



STATEMENT OF
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WASHINGTON, D.C.

BEFORE THE

Committee on Financial Services

Subcommittee on Oversight and Investigations

House of Representatives

ON

“The Impact of Credit-Based Insurance Scoring on the Availability and
Affordability of Insurance”

May 21, 2008

Chairman Watt, Ranking Member Miller and Members of the Subcommittee, thank you for this opportunity to appear before this Subcommittee. I am Stuart Pratt, President and CEO of the Consumer Data Industry Association (CDIA).

The CDIA is an international trade association representing approximately 300 consumer data companies that are the nation's leading institutions in credit and mortgage reporting services, fraud prevention and risk management technologies, tenant and employment screening services, check fraud prevention and verification products, and collection services.

We commend you for holding this hearing, and welcome the opportunity to share our views.

My comments today will focus on:

- The states' extensive oversight of the use of credit histories and scores for insurance underwriting;
- Congressional oversight of the Fair Credit Reporting Act is substantial;
- Our members' management of the quality of data in their databases, which is a success story proven by studies and consumers;
- How the market is addressing the question of consumers with a thin credit report or no credit report at all; and
- Brief comments on H.R. 5633 and 6062.

I) State Oversight of Insurance Industry Use of Credit Histories and Scores for Insurance Underwriting.

The question of the use of credit histories for insurance purposes is not new, and there is no shortage of investigation and oversight of this factor. CDIA has been a constructive voice in these many state-level deliberations.

As you know, virtually all states permit the use of credit histories and scores for insurance purposes, and the states have not made these decisions capriciously. They have sought and found an empirical basis for the use of credit histories and credit-history-based insurance scores.

For example, states have formally studied the question of the use of credit histories for insurance underwriting, and many, including Arkansas, Texas and Virginia, have issued reports about these issues. State legislatures have spent countless hours holding hearings, debating testimony, listening to their regulators and ultimately enacting laws which recognize the predictive value of credit histories and credit-history-based insurance scores.

Voters themselves have also supported the use of credit histories. For instance, a state ballot initiative in Oregon led to a rejection of a proposed ban on the use of credit histories and scores by a vote of 65.21% to 34.79%. Insurance commissioners themselves have held hearings in their respective states and have issued regulations

regulating the use of scores. The National Association of Insurance Commissioners has also hosted forums on the use of credit histories and scores for underwriting on multiple occasions without coming to the conclusion that a ban is appropriate. Finally the National Conference of Insurance Legislators held extensive meetings on the subject and ultimately approved model legislation to ensure the fair use of credit histories and scores. This robust system of oversight by the states is not static and continues today.

II) Congressional Review of FCRA and Credit Histories and Credit-based Insurance Scores for Underwriting

In 1996, and again in 2003, the congress extensively reviewed and materially updated the Fair Credit Reporting Act. In neither case did it choose to ban the use of credit histories or scores, nor did it suggest that such a ban was appropriate.

In fact, the Fair and Accurate Credit Transactions Act of 2003¹, often known as the FACT Act, was considered a tremendous bipartisan success. It originally passed by the House by a vote in this committee of 63-3 and by the House by a vote of 392-30.

Regarding the Senate efforts, Senator Sarbanes (D-MD), then ranking member on the Senate Banking Committee, was quoted in the Congressional Record as saying that

“I want to acknowledge the thorough examination of these important issues provided by the comprehensive series of six hearings on this subject that Chairman Shelby held in the Banking Committee. The bill passed unanimously out of the Banking Committee on a voice vote on September 23, 2003 and was adopted 95-2 on the floor on November 5,

¹ PL 108-159

2003. These votes, I believe, are a testament to our chairman's willingness to work on a bipartisan basis.”²

As we all know, through the bipartisan FACT Act Congress tasked the FTC and FRB with producing a report focusing on the use of credit histories and scores used for credit and insurance underwriting.

The FTC concluded that:

“Credit-based insurance scores may benefit consumers overall. Scores may permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers. Scores also may make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums.”

We again commend this committee for holding a hearing on the FTC’s first report to hear first-hand from the FTC what it found in its review of automobile insurance policies.

Finally in August 2007, the Federal Reserve also issued its long-awaited credit scoring report.

The report, produced as required by FACTA Sec. 215, “assess[es] the effects of credit scoring on credit markets”. “In the broadest terms” the Federal Reserve finds:

“Results obtained with the model estimated especially for this study suggest that the credit characteristics included in credit history scoring models do not serve as substitutes, or proxies, for race, ethnicity, or sex. The analysis does suggest, however, that certain credit characteristics serve, in part, as limited proxies for age. A result of this limited proxying is that the credit scores for older individuals are slightly lower, and those of younger individuals somewhat higher, than would be the case had these credit characteristics not partially proxied for age. Analysis shows that mitigating this effect by dropping these credit characteristics from the model would come at a cost, as these credit characteristics have strong predictive power over and above their role as age proxies.”

² Senate Record (GPO Version) – Page S15806 – November 24, 2003.

III) Credit Histories – Background

In the process of working with state oversight processes, whether it involves an insurance commissioner or a legislative hearing, there are some questions which are often asked of us. We hope the following review of some of these core questions and our answers is helpful in this Committee's inquiry.

1) How are consumer reporting agencies regulated, particularly those which produce the types of consumer reports often termed credit reports?

The FCRA regulates the operations of all consumer reporting agencies (CRAs) and thus there are many types of databases used by the insurance industry which are covered by the statute. As previously discussed, the FCRA is a very contemporary consumer protection statute. Rights accorded to consumers are extensive and included below is the FTC's own accounting of those rights:

A Summary of Your Rights Under the Fair Credit Reporting Act

The federal Fair Credit Reporting Act (FCRA) is designed to promote accuracy, fairness, and privacy of information in the files of every "consumer reporting agency" (CRA). Most CRAs are credit bureaus that gather and sell information about you -- such as if you pay your bills on time or have filed bankruptcy -- to creditors, employers, landlords, and other businesses. You can find the complete text of the FCRA, 15 U.S.C. 1681-1681u, at the Federal Trade Commission's web site (<http://www.ftc.gov>). The FCRA gives you specific rights, as outlined below. You may have additional rights under state law. You may contact a state or local consumer protection agency or a state attorney general to learn those rights.

- **You must be told if information in your file has been used against you.** Anyone who uses information from a CRA to take action against you -- such as denying an application for credit, insurance, or employment -- must tell you, and give you the name, address, and phone number of the CRA that provided the consumer report.

- **You can find out what is in your file.** At your request, a CRA must give you the information in your file, and a list of everyone who has requested it recently. There is no charge for the report if a person has taken action against you because of information supplied by the CRA, if you request the report within 60 days of receiving notice of the action. You also are entitled to one free report every twelve months upon request if you certify that (1) you are unemployed and plan to seek employment within 60 days, (2) you are on welfare, or (3) your report is inaccurate due to fraud. Otherwise, a CRA may charge you up to eight dollars.
- **You can dispute inaccurate information with the CRA.** If you tell a CRA that your file contains inaccurate information, the CRA must investigate the items (usually within 30 days) by presenting to its information source all relevant evidence you submit, unless your dispute is frivolous. The source must review your evidence and report its findings to the CRA. (The source also must advise national CRAs -- to which it has provided the data -- of any error.) The CRA must give you a written report of the investigation, and a copy of your report if the investigation results in any change. If the CRA's investigation does not resolve the dispute, you may add a brief statement to your file. The CRA must normally include a summary of your statement in future reports. If an item is deleted or a dispute statement is filed, you may ask that anyone who has recently received your report be notified of the change.
- **Inaccurate information must be corrected or deleted.** A CRA must remove or correct inaccurate or unverified information from its files, usually within 30 days after you dispute it. **However, the CRA is not required to remove accurate data from your file unless it is outdated (as described below) or cannot be verified.** If your dispute results in any change to your report, the CRA cannot reinsert into your file a disputed item unless the information source verifies its accuracy and completeness. In addition, the CRA must give you a written notice telling you it has reinserted the item. The notice must include the name, address and phone number of the information source.
- **You can dispute inaccurate items with the source of the information.** If you tell anyone -- such as a creditor who reports to a CRA -- that you dispute an item, they may not then report the information to a CRA without including a notice of your dispute. In addition, once you've notified the source of the error in writing, it may not continue to report the information if it is, in fact, an error.
- **Outdated information may not be reported.** In most cases, a CRA may not report negative information that is more than seven years old; ten years for bankruptcies.
- **Access to your file is limited.** A CRA may provide information about you only to people with a need recognized by the FCRA -- usually to consider an application with a creditor, insurer, employer, landlord, or other business.
- **Your consent is required for reports that are provided to employers, or reports that contain medical information.** A CRA may not give out information about you to your employer, or prospective employer, without your written consent. A CRA may not report medical information about you to creditors, insurers, or employers without your permission.
- **You may choose to exclude your name from CRA lists for unsolicited credit and insurance offers.** Creditors and insurers may use file information as the basis for sending you unsolicited offers of credit or insurance. Such offers must include a toll-free phone number for you to call if you want your name and address removed from future

lists. If you call, you must be kept off the lists for two years. If you request, complete, and return the CRA form provided for this purpose, you must be taken off the lists indefinitely.

- **You may seek damages from violators.** If a CRA, a user or (in some cases) a provider of CRA data, violates the FCRA, you may sue them in state or federal court.

The FCRA gives several different federal agencies authority to enforce the FCRA:

FOR QUESTIONS OR CONCERNS REGARDING:	PLEASE CONTACT:
CRA's, creditors and others not listed below	Federal Trade Commission Consumer Response Center - FCRA Washington, DC 20580 1-877-382-4367 (Toll-Free)
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 Board Division of Consumer & Community Affairs Washington, DC 20551 202-452-3693
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 Programs 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 703-518-6360
State-chartered banks that are not members of the Federal Reserve System	Federal Deposit Insurance Corporation Division of Compliance & Consumer Affairs Washington, DC 20429 800-934-FDIC
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

2) *What are credit reports, what information do they contain?*

The term “credit report” is not defined by the FCRA. The FCRA defines the term consumer report and a subset of this term are those reports which include credit payment data and other similar data. The type of information contained in a credit report is:

- Identifying Information – Name, Current and Previous Addresses, Social Security Number, Date of Birth;
- Credit History – History of satisfying obligations to retail stores, banks, finance companies, mortgage companies and other lenders;
- Public & Collection Agency Records (that bear upon credit-worthiness) – Judgments, Foreclosures, Bankruptcies, Collections, Tax Liens, Garnishments; and
- Inquiries – Identifies credit grantors or other parties authorized by the consumer that have received a copy of the consumer’s credit report, typically during the past 2 years. Also, lists companies who received consumer information for the purpose of offering credit or other promotions.

Notably, credit reports do not contain information about an individual’s race, color, religion, or national origin.

Note that the vast majority of data in our members' systems simply confirms what most of you would expect: consumers pay their bills on time and are responsible, good credit risks. This contrasts with the majority of systems maintained in other countries, such as Japan or Italy, which store only negative data and do not give consumers recognition for the responsible management of their finances. Ultimately, the U.S. credit reporting system is the benchmark for other countries, and results far greater fairness measured by the allocation of risk relative to the price paid by a consumer.

3) Are credit reports accurate?

The accuracy of all consumer reports (including credit reports) is a matter of law and is also a marketplace expectation. Never before in the history of this nation do we have so much definitive data on the accuracy of credit reports.

First, the Federal Reserve Board studied approximately 300,000 credit reports for purposes of determining the quality of data. Their report included the following finding:

“This analysis of the effects of data problems on credit history scores indicates that the proportion of individuals affected by any single type of data problem appears to be small...”

“Available evidence indicates that the information that credit-reporting [sic] agencies maintain on the credit-related experiences of consumers, and the credit history scoring models derived from these experiences, have substantially improved the overall quality of credit decisions while reducing the costs of such decision making.” Avery, Robert, et al., Federal Reserve Bulletin, “Credit Report Accuracy and Access to Credit”, Summer 2004.

Further, since December 2004, consumers themselves have been reviewing their credit report disclosures at rates never before seen in the history of the industry due to the system designed by our members to give consumers free access to them. Ultimately the consumer experience in reviewing their own credit report disclosures validates the conclusions of the Federal Reserve study. Between 2004 and 2006, more than 52 million free credit report disclosures were provided to consumers who exercised their rights under the FACT Act. Approximately 90% of consumers had no questions or disputes regarding their reports, and, only 1.98% of them resulted in a dispute where data was deleted from the file.

Users of credit reports have similar experiences regarding dispute rates and the accuracy of the data used for underwriting. Consider the following, which involves 17 million credit reports:

“In 2001, Allstate ordered over 17 million credit reports. The number of written requests from consumers disputing information on their credit report totaled less than 3,000, or .017 percent of the total number of reports ordered. Of the number of legitimate disputes, only some would have any bearing on the insurance score because we only look at certain characteristics. Of the number affecting the insurance score, only some would affect the discount amount because the score must change by a certain amount to move into another discount category. Thus, the number of inaccurate credit reports that affect the premium charged is at most a subset of a subset of a subset of .017 percent.”³

While there have been prior efforts to quantify the accuracy of data, none involved large or valid samples of data. In fact the General Accountability Office makes the following observation regarding these efforts:

“We cannot determine the frequency of errors in credit reports based on the Consumer Federation of America, U.S. PIRG, and Consumers Union studies. Two of the studies did not use a statistically representative methodology because they examined only the credit files of their employees who verified the accuracy of the information, and it was not clear if the sampling methodology in the third study was statistically projectable.” Statement of Richard J. Hillman, Director, Financial Markets and Community Investment, General Accountability Office, Before the Senate Banking Committee, July 31, 2003.

The data cited above speaks to the success of our members’ ongoing efforts, though they are always striving to ensure the quality of the data coming into in their systems.

Following is a sampling of just some of the strategies they employ in this regard:

New data furnishers – all of our members utilize specialized staff, policies and procedural systems to evaluate each new data furnisher and assist them in becoming compliant. Common practices include reviews of licensing, references, and site visits. All apply robust tests to sample data sets and all work with the furnisher to conform data reporting to the Metro 2 data standard. Once a furnisher is approved, there may be ongoing monitoring of this data reporting stream during a probationary period of time.

³ Allstate Insurance Company’s Additional Written Testimony: Allstate’s Use of Credit Scoring, before the Michigan Office of Financial and Insurance Services, July 23, 2002.

Ongoing furnishing – Our members employ a variety of practices to ensure continued and on-going accuracy:

- Producing reports for data furnishers which outline data reporting problems, including errors in loading data and data which is not loaded. This reporting process ensures data furnishers are receiving feedback regarding the quality of their data furnishing practices;
- Cross-referencing data in certain fields to look for logical inconsistencies is often used as a data quality check;
- Historical data reporting trends, at the database level or data furnisher level, are used as baseline metrics upon which to evaluate incoming data;
- Manual reviews of data can occur when anomalous data reporting trends are identified; and
- Reviewing incoming data for consistency with the Metro 2 data standard.

Furnishers and Metro 2 Data Reporting Standard

CDIA members have also voluntarily developed a data reporting standard for all 18,000 data sources which contribute to their databases; the latest iteration of this standard is titled Metro2.

Standardizing how data is reported to the consumer is a key strategy for improving data quality by creating a uniform and universal method of data sharing.

Use of the Metro 2 data reporting format is climbing steadily. In 2005 CDIA reported that approximately 50 percent of all data provided to our members' data bases was reported using the Metro2 Format. Today, this percentage has grown to 81.3 percent. Our members' data quality teams believe this 62.6 percent increase is directly attributable not only to our members' tenacious efforts, but also to the FACT Act's focus on accuracy and the proposed guidelines and rules governing accuracy and integrity of data.

In addition to our members' individual efforts to encourage adoption of the Metro 2 Format, CDIA provides furnishers with free access to a "Credit Reporting Resource Guide," which is the comprehensive overview of the Metro2 Format. This guide is designed for all types of data furnishers, to encourage the proper use of the format.

This Guide also provides specific guidance for certain types of furnishers, such as collection agencies, agencies which purchase distressed debt, all parties which report data on student loans, child support enforcement agencies and utility companies, which may have unique issues that need to be addressed.

More than 500 of these guides are provided free of charge to data furnishers each year. Further, since 2004, CDIA and its Metro2 Task Force have held workshops for thousands of data furnishers on a range of specialized topics regarding Metro2 including, for example:

- Reporting Requirements for Third Party Collection Agencies and Debt Purchasers; and

- Reporting Requirements Specific to Legislation & Accounts Included in Bankruptcy.

4) *What about the data sources themselves and accuracy?*

As this Committee knows better than any other in the House, there are also legal requirements that data furnishers must abide by to ensure that the data that they submit to a consumer reporting agency is accurate.

The FACT Act made a number of significant changes to the FCRA to enhance the accuracy of consumer credit files.⁴ For instance, data furnishers are prohibited from furnishing data they know is inaccurate, and they have an affirmative duty to correct and update information. The new FACT Act regulations in the pipeline will also enhance accuracy.

- Direct Disputes - The FRB, NCUA and FTC have published proposed guidelines and regulations that would provide consumers with the opportunity to initiate disputes directly with data furnishers, as opposed to going through the CRA to run that dispute;
- Accuracy and Integrity – The same agencies have also published proposed guidelines and regulations to address the accuracy and integrity of the data furnished to consumer reporting agencies ; and

⁴ Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003, Dec. 2004, vii.*

- Red Flag Guidelines – New rules have been finalized for resolving address discrepancies. Resolving such discrepancies at the account opening will reduce the likelihood that data reported to a consumer reporting agency is inaccurate.

However, Congress must give these rules and regulations time to work before making additional changes to the process. In fact, the FRB and FTC issued a FACTA required study in August of 2006 that concluded that no new legislative requirements should be instituted at this time:

“The FACT Act Section 313(b)(4) requires the FTC and the Board include in this report any legislative or administrative recommendations for improvements to the dispute process that the agencies jointly determine to be appropriate. The agencies recommend that no legislative action be taken at this time, in large part because the agencies believe such action would be premature. The FACT Act imposes a number of new requirements on CRAS and furnishers that should enhance the consumer dispute process and improve accuracy, including measures to reduce identity theft and new requirements on furnishers. Many of these requirements are being implemented, and their effects on the dispute process have yet to be seen. This is particularly important given the voluntary nature of the reporting system and the uncertainty of how additional requirements and burdens would affect that system.” Federal Trade Commission “Report to Congress on the Fair Credit Reporting Act Dispute Process”, August 2006, Pp. 34.

5) What about consumers whose credit reports cannot be scored or who simply do not have one?

CDIA's members are at the forefront of studying this question and bringing forward market-based solutions. Interestingly enough, as Mr. Birnbaum of the Center for Economic Justice pointed out in his earlier testimony on this topic before this Committee, many "non-traditional" lenders, such as rental landlords, finance companies and other lenders, often do not report any data to credit bureaus. This means that consumers who have not been part of the system, who do not have established credit, may have difficulty establishing credit, trapping them in a catch-22.

Fortunately, the National Conference of Insurance Legislators (NCOIL) model bill addresses this problem with regards to insurance scoring by prohibiting insurers from "denying, canceling, or non-renewing a policy based solely on credit information, without considering any other applicable underwriting factor. (*Note: This provision would prohibit an insurer from refusing to insure an applicant or insured because the person's insurance score fails to meet or exceed a minimum numeric threshold, unless at least one other applicable underwriting factor is considered.*)" (Emphasis in original)

However, what this committee needs to know is that there is tremendous progress and real-world products on the market today that are helping to further address the issue of how consumers with little "traditional" payment history can establish credit and benefit from a positive payment history in a traditional underwriting process.

Publicly Available Data - Several of our members already compile public record data which can then be used for underwriting loans. A consumer's ownership of a home, a car or other asset can help contribute to an underwriting process. These data are commercially available today, are being used in credit underwriting processes where there is no traditional credit report or one which cannot be scored.

Rental and Utility Payment Data – A number of our members are adding utility and telecommunications payment data to traditional credit reporting databases. These data are being used in credit underwriting decisions today. We also have members who are in direct discussions with rental payment data sources to expand reporting of these data for underwriting purposes. Other members of the CDIA are aggregating consumer payment data where such data reported by the consumer's bank through direct payments made from checking accounts.

Validating Consumer-Submitted Data – A number of our members also provide services where they will validate payment data (paid bills, etc.) provided by a consumer directly to a lender. In some cases a scoring system is built into these models.

Empirical Studies Suggest a Promising Future – The Political & Economic Research Council⁵ has engaged in empirical studies of the question of using various forms of payment data for purposes of underwriting. In their most recent study, "Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data" the Council, which was funded by CDIA and its members and which

⁵ www.infopolicy.org

involved the use of 8 million credit reports, suggests that:

“Including alternative data was especially beneficial for members of ethnic communities and other borrower subgroups. For instance, Hispanics saw a 22 percent increase in acceptance rates. The rate of increase was 21 percent for Blacks; 14 percent for Asians; 14 percent for those aged 25 or younger; 14 percent for those aged 66 older; 21 percent for those who earn \$20,000 or less annually; and 15 percent for those earning between \$20,000 and \$29,999. In addition, renters (as opposed to homeowners) saw a 13 percent increase in their acceptance rate, and those who prefer Spanish as their primary language saw a 27 percent increase in their acceptance rate.”

FTC FACT Act Study – The December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act indicates that bill payment histories at utilities and telecommunications companies could be utilized as a source of predictive data.

With this positive context in mind, it is important for this Committee to know that there are barriers to wide-spread reporting of key payment which may impinge on fully integrating such data into underwriting processes. For instance, anecdotally we have heard that some companies do not want to incur the expense and potential liability associated with reporting information to a credit bureau. State Public Utility Commissions (PUCs) may also have barriers that prevent them from reporting.

IV) Comments on H.R. 5633 and H.R. 6062

Finally, Mr. Chairman, you asked us to comment on H.R. 5633 and 6062. It is our view that the right balance has been struck today with regard to the role of the federal government and the states, and that no new law is necessary.

As discussed at the opening of our statement, the states have been active on the question of the use of credit histories and scores both legislatively and through the regulatory process. Regulatory reviews and insurance commission powers at the state level are ongoing and robust. Reviews by NCOIL and NAIC have also held extensive inquiries. Consumer protections are robust and protective at the state level and the federal Fair Credit Reporting Act has been the focus of very recent and extensive oversight and new regulations continue to be issued as a result of the FACT Act.

We are concerned about the underlying hypothesis of the proposed legislation which suggests that it is best to study a single underwriting factor in a manner that does not put it into the proper context of the other factors which are used during the same underwriting decision. Further, while we have great respect for the Federal Trade Commission, only the states have the proper market context to understand how best to use their extensive powers to regulate the use of all factors in underwriting processes.

Ultimately we believe that our members' data contributes to proper risk attribution, and thus helps to ensure that ensuring consumers receive the lowest price and are rewarded for their years of care and good decisions, regardless of their race or ethnicity.

Thank you for your time, and I look forward to answering any questions.