Temporary loss of employment for a period of 3 months or more, if it results from involuntary termination

7. Military deployment overseas

8. Other events, as determined by the insurer

B. If an applicant or insured submits a request for an exception as set forth in Section 6(A), an insurer may, in its sole discretion, but is not mandated to:

1. Require the consumer to provide reasonable written and independently verifiable documentation of the event.

2. Require the consumer to demonstrate that the event had direct and meaningful impact on the consumer's credit information.

3. Require such request be made no more than 60 days from the date of the application for insurance or the policy renewal.

4. Grant an exception despite the consumer not providing the initial request for an exception in writing.

5. Grant an exception where the consumer asks for consideration of repeated events or the insurer has considered this event previously.

C. An insurer is not out of compliance with any law or rule relating to underwriting, rating, or rate filing as a result of granting an exception under this section. Nothing in this section shall be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this section.

D. The insurer shall provide notice to consumers that reasonable exceptions are available and information about how the consumer may inquire further.

E. Within 30 days of the insurer's receipt of sufficient documentation of an event described in Section 6(A), the insurer shall inform the consumer of the outcome of their request for a reasonable exception. Such communication shall be in writing or provided to an applicant in the same medium as the request.

Section 7. Dispute Resolution and Error Correction

If it is determined through the dispute resolution process set forth in the federal Fair Credit Reporting Act, 15 USC 1681i(a)(5), that the credit information of a current insured was incorrect or incomplete and if the insurer receives notice of such determination from either the consumer reporting agency or from the insured, the insurer shall re-underwrite and re-rate the consumer within 30 days of receiving the notice. After re-underwriting or re-rating the insured, the insurer shall make any adjustments necessary, consistent with its underwriting and rating guidelines. If an insurer determines that the insured has overpaid premium, the insurer shall refund to the insured the amount of overpayment calculated back to the shorter of either the last 12 months of coverage or the actual policy period.

Section 8. Initial Notification

A. If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or its agent shall disclose, either on the insurance application or at the time the insurance application is taken, that it may obtain credit information in connection with such application. Such disclosure shall be either written or provided to an applicant in the same medium as the application for insurance. The insurer need not provide the disclosure statement required under this section to any insured on a renewal policy, if such consumer has previously been provided a disclosure statement.

B. Use of the following example disclosure statement constitutes compliance with this section: "In connection with this application for insurance, we may review your credit report or obtain or use a credit-based insurance score based on the information contained in that credit report. We may use a third party in connection with the development of your insurance score."

Section 9. Adverse Action Notification

If an insurer takes an adverse action based upon credit information, the insurer must meet the notice requirements of both (A) and (B) of this subsection. Such insurer shall:

A. Provide notification to the consumer that an adverse action has been taken, in accordance with the requirements of the federal Fair Credit Reporting Act, 15 USC 1681m(a).

B. Provide notification to the consumer explaining the reason for the adverse action. The reasons must be provided in sufficiently clear and specific language so that a person can identify the basis for the insurer's decision to take an adverse action. Such notification shall include a description of up to four factors that were the primary influences of the adverse action. The use of generalized terms such as "poor credit history," "poor credit rating," or "poor insurance score" do not meet the explanation requirements of this subsection. Standardized credit explanations provided by consumer reporting agencies or other third party vendors are deemed to comply with this section.

Section 10. Filing

A. Insurers that use insurance scores to underwrite and rate risks must file their scoring models (or other scoring processes) with the Department of Insurance. A third party may file scoring models on behalf of insurers. A filing that includes insurance scoring may include loss experience justifying the use of credit information.

B. Any filing relating to credit information is considered trade secret under *[cite to the appropriate state law]*.

Section 11. Indemnification

An insurer shall indemnify, defend, and hold agents harmless from and against all liability, fees, and costs arising out of or relating to the actions, errors, or omissions of [an agent / a producer] who obtains or uses credit information and/or insurance scores for an insurer, provided the [agent / producer] follows the instructions of or procedures established by the insurer and complies with any applicable law or regulation. Nothing in this section shall be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this section.

Section 12. Sale of Policy Term Information by Consumer Reporting Agency

A. No consumer reporting agency shall provide or sell data or lists that include any information that in whole or in part was submitted in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. Such information includes, but is not limited to, the expiration dates of an insurance policy or any other information that may identify time periods during which a consumer's insurance may expire and the terms and conditions of the consumer's insurance coverage.

B. The restrictions provided in subsection (A) of this section do not apply to data or lists the consumer reporting agency supplies to the insurance [agent / producer] from whom information was received, the insurer on whose behalf such [agent / producer] acted, or such insurer's affiliates or holding companies.

C. Nothing in this section shall be construed to restrict any insurer from being able to obtain a claims history report or a motor vehicle report.

Section 13. Severability

If any section, paragraph, sentence, clause, phrase, or any part of this Act passed is declared invalid due to an interpretation of or a future change in the federal Fair Credit Reporting Act, the remaining sections, paragraphs, sentences, clauses, phrases, or parts thereof shall be in no manner affected thereby but shall remain in full force and effect.

Section 14. Effective Date

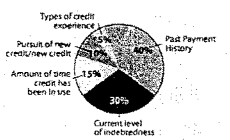
This Act shall take effect on *[insert date]*, applying to personal insurance policies either written to be effective or renewed on or after 9 months from the effective date of the bill.

ATTACHMENT 3

FICO

Answers to Your Questions About FICO® Credit-Based Insurance Scores

What a FICO® Credit-Based Insurance Score examines:



These percentages are based on the importance of the five categories for the general population. For particular groups—for example, for people who have not been using credit long—the importance of some categories may be different.

Your score will improve over time through a pattern of responsible credit use.

An insurance score is a snapshot of your insurance risk picture at a particular point in time based on credit report information.

Review your credit reports once a year (*www.annualcreditreport.com*) and report any errors to the credit reporting agencies.

Insurance scores provide underwriters with an objective, accurate and consistent tool that, used with other underwriting information, helps them issue new and renewal insurance policies.

1. What is a credit-based insurance score?

A credit-based insurance score, also known simply as an insurance score, is a snapshot of a consumer's insurance risk picture at a particular point in time based on credit report information. Insurers use insurance scores along with motor vehicle records, loss history reports and/or application information to evaluate new and renewal auto and homeowner insurance policies. It helps them decide, "If we accept this applicant or renew this policy, will we likely be exposed to more losses than our collected premiums will allow us to handle?"

Insurance scores are based solely on information in consumer credit reports. The scores are dynamic, changing as new information is added to a consumer's credit report. Insurers will typically ask for a current score when they receive a new application for insurance, or prepare to renew an existing policy, so they have the most recent information available.

2. Where do insurance scores come from?

FICO® Credit-Based Insurance Scores are calculated for insurers by the three major credit reporting agencies: Equifax, Experian and TransUnion, using FICO's scoring formula. These scores are based on information provided by the consumer reporting agencies. Information from these consumer credit reports used in scoring in most states includes:

- » Late payments, collections, bankruptcies
- » Length of credit history
- » Outstanding debt
- » New applications for credit
- » Types of credit in use

3. What's not included in an insurance score?

FICO® Credit-Based Insurance Scores do not consider the following information:

- » Ethnic group
- » Age
- » Familial Status
- » Address
- » Nationality
- » Gender
- » Income
- » Medical Collections
- » Religion
- » Marital Status
- » Handicap
- » Occupation/Employment

4. Why do insurance companies use FICO® Credit-Based Insurance Scores?

Insurance companies use insurance scores to help them issue new and renewal insurance policies. Insurance scores provide an objective, accurate and consistent tool that insurers use with other applicant information to better anticipate claims, while streamlining the decision process so they can issue policies more efficiently. By better anticipating claims, insurers can better control risk, enabling them to offer insurance coverage to more consumers at a fairer cost.

5. How do you know it works?

Independent tests by government regulators, universities, actuarial consulting firms and insurance companies have consistently demonstrated that insurance scores very effectively predict the likelihood of claims.

6. How can I find out my score?

While you can get copies of your credit reports from credit reporting agencies, currently only insurance companies can obtain FICO® Credit-Based Insurance Scores. However, your insurance company or your agent can tell you the main factors behind your score.

Keep in mind that your score is one of many pieces of information an underwriter uses to review an application or a policy. Factors like motor vehicle reports and application information also impact the insurer's decision to issue or renew a policy. Also, remember that the score changes as new information is added to your credit report.

FICO (NYSE:FICO) transforms business by making every decision count. FICO's Decision Management solutions combine trusted advice, world-class analytics and innovative applications to give organizations the power to automate, improve and connect decisions across their business. Clients in 80 countries work with FICO to increase customer loyalty and profitability, cut fraud losses, manage credit risk, meet regulatory and competitive demands, and rapidly build market share. FICO also helps millions of individuals manage their credit health through the ***www.myFICO.com*** website. Learn more about FICO at ***www.fico.com.***

Make sure the information in your credit report is correct by reviewing your credit report from each credit reporting agency at least once a year (***www.annualcreditreport.com***). Call these numbers to order a copy (a fee may be required):
Equifax: 800 685 1111
Experian: 888 397 3742
TransUnion: 800 888 4213

7. How can I improve my score?

An insurance score is a snapshot of your insurance risk picture based on information in your credit report, with more emphasis on recent information. Your credit report reflects your credit payment patterns over time. To improve a score, you should:

» **Pay bills on time.** Delinquent payments and collections can have a major negative impact on a score.
» **Keep balances low on unsecured revolving debt like credit cards.** High outstanding debt can affect a score.
» **Apply for and open new credit accounts only as needed.**

You can increase your score over time by using credit responsibly. It's also a good idea to periodically obtain a copy of your credit reports (***www.annualcreditreport.com***) from the three major credit reporting agencies to check for any inaccuracies.

8. What if I'm turned down for insurance or my rate is increased?

If consumer credit information played a role in an insurer's decision to decline your insurance policy or increase your rate, the federal Fair Credit Reporting Act (FCRA) requires that the insurer tell you, and give you the name of the credit reporting agency that provided the information. In these situations, you are entitled by law to receive a free copy of your credit report to review, in order to help you understand how to better manage your credit or to challenge any errors that might appear on your report.

9. What if the information in my credit report is wrong?

If you find errors in your credit report, you should report the errors to the credit reporting agency. By law, the credit reporting agency must investigate and respond to your request within 30 days. If you are in the process of applying for an insurance policy, you should immediately notify your insurance company or agent about any incorrect information in your report. Small errors may have little or no effect on the score. If there are significant errors, the insurance company may choose to disregard the score and rely more on other underwriting information to make a decision on your application.

Scoring facts and fallacies

Fallacy: With scoring, computers are making the underwriting decisions.

Fact: Computers don't make underwriting decisions, people do. While a computer does calculate an insurance score, the score is only one of several pieces of information that insurance underwriters use to help make a decision on new and renewal policies. Some insurance companies use scores to help them decide when to ask for more information from the applicant.

Fallacy: A poor score will haunt me forever.

Fact: Just the opposite is true. An insurance score is a snapshot of your insurance risk picture at a particular point in time. Your score changes as new information is added to your credit reporting agency file. Over time, your score changes gradually as you change the way you handle your credit responsibilities. Because recent credit information is more predictive than older information, past credit problems will impact your score less as time passes. Insurance companies typically request a current score when you submit a new application so they have the most recent information available.

Fallacy: My insurance score will be hurt if I contact several insurance companies who each access my credit report.

Fact: Insurance company requests, or "inquiries," are not considered by FICO® Credit-Based Insurance Scores or by FICO® credit risk scores used by lenders and will not affect your score.

Fallacy: Insurance scores are unfair to minorities.

Fact: FICO® Credit-Based Insurance Scores are built with depersonalized data. The models do not consider ethnic group, religion, gender, marital status, nationality, age, income or address. Only credit-related information is included.

FICO® Credit-Based Insurance Scores have proven to be an accurate and consistent measure of insurance risk for all people who have some credit history. In other words, at a given score both non-minority and minority applicants present an equal level of insurance risk, or the likelihood of future insurance claims.

Fallacy: Scoring is an invasion of my privacy.

Fact: Insurance companies have used consumer credit information to assist in their underwriting decisions since the FCRA was enacted in 1970. An insurance score is simply a number that provides an objective and consistent summary of that credit information. In fact, by using scores, some insurance companies don't need to ask for as much information on their application forms.

FICO

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fact sheet

FICO

FICO® Credit-Based Insurance Scores

1. Most consumers benefit from the use of insurance scores

Lower premiums—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission noted "If credit-based insurance scores are used, more consumers (59%) would be predicted to have a decrease in their premiums than an increase." According to insurers, up to 75 percent of their policyholders pay lower premiums because of the insurer's use of credit-based insurance scoring within their underwriting process.

Objective and timely decisions—The use of scoring enables insurers to make more accurate, objective, consistent and timely underwriting and pricing decisions. Insurance scores are snapshots of consumers' insurance risk based on information in their credit report that reflects their credit-payment patterns over time, with more emphasis on recent information. An insurance score is the result of an objective, statistical analysis of credit report information identifying the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial patterns.

Most consumers have good scores—Most consumers manage their credit obligations well over time and, as a result, have good scores. Insurance scoring helps identify those consumers who present lower risk of loss so insurers can offer them lower insurance premiums. This helps to make insurance coverage more available and affordable to the majority of consumers.

2. Correlation between credit behavior and insurance risk has been proven

FTC concludes these scores are effective risk predictors—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission said, "Credit-based 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."

Independent studies agree—Separate studies by the Texas Department of Insurance (TDI), the University of Texas, Tillinghast Towers-Perrin, EPIC Consultants and others have proven that credit-based history correlates with the risk of insurance loss. The TDI study included the following key findings: *(source: Insurance Information Institute, January 2005)*

- The average loss per vehicle for people with the worst insurance scores is double that of people with the best credit-based insurance scores.
- Homeowners insurance loss ratios (claims paid/premium paid) for people with the worst insurance scores are triple that of people with the best scores.
- Drivers with the best credit history are involved in about 40 percent fewer accidents than those with the worst credit history.

Scores are based on most accurate data—The data at credit reporting agencies is one of the most accurate sets of consumer data available to insurers. Based on studies, the error rate in credit reports is considerably lower than the error rate found in motor vehicle records.

3. It makes sense that credit habits relate to insurance risk

Overall behavior is consistent—In general, people with good credit habits demonstrate careful behavior overall. This crosses over into their driving habits, care of their automobiles, and care taken in the maintenance and safety of their homes.

4. For insurers the issue is risk, not race

FTC finds scores are not a proxy for race—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission wrote, "Credit-based insurance scores appear to have little effect as a 'proxy' for membership in racial and ethnic groups in decisions related to insurance. ...Tests also showed that scores predict insurance risk within racial and ethnic minority groups. ...This within-group effect of scores is inconsistent with the theory that scores are solely a proxy for race and ethnicity."

Scores are color-blind and objective—An independent study by the Texas Department of Insurance confirmed that credit-based insurance scoring does not discriminate racially or by income. According to that study, a higher percentage of adults in low-income groups and certain minority groups (African-American and Hispanic) have somewhat lower scores compared with the rest of the adult population. However, the study also showed that each group studied receives the full range of insurance scores. This is possible only if insurance scoring is a color-blind, objective process.

5. Scores remain an effective tool during current economic conditions

Scores have shown to be very stable—In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. More and more consumers appear to be realizing the value of prudent financial and credit management practices.

Scores may decline for those directly impacted—As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case, the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.

Scores may change when lenders reduce credit limits:

- FICO® Credit-Based Insurance Scores assess a wide variety of data on credit reports, so the impact to the score from a single factor like credit limit reductions will depend on what other data is on the credit report and the amount of line reduction taken by a lender. The consumer's score could be unchanged, it could go down, or in some cases it could go up in combined response to other changes on the credit report.
- Our ongoing research indicates that lenders have reduced the revolving account limits for a relatively small percent of the population, and those line reductions have also been a relatively small amount for that population.
- An important FICO principle is to let data—rather than judgmental factors—drive any changes to our credit-based insurance scoring models. Our most recent score performance studies indicate that our scores continue to appropriately rank-order consumers based on insurance risk.
- While credit card holders don't control their credit limits, in many cases, they do control their account balances. Recent data shows that a notable number of consumers have reduced their revolving credit usage, helping to minimize any effect from lenders reducing their account limits.
- FICO continues to periodically analyze credit industry activity and its potential impact on our credit-based insurance scores going forward.

6. FICO® Credit-Based Insurance Scores are fair to consumers

Evaluate only statistically-proven data—Our insurance models are built with only depersonalized data and our scores evaluate only credit-related information from consumer credit reports. They do not consider the person's income, age, marital status, gender, race, ethnic group, religion, nationality or location. People who are in identical situations would be charged the same amount for auto or homeowners insurance, irrespective of differences in race, ethnicity or levels of income, under a rating plan that permits the use of credit-based insurance scores in underwriting.

Support anti-discrimination laws—U.S. law requires businesses to avoid deliberate bias against minority groups. Through the use of insurance scoring, only individual consumers who represent potentially higher risk pay higher premiums, regardless of their race or income.

Consumers gain control—Consumers with low credit-based insurance scores can improve their scores by improving their credit habits. Better scores can lead to lower insurance premiums for most consumers.

7. Use of insurance scoring helps stabilize and open the marketplace for consumers

Competition is good for consumers—The use of insurance scores keeps the insurance marketplace competitive, resulting in the availability of lower prices, better service, and more choices for consumers. Underwriters gain opportunities to identify and write insurance for people who in the past they may have declined because of incomplete knowledge or information. Also, a good credit history can offset negative underwriting factors such as a prior loss, thereby enabling someone to get insurance who might otherwise have been denied or charged more.

8. FICO® Credit-Based Insurance Scores are different from FICO® credit-risk scores

Predict very different things—While both types of scores use information from consumer credit reporting agency files, they predict very different outcomes. Credit-risk scores such as FICO® Scores are built to predict the likelihood of delinquency or non-payment of credit obligations. Insurance scores are built to predict the probability of future insurance losses.

Insurance scores apply to customer groups—Individuals can have low insurance scores without ever having filed an insurance claim. That's because insurance scores are applicable to customer groups. Consider that some teenage drivers will never have an accident. As a group, however, teenage drivers experience many accidents. Similarly, as a group, customers with low insurance scores tend to have more losses than those with high scores.

9. Use of insurance scoring frees insurers to focus on exceptional cases

More attention for people with unusual needs—Insurers use insurance scoring to help make routine underwriting and pricing decisions. This frees underwriters to spend more time helping applicants or existing customers who have unusual situations or needs.

10. FICO is committed to helping consumers obtain credit and insurance coverage fairly and affordably

Free educational resources—We have established web sites such as ***www.insurancescore.com*** and educational programs to help consumers become better informed about credit-risk and insurance scores. These programs explain the credit behaviors that will help consumers improve their scores.

Every score includes explanation—Each insurance score based on credit reporting agency data is accompanied by up to four (4) score reasons to help consumers who receive an adverse action notice identify where they may have lost points, providing insight into how credit behaviors are impacting scores, underwriting decisions and pricing. Consumers who believe these score reasons misrepresent their credit history can examine their credit reports and request investigation of any information that they find to be inaccurate or incomplete.

Opportunities to address issues—We encourage our clients to use scores responsibly. We also welcome opportunities to address scoring issues with credit grantors, insurance companies, regulatory and legislative bodies, consumer advocates, consumers and the media.

11. FICO recommends the following guidelines to help consumers manage their scores in either a stable or volatile economy

Make *all* your credit and loan payments on time—The calculation of FICO® Credit-Based Insurance Scores weighs payment history more heavily than any other variable on your credit report. Making all your payments by their due date is a key ingredient for a good score. When money is tight, pay at least the minimum amount due on credit card debt to avoid being reported delinquent. Overdue bills can significantly lower your score, including unpaid debts sent to collection agencies.

Keep credit card balances low—Individuals with good scores come from every income level, and in tough times they tend to scale back their use of credit cards and pay down their debts. If your credit card balances are close to your credit limits, budget your finances to make debt reduction a top priority. Your indebtedness is the second most important factor for scores.

Open new credit cards or loans only when necessary—Opening new credit accounts may cause your score to go down so be cautious about taking on new debt. This includes thinking twice before opening a retail store card just to get an extra 10 percent off your current purchase.

Get your free annual credit report from each national credit reporting agency through ***www.AnnualCreditReport.com***, and check your credit history carefully for errors. Contact the appropriate credit reporting agency if you spot an error so they can investigate it.

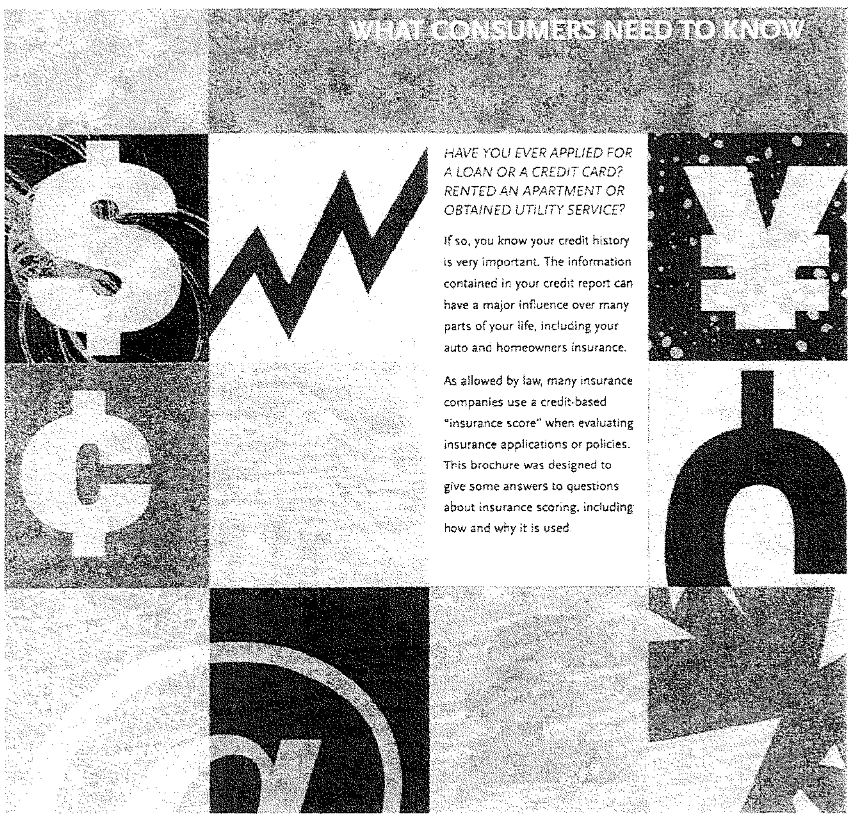
FICO

For more information	US toll-free	International	email	web
	+1 888 342 6336	+44 (0) 207 940 8718	info@fico.com	www.fico.com

ATTACHMENT 4

American Insurance Association

CREDIT-BASED INSURANCE SCORES



WHAT CONSUMERS NEED TO KNOW

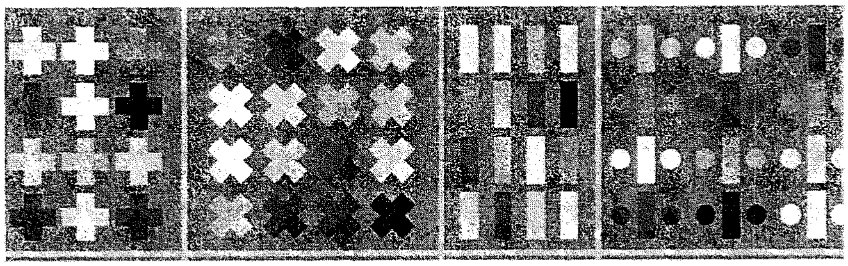
HAVE YOU EVER APPLIED FOR A LOAN OR A CREDIT CARD? RENTED AN APARTMENT OR OBTAINED UTILITY SERVICE?

If so, you know your credit history is very important. The information contained in your credit report can have a major influence over many parts of your life, including your auto and homeowners insurance.

As allowed by law, many insurance companies use a credit-based "insurance score" when evaluating insurance applications or policies. This brochure was designed to give some answers to questions about insurance scoring, including how and why it is used.

What is a credit-based insurance score? Why do insurance companies use them?

A credit-based insurance score uses information from your credit report to help predict how often you are likely to file claims, and/or how expensive those claims will be. Studies by federal and state regulators, universities, independent auditors and insurance companies have proven that credit characteristics are predictive of certain outcomes, such as insurance loss. The way you handle your credit says a lot about how responsible you are. Insurance companies want to reward responsible people by making sure you don't pay more than you should. That's why insurance scores are so useful.



It is important to understand that an insurance score is not the same thing as a credit score. Both are derived from data found in your credit report, but they predict very different things. A credit score predicts how likely you are to repay a loan or other credit obligation. When you are applying for a loan for example, the bank will consider your credit history as well as other factors, such as income - which insurers do not consider - in determining whether you are likely to repay your debt.

When you apply for insurance, the insurance company orders credit information from one or more of the three major U.S. credit bureaus. This information is entered into a computer program that generates an insurance score. Most of these programs, or "models," look at things like payment history, collections, credit utilization and bankruptcies. For example, if you have never been late paying your mortgage, you will probably have a better score than a person who pays late. If you have "maxed out" credit cards, that will negatively affect your score.

What does my credit history have to do with how I drive my car?

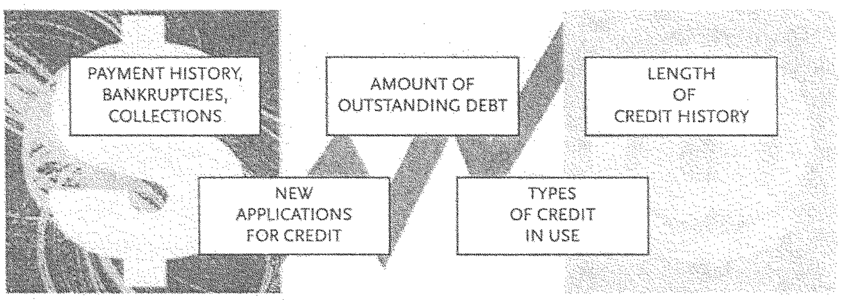
Research has shown that consumers with better insurance scores generally file fewer claims and have lower insurance losses. That is not to say that all people with low insurance scores are higher risks.

For instance, if you add a 17-year-old driver to your auto policy, your premiums will likely increase. This is because, as a group, younger drivers have more claims and losses than those with more experience. That does not mean that all 17-year-olds are bad drivers but research shows that drivers in that age group are more likely to have losses, so they pay more in premiums. It's the same with insurance scores – research shows that people with certain patterns of behavior in their credit history are more likely to result in losses for the insurance company. As a result, they may pay higher premiums, or, in extreme cases, they might have trouble getting insurance from some companies. A Federal Trade Commission (FTC) study of insurance scores released in July 2007 found: "credit-based 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." Additionally, the FTC study found that such scores may make the insurance process "quicker and cheaper" with "costs savings that may be passed on to consumers in the form of lower premiums." Also, a 2007 Federal Reserve study found credit information has similar risk-predictive and objective value for banks and other financial services companies.

What kinds of things affect my insurance score?

Insurance scores are based on information like payment history, bankruptcies, collections, outstanding debt and length of credit history. For example, regular, on-time credit card and mortgage payments affect a score positively, while late payments affect a score negatively.

SAMPLE TYPES OF CREDIT REPORT INFORMATION USED IN INSURANCE SCORES



Any time someone looks at your credit report, the credit bureaus record this activity as an "inquiry." The number of inquiries on your record can also affect your insurance score. There are several types of inquiries, but under the models used by most insurance companies, the only inquiries that affect your insurance score are those you initiate when seeking new credit products, such as a new car loan or "easy financing" on new bedroom furniture.

One way to improve your insurance score is to limit the number of self-initiated inquiries in your credit report. This can be done by only applying for credit when you really need it. For example, an unsolicited "pre-approved" credit card notice in the mail would not affect your score, because you did not initiate the offer. If you fill out the form and send it back, though, you are applying for new credit. An inquiry will then be posted in your credit history, which may have an effect on your score.

There is no one formula to get a "perfect" score because your credit report is ever changing as time elapses and new payment history is added, accounts are closed or opened, etc. The key to a "good" score is using credit wisely - paying bills on time and exercising common sense in credit related activities.

Credit-based insurance scores look at patterns of financial management. Applying for one credit card is unlikely to have much effect on an individual's score. But applying for several lines of credit in a short period probably will have an impact.

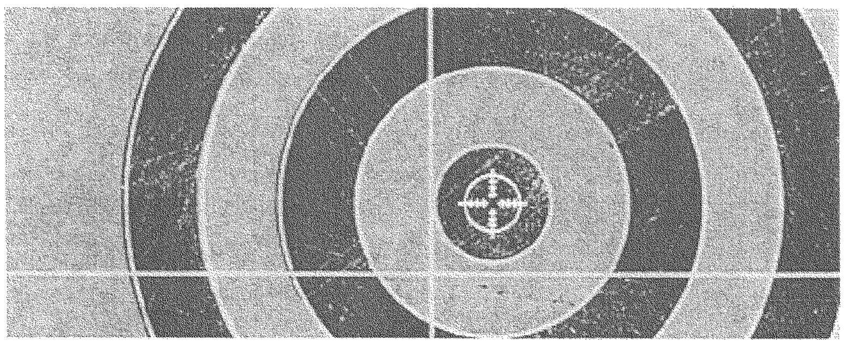
If you are shopping for a car or a house, you may fill out lots of applications within a short period to find the best deal. This shows that you are a responsible consumer. Under most of the current credit-based scoring models, applying for several car loans over a certain amount of time will only count as one inquiry. Also, most models do not consider inquiries you initiate when you are shopping for insurance.

Do credit-based insurance scores discriminate against certain ethnic or income groups?

No. Insurance companies DO NOT consider the following information in the calculation of your credit-based insurance score:

- Income
- Gender
- Disability
- Public assistance sources of income
- Ethnic group
- Religion
- Nationality

The FTC's comprehensive study found that insurance scores are objective and "blind" to things such as race or gender, saying they "have little effect as a 'proxy' for membership in racial and ethnic groups in decisions related to insurance."



Can my insurance score help me save money on insurance?

Yes. Credit-based insurance scores allow companies to charge lower premiums to customers who are better risks. For example, people with better insurance scores and a good driving record could qualify for a better auto insurance rate.

Do I have any rights if I am denied insurance based on my credit history?

Absolutely. If an insurance company takes an "adverse action" against you (such as denying you coverage) as the result of information contained in your credit report, you may obtain a copy of your credit report free of charge from the credit bureau that provided the information. If you believe there are errors in the report, you should immediately notify the credit bureau – they must promptly correct errors.

In recent years, some states have enacted legislation addressing insurance scores. This information is available from each state's insurance department.

Can I get a copy of my credit report before I apply for insurance?

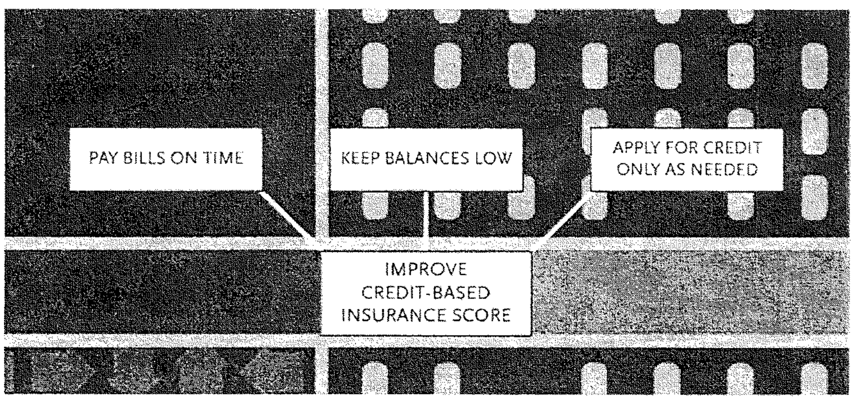
Since December 1, 2004, consumers have been entitled to one free credit report a year (visit ww.annualcreditreport.com or call 1-877-322-8228 for more information). At other times, for a small fee, each of the three major credit reporting bureaus will send you an updated copy of your credit report. If you believe there are errors in the report, you should immediately notify the credit bureau. Again, if the information is incorrect, the bureau is required by law to promptly correct any errors. Contact information for the three major credit bureaus is listed at the end of this brochure.

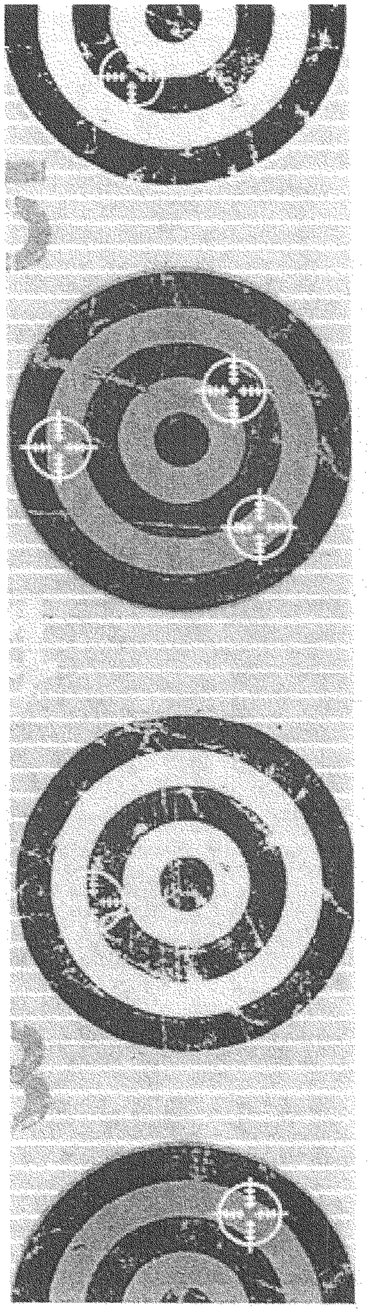
How do credit-based insurance scores benefit consumers?

- Credit-based insurance scores can help you qualify for lower premiums, because insurance companies charge better rates to customers who are considered lower risk.
- The use of credit-based insurance scores allows more insurance companies to offer a wider range of products to more people. Since insurance scores have been used, competition in the auto insurance market has increased significantly - and competition quite often leads to more choices and lower costs.
- Insurance scores can be improved. By using credit wisely – paying bills on time and exercising responsibility in other financial activities – you can usually qualify for lower rates.**

***Insurance companies have different policies with regard to how often they will recheck your insurance score. Check with your insurer to find out their policy.*

- The Federal Fair Credit Reporting Act, and Fair and Accurate Credit Transaction Act provide numerous consumer protections. These include:
  - *The right to obtain a free copy of your credit report if you are adversely affected (for example, denied coverage) based on information in your credit report*
  - *The right to contest any inaccuracies in your credit report and have incorrect information removed*
  - *The right to obtain one free copy of your credit report annually from a credit bureau*





American Insurance Association

Contacts and other resources:

Federal Trade Commission (FTC)
(www.ftc.gov)

Visit the FTC's website for information on credit and your rights under the Fair Credit Reporting Act (FCRA) and the Fair and Accurate Credit Transaction Act (FACT Act), or call 202-326-2222.

Equifax *(www.equifax.com)*

For a copy of your report, call 1-800-685-1111.

To dispute information in your report, write to:
P.O. Box 740241, Atlanta, GA 30374

Experian *(www.experian.com)*

For a copy of your report, call 1-888-397-3742.

TransUnion *(www.transunion.com)*

For a copy of your report, call 1-800-888-4213.

If you have a copy of your report and wish to discuss it, call 1-800-916-8800.

To dispute information in your report, write to:
P.O. Box 2000, Chester, PA 19022

Consumer Data Industry Association (CDIA)
(www.cdiaonline.org)

Contact the CDIA to learn more about the credit reporting industry.

Fair Isaac Corporation *(www.fairisaac.com)*
Contact Fair Isaac to learn more about credit and insurance scores.

Choicepoint
(www.choicepoint.com or www.choicetrust.com)
Contact Choicepoint to learn more about insurance scores.

American Insurance Association
1130 Connecticut Avenue, N.W. Suite 1000
Washington, D.C. 20036
202-828-7100 www.aiadc.org

American Insurance Association

LAS PUNTUACIONES DE SEGURO BASADOS EN EL CRÉDITO

LO QUE LOS CONSUMIDORES DEBEN SABER

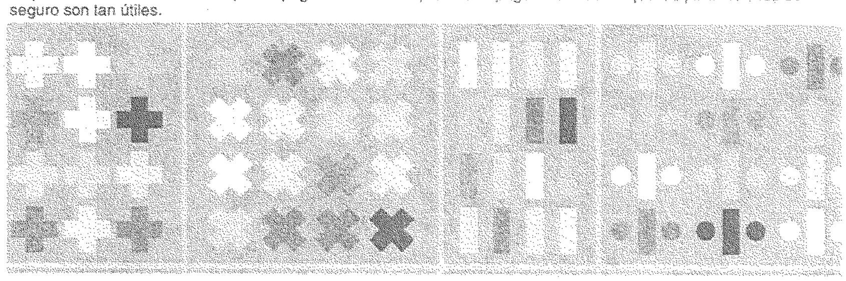
¿ALGUNA VEZ HA SOLICITADO UN PRÉSTAMO O UNA TARJETA DE CRÉDITO? ¿HA ALQUILADO UN APARTAMENTO U OBTENIDO SERVICIOS PÚBLICOS?

Si lo ha hecho, sabe que el historial crediticio es muy importante. La información del informe de crédito ejerce una gran influencia en muchas partes de la vida de uno, incluso el seguro automovilístico y el seguro para propietarios de casas.

Conforme a lo permitido por las leyes, muchas compañías de seguros emplean la "puntuación de seguro" basado en el crédito para evaluar las solicitudes o las pólizas de seguro. Este folleto fue diseñado para responder algunas de las preguntas sobre la puntuación de seguro, cómo y por qué se usa.

¿Qué es una puntación de seguro basado en el crédito? ¿Por qué los usan las compañías de seguros?

La puntuación de seguro usa la información del informe de crédito para predecir la probabilidad y la frecuencia con la que uno presenta reclamaciones, y/o lo costosas que van a ser. Los estudios hechos por los reguladores federales y estatles, universidades, auditores independientes y compañías de seguros han comprobado que las características crediticias de ciertos resultados son predecibles, tal como la siniestralidad. La forma de manejar el crédito evidencia lo responsable que uno es. Las compañías de seguro quieren premiar a las personas responsables cerciorandos de que no paguen más de lo que deben pagar. Por eso es que las puntuaciones de seguro son tan útiles.



Es importante entender que la puntuación de seguro no es lo mismo que la puntuación crediticia. Ambos se obtienen de los datos del informe de crédito, pero predicen cosas muy distintas. El informe de crédito predice la probabilidad que uno tiene de pagar un préstamo u otras deudas. Por ejemplo, cuando uno solicita un préstamo, el banco tiene en cuenta el historial crediticio y otros factores como el ingreso - lo cual no es tenido en cuenta por las aseguradoras - para determinar la probabilidad de pago de la deuda.

Al solicitarle cobertura, la compañía de seguros le pide información de crédito a una o a más de las tres agencias estadounidenses de informes crediticios. Dicha información se le suministra a un programa computarizado que genera la puntuación de seguro. La mayoría de esos programas, o "modelos," tienen en cuenta cosas como el historial de pago, cobranzas, uso del crédito y bancarrotas. Por ejemplo, si jamás se ha atrasado con el pago hipotecario, usted tal vez tenga una mejor puntuación que el de la persona que paga tarde. Si ha maximizado las tarjetas de crédito, eso afecta negativamente la puntuación.

¿Qué tiene que ver mi historial crediticio con la conducción de mi carro?

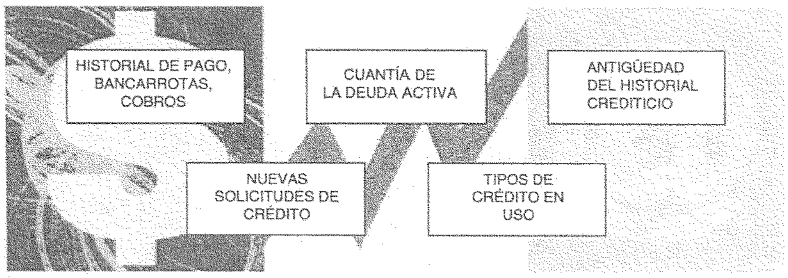
Las investigaciones han demostrado que los consumidores que tienen una mejor puntuación de seguro generalmente presentan menos reclamaciones y tienen menos pérdidas de seguro. Eso no significa que todas las personas con puntuaciones de seguro bajos presentan un mayor riesgo.

Por ejemplo, si le agrega un conductor de 17 años a la póliza de seguro automovilístico, las primas probablemente aumentan. Eso se debe a que, como grupo, los conductores mas jóvenes tienen mas reclamaciones y pérdidas que las personas de mayor experiencia. Eso no significa que todos los de 17 años sean malos conductores pero la investigación demuestra que los conductores de ese grupo de edad tienen mayores probabilidades de pérdidas, así que pagan primas mayores. Lo mismo sucede con la puntuación de seguro -- estudios demuestran que la gente con ciertos patronos de comportamiento en su historia crediticia tienden más a ocasionarle pérdidas a la compañía de seguros. A raíz de eso, ellos pagan mayores primas, o, en casos extremos, la consecución de seguro se les complica en ciertas compañías. Un estudio de la Comisión Federal de Comercio (FTC) sobre los puntajes del seguro publicado en julio de 2007 demostró que: "las puntuaciones de seguro con base en el credito predican efectivamente el riesgo en las pólizas automovilisticas. Predicen la cantidad de reclamos que losconsumidores presentan y el costo total de ellos." Además, el estudio de la FTC concluyó que dichos puntuaciones hacen que el proceso de seguro sea "más rápido y brato" con "ahorros de costos para los consumidores en forma de menores primas." Un estudio del Banco Central do 2007 también concluyó que la información de crédito tiene un valor de riesgo predictivo y objetivo para los bancos y otras empresas de servicios financieros.

¿Qué clase de cosas afectan mi puntación de seguro?

Las puntuaciones de seguro se basan en información como el historial de pago, bancarrotas, cobros, deuda activa y la antigüedad del historial crediticio. Por ejemplo, los pagos corrientes y puntuales de las tarjetas de crédito e hipotecas afectan la puntuación en forma positiva, mientras que los pagos tardíos lo afectan en forma negativa.

MUESTRAS DEL TIPO DE INFORMACIÓN DE LOS INFORMES DE CRÉDITO
QUE SE EMPLEA EN LAS PUNTUACIONES DE SEGURO



Cada vez que alguien examina el informe crediticio, las agencias de informe crediticio registran esa actividad como una "consulta." La cantidad de pedidos de informe en el historial también afecta la puntuación de seguro. Hay varias clases de pedidos de informe, pero bajo los modelos usados por la mayoría de compañías de seguro, las únicas que afectan el seguro son las que uno inicia al solicitar nuevos productos crediticios, tal como un nuevo préstamo para comprar automóvil, o el "financiamiento fácil" de un juego de dormitorio.

Una forma de mejorar la puntuación de seguro es limitar la cantidad de pedidos de informe iniciadas por uno mismo en el informe crediticio. Eso se hace al solicitar crédito solamente cuando uno verdaderamente lo necesita. Por ejemplo, el aviso de una tarjeta de crédito "preaprobada" no solicitada recibido por correo no afecta la puntuación, pues uno no inició la oferta. Sin embargo, si uno llena el formulario y lo envía, es uno quien solicita crédito. El pedido de informe queda registrada en el historial crediticio, lo cual afecta la puntuación.

No existe una fórmula para conseguir la puntuación "perfecto" puesto que el informe de crédito siempre cambia con el tiempo cuando le agregan la historia de pagos, se cierran o abren cuentas, etc. La clave para tener un buen puntaje es usar el crédito con prudencia – pagar las cuentas puntualmente y tener sentido común en las actividades relacionades con el crédito.

Las puntuaciones de seguro basados en el crédito observan patronos de administración financiera. La solicitud de una tarjeta de crédito no tiene mucho efecto en la puntuación de una persona. Pero la solicitud de varias líneas de crédito en un período corto probablemente tenga un impacto.

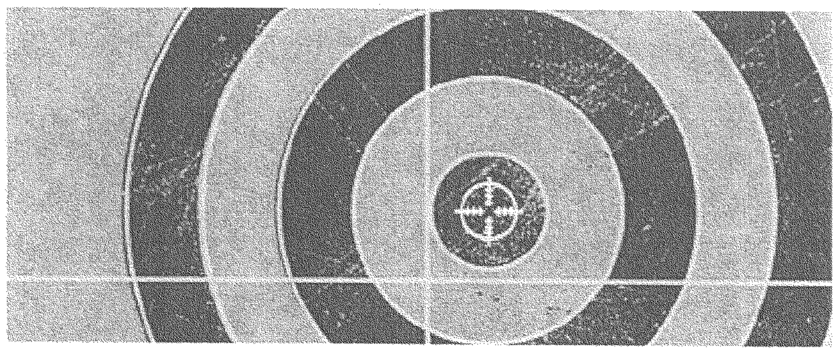
Si uno anda en busca de un automóvil o una casa, llena bastantes solicitudes en un período corto para encontrar la mejor oferta. Eso demuestra que uno es un consumidor responsable. Bajo la mayoría de los modelos actuales de calificación las puntuaciones con base en el crédito, la solicitud de varios prestamos automovilísticos en cierta cantidad de tiempo solamente cuenta como una consulta. Además, la mayoría de modelos no considera pedidos de informe que uno inicia al buscar cobertura de seguros.

¿Discriminan las puntuaciones de seguro basados en el crédito contra ciertos grupos étnicos o salariales?

No. Las compañías de seguro **NO** tienen en cuenta la siguiente información al calcular la puntuación de seguro basado en el crédito:

- INGRESO
- SEXO
- INCAPACIDAD
- FUENTES DE INGRESO DE AYUDA PÚBLICA
- RELIGIÓN
- NACIONALIDAD
- GRUPO ÉTNICO

Un amplio estudio hecho por la FTC conclyó que las puntuaciones de seguro son objectivos y no ven cosas como la raza o el género, diciendo que "tienen poco efecto como representación de afiliacion en grupos raciales y étnicos en las decisiones relacionadas con el seguro."



¿Me puede ayudar a ahorrar dinero en el seguro la puntuación de seguro?

Sí. Las puntuaciones de seguro basados en el crédito permiten que las compañías le cobren primas menores a los consumidores cuyo riesgo sea mejor. Por ejemplo, la gente que tenga mejores puntuaciones de seguro y un buen historial de tránsito podría recibir una mejor tarifa de seguro.

¿Tengo derechos si me niegan el seguro con base en la historia crediticia?

Absolutamente. Si la compañía de seguros toma una "decisión adversa" en su contra (tal como negarle la cobertura) a raíz de la información del informe crediticio, usted puede obtener una copia gratis del informe expedido por la agencia de crédito que suministró la información. Si cree que el informe contiene errores, debe informarle inmediatamente a la agencia de informes crediticios – ellos deben corregir los errores con prontitud.

Algunos estados han promulgado leyes relacionadas con las puntuaciones de seguro en los últimos años. Dicha información se encuentra en el departamento de seguros de cada estado.

¿Puedo obtener una copia del informe crediticio antes de solicitar el seguro?

Desde 1 de diciembre de 2004, los consumidores tienen derecho a recibir un informe gratis al año (vaya a www.annualcreditreport.com o llame al 1-877-322-8228 para recibir mas información). En otras ocasiones, cada una de las tres agencias de informes crediticios principales le envía una copia actualizada del informe por una suma módica. Una vez más, si cree que el informe contiene errores, se lo debe comunicar inmediatamente a la agencia. Si la información es incorrecta, la agencia tiene que corregir todo error con prontitud conforme a las leyes. La información para contactar a las tres agencias de informes crediticios principales aparece al final de este folleto.

¿Como benefician a los consumidores las puntuaciones de seguro basados en el crédito?

- Las puntuaciones de seguro basados en el crédito le ayudan a obtener menores primas porque las compañías de seguro le cobran menos a los consumidores de menor nesgo.

- El empleo de puntuaciones de seguro basados en el crédito permite que más compañías de seguros le ofrezcan una mayor variedad de productos a más personas. La competitividad en el mercado de seguro automovilístico ha aumentado considerablemente desde que se empezaron a usar Las puntuaciones de seguro – y la competencia comúnmente resulta en mayores opciones y costos reducidos.

- Las puntuaciones de seguro se pueden mejorar. Al usar el crédito con prudencia – pagar las cuentas a tiempo y actual responsablemente en otras actividades economicas – uno generalmente paga menos.**

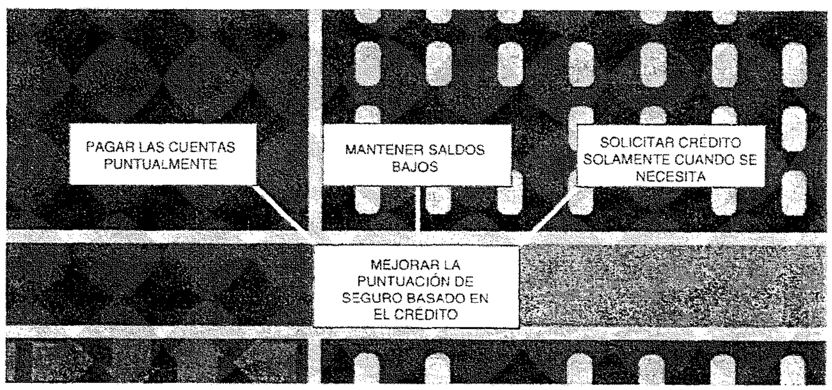
***Las compañías de seguro tienen políticas distintas con respecto a la frecuencia con la que revisan la puntuación de seguro. Consulte con la compañía aseguradora para avenguar cuál es la política de ellos.*

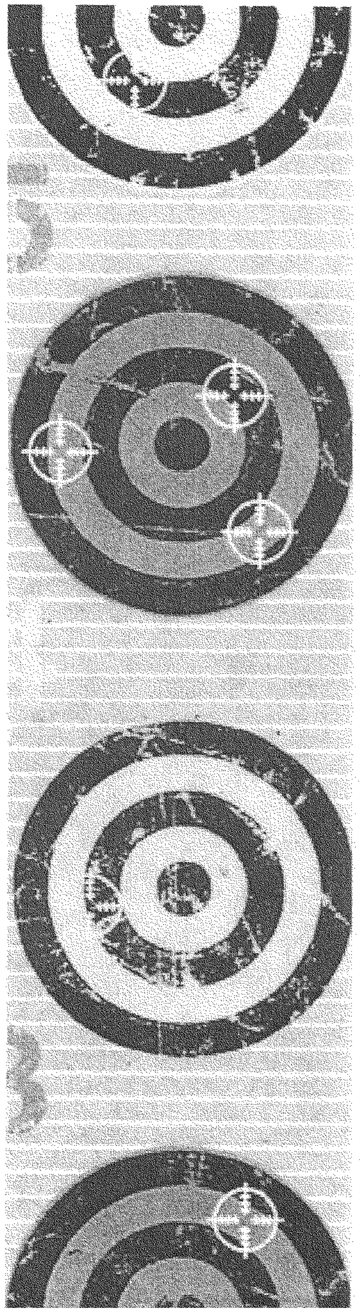
- La Ley Federal para la Información Justa en el Informe de Crédito, y la Ley de Transaccón Crediticia Justa y Precisa establecen numerosas protecciones para el consumidor. Estos incluyen:

  – *El derecho a obtener una copia gratis del informe crediticio si le afecta adversamente (por ejemplo, le niegan la cobertura) con base en la información del mismo*

  – *El derecho a refutar toda imprecisión en el informe y que le supriman la información incorrecta.*

  – *El derecho a obtener una copia gratis del informe crediticio anualmente de la agencia.*





American Insurance Association

Contactos y otros recursos:

Comisión Federal de Comercio (FTC)
(www.ftc.gov)

Vaya al sitio de la FTC para obtener información sobre el crédito y los derechos bajo la Ley para Información Justa en el Informe Crediticio (FCRA) y la Ley de Transacción Crediticia Justa y Precisa (FACT Act), o llame al 202-326-2222.

Equifax *(www.equifax.com)*

Llame al 1-800-685-1111 para conseguir una copia del informe.
Para disputar la información del informe, escríbales a:
P.O. Box 740241, Atlanta, GA 30373

Experian *(www.experian.com)*

Llame al 1-888-397-3742 para conseguir una copia del informe.

TransUnion *(www.transunion.com)*

Llame al 1-800-888-4213 para conseguir una copia del informe.
Si tiene una copia del informe y quiere hablar sobre ella, llame al 1-800-916-8800.
Para disputar la información del informe, escríbales a:
P.O. Box 2000, Chester, PA 19022

Asociación de la Industria de Datos del Consumidor (CDIA)
(www.cdiaonline.org)

Contacte a la CDIA para informarse más sobre la industria de informes crediticios.

Fair Isaac Corporation
(www.fairisaac.com)

Contacte a Fair Isaac para informarse sobre las puntuaciones crediticios y seguro.

Choicepoint
(www.choicepoint.com o www.choicetrust.com)

Contacte a Choicepoint para informarse más sobre las puntuaciones de seguro.

American Insurance Association
1130 Connecticut Avenue, N.W. Suite 1000
Washington, D.C. 20036
202-828-7100 www.aiadc.org

LexisNexis®

Before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives

Hearing on
The Use of Credit Information Beyond Lending:
Issues and Reform Proposals

May 12, 2010

John Wilson
Director, Analytics
LexisNexis Risk Solutions

Introduction

Good morning. My name is John Wilson and I am the Director of Analytics for the Insurance Data Services group of LexisNexis Risk Solutions. LexisNexis is a leading provider of authoritative legal, public records, and business information. The LexisNexis Risk Solutions Group provides technology and information that helps reduce fraud and mitigate risk. LexisNexis provides information, identification, verification, and fraud prevention tools to business, government, and law enforcement customers. Specifically, LexisNexis is a market leading provider of credit-based insurance scoring services to personal insurance lines (property and casualty).

On behalf of LexisNexis I welcome the opportunity to be here today to discuss credit-based insurance scores and how these scores are used by insurance companies, along with other factors to properly classify an insured party according to his or her future loss potential. In my testimony I will focus specifically on how LexisNexis insurance scores are developed, utilized, and regulated.

About Insurance Scores

Insurance companies use financial history along with other factors such as years of driving experience or claims history to properly classify an insured according to his or her potential risk. Studies have shown a correlation between a consumer's financial history and his or her future insurance loss potential.

Deriving an insurance score follows a straight forward process. A carrier compiles historical policy experience information on a selected population of policyholders. This information includes observed loss ratio performance (earned premiums and incurred loss information). LexisNexis then works with a credit bureau to match the historical consumer credit data associated with the relevant population for the particular point (or points) in time to which the policy performance data pertains. The research file is stripped of any identifiers. Then using regression techniques, we identify the credit variables and their associated bins and parameter estimates that taken together provide the best representation of the observed loss ratio performance. The resulting model rank orders claim risk and loss ratio risk over and above the driving history and claim history indications that are already accounted for in the premium component.

Because of the depth of content available in a credit report, it is possible to derive hundreds of credit variables for model consideration. In practice, most credit variables can be grouped into one of five primary areas: 1) the length of time that accounts have been established; 2) the number and type of credit accounts held; 3) indications of recent activity, including inquiries and new account openings; 4) the degree of utilization on accounts; and 5) payment practices, including measures of payment timeliness or delinquency and the presence or absence of collection entries or adverse public records. The relative weight of each of these areas can vary depending on the line of business being modeled, but for any specific model the insurance regulator is given access to the individual variable descriptions, bins, and point assignments.

Insurance scores do not consider factors such as race, religion, national origin, gender, marital status, age, sexual orientation, address, income, occupation, disability, or education. Additionally, inquiries made for account reviews or for promotional or insurance purposes are not used in calculating an insurance score.

Since insurance scores were introduced in 1993, they have been validated by carriers, by third party actuarial firms, and by various independent studies. In most states, the carriers must file their scoring models for regulatory review.

LexisNexis, as a third-party information provider, does not advise insurers how to use the data it provides. LexisNexis is not involved in insurer rate setting determinations or rate decisions with respect to groups of individuals or individual consumers. LexisNexis does not develop insurer rates or rating plans. LexisNexis does not offer rate setting forms or services.

LexisNexis is neither a consumer credit bureau nor an insurance company. LexisNexis does not make credit decisions nor determine insurance underwriting guidelines. LexisNexis' role is to supply information to the insurance carriers to assist them in making an underwriting decision.

About How LexisNexis is Regulated

The credit-based insurance scoring process is currently regulated at multiple levels and steps. LexisNexis is considered a consumer reporting agency under the federal Fair Credit Reporting Act ("FCRA") and its state analogues. As required by the FCRA, LexisNexis provides consumers, upon request, with access to all information in the consumer's file at the time of the request. The consumer also has the right to dispute information in his or her file that he or she believes to be inaccurate or incomplete. LexisNexis is then required to reinvestigate and to correct the information where it is determined to be incomplete or inaccurate.

While the FCRA does not require companies to disclose to consumers information concerning insurance scores, we feel that this information is valuable for consumers to know. Therefore, we have set up a process by which a consumer may order a copy of his or her insurance score via our www.choicetrust.com website.

Additionally, because insurance is regulated at a state level, LexisNexis must also conform its models to specific state statutes, regulations and/or guidelines relative to insurance scoring. Virtually every state has adopted statutes, regulations or guidelines based on or derived from the model law on insurance scoring developed by the National Conference of Insurance Legislators.

Pursuant to such requirements, a third-party vendor like LexisNexis must file its model for review and approval with each state insurance commissioner either directly or through individual carriers before the model can be used by an insurer as a component of the insurer's overall filing. Finally, the insurer itself must gain approval of its rate filing that may include an insurance scoring component. As a result, LexisNexis works on a regular and on-going basis with state departments of insurance to create state-approved scoring solutions for our carrier customers.

About Transparency

LexisNexis works closely with state departments of insurance and provides each state insurance department with confidential copies of our models for review and approval. We do request that our model details be treated as confidential / trade secret under the relevant state trade secret law.

Furthermore, in many states individual carriers are required to include the LexisNexis model filing materials as a part of their overall rate filings that are reviewed and approved by the particular department of insurance. In other states, a carrier may be allowed to reference the LexisNexis model filing once it has been approved.

We regularly communicate and meet with Insurance Commissioners and/or their staff, and have provided appropriate information and made adjustments to our scoring processes where doing so was required for approval. We have provided our scores for many studies undertaken by various parties, including the Federal Trade Commission, the Texas Department of Insurance, the Bureau of Business Research, and EPIC Actuaries.

We developed a training program for insurance agents on the topic of insurance credit scores, and we regularly present updates and developments concerning our insurance scoring products at regulatory conferences and hearings.

We have developed expanded versions of our reason codes and are currently developing a new, more detailed reason code reporting methodology to help consumers understand the factors that adversely impact their insurance score. In addition, LexisNexis provides two consumer facing web sites – www.choicetrust.com and www.consumerdisclosure.com – to make information about our insurance scores and processes readily accessible to consumers and to any other interested individual or group. As discussed above, a consumer may order a copy of his or her insurance score via our www.choicetrust.com website.

About C.L.U.E.

LexisNexis maintains the Comprehensive Loss Underwriting Exchange (C.L.U.E.), a contributory database for personal insurance lines (property and casualty claims records). Prior claims experience is used as an underwriting and/or rating consideration by nearly all carriers. The contributory nature of the C.L.U.E. database means that a carrier must contribute its claims experience to the database in order to retrieve claims reports from the database on its applicants. LexisNexis considers C.L.U.E. a consumer report. In keeping with this, we support consumer disclosure and dispute resolution as required under the Fair Credit Reporting Act. C.L.U.E. report content is not considered in the development of our insurance scores.

Conclusion

Credit-based insurance scores have been used by insurance company underwriters and actuaries for nearly two decades to more accurately assess risk for automobile and homeowners' insurance policies. Insurance scores provide an objective, effective, and consistent tool that insurers use with other information to better predict the likelihood of future claims and the cost of those claims.

LexisNexis has been a leading provider of insurance score services to property and casualty insurers since 1999. Since that time, LexisNexis has operated on a philosophy of openness and transparency for regulators, consumers, and insurers alike. Furthermore, existing federal and state regulation and approval processes provide comprehensive oversight by individual state departments of insurance over insurance scores, insurance score developers, and insurer use of insurance scores.

NCLC

NATIONAL
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in the Marketplace for All

Testimony before the

**U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT**

regarding

"Use of Credit Information beyond Lending: Issues and Reform Proposals"

May 12, 2010

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Testimony of Chi Chi Wu, National Consumer Law Center
Before the Subcommittee on Financial Institutions and Consumer Credit
of the U.S. House Committee on Financial Services
regarding
"Use of Credit Information beyond Lending: Issues and Reform Proposals"
May 12, 2010

Mr. Chairman, Ranking Member Hensarling, and Members of the Subcommittee, the National Consumer Law Center thanks you for inviting us to testify today regarding the use of credit reports in areas beyond lending, such as employment and insurance. We also thank you for inviting us to speak about the need to fix a scrivener's error in the Fair Credit Reporting Act (FCRA). We offer our testimony here on behalf of our low income clients.[1]

I. CONGRESS SHOULD BAN THE USE OF CREDIT HISTORIES IN EMPLOYMENT WITH LIMITED EXCEPTIONS

We wish to thank Chairman Gutierrez for his introduction of H.R. 3149, the Equal Employment Opportunity for All Act. The use of credit reports in employment is a growing practice that is harmful and unfair to American workers. Despite many good reasons to avoid engaging in this practice, nearly half of employers (47%) do so today.[2] It is because of the harms, as well as the absurdities of this practice, that we strongly support H.R. 3149. This bill would restrict the use of credit reports in employment to only those positions for which it is truly warranted, such as those requiring a national security or FDIC mandated clearance.

We oppose the unfettered use of credit histories and support H.R. 3149, for the following reasons:

- **Credit checks in hiring create a fundamental "Catch-22" for job applicants.**
- **The use of credit in hiring discriminates against African American and Latino job applicants.**

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1 The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of the damage wrought by inaccurate credit reporting from every part of the nation. It is from this vantage point – many years of observing the problems created by incorrect credit reporting in our communities – that we supply these comments. *Fair Credit Reporting* (6th ed. 2006) is one of the eighteen practice treatises that NCLC publishes and annually supplements. This testimony was written by Chi Chi Wu, with assistance from Nat Lippert of UNITE HERE, Richard Rubin and Leonard Bennett.
2 Statement of Elizabeth Owens Bille, Associate Counsel – Society for Human Resource Management, Presented to the Communications, Financial Services and Interstate Commerce Committee of the National Conference of State Legislatures, Dec. 11, 2009.

- **Credit history does not predict job performance.**

- **Credit reports suffer from unacceptable rates of inaccuracy, especially for a purpose as important as use in employment.**

Fundamentally, the issue at stake is whether workers are fairly judged based on their ability to perform a job or whether they're discriminated against because of their credit history. Eighteen states and the District of Columbia have recently considered legislation to restrict this practice.[3] Despite the lobbying efforts of the credit reporting industry, Oregon recently signed a bill (S.B. 1045) into law and other states are on their way to doing the same.

A. Considering Credit Histories in Hiring Creates an Absurd "Catch-22" for Job Applicants

The first and foremost reason to oppose the use of credit history for job applications is the sheer, profound absurdity of the practice. Using credit history, especially in an economy with such massive numbers of job losses such as the current one, creates a grotesque conundrum. Simply put, a worker who loses her job is likely fall behind on paying her bills due to lack of income. With the increasing use of credit reports, this worker now finds herself shut out of the job market because she's behind on her bills. As one law professor at the University of Illinois puts it "You can't re-establish your credit if you can't get a job, and you can't get a job if you've got bad credit."[4]

Some commentators have even said the use of credit reports to screen job applicants leads to a "financial death spiral: the worse their debts, the harder it is to get a job to pay them off."[5] This phenomenon has created concerns that the unemployed and debt-ridden could form a luckless class. It could affect future generations, as workers with impaired credit continue to struggle financially and cannot build assets to move ahead. These workers move further and further behind, while workers with good credit histories can get the best jobs, the best credit and the best insurance rates. Use of credit reporting in employment could contribute to the widening gap between haves and have-nots.

B. The Use Of Credit History In Hiring Discriminates Against African American And Latino Job Applicants.

There is no question that African American and Latino applicants fare worse than white applicants when credit histories are considered for job applications. For one thing,

3 For a useful listing of state legislation on this issue, please visit the website set up by the National Conference of State Legislatures:
<http://www.ncsl.org/IssuesResearch/BankingInsuranceFinancialServices/UseofCreditInformationinEmployment2010Legis/tabid/19825/Default.aspx>
4 Jonathan D. Glater, *Another Hurdle for the Jobless: Credit Inquiries*, New York Times, Aug. 6, 2009, available at http://www.nytimes.com/2009/08/07/business/07credit.html?pagewanted=all (quoting Professor Matthew W. Finkin).
5 *Id.*

these groups are already disproportionately affected by predatory credit practices, such as the marketing of subprime mortgages and overpriced auto loans targeted at these populations.[6] As a result, these groups have suffered higher foreclosure rates.[7] African Americans and Latinos also suffer from disparities in health outcomes, and as discussed in Section III of this testimony, health care bills are another source of black marks on credit reports.

Furthermore, African Americans and Latinos have markedly higher rates of unemployment. While the unemployment rate for whites was 9% in April 2010, it was 16.5% for African Americans and 12.5% for Latinos.[8] As discussed above, the simple fact of being unemployed is likely to harm an applicant's credit history because of the loss of income with which to pay bills.

In addition, numerous studies have documented how, as a group, African Americans and Latinos have lower credit scores than whites. If credit scores are supposed to be an accurate translation of a consumer's credit report and creditworthiness, that means these groups will fare worse when credit history is considered in employment. Studies showing racial disparities in credit scoring include:

- A 2007 Federal Reserve Board report to Congress on credit scoring and racial disparities, which was mandated by the 2003 Fair and Accurate Credit Transactions Act of 2003 (FACTA), amending the Fair Credit Reporting Act (FCRA).[9] This study analyzed 300,000 credit files matched with Social Security records to provide racial and demographic information. While the Federal Reserve's ultimate conclusion was to support credit scoring, its study found significant racial disparities. In one of the two models used by the Federal Reserve, the mean score of African Americans was approximately half that of white non-Hispanics (54.0 out of 100 for white non-Hispanics versus 25.6 for African Americans) with Hispanics fairing only slightly better (38.2).[10]

- A 2007 study by the Federal Trade Commission on racial disparities in the use of credit scores for auto insurance, also mandated by the 2003 FACTA amendments.[11] The FTC study found substantial racial disparities, with African Americans and Hispanics strongly over-represented in the lowest scoring categories.[12]

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6 *See* National Consumer Law Center, Credit Discrimination, §§ 1.1.1 and 8.4.2 (5th ed. 2009) (summarizing studies).
7 United for a Fair Economy, *Foreclosed: State of the Dream 20008* (January 2008).
8 Bureau of Labor Statistics, *Employment Situation Summary*, USDL-10-0589, May 7, 2010, *available at* http://www.bls.gov/news.release/empsit.nr0.htm.
9 Pub. L. No. 108-159, § 215 (2003).
10 Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* 80-81 (Aug. 2007).
11 Pub. L. No. 108-159, § 215 (2003).
12 Federal Trade Commission, *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* 3 (July 2007).

- A 2006 study from the Brookings Institution which found that counties with high minority populations are more likely to have lower average credit scores than predominately white counties.[13] In the counties with a very low typical score (scores of 560 to 619), Brookings found that about 19% of the population is Hispanic and another 28% is African American. On the other hand, the counties that have higher typical credit scores tend to be essentially all-white counties.

- A 2004 study by Federal Reserve researchers finding that fewer than 40% of consumers who lived in high-minority neighborhoods had credit scores over 701, while nearly 70% of consumers who lived in mostly white neighborhoods had scores over 701.[14]

- A 2004 study published by Harvard's Joint Center for Housing Studies finding that the median credit score for whites in 2001 was 738, but the median credit score for African Americans was 676 and for Hispanics was 670.[15]

- A 2004 study conducted by the Texas Department of Insurance on insurance scoring finding that African-American and Hispanic consumers constituted over 60% of the consumers having the worst credit scores but less than 10% of the consumers having the best scores.[16]

- A 1997 analysis by Fair Isaac itself showing that consumers living in minority neighborhoods had lower overall credit scores.[17]

- A 1996 Freddie Mac study which found that African-Americans were three times as likely to have FICO scores below 620 as whites. The same study showed that Hispanics are twice as likely as whites to have FICO scores under 620.[18]

Based on this disparity, the Equal Employment Opportunity Commission has repeatedly expressed concern that the use of credit histories in the hiring process violates Title VII of the Civil Rights Act.[19] The EEOC has recently sued one company over its use of credit checks[20] and has suggested that it may issue formal guidance on the practice.

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13 Matt Fellowes, Brookings Inst., *Credit Scores, Reports, and Getting Ahead in America* 9-10 (May 2006).
14 Robert B. Avery, Paul S. Calem, & Glenn B. Canner, *Credit Report Accuracy and Access to Credit*, Federal Reserve Bulletin (Summer 2004).
15 Raphael W. Bostic, Paul S. Calem, & Susan M. Wachter, Joint Ctr. for Hous. Studies of Harvard Univ., *Hitting the Wall: Credit As an Impediment to Homeownership* (Feb. 2004).
16 Tex. Dep't of Ins., *Report to the 79th Legislature--Use of Credit Information by Insurers in Texas* (Dec. 30, 2004).
17 Fair, Isaac & Co., *The Effectiveness of Scoring on Low-to-Moderate Income and High-Minority Area Populations* 22, Fig. 9 (Aug. 1997).
18 *See* Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families* (Sept. 1996), *available at* www.freddiemac.com/corporate/reports/moseley/mosehome.htm.
19 *See* Dianna B. Johnston, Assistant Legal Counsel, EEOC Informal Discussion Letter re Title VII: Employer Use of Credit Checks, Mar. 9, 2010, *available at* http://www.eeoc.gov/eeoc/foia/letters/2010/titlevii-employer-creditck.html. *See also* EEOC, Pre-

C. Credit History is Not a Valid Predictor of Job Performance

Credit reports were designed to predict the likelihood that a consumer will make payments on a loan, not whether he would steal or behave irresponsibly in the workplace. There is no evidence showing that people with weak credit are more likely to be bad employees or to steal from their bosses. The sole study on this issue, presented to the American Psychological Association in 2003, concluded there is no correlation between credit history and an employee's job performance.[21]

Regulators agree with this assessment. Dianna Johnston, assistant legal counsel to the Equal Employment Opportunity Commission, has stated: "Employers seem to be assuming that somebody with a poor credit history is more likely to steal, and I don't think there's any kind of evidence that supports that.[22]

Even TransUnion's representative on this issue, Eric Rosenberg, admitted at a recent legislative hearing in Oregon: "At this point we don't have any research to show any statistical correlation between what's in somebody's credit report and their job performance or their likelihood to commit fraud."[23] This is significant, as TransUnion has been the credit bureau that has led efforts against legislation restricting the use of credit reports in a number of states.

Unfortunately, proponents of using credit reports for employment use a "sloppy credit, sloppy person" hypothesis, arguing that a financial history is a good measure of an applicant's organization and responsibility. As one executive at an employment firm argued "[i]f you cannot organize your finances, how are you going to responsibly organize yourself for a company?"[24] The flaw in this hypothesis is that many people end up with a negative credit history for reasons they can't control. A consumer's financial problems reflected on a credit report may stem from, not irresponsibility, but because of a layoff, divorce, identity theft, or as discussed below, medical bills. A well-known Harvard study found that medical reasons cause about half of all bankruptcies in the U.S.[25] Many hard-working Americans live just one paycheck away from financial disaster.

Employment Inquiries and Credit Rating or Economic Status, undated, *available at* http://www.eeoc.gov/laws/practices/inquiries_credit.cfm; EEOC, *E-RACE Goals and Objectives*, at http://www.eeoc.gov/eeoc/initiatives/e-race/goals.cfm.

20 Complaint, EEOC v. Freeman, Case No.8:09-cv-02573-RWT (D. Md. Sept. 30, 2009).

21 Palmer, Jerry K. and Laura L. Koppes. *Further Investigation of Credit History as a Predictor of Employee Turnover*. Presentation to the American Psychological Society, 2003.

22 Ben Arnoldy, *The Spread of Credit Checks as a Civil Rights Issue*, Christian Science Monitor. January 18, 2007.

23 Andrew Martin, *As a Hiring Filter, Credit Checks Draw Questions*, New York Times, April 9, 2010, *available at* http://www.nytimes.com/2010/04/10/business/10credit.html.

24 Diane E. Lewis, *Qualification: Must Have a Good Credit History*, Boston Globe, September 5, 2006, at E1.

25 David U. Himmelstein, Elizabeth Warren, Deborah Thorne, & Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, *Health Affairs--Web Exclusive*, Feb. 2, 2005, *available at* http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1.

D. Credit Reports Suffer from Rates of Inaccuracy that are Unacceptable for Use in Employment.

As NCLC and many other consumer advocates have testified before, the consumer reporting system suffers from high rates of inaccuracy. In addition, growing numbers of Americans have their credit reports horribly damaged from identity theft, predatory loans, or other abusive practices. Credit reports should be considered too unreliable to use as a critical (and sometimes determining) factor in whether a worker is able to obtain employment, especially in an environment where joblessness is so high and jobs are so scare. A consumer who has an error in her credit report might be able to later fix it[26] and reapply for credit, but if she loses a good job opportunity, it could doom her financially for months, harm her for years, or even affect her permanently. Very few employers will voluntarily hold up a hiring process for one or more months to allow an applicant to correct an error in a credit report.

In the hearings that led to the 2003 FACTA Amendments, Congress was presented study after study documenting errors in credit reports. For example, a study by the Consumer Federation of America and National Credit Reporting Association documented numerous serious errors and inconsistencies, such as the fact that 29% of credit files had a difference of 50 points or more between the highest and lowest scores from the three nationwide credit reporting agencies (i.e., Equifax, Experian and TransUnion).[27] Members of Congress cited studies from U.S PIRG showing errors in 70% of credit reports, of which 25% were serious enough to cause a denial of credit.[28]

This level of inaccuracy continues after the 2003 FACTA amendments. An on-line survey by Zogby Interactive found that 37% of consumers who ordered their credit report discovered an error, and 50% of those were not easily able to correct the error.[29] A subsequent 2004 study by U.S. PIRG showed no improvement, finding that 25% of credit reports studied still contained serious errors.[30] Even the Consumer Data Industry Association (CDIA) has admitted that, out of 57.4 million consumers who ordered their own credit reports in 2003, 12.5 million (or 21.8%) filed a dispute that resulted in an investigation.[31]

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26 Even the ability of consumers to fix errors in their credit reports is questionable, given the automated and perfunctory nature of the credit bureaus' dispute resolutions systems. See Chi Chi Wu, National Consumer Law Center, *Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking to Fix Errors in Their Credit Reports*, January 2009.
27 *The Fair Credit Reporting Act and Issues Presented by Reauthorization of the Expiring Preemption Provisions: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs*, 108th Cong. 381 (2003)(statement of Stephen Brobeck, Executive Director, Consumer Federation of America).
28 *Id.* at 351 (statement of Senator Paul S. Sarbanes).
29 Zogby Interactive, *Most Americans Fear Identity Theft*, Zogby's American Consumer, April 2007, at 3.
30 Nat'l Ass'n of State PIRGs, *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports* 11 (2004).
31 Federal Trade Commission and Federal Reserve Board, *Report to Congress on the Fair Credit Reporting Act Dispute Process* (Aug. 2006), at 12.

As a result of the FACTA debates, the FTC was required to undertake a comprehensive study of errors in credit reports. The FTC is in the midst of this study. In the pilot phase of the study, 53% (16 out of 30) of consumers found an error in their credit reports. Sixteen percent of the consumers found errors that either would have likely had a material effect on their credit score (3 out of 30), or the effect was uncertain (2 out of 30).[32] In the second phase of the study, 31% of participants (40 of 128) found errors in the credit reports, and 12% (15 of 128) found errors that would have a material effect on their credit scores.[33] Note that the FTC has admitted that both of these studies were significantly skewed toward consumers with higher scores, who are less likely to have errors in their credit reports. For example, half of those consumers with a credit score under 610 had a material error but no consumer with a credit score over 790 had a material error. The study was also skewed to consumers with higher income households (with 34% having incomes over $100,000) and college graduates (66%).

The industry has attempted to rebut these statistics by claiming that fewer than 3% of credit reports are inaccurate; however, it reached this statistic by counting only those credit reports in which the consumer: (1) was denied credit; (2) requested a copy of their credit report; (3) filed a dispute; and (4) the dispute resulted in a reversal of the original decision to deny credit.[34] Thus, the industry's statistic did not include inaccuracies in the credit reports of consumers who did not apply for or were denied credit, had not filed a dispute, or who did not seek a reversal of the original denial of credit.

Error rates of 12% to 37% are simply too high to allow use of credit reports as a screening tool. Americans should not be put at risk of being shut out of the job market by a system that is flawed enough to harm as many as 1 in 3 workers. Even if one were to use the industry's highly questionable statistic of 3%, that leaves over 6 million American workers in jeopardy of being denied employment on the basis of an inaccurate credit report. American workers deserve better.

E. Congress Should Pass H.R. 3149

TransUnion recently stated in a legislative hearing that credit reports are the "de facto economic passport for every individual in this country, whether you like it or not."[35] Workers across the board have suffered wage cuts, layoffs and foreclosures during this economic crisis, all of which have impacted their credit history. As we work to rebuild our economy, we believe that hard work and dedication, not discriminatory and

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32 Federal Trade Commission, *Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003* (December 2006), Appendix at 15..
33 Federal Trade Commission, *Report to Congress Under Section 319 of the Fair and Accurate Credit Transaction Act of 2003* (December 2008).
34 Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 2004), at 25, *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf (citing an Arthur Andersen study commissioned by the credit bureaus).
35 Statement of TransUnion Director of State Government Relations Eric Rosenberg before the Oregon Senate Commerce and Workforce Development Committee, February 8, 2010.

unreliable hiring tools such as credit reports, should be the economic passport for workers in the United States. Congress should act quickly to pass H.R. 3149, Equal Employment for All Act.

II. CONGRESS MUST ACT TO CORRECT AN INJUSTICE RESULTING FROM A SCRIVENER'S ERROR IN THE FCRA.

The FACTA amendments of 2003 may have inadvertently deprived consumers of a 30 year-old pre-existing right they had to enforce the FCRA requirement that users of credit reports disclose to consumers when an "adverse action" is taken, *i.e.,* credit or insurance is denied or provided on less favorable terms, on the basis of an unfavorable credit report. 15 U.S.C. § 1681m. Congress can easily fix this scrivener's error and should do so, as it was never part of the legislative bargain struck by FACTA.

- **The adverse action disclosure is fundamental to ensuring the effectiveness of the FCRA's accuracy protections. The ability for consumers to seek redress for an adverse action disclosure violation has been key to its enforcement for over 30 years.**

- **FACTA's legislative history clearly indicates that Congress had absolutely no intention of abolishing the consumer's right to seek redress of this important right. Current provisions of the FCRA, which exempt another subsection of section 1681m from private enforcement, make no sense and indicate that Congress did not intend to abolish consumer remedies for all of section 1681m.**

- **Even after FACTA's enactment, the credit industry did not claim to have eliminated the consumer remedy for the adverse action disclosure, with the *American Banker* only noting that FACTA "*perhaps inadvertently* eliminates the existing right of consumers and state officials to sue for any violations of the adverse-action provisions of the FCRA."**

- **Despite Congress's expressed intent in FACTA to preserve all then pre-existing rights of action in the FCRA, several dozen court decisions have held that FACTA abolished consumer remedies for adverse action disclosure violations, depriving hundreds of consumers of their rights.**

A. Importance of the Adverse Action Disclosure Requirement and its Enforceability by Consumers

When Congress enacted the FCRA, in addition to regulating credit reporting agencies, it imposed significant disclosure requirements on those who obtain and use consumer reports ("users"). Pub. L. No. 91-508, Title VI, 84 Stat. 1127 (1970) Section 615 of the Act, codified as 15 U.S.C. § 1681m, mandated that lenders, insurers, employers, and others using consumer reports disclose to a consumer whenever they use the consumer's report to make a decision adverse to the consumer's interests.

In the original FCRA and for over 30 years, adverse action disclosure by users of credit reports has been fundamental to the consumer protection structure Congress established in the FCRA. Adverse action disclosure is the linchpin of a three-part scheme. The user's disclosure of adverse action alerts the consumer to the presence of negative information in a credit report. After receiving this disclosure, the consumer has a statutory right to obtain a free copy of the report containing the negative information. 15 U.S.C. § 1681j. As the final element of this three-part self-help system, Congress created a formal dispute process by which the consumer could obtain correction of inaccurate information in the report that led to the adverse action. 15 U.S.C. § 1681i. The adverse action disclosure is thus the direct link to the dispute process through which consumers may seek correction of inaccuracies in their credit reports.

In 1970, Congress recognized that no one has a bigger stake in the accuracy of a credit report than the consumer whose name is on it. By establishing the right of consumers to seek private redress under sections 1681n and 1681o, Congress assigned the primary enforcement role to those with the greatest interest in accomplishing such a task – the individuals whose peace of mind and material wellbeing are directly impaired by inaccurate credit reports. In section 1681o, Congress gave consumers the right to recover actual and punitive damages against "[a]ny consumer reporting agency or *user* of information which willfully fails to comply with any requirement" of the Act. (Emphasis added.) Section 1681n in parallel fashion authorized the recovery of actual damages for any negligent violation of the Act. In the 1970 legislation, there were no exceptions to this private enforcement scheme.

Thus, since 1970, consumers have had the right to seek redress for violations of the adverse action disclosure requirement. And for over 30 years, private litigants provided the most significant enforcement of section 1681m's user disclosure requirements. A Westlaw search for reported Fair Credit Reporting Act cases in which section 1681m has been cited together with either section 1681n or 1681o yields 292 hits.

In contrast, there was been much less enforcement by federal regulators. According to the FTC, as of 2004, it brought twenty-nine enforcement actions involving the adverse action disclosure requirements.[36] A search of the FTC's website reveals only two more such since 2004.

In 1996, Congress made its first major revision to the FCRA after 25 years of experience under the original statutory regime. Congress substantially amended the FCRA in the Consumer Credit Reporting Reform Act of 1996 ("1996 Amendments"). Pub. L. No. 104-208, 110 Stat. 3009 (1996). These Amendments left the central core of section 1681m intact, and thus reaffirmed the adverse action disclosure requirement.

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36 Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 2004), at 18-19, nn. 61-64, *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf

These amendments also left untouched sections 1681n and 1681o, confirming the primacy of private enforcement. During the 1996 amendment process, the FTC acknowledged that the FCRA "was designed to be largely self-enforcing" and expressed its position directly to Congress that any amendments maintain "the capacity of consumers to bring private actions to enforce their rights under the statute." S. Rep. 103-209, at 6 (1996).

B. Congress Did Not Intend FACTA to Abolish the Consumer's Right to Seek Redress for Violation of the Adverse Action Disclosure Requirements of the FCRA

The legislative history can be no clearer than Congress did not intend to abolish private enforcement of the FCRA's adverse action disclosure requirements when it enacted FACTA in 2003. At that time, credit reporting came to the legislative fore due to the imminent sunset of several provisions in the 1996 amendments that preempted state law. Competing House and Senate credit reporting bills worked their way through Congress during the fall of that year.

1. *The House Bill*

On September 10, 2003, the House passed House Bill No. 2622, entitled the "Fair and Accurate Credit Transactions Act of 2003." 149 Cong. Rec. H8167 (2003). The House Bill did not propose any amendments to the adverse action disclosure requirements under subsections (a) and (b) of section 1681m. H.R. Rep No. 108-396 (2003). The bill proposed only two amendments to section 1681m: (i) section 403 of the bill proposed a new subsection (c) to section 1681m to require debt collectors to provide information to identity theft victims under certain circumstances; and (ii) section 503 of the bill made some modifications to subsection (d) of section 1681m. The bill did not propose any limitations on the application of the FCRA's private enforcement provisions.

2. *The Senate Bill*

Senate Bill No. 1756, entitled the "National Consumer Credit Reporting System Improvement Act of 2003," proposed adding five new subsections to section 1681m. 149 Cong Rec. S13912 (2003), available at http://www.gpoaccess.gov/crecord/retrieve.html.:

- Section 114(a) proposed a new subsection (e) to section 1681m, requiring federal agencies to promulgate "Red Flag Guidelines and Regulations" to protect against identity theft.
- Section 154(b) proposed adding subsection (g) to prohibit the sale of debt known to be the result of identity theft.
- Section 155 proposed the addition of subsection (h) requiring debt collectors to provide information to identity theft victims.
- Section 212(b) proposed a new subsection (i), requiring users to disclose extensive credit scoring information in consumer mortgage transactions.

- Finally, section 311(a) proposed a new subsection (j), requiring users to make detailed disclosures to consumers in risk-based pricing credit transactions ("risk based-pricing notice").

The Senate Bill also explicitly addressed — and thus confirmed — the continued vitality of private enforcement of the existing subsections of section 1681m. Section 312(c) of the bill proposed to restrict private rights of action under FCRA only as to violations of proposed new subsections "(e) and (f)" of section 1681m. Subsection "(e)" referred to the newly proposed Red Flag Guidelines and Regulations; the reference to subsection "(f)" appears to be a drafting error because no such subsection existed, and the bill didn't propose one. A parallel provision limited enforcement of these same subsections (e) and (f) to federal and state regulatory agencies.

Section 312 of the Senate Bill also contained a clause prohibiting any interpretation of the bill that would limit private enforcement under sections 1681n and 1681o based on violations of any of the then existing FCRA provisions. Section 312(d) stated:

> Rule of Construction.--Nothing in this section, the amendments made by this section, or any other provision of this Act shall be construed to affect any liability under section 616 or 617 of the Fair Credit Reporting Act (15 U.S.C. 1681n, 1681o) that existed on the day before the date of enactment of this Act.

This provision expressly preserved all private enforcement rights that existed under the FCRA as of the date of the new law. The only restrictions in the Senate Bill on private enforcement under sections 1681n and 1681o appeared in section 312(c) (with respect to proposed newly added subsections of section 1681m) and in section 151(a), which added new protections for identity theft victims as part of section 1681g. Because these were new provisions of the FCRA, section 312(d) did not apply to them. Section 312(d) stated directly that regardless of any limitations on the enforcement of these newly added provisions, Congress had no intention to cut back the pre-existing private enforcement regime.

3. *The Conference Bill*

The provisions of FACTA come from the Senate Bill, as amended in the Senate and later by House and Senate conferees. On November 5, 2003, without voting on the Senate Bill, the Senate amended the House Bill by gutting it, replacing it with the provisions of the Senate Bill, and passing it. 149 Cong Rec. S13980-94 (2003).

On November 6, both houses agreed to a conference. 149 Cong Rec. H10514-15, S13994 (2003). The conferees hurriedly negotiated a conference report, which was completed on November 21. H.R. Rep No. 108-396 (2003); 149 Cong. Rec. H12198. The House immediately passed the conference bill on November 21. 149 Cong. Rep. 12247 (2003). The Senate passed the bill the following day. Id. S15570. The President signed the conference report version of House Bill No. 2622 — now FACTA — into law two weeks later on December 4, 2003. Pub. L. 108-159, 117 Stat. 1960 (2003).

If the House had simply accepted the Senate's amendments — that is, had accepted the Senate Bill — FACTA would not have clouded private enforcement of section 1681m. The House and Senate conferees, however, agreed to changes to section 1681m in the Senate Bill that resulted in the scrivener's error.

The conference version of the House Bill — that is, the bill that became FACTA itself — incorporated the risk-based pricing notice section of the Senate Bill, section 311. *See* 149 Cong. Rec. S13989 (2003). Subsection (a) of section 311 is now codified as 15 U.S.C. § 1681m(h). The conference report adopted the Senate's section 311 with two exceptions. First, the risk-based pricing subsection was re-lettered from (j) to (h) in the codified version. Second, the conference version of section 311 added two new paragraphs to the new section 1681m(h):

> (7) Compliance.--A person shall not be liable for failure to perform the duties required by this section if, at the time of the failure, the person maintained reasonable policies and procedures to comply with this section.
>
> (8) Enforcement.—
>
> > (A) No civil actions.—[Sections 1681n and 1681o] shall not apply to any failure by any person to comply with this section.
> >
> > (B) Administrative enforcement.--This section shall be enforced exclusively under [section 1681s] by the Federal agencies and officials identified in that section.
>
> (Code sections inserted.)

The conferees also adopted section 312(c) of the Senate Bill, which had been the only provision in that bill relating to private rights of action under section 1681m. This subsection of the Senate Bill had stated in part: "sections [1681n and 1681o] do not apply to any violation of ... (3) subsection (e) or (f) of [1681m]." 149 Cong Rec. S13990 (2003) (code sections inserted). The conferees included this provision of the Senate version in FACTA, but eliminated the reference to section 1681m(f). FACTA § 312(e)(1).

The conferees also agreed to include section 312(d) from the Senate Bill in FACTA, which appears as section 312(f) in the conference bill. 149 Cong. Rec. S13990 (2003). This is the provision (noted above) stating that "nothing in the Act shall be construed to affect any liability under section 616 or 617 of the Fair Credit Reporting Act (15 U.S.C. 1681n, 1681o) that existed on the day before the date of enactment of this Act."

Because the Senate Bill contained no limitation on private enforcement of the existing subsections of section 1681m, any provisions in FACTA eliminating these remedies must have been introduced by the House conferees into the conference version of the bill. However, the report on the conference bill presented to the House before its November 21 vote contained no indication that the House conferees had obtained elimination of private enforcement of section 1681m as a concession from the Senate, or even that this had ever been an issue in the conference.

To the contrary, this report shows that the new paragraph (8) of subsection 1681m(h) was not intended to have that effect. Representative Michael Oxley (R-OH), one of the House conferees, provided the House this section-by-section report on the conference bill. 149 Cong. Rec. E2512-19 (2003). With specific respect to section 311, which mandated the risk-based pricing disclosures to consumers, he reported:

> The FTC and FRB are directed to jointly prescribe rules to carry out this section. *The rules are to address the form, content, time and manner of delivery of the notice; the meaning of the terms used in the section; exceptions to the notice requirement; and a model notice.* The section provides creditors with a safe harbor if they maintain reasonable policies and procedures for compliance, and *the section is only subject to administrative enforcement by the appropriate Federal agencies.*
>
> *Id.* at E2516 (emphasis added).

Representative Oxley's references to "section" are to section 311 of the conference bill, not to section 1681m of the FCRA.

4. *Deliberately Abolishing Private Enforcement of the Adverse Action Disclosure Requirement Creates Multiple Inconsistencies and Redundancies*

If Congress had intentionally abolished private enforcement of all of section 1681m by the use of the word "section" in paragraph (8) of subsection 1681m(h), it would render several other provisions of FACTA as redundant and superfluous First, it would render Section 1681s-2(c)(3), as amended by FACTA § 312(e), to be totally superfluous. That section expressly provides that the private remedies sections do not apply to one portion of section 1681m, namely subsection 1681m(e), the provision dealing with the Red Flag Guidelines. It would make no sense for Congress to exempt section 1681m(e) from private enforcement if all of section 1681m were already exempt by virtue of §1681m(h)(8).

This redundancy indicates that the reference to "section" in § 1681m(h)(8) was intended to apply to § 1681m(h) only. Indeed, "this section," standing alone and taken even in its most technical sense in the drafting hierarchy, may sensibly refer to the "section" of which it is a part — 311 of FACTA — rather than section 1681m of the

FCRA. Using "this section" to refer to a section of FACTA is entirely consistent with the hierarchical organization of statutes described in the Congressional drafting manuals.

Furthermore, Congress repeatedly used "this section" to refer to sections of FACTA itself. *See, e.g.*, FACTA §§ 211(d)(1)(A), 211(d)(4), 213(b), 312(f), 313(b)(3), 318(b), 411(d), 412(d), 412(g), 515(d), 518(a), 518(e), 518(f). Congress also used FACTA section numbers within text to be codified in Title 15. *See, e.g.*, FACTA § 211(a) (adding a new subsection (a) to 1681j, including paragraph (1)(B), stating in part: "Subparagraph (A) shall apply with respect to a consumer reporting agency described in section 603(p) only if the request from the consumer is made using the centralized source established for such purpose in accordance with *section 211(c)* of the Fair and Accurate Credit Transactions Act of 2003") (emphasis added); § 211(c) (amending § 1681g(c)(1)(B)(5) in similar fashion). In section 151, Congress used "this section" to refer to section 151 itself in amending section 1681g. Section 151(a) added a new subsection (e) to section 1681g. Section 151(a) of FACTA provides that new section 1681g(e)(3)(c) will state in part: "The request of a victim under paragraph (1) shall ... (C) if asked by the business entity, include relevant information about any transaction alleged to be a result of identity theft to facilitate compliance *with this section* ..." (Emphasis added.) "This section" refers to section 151, not section 1681g, because the information to be included in the victim request is to facilitate compliance with the new disclosures businesses are now required to provide identity theft victims under section 151, not compliance with any other part of section 1681g.

5. *Multiple Facts Demonstrate that Congress Did Not Intend to Deliberately Abolish Private Enforcement of the Adverse Action Disclosure.*

The legislative history of FACTA leaves little doubt that use of "this section" was not intended to eliminate the 30 year old pre-existing right of consumers to seek redress of the adverse action disclosure requirements. Evidence of this includes:

- Neither the House nor the Senate Bills ever proposed to limit private enforcement of any of the pre-existing subsections of section 1681m.
- FACTA included section 312(f), which expressly preserves private enforcement under the existing provisions of the FCRA. While not codified in the United States Code, this provision is still effective law as part of the Statutes at Large. Pub. L. 108-159, 117 Stat. 1960, § 312(f) (2003).
- FACTA specifically added current section 1681s-2(c)(3), which exempts "subsection (e) of section 1681m" from private enforcement. In addition, Congressional conferees deliberately amended this provision to remove subsection 1681m(f) from the list of FCRA provisions for which FACTA excluded from private enforcement. Removing subsection 1681m(f) would have been a meaningless exercise if Congress had intended FACTA to abolish private enforcement of all of the subsections of section 1681m.

- Representative Oxley's section-by-section report on FACTA before the vote in the House referred to the liability and enforcement limitation provisions of section 311 as applying only to that FACTA section, not to section 1681m as a whole.

Thus, Congress did not intend to limit private enforcement of section 1681m except with respect to two of the newly added subsections, (e) and (h). But in the hurry to prepare the conference report in the days between November 6 and November 21, "this section" was inadvertently used instead of "this subsection" in the conferees' insertions at the end of section 311(a), namely paragraph (8) of section 1681m(h). This was simply one of likely many drafting irregularities in the huge bill, hurriedly negotiated between the houses under the looming January 1, 2004 deadline for the sunset of the FCRA's state law preemption provisions, and then passed hurriedly without time for review or debate. FACTA includes 45 sections with subparts almost too innumerable to count. It contains over 26,000 words.

C. After FACTA's Enactment, the Industry Did Not Claim to Have Eliminated Consumer Enforcement of the Adverse Action Disclosure Requirement.

A week after FACTA was signed into law, an article appeared in *American Banker* regarding the 35-day gap that the bill had left between the expiration of preemption provisions under the 1996 amendments and the effective date of FACTA.[37] The reporter for *American Banker* noted in passing that FACTA *"perhaps inadvertently* eliminates the existing right of consumers and state officials to sue for any violations of the adverse-action provisions of the FCRA." (emphasis added).

Had Congress intended FACTA to carve private damages suits wholesale out of the user liability section of the FCRA, the banking and credit industry would have trumpeted that change in the days following the President's signature. Instead, just days after FACTA became law, a leading industry trade journal reported that private enforcement of section 1681m was only "perhaps" and only "inadvertently" eliminated. *American Banker* was reporting the simple truth that neither Congress nor the industry ever contemplated that result.

It would have been extraordinary for Congress, after over 30 years of well-established private enforcement of section 1681m, to abolish that right without the slightest indication from any member of Congress or any lobbying or fanfare from the consumer credit industry. Even four years after FACTA's passage, industry representatives declined to claim that FACTA had intentionally abolished this private enforcement remedy. In a 2007 hearing before the full committee, Chairman Barney Frank engaged in the following colloquy with Stuart Pratt, President and CEO of the Consumer Data Industry Association, and Anne Fortney of Hudson Cook, another industry representative.[38]

37 M. Heller, *Regulators Scurry to Close FACT Act Loophole*, American Banker (Dec. 12, 2003), at 3.
38 *Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information: Hearing Before the H. Comm. on Fin. Serv.*, 110 Congr. 50 (2007).

The CHAIRMAN. We will look into that. Let me just ask, the other question is to Ms. Fortney and Mr. Pratt, because both Ms. Wu and Mr. Bennett talked about the interpretation that we had sub silentio repeal of the private right of action. Do you agree that was something that was not done intentionally? And what would your view be to our restoring it? Mr. Pratt?

Mr. PRATT. We didn't work on that section of the FACT Act. It relates to the date of furnishers and the date of—

The CHAIRMAN. Okay. Ms. Fortney?

Ms. FORTNEY. I think the statute is clear, and that is why the vast majority—

The CHAIRMAN. That wasn't the question.

Ms. FORTNEY. Okay. I know.

The CHAIRMAN. Then why don't you answer it?

Ms. FORTNEY. The answer is, I don't know that whoever drafted that—

The CHAIRMAN. Fair point. But would you like to leave it the way it is?

Ms. FORTNEY. I am sorry?

The CHAIRMAN. Would you object if we restored the right of action that is in the bill?

Ms. FORTNEY. I don't have an opinion on that, sir.

The CHAIRMAN. Oh, okay. Then it is two to nothing, two abstentions.

D. Court Decisions Abolishing Consumer Redress for Adverse Action Disclosure Violations Have Deprived Consumers of their Rights under the FCRA

Unfortunately, the mistaken use of the phrase "this section" in Section 1681m(h)(8) has been interpreted by most of the 46 courts to address the issue to apply to the pre-existing adverse action requirements, creating chaos and uncertainty.[39] These

39 Perry v. First Nat. Bank, 459 F.3d 816 (7th Cir. 2006) (collecting cases); Banga v. Allstate Ins. Co., 2010 WL 1267841 (E.D. Cal. Mar. 31, 2010); Tobler v. Equifax, 2009 WL 1491046, at *3 (E.D. Mich. May 27, 2009); Meyers v. Freedom Credit Union, 2007 WL 2753172, at *5 (E.D. Pa. Sept. 21, 2007); Gelman v. State Farm Mut. Auto. Ins. Co., 2007 WL 2306578, at *9 (E.D. Pa. Aug. 9, 2007); Soroka v. JP Morgan Chase & Co., 2007 WL 895249, at *6 (S.D.N.Y. Mar. 19, 2007); Miller v. Corestar Fin. Group of Pa., Inc., 2007 WL 419194, at *2 (Feb. 5, 2007);; Murray v. HSBC Auto Fin., Inc., 2006 WL 2861954, *7 (N.D. Ill. Sept. 27, 2006); Panko v. Discover Fin. Servs., LLC, 458 F. Supp. 2d 580, 584 (N.D. Ill. 2006); Murray v. E*Trade Fin. Corp., 2006 WL 2054381, at *3 (N.D. Ill. July 19, 2006); Soroka v. Homeowners

courts that have addressed this issue have fastened on the term "section" in paragraph (8) of section 1681m(h), holding that this term unambiguously refers to section 1681m as a whole.

Only two courts have been percipient enough to analyze the legislative history and realize that use of the word "section" was an error.[40] It was the court in one of these cases that term this a "scrivener's error."[41]

As a result, there have been allegedly at least 44 users of credit reports –lenders, insurers, and other businesses - that have denied potentially hundreds of consumers their right to receive adverse action disclosures. These documented cases are perhaps only the tip of the iceberg, as we assume that attorneys representing consumers have been discouraged from bringing these cases by these unfavorable court decisions. Indeed, an informal and quick poll of attorneys who represent consumers in credit reporting cases found six respondents who had seen violations of the FCRA adverse action requirements who had declined to bring a case because of the decisions holding that FACTA had abolished the pre-existing right of action for these violations. One of these attorneys noted that he had just turned away a client who presented such a violation, in connection with seeking rental housing. Another attorney noted that he had seen lack of adverse action notices from mortgage companies, car dealers, and providers of rental housing, all of whom had accessed consumer reports. A legal services attorney noted: "I have found that employers and landlords routinely fail to provide notice or copies of the consumer reports."

Loan Corp., 2006 WL 4031347, at *7 (M.D. Fla. June 12, 2006); Shellman v. Country Wide Home Loans, Inc., 2006 WL 1544427, at *2 (N.D. Ind. June 1, 2006); Bruce v. Keybank Nat'l Ass'n, 2006 WL 1408349, at *5 (N.D. Ind. 2006); Cavin v. Home Loan Ctr., Inc., 2006 WL 1313191, at *7 (N.D. Ill. May 10, 2006); Tremble v. Town & Country Credit Corp., 2006 WL 163140, at *2 (N.D. Ill. Jan. 18, 2006); Bonner v. CorTrust Bank, N.A., 2006 WL 1980183, at **3-4 (N.D .Ind. July 12, 2006); Miller v. CoreStar Fin. Group of Pa., Inc., 2006 WL 1876584, *2 -3 (E.D.Pa. June 29, 2006); Bruce v. Wells Fargo Bank, N.A., 2006 WL 1195210, at *2 (N.D. May 2, 2006); Crowder v. PMI Mortg. Ins. Co., 2006 WL 1528608, at *4 (M.D. Ala. May 26, 2006) (rejecting argument that section 1681m(h)(8) should not be applied retroactively); Bonner v. Home123 Corp., 2006 WL 1518974, at *4 (N.D. Ind. May 25, 2006); Bruce v. Grieger's Motor Sales, Inc., 422 F. Supp. 2d 998, 991 (N.D. Ind.); Putkowski v. Irwin Home Equity Corp., 423 F.Supp.2d 1053, 1060 62 (N.D.Cal.2006); Bonner v. H & R Block Mortg. Corp., 2006 WL 760258, at *3 (N.D. Ind. Mar. 23, 2006); Phillips v. New Century Fin. 2006 WL 517653, at *2-4 (C.D. Cal., Mar. 1, 2006); Harris v. Fletcher Chrysler Prods., Inc., 2006 WL 279030, at *2 (S.D. Ind. Feb 02, 2006); White v. E-Loan, Inc., 409 F. Supp. 2d 1183, 1184-87; Killingsworth v. Household Bank (SB), N.A., 2006 WL 250704, at *3 (N.D. Ill. Jan. 31, 2006); Stavroff v. Gurley Leep Dodge, Inc., 2006 WL 196381, at **2-5 (N.D. Ind., Jan.20, 2006); Villagran v. Freeway Ford, Ltd., 2006 WL 964731 (S.D. Tex. Jan. 19, 2006); Murray v. Cross Country Bank, 399 F. Supp. 2d 843, 844 (N.D. Ill. 2005); Murray v. Household Bank, 386 F. Supp. 2d 993, 997-99 (N.D. Ill. 2005); Hernandez v. Citifinancial Servs., Inc., 2005 WL 3430858, at *6 (N.D. Ill., Dec.9, 2005); McCane v. America's Credit Jewelers, Inc., 2005 WL 3299371, at *3 (N.D. Ill. Dec. 1, 2005); Phillips v. New Century Fin. Corp., No. SA CV 05-0692, Order at 5 (C.D. Cal. Nov. 9, 2005); Pietras v. Curfin Oldsmobile, Inc., 2005 WL 2897386, at * 4 (N.D. Ill. Nov. 1, 2005).

40 Barnette v. Brook Road, Inc., 429 F. Supp. 2d 741 (E.D. Va. 2006); Kubbany v. Trans Union, LLC, 2009 WL 1844344 (N.D. Cal. June 2, 2009).

41 Barnette v. Brook Road, Inc., 429 F. Supp. 2d 741 (E.D. Va. 2006).

E. A Simple Fix

The scrivener's error that has deprived hundreds of consumers of their rights already, and has the potential to harm thousands more in the future, can be corrected with a very simple fix. The fix consists of the addition of three letters to two places in the FCRA:

Proposal: Revise 15 U.S.C. § 1681m(h)(8) to read:

(A) No civil actions.---Sections 1681n and 1681o shall not apply to any failure by any person to comply with this subsection.

(B) Administrative enforcement ---- This subsection shall be enforced exclusively under section 1681s of this title by the Federal agencies and officials identified in that section

This change reinstates a right that had existed for over 30 years from to FACTA, and has no impact on any other provision of the FCRA or FACTA.

III. CONGRESS SHOULD REQUIRE THAT PAID OFF MEDICAL DEBT BE DELETED FROM A CONSUMER'S CREDIT REPORT

The National Consumer Law Center, on behalf of its low-income clients, is pleased to support the Medical Debt Relief Act of 2009, H.R. 3421. Millions of Americans struggle with overwhelming medical debts that they can not afford to pay because they do not have health insurance. Even consumers with health insurance coverage can find that their credit histories are damaged because of problems with unaffordable co-pays and deductibles, out-of-network charges, and disputes with insurance companies.

The collective scope and impact on medical debt on the credit histories of American consumers is enormous and cannot be understated. According to the Commonwealth Fund, accrued medical debt plagued nearly 72 million working age adults in 2007.[42] Of those consumers, 28 million were contacted by a collection agency for unpaid medical bills, and thus had the potential of have their credit reports damaged by the negative existence of a collection account on their reports. One stunning statistic from a 2003 Federal Reserve study is that over half of collection agency accounts and nearly one-fifth of lawsuits that show up as negative items on credit reports are for medical debts.[43]

Moreover, consumers may find that their medical debt has been characterized as a debt in collection for credit reporting purposes even though the medical debt has been

42 M. M. Doty, S. R. Collins, S. D. Rustgi, and J. L. Kriss, Seeing Red: The Growing Burden of Medical Bills and Debt Faced by U.S. Families, The Commonwealth Fund, August 2008.
43 Robert Avery, Paul Calem, Glenn Canner, & Raphael Bostic, *An Overview of Consumer Data and Credit Reporting*, Fed. Reserve Bulletin, at 69 (Feb. 2003).

fully paid or settled. This may result from no fault of the consumer, but from a dispute between the insurance company and provider. It may even result from a provider's failure to properly bill the insurer. Despite the fact that the bill is paid off or otherwise settled and has a balance of zero, the presence of the medical bill as a collection matter remains on the consumer's credit records for seven years and may adversely impact a consumer's credit score.

H.R. 3421 amends the Fair Credit Reporting Act to exclude fully paid and settled medical debt from a consumer's credit report. It is a sensible and straightforward approach requiring the removal from a consumer's credit report any reference of a medical account with a balance of zero. The Medical Debt Relief Act of 2009 will prevent the credit records of millions of consumers from being unfairly tarnished. Rather, credit records will show that these hard working consumers, who successfully paid off or settled their medical bills, are more creditworthy than the current system would otherwise lead a prospective lender to believe.

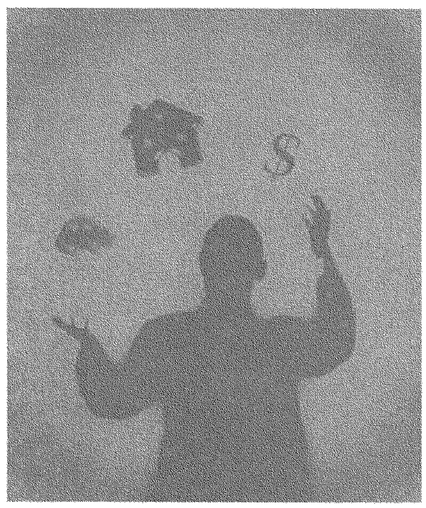
IV. CONGRESS SHOULD BAN THE USE OF CREDIT SCORING IN INSURANCE

Along with many civil rights and consumer groups, the National Consumer Law Center, on behalf of its low-income consumers, opposes the use of credit-based insurance scores. The practice creates wide racial disparities and is fundamentally unfair to consumers. We have attached our 2007 report, *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide*, which discusses the problems with this practice in detail.

Thank you for the opportunity to testify, and I look forward to your questions

ATTACHMENT 1

CREDIT SCORING AND INSURANCE: COSTING CONSUMERS BILLIONS AND PERPETUATING THE ECONOMIC RACIAL DIVIDE



NATIONAL CONSUMER LAW CENTER

CEJ

June 2007

Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide

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Acknowledgments

The views expressed in this report are those of the authors alone and do not necessarily reflect the views of those who provided editorial review. The authors thank Jonathan Lackow for research assistance. At NCLC, thanks to Alys Cohen and Deanne Loonin for substantive and editorial advice, Mallory SoRelle for editorial support, and Svetlana Ladan for technical support.

National Consumer Law Center
Center for Economic Justice

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EXECUTIVE SUMMARY

The use of credit scores in home and auto insurance is a poorly understood phenomenon with a huge economic impact on Americans. It's also a practice that creates wide racial disparities. This report presents an overview of credit scores, which are three digit numbers designed to predict risk based on a consumer's credit record. The report also summarizes the multitude of studies showing the discriminatory impact of credit scoring. It analyzes these racial disparities in light of recent research about the enormous racial wealth divide and its historical origins.

Key findings of this report are:

- Consumers know little about the use of credit scoring and credit records in granting or pricing insurance - only 36% know that a credit history can affect insurance coverage or premiums. When they do find out, they overwhelmingly disapprove of the practice.
- Some of the factors used in insurance scoring models are questionable, such as penalizing consumers with fewer than 2 credit card accounts or those who have installment loans (such as auto loans). Credit scoring in general has been criticized on a number of bases, such as the high rate of errors in credit reports and inconsistent data between the major credit bureaus.
- 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 offered a satisfactory explanation as to *why* there is a correlation between credit scores and loss ratios.
- The use of credit scoring is tied to a significant increase in profits for insurers, whose loss ratios have decreased substantially. Credit scoring may have benefited insurers (and thus cost consumers) somewhere in the neighborhood of $67 billion from 2003 to 2006.
- Study after study has documented the fact that credit scores disfavor minority consumers. Since 1994, at least 5 studies of traditional credit scores (for credit granting purposes) have shown that African Americans and Latinos have lower scores as a group. At least two studies by state insurance bureaus have found that African Americans and Latinos are overrepresented among consumers with low credit scores and under-represented among those with high credit scores. Furthermore, minority consumers are more likely to lack the credit history necessary to even generate a credit score.
- Anti-discrimination laws present limited avenues to challenge the racial disparities created by credit scoring. There are some viable theories to challenge insurance scoring in home insurance, but fewer challenges available in auto insurance.

Finally, we argue that racial disparities in credit scoring are a product of historical economic discrimination against minorities. Government policies that economically boosted whites while leaving minorities behind are responsible for the racial wealth gap. Credit scores act as both a numerical reflection of that gap as well as a force widening the gap. We echo the call of many advocates to ban the use of insurance scoring in order to stop the perpetuation of economic discrimination. If states do continue to permit their use, insurers must be required to develop scoring systems that do not have a disparate impact on minority populations.

I. INTRODUCTION

It is no secret that a huge wealth gap exists in this country, and it is divided along color lines. African Americans earn only 62 cents for every dollar earned by whites, and Latinos earn only 70 cents.[1] Even more disturbing is the divide in assets. African American families own less than seven cents for every dollar in wealth owned by white families, while Latino households own less than nine cents for every dollar of white wealth.[2] These huge disparities in income and wealth are due to a historical legacy of racism, redlining and segregation.[3] Unfortunately, the racial wealth gap is not closing.[4] Indeed, the policies and practices of both the government and the business sector have widened that gap in the last decade.

One of the practices that has reinforced and exacerbated the racial wealth gap is credit scoring. Study after study has shown credit scoring disfavors African Americans and Latinos, and that these communities have lower credit scores as a group. Credit scoring's disparate impact is alarming because this solitary number is being used in a growing number of economic transactions - not just granting of credit, but utility service, apartment rentals and even employment decisions. Credit scores are also being used to decide whether to issue home or auto insurance and at what cost, which is the focus of this report.

The difficult issue is that while credit scoring has a disparate impact, it has been shown to be predictive in the credit context. In the insurance context, companies claim that it is also predictive in forecasting which consumers will have higher loss ratios. Thus, credit scoring may be a useful tool for businesses, but one that discriminates. The issue for our society is whether we permit the use of this tool knowing that it not only hurts minorities, but also that the disparate impact of this tool reflects centuries of discrimination, exclusion, and exploitation of minority groups.

A. *What is Credit Scoring?*

A credit score is a number generated by a computer program based on information from a credit history as recorded by a credit bureau such as Experian, Equifax, and Transunion (the 'Big Three' credit bureaus). A credit history contains information about a consumer's credit experiences, including bill-paying histories, the number and types of accounts she has, whether she has had bills sent to debt collection agencies, her outstanding debt amounts, and the age of her accounts. A credit score supposedly helps predict how creditworthy a consumer is. That is, how likely it is that the consumer will repay a loan and make the payments when due.

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[1] Carmen DeNavas-Walt, Bernadette D. Proctor, and Cheryl Hill Lee, *Current Population Reports, P60-229, Income, Poverty, and Health Insurance Coverage in the United States: 2004*, U.S. Census Bureau (August 2005).

[2] Rakesh Kochhar, *The Wealth of Hispanic Households: 1996 to 2002*, Pew Hispanic Center (October 2004)

[3] These disparities often lead unscrupulous sellers to target minority consumers for higher priced credit, not because of overt bias, but stemming from a perception that these consumers are more vulnerable to "sucker pricing." See Ian Ayres, *Pervasive Prejudice?: Unconventional Evidence of Race and Gender Discrimination* (2001); Jan Pillai & M. Tulloss, *Racial and Gender Discrimination at the Cash Counter*, Miss. State J. Int'l L. 507 (2003) (book review). These disparities sometimes become internalized as well, creating a self-perception by some minority borrowers that they do not qualify for affordable credit and their only option is expensive subprime credit. *See generally* David Dante Trott, *Ghettoes Revisited: Antimarkets, Consumption, and Empowerment*, 66 Brook. L. Rev. 1 (2000).

[4] According to the Pew report, since 1996 the median net worth of black families in the United States has fallen by 16.1 percent. For white families, net worth grew by more than 17 percent. Rakesh Kochhar, *The Wealth of Hispanic Households: 1996 to 2002*, Pew Hispanic Center (October 2004).

The most popular type of credit score is generated by Fair Isaac & Co and is often called a 'FICO score'. It generally ranges between 300 and 850, and is primarily used in the credit context. A higher number is considered a better score. There are many other types of credit scores in addition to FICO scores, some of which are generated using information in addition to a credit history, such as data obtained from a credit application or other sources. The insurance industry uses its own specialized scoring models, discussed in Section II.

According to Fair Isaac, its credit scoring models generally evaluate the following types of information:

- Payment history (35%)
- Amount of credit utilized (30%)
- Length of credit history (15%)
- Recent applications for credit (10%)
- Number and types of credit accounts (10%).

B. Uses of Credit Scoring

Credit scoring has become an increasingly dominant factor in our economic lives. Credit scores dictate whether a person will be able to buy (and keep) a home by obtaining a reasonable mortgage. They also determine how expensive it will be to buy a car, a critical tool for many Americans to get to work. They determine access to other kinds of credit, such as credit cards, as well.

Credit scores, however, are being used far beyond simple credit decisions. Employers use credit scores when evaluating applicants, even for jobs that do not involve handling money.[5] Many utilities use credit scores to determine whether to turn on the lights or the heat without requiring a security deposit.[6] One utility even proposed using it to set the price of electricity for its customers.[7] Landlords use credit scores to decide whether or not to rent an apartment.

Credit scores have become as important a number, if not more so, than a person's salary or grade point average. A bad credit score is a financial "Scarlet Letter" ostracizing a person from the land of reasonably priced credit, good jobs and (as discussed in this paper) insurance coverage.

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[5] John Cook, *Credit Follows Us Everywhere*, Contra Costa Times, May 19, 2003, at 4.
[6] National Consumer Law Center, Access to Utility Service, § 3.7.4.7 (3rd. ed. 2004).
[7] Sudeep Reddy, *Utilities Spark Data Debate: Customer Payment Histories May Be Used To Set Rates Under New Law*, Dallas Morning News, June 30, 2005.

II. INSURANCE SCORING

Over the last decade a growing number of auto and home insurers have been using credit scores to determine whether to insure a consumer and at what price. An early survey found that 92 percent of auto insurers surveyed use credit scores.[8] As a result, a consumer with a poor credit history may be charged anywhere from 40% to several hundred percent more in premiums for automobile insurance.[9] A number of major home insurers use credit scores as well, including Allstate,[10] Nationwide Mutual[11] and Hartford Financial Services Group.[12]

A. Criticisms of Insurance Scoring

Insurance companies justify their use of credit scores by citing several studies that have found a high correlation between credit scores and loss experience. For example, a June 2003 study commissioned by the insurance industry found that individuals with the lowest insurance scores incurred 33% higher losses than average, while the highest scorers incurred 19% lower losses.[13]

The primary criticism of this justification has been simple - there is no explanation for *why* a person with a lower credit score is more likely to cause higher loss to insurers. While there may be a correlation, there does not appear to be an easily identified and logical causal link between a consumer's credit history and whether she will have an auto accident or accident with her home. Even the industry admits they don't understand the link, with a trade association spokesperson noting "it's not the most intuitive connection, the way it is for making a mortgage."[14] The reason for the correlation might be caused by a factor that is not the fault of the consumer, or a factor that we as a society would want to ban as a justification for provision of service- such as race or income.

Insurers sometimes put forth a "moral person" hypothesis to explain the link between credit scoring and loss history, *i.e.*, they argue that a person who is reckless with credit may also be reckless with driving or irresponsible about maintaining a home.[15] This ignores the fact that many people end up in a financial crisis (thus lowering their credit score) due to illness, job loss or divorce.[16]

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[8] Brian Grow and Pallavi Gogoi, *Insurance: A New Way to Squeeze the Weak?* Business Week, January 28, 2002, at 92 (citing study by Conning & Co.).

[9] Pamela Yip, *One Number, Many Uses*, Dallas Morning News, April 8, 2002, at 1D; Kathy Chu, *Getting Personal: Poor Credit Can Drive Insurance Rates Higher*, Dow Jones Newswires, May 21, 2003.

[10] DeHoyos v. Allstate Corp., 345 F.3d 290 (5th Cir. 2003).

[11] Owens v. Nationwide Mutual Insurance Co., 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005).

[12] Reynolds v. Hartford Financial Services Group, 435 F.3d 1081 (9th Cir. 2006), *rev'd sub nom.*, Safeco Ins. Co. v. Burr, --- S. Ct. ---, 2007 WL 1582951 (June 4, 2007).

[13] Michael J. Miller and Richard A. Smith, *The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity*, EPIC Actuaries (June 2003).

[14] Jonathan Epstein, *Outraged by 'Credit Scoring'? Auto, Home Insurers Use a Person's Credit History to Set Rates*, Buffalo News, November 28, 2004 (quoting spokesperson for the Property Casualty Insurers Association).

[15] *See, e.g.*, Insurance Information Institute, *FAQs*, at http://www.insurancescoring.info/faq.htm (last viewed June 2007) ("people who manage their money well tend to manage their most important financial asset - their home - just as well. People who handle money responsibly also tend to handle their driving responsibly").

[16] *See, e.g.*, David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, Health Affairs – Web Exclusive, February 2, 2005, *available at* http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1 (finding that half of all bankruptcies are caused in part by medical reasons, such as illness or injury, medical debt, or lost work due to medical reasons).

Consumer advocates believe that an alternative explanation for the correlation, if one truly exists, is simply wealth. There is a correlation between insurance scores and income (discussed below in Section IV.B). Consumers with lower incomes and lower scores simply may have fewer financial resources, and thus be more likely to file a claim rather than "eating" the loss.[17] For example, a Texas study found that while credit scores were related to loss experience, the correlation was due to a higher frequency of claims for low scorers, not a greater dollar amount per claim.[18] This suggests that to the extent there is a correlation, it is because low scoring consumers are more likely to file claims, not because they actually sustain greater losses.

Finally, there is some question as to whether this correlation between credit scores and insurance loss ratios actually exists and how robust it is. While industry studies claim there is a correlation, the underlying data behind these studies has never been provided so that the results can be independently verified.

For further resources on the problems with insurance scoring, readers should consult the Center for Economic Justice's website at www.cej-online.org/creditscoringmainpage.htm.

B. Consumer Awareness of Insurance Scoring

Most consumers are not aware that credit scores can have an impact on their ability to obtain insurance or the price they will pay for it. A telephone survey conducted by the Government Accountability Office of 1578 consumers found that only 36% of them knew that a credit history can impact their insurance coverage or premiums. More consumers (42%) actually believed the opposite, *i.e.,* that credit history does not affect insurance, and 22% of consumers responded that they did not know.[19]

Consumers also expressed their belief that the use of credit scoring in insurance is unfair. A Scripps Howard telephone poll conducted in Texas found that 68% of respondents favored a ban on the use of credit history for insurance underwriting and pricing.[20]

C. Elements of an Insurance Score

The credit scores used by insurers, or "insurance scores," are specially developed for insurance purposes and not the same as generic FICO scores for credit granting. Insurance scores are generated using a different scoring model (or computer program) than for generic credit scores. Insurance scoring programs use different factors, and give those factors a different weighting than for generic credit scores. What they do share in common with FICO-type scores is a reliance solely on credit history.

In Texas, a consumer advocacy group was able to get a glimpse into the black box of insurance scoring. Texas Watch analyzed some of the scoring models used for home and auto insurance in

[17] Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.
[18] Texas Department of Insurance, *Report to the 79th Legislature - Use of Credit Information by Insurers in Texas*, December 30, 2004.
[19] Government Accountability Office, *Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts*, GAO-05-223, March 2005.
[20] *The Scripps Howard Texas Poll*, Spring 2003, results on file with author.

that state and found some interesting scoring criteria. Some of the examples being used in various insurance scoring systems included:[21]

- Average number of months all accounts on file have been open.

- Number of accounts opened in the last year. Consumers were penalized for opening more than 1 or 2 new accounts in a year.

- Age of oldest account in months. Consumers lost points for not having accounts that were over several years old. In addition to penalizing young consumers, it presents risks to a homeowner who pays off her 30 year mortgage, which may be her oldest account.

- Number of consumer-initiated credit inquiries in last 2 years. Insurance scores suffer after more than 2 inquiries.[22] Inquiries happen, not just when a consumer shops for credit, but if she switches cell phone service, rents an apartment, or opens a utility account (electric, heat, and even cable service). So consumers' insurance scores take big hits when they move.

- Number of credit card accounts open. Consumers with fewer than 2 credit cards are penalized.

- Number of credit card accounts where balance is 75% or greater than limit.

- Number of months since last account activity. Consumers lose points for not having any activity in the last month. So consumers are penalized, for example, if they have a credit card but don't use it.

- Number of installment loan accounts (car loans for example). Ironically, having a car loan costs points on an insurance score.

- Number of accounts in good standing *with a balance*. Not having a balance on an account can hurt a consumer. Once again, a consumer with a credit card is penalized for not using it. One would think paying off an account should be considered favorable.

- Number of open retail store or sale finance accounts. Having even one store card (e.g., Sears, Best Buy or Home Depot) will result in a lower insurance score.

- Number of open automotive related accounts. Consumers with car loans face a double whammy. They lose points for having an installment loan and having an auto-related loan.

- Number of open oil company accounts. Consumers get points for having a gas company credit card.

- Number of public records (includes bankruptcies, liens, collections, etc.).

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[21] Texas Watch, *Sample Credit Scoring Model, Consumer Insurance Tips - Credit Scoring* (undated).
[22] For credit granting purposes, FICO scores count multiple inquiries for home and auto loans with a certain time period, such as 14 days, as a single inquiry.

- Longest delinquency on an account.

Some of these factors, such as having too few credit cards, are questionable at best.

In Georgia, an analysis by the Atlanta Journal-Constitution of insurance scoring models in that state found similar factors being used, such as:[23]

- Some models reward customers with Visa or MasterCard credit cards over those with department store cards.

- Spreading debt over three credit cards can result in a better score than consolidating the same amount of debt onto one card.

- Too many credit cards would lower the score, but so would too few.

- Various insurance companies will score the same person in a completely different way.

Furthermore, the questions raised by some of the dubious criteria used in insurance scoring are in addition to problems presented by traditional credit scores. There have been a number of criticisms of credit scoring in general, including:

- Credit reports are notorious for containing errors. In one study, 79% of consumers reviewing their own credit reports found mistakes in the reports, and 25% of them contained mistakes that were serious enough to result in the denial of credit.[24] Another study estimated that at least one in five borrowers are likely being penalized because of an inaccurate credit score due to credit reporting problems.[25]

- Credit scores are inconsistent depending on which credit bureau's data is being used. An examination of over 500,000 consumer credit files found that 29 percent of consumers have credit scores that differ by at least 50 points between credit bureaus, while 4 percent have scores that differ by at least 100 points.[26] A difference of 50 points in a credit score could mean the difference in a mortgage, for example, between 6.522% APR (for a score of 670) versus 7.332% APR (for a score of 620), which is a difference of $108 per month on a $200,000 30-year fixed mortgage.[27]

- Credit scores penalize young consumers by favoring "old" credit.

- Credit scores allow creditors to artificially manipulate their customers credit scores by, for example, not reporting credit limits. Since one of the factors in a scoring model is the

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[23] Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.
[24] Alison Cassidy and Edmund Mierzwinski, *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports*, MASSPIRG Educational Fund (June 2004).
[25] Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers*, December 17, 2002.
[26] *Id.*
[27] Rate quotes from the www.myfico.com website as of June 5, 2007.

ratio of credit used to credit available, failing to report a credit limit will depress a credit score by making it seem that a consumer is "maxed out."[28]

D. Examples Of Consumers Hurt By Insurance Scoring

The use of credit scoring in insurance has had a personal impact on many Americans. Here are some case studies of consumers who have seen their insurance rates skyrocket due to credit scoring:

> Jose DeHoyos, a 65-year-old Hispanic-American from Somerset, Texas, saw his rates go up 25% with the use of credit scoring. DeHoyos had been a customer of Allstate for 26 years when the giant insurer raised his rates. During those 26 years, DeHoyos had filed only one claim --for hailstorm damage to his car five years ago. To add insult to injury, DeHoyos had only minor blemishes on his credit history -- two late payments totaling $131 to a hospital and a gas station.[29]

> Kathryn Perry fell behind in paying bills when her daughter died, but got back on track six months later. The black marks on her record from that six month period, however, cost her dearly. Her auto insurer refused to renew her policy at the $435 a year she had been paying. Instead, she was offered a high risk policy costing a whopping $6,000 per year.[30]

> James White, a 60 year old assistant school superintendent, saw his rate rise by 60% for his homeowner's insurance. His problem was that too many lenders had pulled his credit report. While some of the inquiries occurred when he went shopping for a mortgage, car, and other credit, more than half of the two dozen inquiries came unsolicited from business looking to sell him something.[31]

One group that is particularly vulnerable to insurance scoring is elders, because many of them have paid off their mortgages and do not use other types of credit. They may not have insurance scores or have low scores due to only a few accounts. For example:

> Pat and Clyde Henry are a retired couple in their 60s from Akron, Ohio. They paid off their mortgage years ago, paid cash for their cars, and have no credit cards. As a result, they have no credit record and no insurance score. One would assume the Henrys are a good risk given their responsible financial behavior and lack of debt. But because they did not have a credit score, they were instead penalized. Their homeowner's insurance premiums doubled, from $286 per year to $596 per year.[32]

The Henrys were not alone in being punished for not having or using credit cards:

> Mattie Grainger, a senior citizen in South Carolina, had used the same insurance company for 34 years. This company increased her auto insurance premium by $100

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[28] Evan Hendricks, *Credit Scores & Credit Reports: How the System Really Works, What You Can Do*, Privacy Times (2d ed. 2005), Ch. 22.
[29] Mr. DeHoyos is the lead plaintiff in the case, DeHoyos v. Allstate Corp., 345 F.3d 290 (5th Cir. 2003).
[30] Kathy Chu, *Getting Personal: Poor Credit Can Drive Insure Rates Higher*, Dow Jones Newswires, May 21, 2003.
[31] Kathy Chu, *Getting Personal: Credit May Affect Your Insurance Rates*, Dow Jones Newswires, July 7, 2004.
[32] Betty Lin-Fisher, *Couple Penalized for Having No Debt*, Beacon Journal, February 29, 2004.

because her score was not considered top tier. Ms. Grainger's problem: she only had a few accounts and rarely used the two credit cards she owned. Her relatively debt-free life cost her points on her insurance score.[33]

Donald Tonack, who himself is a former insurance underwriter, was hit with an 11% increase in his auto insurance because of his insurance score. The 65 year old Oregon man had used the same insurance company for 17 years and had a clean driving record for 40 years. Despite this, Mr. Tonack saw his insurance rates rise because he didn't have a revolving credit account (*i.e.*, a credit card account).[34]

Finally, insurance scoring penalizes consumers who have been the victim of identity theft, the fastest growing crime in this country:

Ted Jordan, a Georgia resident, was victimized by an identity thief who took out $18,000 in student loans in Jordan's name to attend a car repair trade school in California. Jordan was forced to file a lawsuit to clean up his credit record. In the meantime, Jordan saw his homeowner's insurance rate from Allstate spike due to the black marks on his credit record.[35]

III. INSURANCE CREDIT SCORING MAY BE LINKED TO BILLIONS IN INCREASED PROFITABILITY TO INSURERS

When appearing before legislatures and regulators, insurers argue that insurance scoring allows them to more accurately price risks and is "revenue neutral." By "revenue neutral," insurers mean that insurance scoring raises the rates for some consumers and lowers the rates for others, but does not change the overall premium level. Insurers argue that insurance scoring simply enables them to better assign premiums to consumers based on the risk posed by those consumers.

In fact, insurers' use of credit scoring – the introduction of many, many rate levels based predominantly on the insurance score – may have contributed to a dramatic increase in insurance profitability. Table A shows loss ratios for private passenger auto liability insurance from 1999 through 2005. The loss ratio is the ratio of losses to premium[36] and shows what portion of the premium dollar is returned to consumers in claim payments. The table shows that loss ratios declined dramatically over the period – the same period in which insurers' use of credit scoring became more widespread and became more influential on rates charged. An explanation for the sources and calculation of the data is set forth in Appendix A of this report.

The data shown in Table A are inconsistent with insurers' claims about "revenue neutrality." If credit scoring was, in fact, revenue neutral, we would expect loss ratios to remain relatively constant over the period. The fact that loss ratios dropped dramatically indicates that premium growth far exceeded growth in losses and that insurers used credit scoring to raise rates for certain groups of

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[33] Elaine Gaston, *Bills Would Unlink Credit, Insurance*, Myrtle Beach Sun News, February 23, 2002.
[34] Kathy Chu, *Getting Personal: Credit May Affect Your Insurance Rates*, Dow Jones Newswires, July 7, 2004; Ellyn Ferguson, *Legal Battle Brewing Over Release of Credit Score*, Chicago Sun-Times, November 7, 2003.
[35] Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.
[36] The loss ratios presented are, more precisely, incurred losses to earned premiums. See Appendix A for a description of data, data sources and calculations.

consumers without commensurate reductions for other consumers and failed to lower rates to reflect lower claim costs.

Insurers would argue that the initial years in the period cited were unprofitable and that recent loss ratios are simply a return to profitability. Table A and Appendix A refute this claim by showing that rates and premiums have been, in recent years, significantly in excess of levels commensurate with a reasonable profit.[37] Premiums were excessive by about 8%, 14%, 11% and 14% in 2003, 2004, 2005 and 2006 respectively, for a total overcharge of $67 billion during the four-year period.

When insurers pitch their company's stock to investment analysts, they tell a different story about credit scoring – they admit that credit scoring has increased insurer profitability. Consider the presentation by Ed Liddy, then CEO of Allstate, to investment analysts in 2005, in which he stated:

> 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.[38]

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[37] Using the reasonable profit provision as determined by the Texas Commissioner of Insurance, discussed in Appendix A. The Texas Commissioner established a profit provision for private passenger auto which can be applied generally, not just for use in Texas. It was the outcome of a contested case hearing in which several parties put forth their proposed profit provisions and the Commissioner decided and explained in detail in his rate order why the specific provision was adopted.

[38] 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.

Table A: Private Passenger Automobile Insurance, Loss Ratios and Excessive Premium

	1999	2000	2001	2002	2003	2004	2005	2006
Loss Ratio	65.9%	71.3%	72.7%	67.5%	62.8%	58.6%	60.1%	57.9%
% Excessive ($ billions)	3.5%	-2.7%	-4.1%	1.8%	7.8%	14.0%	10.8%	14.5%
$ Excessive ($ (billions)	4.0	(3.3)	(5.6)	2.5	11.1	19.6	15.7	20.5

As with personal auto insurance, credit scoring may have increased insurers' profitability for homeowners insurance. Although homeowners results for insurers are affected by catastrophic events, such as Hurricane Katrina, the table below shows that insurers' payouts for homeowners claims did not exceed premiums on a nationwide basis even in 2005 when insurers experienced the worst catastrophe losses – by far – of any year.

Table B: Nationwide Loss Ratios for Homeowners Insurance

Year	Ratio
1999	63.7%
2000	66.4%
2001	77.2%
2002	65.9%
2003	59.2%
2004	66.0%
2005	75.2%
2006	48.2%

In most states, loss ratios have declined to 50% or less. In 2005 – a year in which several states were affected by Hurricanes Katrina and Rita – 20 states had loss ratios below 40% and 20 more states had loss ratios below between 40% and 50%. The increased profitability of homeowners insurance for non-catastrophic coverage is evident from a review of loss ratios in a number of states not subject to the hurricane risk along the southeast coast of the country and even in some southeastern states. For example, just looking at the three most populous states in the country shows loss ratios generally under 50% by 2004. Even in 2005, the year of Hurricane Rita, the Texas loss ratio was only 57%.

Table C: Loss Ratios for Homeowners Insurance (CA, NY, TX)

	2001	2002	2003	2004	2005	2006
CA	64.2%	59.2%	74.2%	30.9%	34.1%	33.3%
NY	55.6%	47.8%	51.5%	47.7%	43.3%	42.7%
TX	115.6%	108.3%	58.5%	28.1%	57.3%	33.8%

IV. CREDIT SCORING AND DISCRIMINATION

The potentially most controversial issue in credit scoring in general, and insurance scoring in particular, is the impact on certain minority groups. Ever since credit scoring became prevalent, there have been concerns that scoring systems contain biases that disproportionately impact minorities and other disaffected groups. These concerns turned out to be justified, as study after study found that certain racial and ethnic groups tend to have lower credit scores than whites. Furthermore, minority consumers are less likely to even have the credit history necessary to generate a credit score.

The insurance industry's defense to charges of discrimination has been to cite (and commission) studies that show insurance scores are predictive. In essence, they are saying that minorities and low-income persons may have lower scores as a group, but they present more risk, so the use of scoring is reasonable and there is no discrimination.

As with their overall defense of insurance scoring, there is a disturbing "moral person" proposition in the insurers' argument with respect to the disparate impact of scoring, although it is never explicitly stated: minorities and low-income consumers are sloppy with their credit (and therefore with their driving). The counter argument is that the disparate impact in credit scoring reflects other correlations - race is correlated with wealth and wealth is correlated with risk because the more wealth one has, the more likely the consumer can "eat" insurance losses. Furthermore, as discussed in Section VI, the correlation between race and wealth is no accident, but a reflection of decades of intentional discrimination and exclusion of minorities from wealth building programs.

The following sections provide a brief overview of the statistical evidence of credit scoring's disparate impact both with respect to generic credit scores used for credit granting as well as insurance scoring specifically. It is important to note, as more fully discussed in Section V below, that a practice might be considered discriminatory because of its disparate impact on a minority group, even if the entity engaged in the practice did not have the intent to discriminate.

A. General Credit Scoring Studies

The first study on the issue of race and credit scores came from home mortgage giant Freddie Mac. This study issued in 1994 found that African Americans were three times as likely to have FICO scores below 620 (a typical threshold for a "bad" credit score) as were whites. The same study showed that Hispanics are twice as likely as whites to have FICO scores under 620.[39]

During the mid-1990s, Fair Isaac conducted its own study of the relationship between scores and race, in response to concerns over disparate impact. Fair Isaac analyzed 800,000 consumer credit files to see how they performed over a two year period. Fair Isaac also used U.S. Census data to determine if the consumers lived in "high minority areas," employing neighborhood as a proxy for race. Fair Isaac's report found that its scoring models were equally predictive for consumers living in minority neighborhoods as in white neighborhoods. However, this same analysis also clearly showed that consumers living in minority neighborhoods had lower overall credit scores. For

[39] Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families*, September 1996, at 27.

example, over one quarter of consumers in minority neighborhoods scored under 620 while less than 14% of consumers in white neighborhoods scored that low.[40]

A few years later, researchers at the University of North Carolina analyzed the credit scores of 5,500 borrowers who had received community reinvestment mortgages. This analysis showed that one-third of African Americans in this pool had credit scores under 620, as compared to only 15 percent of whites. Furthermore, the study found that another one-third of African Americans had credit scores between 621 and 660 (as compared to 20% of whites), which means that two-thirds of African Americans in this pool had what is considered marginal or poor credit.[41]

In addition to having lower credit scores, minority consumers are also more likely to lack the credit history necessary to even generate a credit score, because they are less likely to have those forms of traditional credit that get reported to the credit bureaus. The University of North Carolina study discussed above found that 22% of Hispanics did not have enough of a credit history to generate a credit score, as opposed to fewer than 5% of whites.[42]

A study conducted by Federal Reserve Board researchers in 2003-2004 of over 300,000 credit history files found that fewer than 40% of consumers who lived in high minority neighborhoods had credit scores over 701, while nearly 70% of consumers who lived in mostly white neighborhoods had scores over 701. Furthermore, consumers living in minority and lower-income neighborhoods experienced errors or omissions in credit data more frequently.[43]

One of the most striking analyses of credit scoring disparities comes from a study published by the Joint Center for Housing Studies at Harvard University.[44] This study was based on a simulation of credit scores using a set of 200,000 credit files purchased by the Federal Reserve Board, matched with data from the triennial Survey of Consumer Finances. Researchers found that, for the period of 1989 to 2001, the median credit score had increased slightly for the general population. However, this increase masked a tremendous divergence in credit scores during that same period of time.

The study's researchers observed that the median credit score for whites increased significantly during the 1990s, from 727 to 738, while the median credit score for African Americans dropped from 693 to 676. The median score dropped even more for Latinos, from 695 to 670. The percentage of African Americans with credit scores under 660 (which is considered the cut off for "good credit") grew from 27% to 42% and for Latinos it grew from 29% to 49%, while among whites it rose only slightly from 17% to 19%.

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[40] Fair, Isaac & Co., *The Effectiveness of Scoring on Low-to-Moderate Income and High-Minority Area Populations*, Aug. 1997.

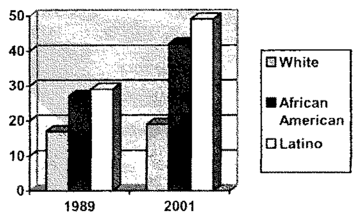
[41] Roberto G. Quercia, Michael A. Stegman, Walter R. Davis and Eric Stein, *Performance of Community Reinvestment Loans: Implications for Secondary Market Purchases*, in Low Income Homeownership: Examining the Unexamined Goal (Nicolas P. Retsinas and Eric S. Belsky, eds. 2002), at 363: Table 12-7

[42] *Id.*

[43] Robert B. Avery, Paul S. Calem, and Glenn B. Canner, *Credit Report Accuracy and Access to Credit*, Federal Reserve Bulletin, Summer 2004, at 313 (Table 2).

[44] Raphael W. Bostic, Paul S. Calem, and Susan M. Wachter, *Hitting the Wall: Credit as an Impediment to Homeownership*, Joint Center for Housing Studies of Harvard University, February 2004.

Table D: Percentage of population with credit scores under 660, by race



The most recent study showing a disparate impact in credit scoring comes from the Brookings Institution.[45] This study found that counties with relatively high proportions of racial and ethnic minorities are more likely to have lower average credit scores than predominately white counties. In the counties with a very low typical score (scores of 560 to 619), Brookings found that about 19 percent of the population is Latino and another 28 percent is black. On the other hand, the counties that have higher typical credit scores tend to be essentially all white counties. In particular, Brookings noted that in counties with average credit scores between 700 and 719, only about 5.1 percent of the population was Latino and just 1.1 percent was black. The study's author did caution that his finding was not evidence of bias, but "point[ed] to an association, which frankly is not very well understood..."

An important study on the statistical disparities in credit scoring by race is due (actually overdue) to be issued by the federal government. The Fair and Accurate Credit Transactions Act of 2003 required the Federal Reserve Board, Federal Trade Commission, and the U.S. Department of Housing and Urban Development to study the issue credit scoring and disparate impact in both the credit and insurance context, and to issue a report to Congress.[46]

In addition to racial disparities, there appears to be a growing credit scoring "gap," in which the divide between "good" and "bad" scorers seems to be growing, reflecting an increasing gulf between the credit haves and have-nots. For example, the Brookings Institution study found that counties with lower average credit scores saw a decline in those scores over a five year period of 17% on average, while counties with higher average scores saw them improve slightly.[47] This trend suggests that credit scores are "path dependent," i.e., low scoring consumers tend to see their scores decline while high scorers see them improve. The Brookings report expressed concern that this trend pointed to a "potentially ruinous fiscal cycle" for consumers with low credit scores. The Harvard Joint Center for Housing Studies study revealed similar results, finding that the median credit score for the top quintile of income increased significantly during the 1990s, from 729 to 754, while the median credit score for the bottom quintile dropped from 703 to 688.[48] Moreover, the percentage

[45] Matt Fellowes, *Credit Scores, Reports, and Getting Ahead in America*, Brookings Institution, May 2006.

[46] Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, § 215 (2003).

[47] Matt Fellowes, *Credit Scores, Reports, and Getting Ahead in America*, Brookings Institution, May 2006.

[48] Raphael W. Bostic, Paul S. Calem, and Susan M. Wachter, *Hitting the Wall: Credit as an Impediment to Homeownership*, Joint Center for Housing Studies of Harvard University, February 2004.

of consumers who scored under 660, and thus have marginal or worse credit, increased from 19% to 25% of the overall population.

B. Insurance Scoring Studies of Race & Scores

A number of state insurance commissions have conducted studies on the relationship between insurance scores and race, as well as gender, age, and income. While the first few studies were not conclusive, the most recent studies showed significant racial disparities similar to those found in the studies of traditional credit scoring.

The first few studies did not produce conclusive results. A study conducted by the Virginia Bureau of Insurance concluded that credit scoring would not be an effective tool for an insurer to redline out minorities, which would be disparate treatment; however, this study did not report findings on disparate impact.[49] In 2003, the Washington State Insurance Commissioner issued a study that showed a correlation between insurance scores and income. However, its findings regarding the racial impact of insurance scoring were inconclusive, primarily because of the small number of minorities sampled from Washington State's relatively homogeneous population.[50]

A Maryland study showed a correlation between race, income and insurance score, finding that in Baltimore City, the percentage of residents with high credit scores decreased as the percentage of minorities and lower-income households increased in a neighborhood. However, because the study used data prior to the passage of Maryland's statute regulating insurance scoring, the Maryland Insurance Administration declined to conclude that there was sufficient data to determine whether the use of insurance credit scores had an adverse impact on low-income or minority populations.[51]

In early 2004, the Missouri Department of Insurance released the first comprehensive study of race and insurance scoring to show definitive disparities.[52] The Missouri study found a stunning correlation between insurance scores and race, as well as income, age, marital status, and educational attainment. Using credit score data aggregated at the ZIP code level collected from the highest volume insurers in Missouri, the study found:

- Insurance scores were significantly worse for residents of high-minority ZIP codes. The average consumer in an "all minority" neighborhood had a credit score that fell into the 18.4th percentile, while the average consumer in a "no minority" neighborhood had a credit score that fell into the 57.3rd percentile – a difference of 38.9 percentile points.

- Insurance scores were significantly worse for residents of low-income ZIP codes. The average consumer in the poorest neighborhood had a credit score 12.8 percentile points lower than residents in the wealthiest communities.

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[49] Va. Bureau of Ins., *Report on the Use of Credit Reports in Underwriting to the State Commerce and Labor Committee of the General Assembly* (Dec. 1999). For an explanation of the difference between disparate impact & disparate treatment here, see section V below.
[50] Dave Pavelchek & Bruce Brown, Office of Wash. State Ins. Comm'r, *Effect of Credit Scoring on Auto Insurance Underwriting and Pricing* (Jan. 2003).
[51] Md. Ins. Admin., *Report on the Credit Scoring Data of Insurers in Maryland* (Feb. 2004).
[52] Brent Kabler, *Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri*, Missouri Department of Insurance – Statistics Section, January 2004.

- The correlation between race (high minority neighborhoods) and credit scores remained even after eliminating other variables, such as income, education, marital status, and unemployment. Residency in a minority concentration neighborhood proved to be the single most reliable predictor of credit scores.

- The gap in credit scores translated to the individual level. The average gap between the percentage of minorities with poor scores and non-minorities with poor scores was 28.9 points. The gap between lower-income and higher-income households was 29.2 percentage points.

The author and researcher of the Missouri study concluded that "the evidence appears to be credible, substantial, and compelling that credit scores have a significant disproportionate impact on minorities and on the poor."

About a year later, the Texas Department of Insurance issued a study with similar findings.[53] Instead of using geographic neighborhood as a proxy for race, the Texas study was able to determine the actual race of policyholders by using motor vehicle records for approximately 2 million consumers. The Texas study found dramatic disparities by race, finding African Americans and Hispanics were over-represented in the lower credit score categories and under-represented in the better credit score categories.

- African Americans constituted 33% of consumers with the worst scores and only 2% of the consumers with the best scores. African Americans were about 13% of the population of the policyholders sampled.

- Hispanic consumers constituted 28% of consumers with the worst scores and only 5% of consumers with the best scores. About 19% of the population of the policyholders sampled was Hispanic.

- In total, African Americans and Latinos constituted over 60% of consumers having the worst credit scores but fewer than 10% of those having the best scores. (Asian Americans had scores that were the same or slightly worse than whites.) The Texas study concluded there was a consistent pattern of differences in credit scores among racial and ethnic groups, with whites and Asian Americans faring better than African Americans and Hispanics.

- The Texas study also found disparities by income, though they were less dramatic than those for race. The average credit scores for upper income consumers were better than those for lower and moderate income populations. Additionally, the moderate income populations tended to be over-represented in the worse than average credit score categories and under-represented in the better than average credit score categories.

[53] Texas Department of Insurance, *Report to the 79th Legislature - Use of Credit Information by Insurers in Texas*, December 30, 2004.

C. A Less Discriminatory Alternative

As we have noted, the difficult issue with credit scoring is that while it has a disparate impact, it is predictive in the credit context and claimed to be predictive in an insurance context as well. Thus, our society is faced with the decision of whether to permit the employment of a useful tool knowing that it not only disproportionately hurts minorities, but also perpetuates a historical legacy of discrimination.

One possible solution to this quandary is the idea of the "less discriminatory alternative" from civil rights law, which is discussed in Section V below. In disparate impact cases, a plaintiff can argue that a practice is discriminatory even if the defendant did not intend to discriminate. The defendant can then defend the practice if it can show a business necessity for the practice. If the defendant makes this showing, the plaintiff can still prove discrimination by demonstrating there is another equally usefully tool that can be used to fulfill the same necessity but that tool has less of a discriminatory impact on minorities.

There is evidence that such tools exist. For insurance, at least one study has found that formulas using attributes other than credit score yield almost the same correlations with loss ratios as formulas that use credit scores.[54] The settlement of a major discrimination lawsuit against Allstate resulted in that company implementing a new credit scoring algorithm which supposedly results in less disparate impact to minorities.[55]

In the credit granting context, researchers have shown evidence that the credit scoring models themselves could be modified so as to reduce racial disparities, at least for credit granting purposes.[56] Ironically, such modifications would need to actively take race into account. For example, one modification proposed by researchers would require including minority status as a "control variable" during the development of a credit scoring model.[57]

Taking race into account to eliminate racial disparities is not a new concept in civil rights law. As Supreme Court Justice Harry Blackmun noted, "In order to get beyond racism, we must first take account of race. There is no other way."[58]

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[54] Wayne D. Holdredge and Katharine Barnes, *Good News, Bad News or Both?*, Tillinghast-Towers Perrin, February 2003.
[55] DeHoyos v. Allstate Corp., 240 F.R.D. 269 (W.D. Tex. 2007).
[56] Michael LaCour-Little and Elaine Fortowsky, *Credit Scoring and the Fair Lending Issue of Disparate Impact* in Credit Scoring for Risk Managers: The Handbook for Lenders (Elizabeth Mays ed. South-Western Educational Pub. 2003); Elaine Fortowsky and Michael LaCour-Little, *Credit Scoring and Disparate Impact* (Dec. 2001), available at http://fic.wharton.upenn.edu/fic/lacourpaper.pdf.
[57] *Id.* at 20.
[58] University of California Regents v. Bakke, 438 U.S. 265, 98 S. Ct. 2733 (1978).

V. LEGAL STATUS OF INSURANCE SCORING

In this section, we review both the current legal status of insurance scoring and the challenges actually filed or potentially possible using anti-discrimination laws.

A. State Insurance Laws

Many states have passed legislation regarding the practice of insurance scoring.[59] Most of these statutes are based on a model law developed by the National Conference of Insurance Legislators (NCOIL).[60] The NCOIL model law permits insurance scoring and is viewed positively by the insurance industry.[61] It does contain some protections for consumers, such as prohibiting insurers from treating negatively the fact that a consumer has no credit cards or has medical bills sent to a collection agency. However, the enactment of the NCOIL model in many states is seen by advocates as anti-consumer, because it either permitted insurance scoring where it had not been permitted before, or at a minimum, legitimized the practice and prevented a stronger ban from being enacted.[62] State insurance regulators have attempted to rein in insurance credit scoring as well.[63]

B. Discrimination Challenges to Insurance Credit Scoring

The dramatic racial disparities in credit scoring raise the obvious question whether the practice can be challenged as discriminatory. The answer to this question is complex and depends on whether the product at issue is credit, homeowner's insurance, or auto insurance.

There are two main types of discrimination theories under civil rights law - disparate treatment and disparate impact (or the "effects" test). Disparate treatment occurs when a business or employer treats a person differently on the basis of race or another prohibited basis (gender, age, religion, etc.). Disparate impact occurs when a business's policy or practice, neutral on its face, has a disproportionate negative impact on a protected group. Under this theory, the business's motive in treating applicants differently might not be race or another prohibited basis, but the effect is to adversely impact a particular protected class.

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[59] For a summary of some of these laws, see National Consumer Law Center, Fair Credit Reporting, Appendix H, (6th ed. 2006).

[60] National Conference of Insurance Legislators, *Model Act Regarding Use Of Credit Information In Personal Insurance*, November 22, 2002.

[61] National Ass'n of Mut. Ins. Cos., *NAMIC's State Laws and Legislative Trends State Laws Governing Insurance Scoring Practices*, undated, available at www.namic.org/reports/credithistory/credithistory.asp.

[62] *See* Testimony of Birny Birnbaum, Center for Economic Justice, Before the Colorado House Finance Committee, February 18, 2004, *available at* http://www.cej-online.org/bb%20co%20test%20040218.pdf.

[63] *See, e.g.*, Florida Office of Insurance Regulation, *Use of Credit Reports and Credit Scores by Insurers*, Informational Memorandum OIR-06-10M, May 22, 2006, available at http://www.floir.com/Memoranda/OIR-06-10M.pdf (last visited June 2007) (requires insurers to demonstrate that their use of credit reports and credit scores does not disproportionately affect persons of any race, color, religion, marital status, age, gender, income, national origin, or place of residence). However, an administrative law decision has forced the Florida regulator to propose a new rule. The Michigan Insurance Commissioner attempted to ban the use of insurance credit scores; however, that rule was struck down by a Michigan court. *Michigan Judge Shoots Down Proposed Credit-Scoring Ban*, BestWire Services, April 26, 2005.

1. Elements of a disparate impact challenge

Only certain anti-discrimination laws allow for a disparate impact challenge to be brought. In the credit area, the Equal Credit Opportunity Act (ECOA) prohibits racial discrimination in the granting of credit in general, while the Fair Housing Act (FHA) prohibits discrimination in mortgage lending. Both of these laws permit a disparate impact claim to be brought.[64] However, the ECOA probably does not cover discrimination in insurance.[65] The FHA does apply to insurance as well as credit, but only where housing is involved.[66]

In order to make out a "prima facie" or initial case for disparate impact, the plaintiff must:

- **Identify** a specific policy (e.g., use of credit scores) that has a discriminatory effect;
- **Show a disparate impact** of the policy on a group protected by anti-discrimination laws; and
- **Show causation,** i.e. a link between the policy and the disparate impact.

Making out a prima facie case of disparate impact does not necessarily mean that a practice violates the ECOA or FHA. Under the disparate impact analysis, a creditor or company can defend its policy by showing a "business necessity." Courts have articulated a number of different tests and definitions of "business necessity," including "compelling need," "manifest relationship," "legitimate, non-discriminatory rationale," and "demonstrably necessary."[67]

With respect to ECOA, the Federal Reserve Board (which interprets that law) has indicated that creditors can defend a policy that produces disparate impact by showing "a demonstrable relationship between" the challenged policy and "creditworthiness."[68] Thus, if a variable or factor in a credit scoring model causes a disparate impact, but is "demonstrably related" to creditworthiness, it may be permissible under fair lending laws. The variable or factor, however, must be related to creditworthiness and not some other reason, such as generating maximum profit.

Note that the business necessity analysis may differ for scoring models used for credit versus insurance. Credit scores are based on credit histories, and supposedly measure the consumer's likelihood of repaying a loan. There is an understandable connection to their use to measure creditworthiness, and thus a "demonstrable relationship" argument can be easily made. While there might be some correlation between insurance credit scores and loss history, there has been no definitive understandable reason provided as to why credit scores are a good measure of "insurance worthiness." However, one of the first courts to deal with the issue did hold that insurance scoring's supposed predictiveness constitutes a business necessity, as discussed below.[69]

Furthermore, there is one final step in a disparate impact analysis -- whether there is a less discriminatory alternative that can be used to meet the "business necessity." As discussed above,

[64] National Consumer Law Center, Credit Discrimination, § 4.3.1 (4th ed. 2005 and Supp.).
[65] *Id.* at § 7.3.4.1.
[66] *Id.* at § 7.3.4.2.
[67] *Id.* at § 4.3.2.5.
[68] Official Staff Commentary to Regulation B, 12 C.F.R. § 202.6(a)-2.
[69] Owens v. Nationwide Mutual Insurance Co., 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005).

there are suggestions that viable alternatives to credit scoring exist in both the credit and insurance context that are less discriminatory toward minorities.

2. Is a disparate impact analysis available in insurance cases?

A disparate impact analysis is clearly available to challenge the use of credit scoring in the credit granting arena.[70] With respect to insurance, the availability of this theory is mixed, and depends on whether the product is homeowners versus automobile insurance.

Homeowners insurance is covered by one of the federal anti-discrimination laws, the Fair Housing Act.[71] As the Seventh Circuit Court of Appeals aptly noted: "no insurance, no loan; no loan, no house."[72] Thus, the racial disparities created by insurance scoring in homeowners insurance could be challenged under the Fair Housing Act. To date, the leading major legal challenge brought against insurance scoring using this theory is *DeHoyos v. Allstate Corp.*, 345 F.3d 290 (5th Cir. 2003). This case ultimately resulted in a settlement that required Allstate to implement a new credit scoring algorithm which supposedly results in less disparate impact to minorities, and to refund from $50 to $150 to policyholders who filed a claim and whose scores rose due to the new formula.[73]

The initial challenge that the plaintiffs in *DeHoyos* had to overcome was the McCarran-Ferguson Act. Enacted in 1945, McCarran-Ferguson prohibits any federal law interpretation that invalidates, impairs, or supersedes any state insurance law unless the federal law specifically relates to insurance regulation.[74] The Fifth Circuit in *DeHoyos* held that applying the Fair Housing Act and anti-discrimination laws did not 'impair' any Texas or Florida insurance law. In *DeHoyos*, however, there was no state insurance law explicitly allowing or condoning insurance scoring at that time. A potential issue is that many states (including Texas after the *DeHoyos* decision) have enacted laws allowing for or condoning credit scoring.[75] However, every federal Court of Appeal considering the issue has rejected the argument that McCarran-Ferguson preempts an insurance discrimination lawsuit based on federal civil rights laws.[76]

The next hurdle for a disparate impact challenge to the use of credit scores in homeowners insurance is to counter the supposed predictiveness of scoring. At least one federal District Court has already accepted at face value the argument that the predictiveness of credit scores presents an adequate "business necessity" to withstand a disparate impact challenge.[77] The court engaged in little analysis of whether credit scores are truly predictive and why a credit history is related to the "insurance-worthiness" of a consumer. The court also accepted the insurance company's claim that without the use of scoring, it would be at a competitive disadvantage. This latter reason seems

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[70] For a discussion of cases that have challenged credit scoring, see National Consumer Law Center, Credit Discrimination, § 6.4.4 (4th ed. 2005 and Supp.).
[71] *Id.* at § 7.3.4.2.1.
[72] N.A.A.C.P. v. Am. Family Mut. Ins. Co., 978 F.2d 287, 297 (7th Cir. 1992).
[73] DeHoyos v. Allstate Corp., 240 F.R.D. 269 (W.D. Tex. 2007).
[74] 15 U.S.C. § 1012(b).
[75] Tex. Ins. Code art. 21.49-2U. See William Goddard, *Swimming in the Wake of DeHoyos: When Federal Courts Sail Into Disparate Impact Waters, Will State Regulation of Insurance Remain Above the Waves?* 10 Conn. Ins. L. J. 369 (2003-2004).
[76] National Consumer Law Center, Credit Discrimination, § 7.3.4.2.2 (4th ed. 2005 and Supp.).
[77] Owens v. Nationwide Mutual Insurance Co., 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005). The court also held that the supposed predictiveness of insurance scores presented a "legitimate nondiscriminatory reason" to rebut a prima facie showing of disparate treatment under the McDonnell Douglas test.

questionable, because it implies that discrimination cannot be challenged if it is an industry standard, *i.e.*, if everyone discriminates, no one can be held accountable for discrimination.

Note that the plaintiff in this case appears to have failed to present evidence or an argument regarding a less discriminatory alternative. As discussed in Section IV.C above, there is evidence that less discriminatory alternatives exist, and this may be the best argument both legally and on a policy basis to argue against the form of insurance scoring now used by the industry.

As for automobile insurance, there may be few avenues to bring a disparate impact challenge to the use of credit scoring in that context. Discrimination in auto insurance is not generally covered under any federal law. Instead, one would need to look at the anti-discrimination provisions of state insurance laws. While approximately 40 states have anti-discrimination provisions in their insurance laws, many of these states do not allow for consumers to bring a private lawsuit under those laws.[78] Furthermore, there is no clear authority that these laws provide for disparate impact challenges.

One other potential source of legal challenge to insurance scoring might be state laws that prohibit discrimination by 'places of public accommodation.' However, the availability of a disparate impact challenge under these state laws is mixed at best.[79] Furthermore, it is unclear whether state statutes would consider an insurance company a 'place of public accommodation.'[80] Finally, there may be county or municipal human relations laws that might cover auto insurance and provide a disparate impact challenge.

C. Disparate Treatment

Finally, one should not rule out the possibility of a disparate treatment analysis in challenging insurance scoring.[81] Given the very well-documented and well-publicized, controversial link between credit scores and race, it would not be unthinkable to argue that insurers may be tempted to use credit scoring exactly for the reason that it would screen out minorities from their pool of insured.

There are two methods to prove disparate treatment: direct proof and circumstantial evidence. Since very few businesses these days openly admit outright discrimination, many disparate treatment cases will rely on a circumstantial evidence test developed in the employment law area called the McDonnell Douglas test.[82] The McDonnell Douglas test, as adapted in the credit (or insurance) context, requires the plaintiff to show:

- membership in a protected class;

[78] National Consumer Law Center, Credit Discrimination, § 7.3.4.4 (4th ed. 2005 and Supp.).
[79] For example, Minnesota, the District of Columbia and New York City civil rights laws permit disparate impact challenges. Paper v. Rent-A-Wreck, 463 N.W.2d 298 (Minn. Ct. App. 1991) (Minnesota); Mitchell v. DCX, Inc. 274 F.Supp.2d 33 (D.D.C. 2003) (District of Columbia); Levin v. Yeshiva University, 754 N.E.2d 1099 (N.Y. 2001)(New York City). California and Ohio public accommodations laws do not. Harris v. Capital Growth Investors XIV, 805 P.2d 873 (Cal. 1991)(California); Derungs v. Wal-Mart, 141 F.Supp.2d 884 (S.D. Ohio 2000)(Ohio).
[80] For example, under federal law, Title II of the Civil Rights Act of 1964 also prohibits discrimination by places of public accommodation; however, an insurance company does not fit into the definition of public accommodation in that statute. 42 U.S.C. § 2000a.
[81] A disparate treatment claim could be brought under the Civil Rights Acts of 1866. 42 U.S.C. §§ 1981 and 1982.
[82] This test is derived from the U.S. Supreme Court's decision in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973).

- application for credit (or insurance) for which the plaintiff was qualified;
- rejection despite qualification; and
- that the defendant continued to approve credit for similarly qualified applicants.[83]

There is an obvious circularity in the McDonnell Douglas test – what if a criterion being used for qualification is itself the alleged discriminatory conduct (*e.g.*, in the context of discrimination against public assistance recipients, what if the criterion for qualification is having employment) or a pretext for discrimination (as credit scores might be). Can that factor be included in analyzing whether the plaintiff is qualified for the credit or insurance? At least one court has held that a low credit score means that the plaintiff will not be able to make out a *prima facie* case under the modified McDonnell Douglas test.[84]

Also, the modified McDonnell Douglas test only applies when a consumer is rejected for credit or insurance. If a consumer receives the credit or insurance, a reverse redlining analysis is required. In that context, the applicable test is:[85]

- Plaintiff is a member of a protected class;
- She applied for and was qualified for credit;
- Credit was given to her on grossly unfavorable terms; and
- The lender continues to provide loans to other applicants with similar qualifications but on significantly more favorable terms.

Again, a critical issue is whether the disputed criteria (*i.e.*, credit scoring) can be used as a "similar qualification" to compare minority and white applicants.

VI. REVERSE SOCIAL ENGINEERING THROUGH CREDIT SCORING

Credit scoring has become the numerical expression of the racial economic divide and wealth gap in this country. As such, it essentially serves as a proxy for certain behaviors that our society has sought to discourage these past few decades, including -

-- redlining (refusing to make loans to or insure communities of color)

-- reverse redlining (charging more to communities of color)

-- denying services to low-income communities

-- charging more to low-income communities.

[83] National Consumer Law Center, Credit Discrimination, § 4.2.3.1 (4th ed. 2005 and Supp.).
[84] Curley v. JP Morgan Chase Bank, N.A., 2007 WL 1343793 (W.D. La. May 7, 2007).
[85] National Consumer Law Center, Credit Discrimination, § 4.2.3.3 (4th ed. 2005 and Supp.).

From a social policy standpoint each of these behaviors is considered destructive and reprehensible. They are also behaviors that can be highly profitable. Thus, the ability to use credit scoring is a way for lenders, insurers, employers, and others to reap the economic benefits of racial and economic discrimination without having to admit they are discriminating and without being barred from doing so by anti-discrimination laws. As even a high-level Fair Isaacs official admitted:

> 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.[86]

The effect of credit scoring is to create a spiraling down situation, in which minority and low-income consumers are denied credit and insurance, or forced to pay much more for it. The drain on income affects their ability to pay their current bills, let alone build assets to move ahead. These communities fall further and further behind while wealthy white communities get a break on their credit and insurance needs. Credit scoring widens and deepens the gap between haves and have-nots.[87]

In insurance, credit scoring runs counter to the fundamental concept of spreading the risk of loss. Credit scoring results in the insurance companies being able to shed consumers they don't want by denying them coverage or setting prices so high as to be unaffordable. What is the sense of an insurance system that permits insurance companies to cherry pick only well-to-do suburban Caucasians as consumers?

Finally, some might think it is an unfortunate fact that blacks and Latinos are less wealthy, but "that's life" and it should be no reason to change social policy. Groundbreaking research during the last several years shows, however, that the wealth gap is no accident. The wealth gap was created by policies that deliberately benefited whites while excluding African Americans and other racial minorities.[88] For example, during the early years of the Social Security program, pensions were denied for many years to domestic and agricultural workers ---two of the most significant black occupations.[89] Unemployment insurance and the minimum wage did not apply to domestic workers or farm workers either.[90] Another striking example is that, of the 3,229 GI Bill-guaranteed loans for homes, businesses, and farms made in Mississippi in 1947, only two were offered to black veterans.[91]

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[86] Fed. Reserve Bank of Boston, *Perspectives on Credit Scoring and Fair Lending: A Five-Part Article Series* (pt. 1), Communities & Banking, Spring 2000, at 2 (statement of Statement of Peter L. McCorkell, Executive Vice President & General Counsel, Fair Isaac).

[87] Indeed, some insurance companies have decided to skip the step of credit scoring and go straight to directly discriminating against low -income consumers. For example, at least one insurance company has adopted guidelines that directly base insurance rates and eligibility on the factors of education and occupation. Press Release, *GEICO Ties Insurance Rates to Education, Occupation*, Consumer Federation of America, March 20, 2006.

[88] *See* Meizhu Lui, *et al.*, *The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide* (The New Press 2006).

[89] *Id.* at 92-93.

[90] *Id.*

[91] *Id.* at 97.

In short, the racial disparities of credit scoring perpetuate the racist policies of decades past. The playing field was never level, and credit scoring preserves that advantage for whites and the well off. The use of credit scoring given the historical legacy of discrimination would be akin to excluding a sports team from playing games during the first half of a season, considering all those games to be losses, calculating the team's rankings on the basis of those "losses," and then telling the team they could not participate in the playoffs because of their shoddy record.

VII. POLICY RECOMMENDATIONS

Credit scores represent a numerical reflection of the enormous racial wealth gap in this country. As such, their use in insurance - which determines whether a person will be able to own a home or afford to drive a car - perpetuates racial and economic inequality. State legislatures can and should have a role in limiting the use of insurance scores by:

- Enacting laws to ban insurance scoring.

- If insurance scoring continues to be permitted, regulators should require the development and use of scoring models that have less of a discriminatory impact on minority groups. After all, it appears that insurers have tools equally effective as credit scores to control for loss. Regulators should consider requiring insurers and scoring companies to take measures that actively reduce the effect of past racism.

APPENDIX A

Description of Excess Premium Analysis in Tables 1, 2 and 3

This analysis asks: what would premiums have been if insurers had charged rates that were reasonable in relation to actual losses incurred for private passenger automobile insurance?

Tables 1 and 2 show the analyses separately for private passenger automobile liability and physical damage coverages. Liability coverages include bodily injury and property damage liability, personal injury protection, medical payments and uninsured and underinsured motorists' coverages. Physical damage coverages include collision and comprehensive coverages. Table 3 provides a summary of Tables 1 and 2 for all private passenger automobile insurance combined.

Description of Data Sources, Data Elements and Calculations for Tables 1 and 2

Line 1 is the pure loss ratio – the ratio of incurred losses to earned premium. Earned premium is essentially the premium associated with the coverage in force during the calendar year. For example, if an insurer issued a six month policy on October 1 with a premium of $1,000, the earned premium for the year in which the policy was issued would be about $500 and also about $500 in the following year.

Incurred losses are essentially the insurer's estimate of losses it will eventually pay out for policies issued during the calendar year. Incurred losses are losses actually paid during the year plus changes in loss reserves during the year. If insurers are estimating reserves accurately, losses eventually paid for a particular year's worth of policies should equal the incurred losses initially established for that year's worth of policies. Insurers have, however, overstated loss reserves for private passenger automobile insurance frequently in years where incurred loss percentages are high with the result that the ultimate payouts have been less than the initial estimates reflected in the ratio of incurred losses to earned premiums.

The data for the loss ratios come from the "Countrywide Direct" page of the Countrywide Profitability Results by Line section of the National Association of Insurance Commissioners *Report on Profitability by State by Line* for the years 1995 through 2005. These data are compilations of reports by insurance companies on the state pages of the statutory annual statement – Column 6, Direct Losses Incurred divided by Column 2, Direct Premiums Earned.[92] Year 2006 loss ratios were calculated from countrywide earned premium and incurred loss data compiled from the state pages. The raw data for all companies and all states were provided as a dataset by the NAIC. The 2006 data are preliminary. Earned premiums and incurred losses were compiled from the data and the loss ratios calculated. The NAIC is not responsible for any calculations or compilations developed from the data it provides.

Line 2 is the amount of loss settlement expense as a percentage of earned premiums as reported in the NAIC *Profitability Reports* on the same pages as the loss ratios in Line 1. The year 2006 percentage was assumed to be the average of the 2003 through 2005 three-year period.

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[92] The source of the data for homeowners insurance is the state page data from the statutory annual statement, as compiled by and reported in various issues of the *Property Insurance Report*.

Line 3 is the provision for fixed expenses, based on the decision by the Texas Insurance Commissioner in an industry-wide rate hearing in 1999 and 2000 – Commissioner's Order 00-0909, Private Passenger and Commercial Automobile Insurance Benchmark Hearing, Docket 454-00-0408. Fixed expenses include Other Acquisition and General Expenses – which are reporting categories on the state pages described for Lines 1 and 2 – offset for a reduction for excess expenses and for income from installment fees. The actual amounts used are 8.56% for liability coverages and 8.54% for physical damage coverages

Line 4 is the provision for variable expenses, also based on the Texas Insurance Commissioner's benchmark rate order cited in the Line 3 description. Variable expenses include commissions, taxes licenses and fees and the profit provision. The profit provision includes a reasonable return on capital offset by investment income earned by the insurer. The actual amounts used are 8.26% for liability coverages and 12.56% for physical damage coverages. The difference between the provisions for liability and physical damage coverages results from a greater profit provision for physical damage coverage because of less investment income earned for physical damage coverages than for liability coverages. The lesser investment income is a result of smaller reserves held for shorter periods of time and less capital per dollar of premium for physical damage coverage than for liability coverages – there is less money per dollar of premium to earn investment gains for physical damage coverages than for liability coverages.

Line 5 is the calculation of excessive premium as a percentage of the premium dollar. It is the sum of Lines 1, 2 and 3 divided by the number 1 less Line 4. If rates had been reasonable, this calculation would produce the value zero. The calculation specifically accounts for variable expenses as a percentage of premium with the result that variable expenses are a smaller dollar amount with a low loss ratio associated with excessive rates and premium.

Line 6 reports the direct premiums earned, and comes from the same page in the NAIC *Profitability Report* as the loss ratios in Line 1. Year 2006 loss ratios were calculated from countrywide earned premium and incurred loss data compiled from the state pages. The raw data for all companies and all states were provided as a dataset by the NAIC. The 2006 NAIC data are preliminary. Earned premiums and incurred losses were compiled from the data and the loss ratios calculated. The NAIC is not responsible for any calculations or compilations developed from the data it provides.

Line 7 is the calculation of excessive premiums in dollars, calculated by multiplying the percentage excessive in Line 5 times the earned premiums in Line 6.

Table 3 is the combination of Tables 1 and 2. Line 1 in Table 3 is the aggregate loss ratio for liability and physical damage coverages combined and is provided for information purposes. Line 1 is not used in the calculation of Lines 2 through 4 of Table 3. The data from Lines 1 and 2 come from the same sources as Lines 1 and 2 for Tables 1 and 2. Lines 3 and 4 in Table 3 are the sum of Lines 5 and 6 in Tables 1 and 2. Line 2 is calculated by dividing Line 4 by the difference between Line 3 and Line 4.

Table 1: Private Passenger Automobile Liability

	1999	2000	2001	2002	2003	2004	2005	2006
Incurred Loss / Earned Premium	67.6%	74.3%	76.6%	72.1%	66.4%	62.5%	62.3%	59.5%
Loss Settlement Expense / EP	14.4%	14.5%	14.5%	14.4%	14.0%	13.6%	14.0%	13.9%
Fixed Expense Provision	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%
Variable Expense Provision	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%
% Excessive	1.3%	-6.1%	-8.6%	-3.6%	3.0%	7.7%	7.5%	10.7%
Earned Premium ($ 000)	69,666,735	69,766,221	73,779,662	80,712,942	88,836,953	93,790,088	95,669,288	96,276,656
Incurred Loss / Earned Premium	896,084	(4,273,884)	(6,369,467)	(2,920,939)	2,692,029	7,238,215	7,174,675	10,298,615

Table 2: Private Passenger Automobile Physical Damage

	1999	2000	2001	2002	2003	2004	2005	2006
Incurred Loss / Earned Premium	63.4%	67.3%	67.4%	61.3%	58.0%	53.1%	57.0%	55.6%
Loss Settlement Expense / EP	9.8%	10.0%	10.2%	9.7%	9.4%	9.4%	10.6%	9.8%
Fixed Expense Provision	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
Variable Expense Provision	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%
% Excessive	6.5%	1.8%	1.5%	9.0%	13.2%	18.8%	12.9%	15.4%
Earned Premium ($ 000)	48,097,634	50,820,838	54,770,914	59,566,494	63,731,080	65,919,070	66,196,538	66,366,645
Incurred Loss / Earned Premium	3,135,367	929,933	814,298	5,381,694	8,381,832	12,363,595	8,554,676	10,246,451

Table 3: Private Passenger Automobile Total

	1999	2000	2001	2002	2003	2004	2005	2006
Incurred Loss / Earned Premium	65.9%	71.3%	72.7%	67.5%	62.8%	58.6%	60.1%	57.9%
% Excessive	**3.5%**	**-2.7%**	**-4.1%**	**1.8%**	**7.8%**	**14.0%**	**10.8%**	**14.5%**
Earned Premium ($ 000)	117,764,369	120,587,059	128,550,576	140,279,436	152,568,033	159,709,158	161,865,826	162,643,301
Incurred Loss / Earned Premium	**4,031,451**	**(3,343,951)**	**(5,555,170)**	**2,460,755**	**11,073,861**	**19,601,810**	**15,729,351**	**20,545,066**

CHI CHI WU

EXPERIENCE

NATIONAL CONSUMER LAW CENTER
Boston, MA March 2001 - present
Nationally recognized expert on consumer credit issues, including Fair Credit Reporting Act, credit cards, refund anticipation loans, Truth in Lending, immigrant financial services, and medical debt.

- Co-author or contributing author of legal treatises on consumer credit issues: Fair Credit Reporting (6th ed. 2006), Credit Discrimination (3d ed. 2005), Truth in Lending (6th ed. 2007), Cost of Credit (4d ed. 2009), and Collection Actions (2008).
- Author or co-author of books and other publications for the general public, including NCLC Guide to Consumer Rights for Immigrants (2002), NCLC Guide to Consumer Rights for Domestic Violence Survivors (2006), and NCLC Guide to Consumer Bank Account Rights (Mass. ed. 2004).
- Author of policy and investigative reports on consumer credit issues, including annual reports on the refund anticipation loan industry, and investigative report on fee-harvest credit cards and abusive medical debt collection tactics.
- Conducted trainings and presentations on consumer law issues at numerous conferences, summits, and meetings.
- Testified in person, submitted written testimony, and drafted advocacy letters to Congress and the Massachusetts Legislature.
- Filed administrative comments with the Federal Reserve Board, Federal Trade Commission, federal banking regulators, and the Internal Revenue Service.
- Developed case theory, wrote briefs and motions, and conducted discovery including depositions as co-counsel in consumer class action litigation.

MASSACHUSETTS ATTORNEY GENERAL'S OFFICE, CONSUMER PROTECTION AND ANTITRUST DIVISION
Boston, MA June 1996 - March 2001
Investigated, developed and litigated cases enforcing Massachusetts Consumer Protection Act and other consumer protection laws and regulations. Specialized in health fraud, sweepstakes fraud, and immigrant consumer rights. Coordinated Attorney General's Hospital and HMO Community Benefits Initiative. Developed and implemented translation initiative to provide consumer education materials to immigrant communities.

WASSERSTEIN FELLOW-IN-RESIDENCE, OFFICE OF PUBLIC INTEREST ADVISING, HARVARD LAW SCHOOL
Cambridge, MA October-December 1998
Advised and counseled Harvard Law School students on careers in public interest law. Authored revision of Pro Bono Guide for Law Students.

STAFF COUNSEL'S OFFICE, SUPREME JUDICIAL COURT OF MASSACHUSETTS
Boston, MA November 1994 - June 1996
Drafted recommendations for transfer of cases from Massachusetts Appeals Court. Prepared bench memoranda. Coordinated selected administrative matters for monthly docket of the Massachusetts Supreme Judicial Court (SJC). Provided general legal research for SJC Justices.

HARRY H. DOW FUND FELLOW, ASIAN OUTREACH UNIT, GREATER BOSTON LEGAL SERVICES

Boston, MA July 1993 - November 1994
Represented Asian victims of domestic violence in restraining order hearings, divorce proceedings, public housing cases, and immigration cases. Conducted outreach and education to Asian community concerning domestic violence. Represented coalition of residents and community groups opposed to construction of environmentally hazardous parking garage in Chinatown.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES, OFFICE OF THE GENERAL COUNSEL, FOOD AND DRUG DIVISION
Rockville, MD August 1991 - July 1993
Represented U.S. Food and Drug Administration (FDA) in civil and criminal enforcement actions. Interpreted requirements of federal Food, Drug, and Cosmetic Act for agency officials. Served as FDA's primary legal adviser on federal environmental statutes, including National Environmental Policy Act and Clean Air Act.

EDUCATION HARVARD LAW SCHOOL, J.D. cum laude, 1991
THE JOHNS HOPKINS UNIVERSITY, B.A., 1988

AFFILIATIONS

President, Board of Directors, Asian Pacific American Agenda Coalition
President, Asian Pacific American Agenda PAC
Board of Directors, Fair Housing Center of Greater Boston

AWARDS

Community Service Award, Asian American Lawyers Association of Massachusetts (2004).

Independent Insurance Agents & Brokers of America, Inc.

May 12, 2010

The Honorable Luis V. Gutierrez
Chairman
Subcommittee on Financial
Institutions and Consumer Credit
House Committee on Financial Services

The Honorable Jeb Hensarling
Ranking Member
Subcommittee on Financial
Institutions and Consumer Credit
House Committee on Financial Services

Dear Chairman Gutierrez and Ranking Member Hensarling:

On behalf of the Independent Insurance Agents and Brokers of America (IIABA), the nation's oldest and largest association of insurance producers, I write in regards to today's hearing in the Subcommittee on Financial Institutions and Consumer Credit to offer our association's perspective on the manner in which the insurance industry utilizes credit information. IIABA represents a network of more than 300,000 agents, brokers, and employees nationwide, and our members provide insurance products to and serve the insurance needs of millions of American consumers. The independent agent community brings a unique perspective to this issue, largely because we work with insurance companies while remaining sensitive to and focused on the interests and concerns of our customers.

IIABA supports the use of underwriting and rating tools that promote competition and the fair and accurate pricing of risk, and we believe consumer credit information is a valid and powerfully predictive tool when used appropriately. The effectiveness and benefits of utilizing credit information have become increasingly apparent and widely accepted, even to those who were previously critical of its use, and our members can attest to the fact that its use enables insurers to more accurately predict losses and the severity of future claims. The use of credit-based insurance scores has enhanced competition in recent years as companies have become more confident with the accuracy of their underwriting and rating practices, and, as a result, many agents are now able to find coverage (and prices) for clients in instances where such options were previously unavailable.

Insurance agents and brokers believe credit-based insurance scores are an effective, objectively verified, and fair risk measurement tool, and IIABA opposes any effort to ban the use of this information or unnecessarily restrict its use. At the same time, however, agents and brokers believe credit-based insurance scores must be used in sensible, responsible, and consumer-friendly ways – and IIABA has strongly supported and has helped enact a range of meaningful consumer protections at the state level. Most states have now established restrictions that limit when and how credit information and scores may be used in the insurance arena. These safeguards, for example, require additional underwriting factors to be taken into consideration when evaluating whether to underwrite, deny, cancel, or non-renew a policy; protect those with little or no credit history; impose helpful disclosure requirements; require insurers to submit their scoring models to insurance regulators; and restrict the use of certain types of factors or credit information. These and other critical measures have now been implemented in nearly every jurisdiction and have proven to be highly successful.

One of state insurance regulation's greatest strengths is its focus on consumer protection and marketplace oversight, and state policymakers have bolstered their record of accomplishment by effectively regulating the insurance industry's use of credit information. The consumer protections established over the last decade have dramatically improved the manner in which credit information is utilized in the underwriting and rating process, and this effective regulatory regime helps ensure that credit information and credit-based insurance scores are used in reasonable ways. State officials have enacted comprehensive legislation that strikes the proper balance between the concerns of consumers and the needs of the industry, and lawmakers regularly consider additional refinements and modifications to these laws.

We thank you for the opportunity to comment on these important issues and look forward to working with the committee on these and other matters in the future.

Sincerely,

Charles E. Symington, Jr.

Charles E. Symington, Jr.
Senior Vice President, Government Affairs
Independent Insurance Agents & Brokers of America

Consumer Action

www.consumer-action.org

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221 Main St, Suite 480
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213-624-4631

U.S. Rep. Mary Jo Kilroy
1237 Longworth HOB
Washington, D.C. 20515
Fax: (202) 225-3529

March 8, 2010

Dear Ms. Kilroy,

Consumer Action (www.consumer-action.org) is pleased to support The "Medical Debt Relief Act of 2009" (HR 3421) which would amend the Fair Credit Reporting Act to prohibit consumer credit agencies from using paid off or settled medical debt collection in assessing a consumers credit worth.

More adults are struggling to pay medical bills and are accumulating medical debt, according to the Commonwealth Fund, a research foundation that studies health care issues. The Commonwealth Fund found that the proportion of working-age Americans who accumulated medical debt climbed from 34 percent to 41 percent, or 72 million people, between 2005 and 2007.

Thank you for your response to this issue. Consumers should not be unfairly penalized for medical debts, especially those that have been resolved. We especially support the provision that would give creditors and credit rating bureaus 30 days from the date the medical debt collection is paid off or settled to expunge the collection record from the consumer's credit report.

Responsible consumers deserve the right to start fresh, and to seek new credit when and where they need it, without the negative lingering effects of a debt they have resolved continuing to haunt them.

As you so correctly point out, while health care costs have increased, so has medical debt. In fact, 60 percent of those with medical bills and debts were insured at the time they assumed the debt. These debts have presented challenges to those consumers trying to buy a home and could cost responsible consumers thousands of dollars in increased APRs, points and closing costs.

Consumer Action thanks you for your leadership on this issue. We will work to drum up support on this important legislation among your fellow Representatives.

Sincerely,

Linda Sherry

Linda Sherry
National Priorities Director

April 7, 2010

The Honorable Olympia J. Snowe
United States Senate
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Senator Snowe,

As organizations representing a broad and diverse array of consumers and patients, we are writing to urge you to consider sponsoring the Medical Debt Relief Act of 2009, H.R. 3421, in the Senate. Millions of Americans struggle with overwhelming medical debts that they can not afford to pay because they do not have health insurance. Even consumers with adequate health insurance coverage can find that their credit scores are damaged because their medical debt has been characterized as a debt in collection for credit reporting purposes even though the medical debt has been fully paid or settled. This legislation amends the Fair Credit Reporting Act to exclude fully paid and settled medical debt from a consumer's credit report.

According to the Commonwealth Fund, accrued medical debt plagued nearly 72 million working age adults in 2007. Of that amount, 28 million consumers were contacted by a collection agency for unpaid medical bills. A majority of the medical bills in collection are reported to the credit bureaus and appear on a consumer's credit reports as a "debt in collection". However, even after the bill is paid off or otherwise settled and has a balance of zero, the fact that the medical bill was previously reported as a collection matter remains on the consumer's credit records for several years and will adversely impact a consumer's credit score. This makes borrowing money more expensive for consumers and can result in problems accessing the best rates for mortgages, automobile loans, credit cards, and other revolving lines of credit.

The Medical Debt Relief Act of 2009 will prevent the credit records of millions of consumers from being unfairly tarnished. Rather, credit records will show that these hard working consumers, who successfully paid off or settled their medical bills, are more creditworthy than the current scoring system would otherwise lead a prospective lender to believe.

We wholeheartedly endorse this legislation and ask that you please consider sponsoring this bill in the Senate. Thank you for your attention to this important issue.

Sincerely,

Consumers for Affordable Health Care Coalition
Chase's Home Furnishings, Inc. (Diane C. Roberts and Randall F. Roberts)
Roman Catholic Diocese of Portland
Maine Center for Economic Policy
Maine Council of Churches
MSEA-SEIU
The Maine Association of Substance Abuse Programs

Consumers Union
Nonprofit Publisher of Consumer Reports

NATIONAL CONSUMER LAW CENTER

December 8, 2009

The Honorable Mary Jo Kilroy
U.S. House of Representatives
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Congresswoman Kilroy:

Consumer's Union, the non-profit publishers of Consumer Reports, is pleased to support the Medical Debt Relief Act of 2009, H.R. 3421. Millions of Americans struggle with overwhelming medical debts that they can not afford to pay because they do not have health insurance. Even consumers with adequate health insurance coverage can find that their credit scores are damaged because their medical debt has been characterized as a debt in collection for credit reporting purposes even though the medical debt has been fully paid or settled. Your legislation amends the Fair Credit Reporting Act to exclude fully paid and settled medical debt from a consumer's credit report.

According to the Commonwealth Fund, accrued medical debt plagued nearly 72 million working age adults in 2007. Of that amount, 28 million consumers were contacted by a collection agency for unpaid medical bills. A majority of the medical bills in collection are reported to the credit bureaus and appear on a consumer's credit reports as a "debt in collection". However, even after the bill is paid off or otherwise settled and has a balance of zero, the fact that the medical bill was previously reported as a collection matter remains on the consumer's credit records for several years and will adversely impact a consumer's credit score. This makes borrowing money more expensive for consumers and can result in problems accessing the best rates for mortgages, automobile loans, credit cards, and other revolving lines of credit.

We applaud your sensible and straightforward approach requiring the removal from a consumer's credit report any reference of a medical account with a balance of zero within 30 days of a zero balance. The Medical Debt Relief Act of 2009 will prevent the credit records of millions of consumers from being unfairly tarnished. Rather, credit records will show that these hard working consumers, who successfully paid off or settled their medical bills, are more creditworthy than the current scoring system would otherwise lead a prospective lender to believe.

We wholeheartedly endorse this legislation and look forward to working with you as the bill moves through Congress. Thank you for your leadership on this important issue.

Sincerely,

Pamela Banks

Pamela Banks
Policy Counsel
Washington Office

Chi Chi Wu
Staff Attorney
National Consumer Law Center (on behalf of its low-income clients)

cfed
expanding economic opportunity

May 7, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Representative Kilroy:

The Corporation of Enterprise Development (CFED) supports your efforts to enact The Medical Debt Relief Act of 2009, H.R. 3421. As a national nonprofit dedicated to expanding economic opportunities to low-income families and communities, CFED supports expanding access to credit and accuracy credit scores are integral to our goals.

We understand that some individuals' credit scores are lowered due to slow payment by their health insurance company. This policy may be misleading for some consumers, because medical debt does not necessarily correlate to individual debt, and could be a result of timing or contract issues with insurance companies. Current practice permits medical bills previously reported as a collection matter to remain on the consumer's credit records for several years. This negative action adversely impacts a consumer's credit score. In many cases, this makes borrowing money more expensive for consumers and can result in problems accessing the best rates for mortgages, automobile loans, credit cards, and other revolving lines of credit. As credit scores are also used for employment and renting apartments, we believe accuracy is important.

By amending the Fair Credit Reporting Act to exclude fully paid and settled medical debt from a consumer's credit report, consumers can protect their credit and provide an accurate risk profile to future lenders.

Along with the Medical Debt Relief Act of 2009, there are other policies that would improve the credit scores of many Americans. About 70 million Americans are without credit scores, or have too few payment histories in their credit files to be scored with precision. Recent studies show that the use of "alternative data" such as on-time and late utility and telecom payments is predictive of future payment and easily scoreable. Proposals like Alternative Data Reporting should be considered, alongside the Medical Debt Relief Act of 2009, during the amending of the Fair Credit Reporting Act.

Sincerely,

Stephen Crawford

Stephen Crawford
Vice President, Policy & Research

FamiliesUSA
The Voice for Health Care Consumers

April 14, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
Washington, DC 20515

Dear Representative Kilroy:

On behalf of Families USA, the national voice of health care consumers, we enthusiastically endorse the Medical Debt Relief Act of 2009. This bill will help protect millions of Americans who are unable to afford their medical bills and, as a result, fall into medical debt. Unlike credit card or other kinds of debt, medical debt is usually beyond a person's control and impossible to pay for. Yet, consumer credit reports do not differentiate medical debt from other kinds of debt. Your bill would ensure that medical debt that has been fully paid for or settled would not be included in consumer credit reports.

Medical debt is a problem for millions of people today. Uninsured Americans can receive medical bills that are up to two-and-a-half times more than those who have insurance pay. Still, having health insurance does not always protect people from medical debt. In fact, many Americans are underinsured, meaning that they have health insurance, but their coverage is inadequate and does not meet their health care needs. While low-income families are more likely to lack health coverage and struggle to pay their medical bills, middle-class families are increasingly spending a greater proportion of their budgets on health care, putting them at greater risk for accruing medical debt, as well. According to the Commonwealth Fund, collection agencies contacted 28 million consumers for unpaid medical bills in 2007. Consumer credit reports often report these debts, even after the bill is paid off or settled. This poses a real problem for families when they need to borrow money or secure good rates for mortgages, automobile loans or credit cards.

We appreciate that your legislation takes a common-sense approach to resolving this issue by requiring consumer credit companies to remove any reference of a medical debt from a credit report within 30 days of a zero balance on the account. This bill will protect millions of American families from having credit records that unfairly represent their situation. Instead, Americans who work hard to pay off or settle their medical bills will receive credit scores reflective of this.

Thank you for your leadership on this issue and your commitment to America's families. We look forward to working with you as this legislation moves through Congress.

Sincerely,

Ron Pollack

Ronald F. Pollack
Executive Director

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Fax 202-347-2417
E-Mail: info@familiesusa.org ■ Web site: www.familiesusa.org

National
Multiple Sclerosis
Society

April 19, 2010

The Honorable Mary Jo Kilroy
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Congresswoman Kilroy:

On behalf of the more than 400,000 Americans living with multiple sclerosis (MS), the National MS Society would like to commend you for authoring the Medical Debt Relief Act of 2009 (H.R. 3421). As the result of unforeseen medical expenses, many families find that their credit scores have been damaged by medical debt—even if the medical debt has been fully paid or settled. Your legislation addresses this issue by amending the Fair Credit Reporting Act to exclude fully paid and settled medical debt from a consumer's credit report.

As you know, MS is an often disabling, autoimmune disease affecting the central nervous system. Although there is no cure for MS, appropriate medication can slow the disease progression and allow people with MS to live active and productive lives. The annual cost of these treatments, however, often exceeds $30,000, which places a large financial burden on families dealing with MS.

The Medical Debt Relief Act of 2009 will prevent the credit records of millions of individuals from being unfairly tarnished by medical debt. As a result of your legislation, credit records will show that hard working individuals, who successfully paid off or settled their medical bills, are more creditworthy than the current scoring system would otherwise lead a prospective lender to believe.

Protecting the credit history of those affected by medical debt is a great step that can bring piece of mind to individuals who must incur costly treatments in order to live more productive lives. We are thankful for your leadership and we look forward to working with you to advance this legislation.

Sincerely,

David A. Chatel

David Chatel
Executive Vice President
Advocacy Programs

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Medical Debt Stories from Ohio's 15th Congressional District

Julia Mueller, Clintonville

I wanted to share my story. I spent a year arguing with United Health Care. I was covered by them and approved for a sleep study in August of 2008. I got the study and was then told I did not have coverage and would have to pay it all myself, $6200. Apparently they determined that my coverage had lapsed and did not mention this when I called to double check my coverage the day before the testing. I informed the sleep study folks and they were understanding, but still wanted to set up a payment plan. I did so and got a lawyer to talk to United Health Care. It took a year of arguing and in the end United health Care did nothing. I was fortunate enough to have also had Ohio State University student health care. I am going to graduate with a bachelor's in chemical engineering this August. OSU student health care, even though they had no prior knowledge of the condition, were not consulted at the time and did not have a doctor's referral for the testing, agreed to pay half of the cost. The private billing group for the sleep study doctor agreed to forgive the other half and even reimbursed me $500 of the money I had paid them in the mean time. This would seem like a great ending except that as a result of my credit going cockeyed my credit card interest rates shot up from 7% to 25%. Fortunately I do not live beyond my means and continue to not to use it, but I have been unable to get another credit card with a lower rate to replace it. Once I graduate and begin looking for a home to buy I can only hope that I will be able to use the help of first time home buyers programs with the government to get a reasonable mortgage rate. Even with those services I know I will continues to be at a financial disadvantage to my counterparts who did not have the plan bad luck of being subjected to an insurance company's flippant business practices. I really hope this bill goes through. I am financially responsible and I would like to be treated that way. Tell Mary Jo I said thank you for introducing it. Julia Mueller

WASHINGTON BUREAU · NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE
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May 6, 2010

Members
US House of Representatives
Washington, DC 20515

via fax

RE: NAACP SUPPORT FOR H.R. 3421, *THE MEDICAL DEBT RELIEF ACT OF 2009*

Dear Representative;

On behalf of the NAACP, our nation's oldest, largest and most widely-recognized grassroots-based civil rights organization, I strongly urge you to support and co-sponsor H.R. 3421, the *Medical Debt Relief Act of 2009*. This bill will help protect millions of Americans who are unable to afford their medical bills and, as a result, fall into medical debt. Sadly, a disproportionate number of Americans who are in medical debt today are women and racial or ethnic minorities.

A 2005 study by the Commonwealth Fund found that an estimated 77 million Americans age 19 and older— nearly two of five (37%) adults—have difficulty paying medical bills, have accrued medical debt, or both. Even working-age adults who are continually insured have problems paying their medical bills and have medical debt. Unpaid medical bills and medical debt can result in even more serious health care problems: two-thirds of people with a medical bill or debt problem went without needed care because of cost—nearly three times the rate of those without these financial problems. Among the working-age population, 39% of women have medical bill problems, compared with just 25% of men. Furthermore, more than half of working-age African Americans report medical bill problems, in contrast with 34% of Hispanics and 28% of whites.

H.R. 3421, the *Medical Debt Relief Act of 2009* would require consumer credit companies to remove any reference of a medical debt from a credit report within 30 days of a zero balance on the account. H.R. 3421will protect millions of American families from having credit records that unfairly represent their situation. Instead, Americans who work hard to pay off or settle their medical bills will receive credit scores reflective of this.

Thank you in advance for your attention to the NAACP position. Should you have any questions or comments, please do not hesitate to contact me at my office at (202) 463-2940.

Sincerely,

Hilary O. Shelton
Director, NAACP Washington Bureau &
Senior Vice President for Advocacy and Policy

NATIONAL ASSOCIATION OF CONSUMER ADVOCATES

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November 2, 2009

The Honorable Mary Jo Kilroy
U.S. House of Representatives
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Congresswoman Kilroy:

The National Association of Consumer Advocates, a national non-profit organization of more than 1500 attorneys, law professors, and other consumer advocates committed to promoting justice to consumer, is writing to thank you for your leadership in introducing the Medical Debt Relief Act of 2009.

This legislation will address the growing problem of medical debt on consumers' credit reports. The number of American adults under the age of 65 carrying medical debt jumped from 21 percent in 2005 to 28 percent in 2007. According to the Commonwealth Fund, nearly 78 million working age adults accrued medical debt in 2007. That same year, twenty-eight million Americans were contacted by a collection agency for unpaid medical bills. Many consumers are not even aware that medical bills are found on their credit reports as a "debt in collection." Unfortunately, one negative medical collection mark can drop a consumer's credit score, potentially costing that consumer thousands of dollars in higher interest rates on home and automobile loans, credit cards and other revolving lines of credit. Moreover, even after consumers have paid off delinquent medical debt, the negative information stays on their credit record for seven years.

We endorse your proposal that would require the removal of medical accounts, which have been fully paid within 30 days of being settled, from a consumer's credit report. The Medical Debt Relief Act of 2009 will prevent millions of consumers from being unduly burdened with calls from collection agencies and from having their credit records tarnished after they have successfully paid off their medical bills.

We thank you for introducing the Medical Debt Relief Act and are in support of this valuable piece of legislation.

Sincerely,

Ellen Taverna
Legislative Associate

NCLR
NATIONAL COUNCIL OF LA RAZA

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May 11, 2010

The Honorable Barney Frank
Chairman, House Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member, House Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

The National Council of La Raza (NCLR)—the largest national Latino civil rights and advocacy organization in the United States—writes in support of the "Medical Debt Relief Act of 2009" (H.R. 3421). As you know, the economic crisis has disproportionately affected Latinos and other communities of color. There is no denying that financial services, credit and mortgage markets, and credit history, reports, and scores play a central role in recovery for American families and the national economy. In fact, credit issuers, originators, employers, insurers, and landlords have come to rely on credit histories and scores as predictors of risk.

According to The Commonwealth Fund, medical bill problems and/or accrued medical debt affect roughly 72 million working-age adults in America. In 2007, 28 million working-age adults were contacted by a collection agency for unpaid medical bills. Moreover, Latinos widely report that out-of-pocket health care costs are unaffordable, even when they have health insurance. In fact, among the working-age population, 34% of Hispanics and 52% of Blacks report medical bill problems, compared to 28% of Whites.

H.R. 3421 would amend the Fair Credit Reporting Act to prohibit consumer credit agencies from using paid-off or settled medical debt collection in assessing a consumer's credit risk. Thank you for your consideration of H.R. 3421. Should you have any questions, please contact Graciela Aponte, Wealth-Building Legislative Analyst, at (202) 776-1578 or gaponte@nclr.org.

Sincerely,

Janet Murguía

Janet Murguía
President and CEO

UNITEHERE!

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February 16, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
1237 Longworth House Office Building
Washington, DC 20515-3515

Dear Congresswoman Kilroy:

Unite Here, a national labor union representing hundreds of thousands of workers in the hospitality industry and the service sector, writes in strong support of HR 3421, the Medical Debt Relief Act. We are concerned about the increasing impact of medical debt on working families – including our members – and we commend your efforts on this issue.

This legislation will address the growing problem of medical debt on consumers' credit reports. The number of American adults under the age of 65 carrying medical debt jumped from 21 percent in 2005 to 28 percent in 2007. According to the Commonwealth Fund, nearly 78 million working age adults accrued medical debt in 2007. That same year, twenty-eight million Americans were contacted by a collection agency for unpaid medical bills. Many consumers are not even aware that medical bills are found on their credit reports as a "debt in collection."

Unfortunately, one negative medical collection mark can drop a consumer's credit score, potentially costing that consumer thousands of dollars in higher interest rates on home and automobile loans, credit cards and other revolving lines of credit. Moreover, even after consumers have paid off delinquent medical debt, the negative information stays on their credit record for seven years. With a growing percentage of employers now pulling credit reports on job applicants, medical debt may cost job seekers critical opportunities to get back on their feet and contribute to our economic recovery.

We thank you for introducing the Medical Debt Relief Act and are in support of this valuable piece of legislation.

Sincerely,

Tom Snyder
National Political Director

VANTAGESCORE

May 3, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
Washington, DC 20515

Dear Representative Kilroy:

Thank you for your on-going interest in credit scoring issues; I appreciated your active involvement in the March 24th hearing held by the House Financial Services Subcommittee on Financial Institutions and Consumer Credit entitled: "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and their Impact on Consumers." Below are responses to the questions received from your staff following the hearing:

Q1. What percentage of your data is reported directly by medical businesses (ie hospitals, physicians, ambulance companies, dentists, etc) as opposed to third-party collection agencies?

A1. VantageScore Solutions, LLC is an independently managed firm that holds the intellectual property rights to VantageScore, the consumer credit score developed by the nation's three major credit reporting companies (CRCs) -- Equifax, Experian and TransUnion. VantageScore Solutions itself is not a credit reporting company, and as such, we do not receive consumer payment data from any business, including medical businesses and third-party collection agencies. Therefore, we are not able to answer this question. We recommend contacting one or more of the credit bureaus for an answer.

The VantageScore algorithm does not utilize medical payment data in generating consumer scores, when the reporting comes directly from the medical provider.

We do receive anonymous consumer credit files provided by the credit reporting companies for calibration and validation of our algorithm, but these files do not contain medical trade data.

The VantageScore algorithm does include all collections trades when generating a score, including third-party collections activities related to medical debt. However, the algorithm is impartial to the various type of collections debt, that is, medical collections trades are not distinguished from any other kind of collection trade when we calculate a consumer score. All collections trades are treated the same way in the algorithm. Once paid, collections trades are no longer considered in a VantageScore credit score.

VANTAGESCORE

Q2. Is it typically the case that medical accounts are not reported unless they are categorized as delinquent, then assigned to collection and reported?

A2. No – it's our understanding that when medical tradelines are reported to the bureaus, the reporting is both positive and negative. When medical debt enters collections, the collections agencies are required to report and identify medical debt separately from other collections debt.

The caveat is when a consumer has paid a medical bill with a credit card. If the credit card becomes delinquent and then goes to collections, the debt is identified as a credit card debt. In that event, a credit score algorithm has no way to distinguish the underlying transactions related to that credit card, such as separating a store purchase from a paid medical expense.

Q3. Do your credit score algorithms weigh medical debt differently from other forms of debt? If so, do they have more or less influence over one's credit score?

A3. VantageScore does not consider medical trades themselves in the calculation of our score.

Q4. Do your credit score algorithms weight medical debt accounts that have been reported by collection agencies (as opposed to medical providers) differently from other forms of debt in the credit history section of the credit score?

A4. No. As stated in response to Question One, if a medical trade goes to a third-party collections agency and is reported to the bureaus, our algorithm will pick-up and consider that collections account. But, all collection debt is considered in the same manner; medical collections are not treated differently.

Q5. One study published in the Fed Reserve Bulletin found that over half (52%) of non-credit accounts in collection in collection are medical

- **a. Is this figure consistent with your data?**
- **b. Do you know the median balance of medical payment data trade lines?**
- **c. Do you currently continue to report medical payment trade lines in the credit history section that have a zero balance?**
- **d. Do you have data on consumer requests for verification of medical account trade lines that appear on credit reports and comparative data for other types of accounts or trade lines?**

A5. VantageScore Solutions has no access to the data needed to answer items a, b or d. Please see our response to Question One for item c.

VANTAGESCORE

Q6. **Do you consider medical debt trade lines to be of good predictive value of overall credit worthiness? Please explain.**

A6. No. Our understanding is that there are approximately only two million medical tradelines within the total database of 3.4 billion tradelines. Significantly fewer medical collections accounts exist. In our opinion, this is not enough data to use to effectively model consumer behavior. Put another way, we don't believe that medical debt will contribute to predictive performance.

Q7. **Credit score simulation services that have been used to remove recent low balance or zero-balance medical trade lines from a credit report have shown that two or three of these accounts can lower a credit score by 50-100 points. Do you believe this is accurate and that even accounts with a low or zero balance can have such a significant effect on a credit score? Please explain.**

A7. Without access to the simulation study and underlying data, there is not enough information to make an accurate assessment to respond to your question. Because our algorithm does not include medical trades in the calculation of our score, we do not have a need to conduct such studies ourselves. Additionally, as noted in our response to Question One, we also don't have access to the data needed to conduct this kind of a test and therefore can't compare your results to anything we've done.

If you have any further questions or would like additional information please don't hesitate to contact me or our Washington Counsel, Bill Donovan, at (202) 344-4939. Incidentally, while VantageScore Solutions' headquarters are in Connecticut, I frequently travel to Washington and would very much enjoy meeting with you to discuss these and related issues at your convenience.

Sincerely,

Barrett Burns

Barrett Burns
President & CEO