Testimony of
PIRGIM (Public Interest Research Group in Michigan)
Before the Office of Insurance and Financial Services Hearing on
Insurance Credit Scoring
Detroit

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Mr. Fitzgerald: Thank you for the opportunity to present the views of PIRGIM (Public Interest Research Group in Michigan)[1] on the important matter of disclosing consumer credit scores.

Summary

Numerical credit scores have largely replaced narrative credit reports for credit decision-making. Increasingly these credit scores are being used to determine home and auto insurance rates for individuals throughout Michigan. In PIRGIM's view, the process of credit scoring to determine insurance premiums should be banned. This position is held by many current state insurance commissioners, former Texas Insurance Commissioner Bob Hunter, now with the Consumer Federation of America, and other independent consumer protection groups. Specifically, we support HB 5882 that will ban the use of credit scoring to determine insurance rates.

Discussion

(1) Credit Scores Are Based On Error-Ridden Credit Reports

PIRGIM has conducted a series of research reports on the accuracy of consumer credit reports.

The results of our studies are troubling. Our most recent report, *Mistakes Do Happen [*http://www.pirg.org/reports/consumer/mistakes/index.htm*]*, found that 29% of credit reports surveyed contained errors serious enough to cause the denial of credit, insurance, employment or other benefits. Consumers Union, publishers of Consumer Reports Magazine, has had similar findings in its studies. In addition, our discussions with attorneys representing consumers in litigation against consumer reporting agencies (credit

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[1] PIRGIM (Public Interest Research Group in Michigan) is a non-profit, non-partisan citizen watchdog and advocacy organization with 10,000 citizen members throughout the state of Michigan. www.pirgim.org

bureaus) lead us to believe that our methodology is conservative and that error rates in credit reports may in fact be significantly higher.

A credit score ("bureau score"), as used in insurance decision-making, is merely a mathematical summary derived from a narrative credit report. If the credit report contains missing information, or falsely derogatory information, the consumer's score will be deflated.

For consumers at either end of a bell curve, with either very bad or very good credit, the errors may not matter. For consumers on the margin, however, errors resulting in a decreased credit score can result either in credit or insurance denial, or with the increased use of risk-based pricing models, significantly higher (sub-prime) credit or insurance premium (high-risk rating pool) costs.

<u>(2) Credit Bureaus and Credit Scoring Companies Are Not Adequately Transparent to Consumers for Error Correction or Regulators for Evaluation</u>

Problems with inaccurate credit reports and scores are exacerbated by the well-documented intransigence of the credit bureaus toward consumers attempting to resolve credit report error disputes. The so-called Big Three credit bureaus -- Experian, Trans Union and Equifax -- are all operating under Federal Trade Commission consent decrees that resulted in a combined $2.5 million in civil penalties in a 1999 FTC action for failure to, among other things, provide enough staff to answer the phone. The bureaus' incessant use of brain-numbing, voice-mail-jails drives consumers, already driven to frustration by the bureaus' ineptitude and failure to fix errors, into a frenzy.

Worse, however, is the growing use of credit scores derived from these mistake-ridden reports. The Big Three purchase much of their credit scoring software from the market leader, California-based Fair Isaac company, which has a well-deserved reputation for an unacceptable level of secrecy that has prevented independent review of its algorithms.

Fair Isaac's refusal to provide details of its methods extends to rejecting requests by insurance regulators for adequate information to review credit scoring decision-making.[2]

Recently, under pressure from a new California credit scoring disclosure law and the threat of even broader federal legislation, Fair Isaac has begun to provide credit scores to consumers, for a fee, with limited explanations of its methodology[3]. For years, of course, before an unprecedented coalition of realtors and consumer advocates pushed that crucial California legislation to passage, Fair Isaac had patronizingly argued that consumers weren't smart enough to understand credit scores. The reality, of course, is that the only

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[2] Correspondence between former Texas Associate Insurance Commissioner Birney Birnbaum and Fair Isaac in Appendix to "Credit Reports and Insurance Underwriting," National Association of Insurance Commissioners (NAIC), 1997.

[3] See detailed testimony of Edmund Mierzwinski, State PIRGs, before Congress, September 2001, on the need to make credit scores part of credit reports and provided free upon consumer request.

thing consumers wouldn't be able to understand is how the credit bureaus and credit scoring companies could make so many mistakes.

The difficulty both consumers and insurance regulators have in dealing with credit bureaus and Fair Isaacs cannot be understated as a problem that magnifies the already-significant problems caused by errors in credit reports.

<u>(3) Using Credit Scores In Insurance Decisions Or As an Insurance Rating Factor Is Bad Public Policy</u>

Insurance rates should be based directly on the merit of your actions. For instance, your auto rates should be based on your driving record, not on how many credit cards you have.

Even some insurance companies are saying the credit scoring is unfair. In October 2001, the National Association of Professional Allstate Agents wrote a letter to Washington State Insurance Commissioner Mike Kreidler blasting the use of credit scoring. The group said that credit scoring is a "secret methodology" that can't be examined by the insurance commissioner. A credit score also is a "moving target" that can abruptly or frequently change, they argued. The group also said that those who have suffered financial setbacks as a result of divorce, death of a spouse or major medical bills stand to be unfairly affected.

Conclusion

Based not only on the significant numbers of errors in credit reports and, concomitantly, resulting errors in credit scores, but also on the tremendous importance society places on the availability of fairly-priced insurance, PIRGIM recommends credit scoring should be prohibited as an insurance rating factor as a matter of public policy. This goal would be achieved by enactment of the proposed bill, HB 5882.

We look forward to working with you on enacting state policy that will provide greater transparency in credit scoring. Thank you for the opportunity to testify today.