OPENING STATEMENT OF
CHAIRMAN MELVIN L. WATT

"CREDIT-BASED INSURANCE SCORES: ARE THEY FAIR?"

October 2, 2007

Credit-based insurance scores are numerical summaries of the credit histories of consumers. The scores are calculated using information contained in a consumer report, information such as past delinquencies, consumer debt ratios and the length of credit. The use of credit-based insurance scores has increased rapidly since the 1990's and, today, credit-based insurance scores are widely utilized.

While common sense tells you that speeding tickets, driving under the influence of drugs and alcohol or automobile accidents should increase automobile insurance premiums, most Americans would probably be surprised to learn that late payments on credit-cards can dramatically increase the premiums they pay for automobile insurance. In other words, one's credit history, not one's driving history, is likely to be determinative of the cost of one's automobile insurance. That would be equivalent to having your driving history determine whether you get a bank loan or the interest rate you will pay on the loan. The question we need to address is whether this is fair?

Today's hearing is entitled, "Credit-Based Insurance Scores: Are They Fair? Our objective is to shed light on the growing, but often hidden, use of credit information in the pricing and underwriting of insurance and to start analyzing, discussing and determining whether that is fair or whether it even makes sense.

A number of consumer and civil rights groups and some states say that it's not fair. They argue that these scores are used to raise premiums, deny coverage for new customers and deny renewals of existing insurance policies, even in the absence of common sense risk factors such as moving violations or accidents. They say that the use of credit-based insurance scores disproportionately hurts young people and minorities.

Some states have already enacted laws or adopted regulations that either ban or restrict the use of credit-based insurance scores. For example, two of our witnesses today represent states, Hawaii and Washington, that limit or ban the consideration of credit-based insurance scores in writing automobile insurance. We look forward to their testimony.

The first federal study on credit-based insurance scores was recently released by the Federal Trade Commission. The FTC was directed under Section 215 of the FACT Act to study whether the use of credit-based insurance scores "could result in negative or differential treatment of protected classes under the Equal Credit Opportunity Act, and [whether such] underwriting systems . . . could achieve comparable results through the use of factors with less negative impact." The FTC study grew out of a compromise between an outright federal ban on the use of credit-based insurance scoring, on the one hand, and doing nothing on the other hand.

The first FTC report focused exclusively on automobile insurance and, while it concluded that credit based insurance scores are "effective predictors of risk," it also found that in three out of four lines of automobile insurance there is "some" proxy effect based upon race. While the FTC didn't get to this latter finding until page 69 of the report, I believe that *any* finding of a proxy effect, however small, should be cause for concern in this day and time.

Several concerns have been raised about the reliability and validity of the FTC's report. One FTC Commissioner dissented from the report, noting disagreement with the methodology used to generate the underlying data used in the report because it relied solely on data the insurance industry voluntarily submitted and on publicly available data. The dissent suggested that the FTC could have served insurance companies with Section 6(b) orders to obtain a "more accurate and complete data set, which would have provided a strong foundation for staff's complex economic analyses."

Even with perceived shortcomings of the data, the FTC report still concluded that there was some "proxy" effect from the use of credit-based insurance scores in three out of four lines of automobile insurance. As the dissenting Commissioner noted, the study "still found that credit-based insurance scores have a small effect as a 'proxy' for membership in racial and ethnic groups. Given the incompleteness of the data, it is unclear whether the <u>actual</u> proxy effect might be greater." Another Commissioner's concurring statement to the report concedes that the "results in today's Report are . . . no cause for celebration" referring to the differences in credit-based insurance scores across racial and ethnic groups.

In short, the FTC's report; the one on automobile insurance that we're considering today, may raise more questions than it answers, especially about whether the use of credit-based insurance scoring disproportionately impacts minorities.

The FTC is preparing a second report on the impact of using credit-based insurance scoring on homeowners insurance. Given the serious concerns raised about the validity of the data for the automobile insurance report and the critical importance of the second report on homeowners insurance, Chairman Frank, Rep. Gutierrez and I have requested the FTC to consider using its more extensive authority for the homeowners portion of the study to obtain a large and statistically valid data set from insurers. The FTC has advised us that this could take 2-3 years longer and one of the things I'll be asking about today is whether this is likely to get a more reliable conclusion or whether it would just take 2-3 more years to get another study that many would perceive as just as unreliable.

Due to the uncertain reliability of using credit-based insurance scores in setting insurance rates, we certainly must proceed with care. This hearing is the first step, certainly not the last, in the process of raising the important questions that need to be asked and in educating ourselves, other Members of Congress and the public about the critical importance of this issue.

In the final analysis, I think it should be clear that neither the FTC report nor today's hearing should deter the States' from their traditional role in regulating insurance. The fact that Hawaii and Illinois differ in their regulation of credit-based insurance scores is not necessarily a bad thing. States have historically regulated and controlled insurance and have historically been the, so called "legislative and regulatory laboratories for innovation." State insurance regulators are the best equipped to regulate insurance credit scoring and should continue to do so.