<u>Amended</u> Testimony of Birny Birnbaum
Before the Nevada Assembly Commerce and Labor Committee
March 5, 2003

Thank you for the opportunity to speak in favor of AB 194, an important piece of consumer protection legislation.

I ask that whatever your views on insurance credit scoring – whether you like or dislike, agree or disagree with, my testimony – that you aggressively challenge my arguments and facts. I am confident that I can not only respond to your challenges, but can also provide you facts and data for you and your staff to review. I ask you to do the same to proponents of credit scoring and to demand that they, too, provide the data and information to allow an analyst not allied with the industry to review their claims. I am providing you with a report I recently submitted to the Ohio Civil Rights Commission, which contains an extensive bibliography of resources on insurance credit scoring and tables from the *2000 Statistical Abstract of the United States*, which show a vivid correlation between income and the credit characteristics most heavily weighted in insurance credit scoring models.

I would like to cover the following points in my testimony today:

1. **Background and Experience on Insurance Credit Scoring**

2. **Why It Is Reasonable and Necessary to Ban Insurers' Use of Consumer Credit Information for Personal Lines Insurance Underwriting, Rating and Payment Plan Eligibility**

   a. Inherently Unfair
      - i. WTC Attack – charge someone injured in WTC attack higher health insurance premiums because of that injury? Then why allow it for homeowners and auto insurance?
      - ii. Bankruptcy
      - iii. Score Manipulation
      - iv. Variances by Credit Bureau
      - v. Variances by Region
      - vi. Illogical Factors
      - vii. ID Theft
      - viii. Data Quality
      - ix. Use of Data Collected for One Purpose for Unrelated Purpose
      - x. Punishing Consumers Lenders' Business Decisions
      - xi. Agent Groups, NAR, Consumer Groups Positions

   b. Discriminatory
      - i. Nature of Models – Absence of Positive Attributes
      - ii. Nature of Models – Limited Information, What's Missing
      - iii. Good Credit History Does Not Equal Good Credit Score

c. Undermines Regulatory Oversight of Insurers
    i. Use Underwriting and Multiple Tiers to Avoid Rate Oversight
    ii. Growing Use of Third Party Black Boxes

d. Undermines the Fundamental Insurance Mechanism
    i. Risk Classification – More Than Correlation Needed
    ii. Risk Classification – No Loss Prevention
    iii. Risk Classification – Individual Rating Tiers vs. Groupings of Risk

e. Arbitrary and Violates Actuarial Principles for Risk Classification
    i. Insurers' "Diversity" of Credit Use Methods is Definition of Arbitrary
    ii. Risk Classification Principles Violated

3. Industry Arguments – False and Unsupported

a. Rewards Financially Responsible Consumers
    i. Blaming the Victim
    ii. Not a Measure of Financial Responsibility

b. Patterns of Financial Management
    i. Single Incidents Can Have a Huge Impact – Buying a Home
    ii. Doesn't Capture Many Items That Are Part of Financial Management

c. Most Consumers Benefit
    i. Unsupported and Demonstrably False
    ii. Profoundly Anti-American Argument
    iii. Why Are Agents Against Credit Scoring

d. Use of Credit Promotes Competition
    i. Just the Opposite – Larger Insurers Much Better Able to Use Credit
    ii. Unsubstantiated Claim
    iii. Prohibition on Credit Creates Level Playing Field – No Insurer Put at Disadvantage vis a vis Another Insurer

e. We Only Offer Discounts Based on Credit
    i. Credit is Zero Sum Game with No Loss Prevention.
    ii. Can't Offer Discounts Only Without Raising Base Rate – Equivalent to Surcharge for Some Customers

f. Prohibition Will Raise Rates
    i. In Aggregate, Prohibition Will Lower Rates Because Expenses Associated with Obtain Credit History, Running/Licensing Score, Complying with FCRA Disappear

g. More Education Needed for Consumers, Legislators to Understand Benefits and Fairness of Credit Scoring
    i. Industry Refusal to Explain Models to Public
    ii. Bogus Trade Secret Claim – Consumers Only Ones in the Dark, Not Competitors
    iii. FCRA Adverse Action Notice Failure – No Notice to New Applicants

h. Consumers Think It Is Fair
    i. Biased Single Survey
    ii. Why Are Agents Against Credit Scoring?
    iii. Why are Insurers Firing Agents Who Speak Out Against Credit Scoring?

i. Cost-Based Pricing – Subsidies without Credit Scoring
    i. Insurers Practice CBP When Convenient
    ii. No God-Given Risk Classifications -- Public Policy Decisions Necessary – AB 172

j. No Impact by ZIP Code, Income or Race
    i. Secret Studies by Parties with Financial Interest in Outcome
    ii. Actual, Available Data Show Strong Relationship Between Income and Most Heavily Weighted Credit Characteristics – See OCRC Report and Charts from Statistical Abstract

k. Irresponsible to Ignore A Characteristic Predictive of Risk, Leads to Subsidies of Bad Drivers by Good Drivers
    i. Logical Extension of This Argument is Pay As You Go and the End of Insurance
    ii. Criteria for Good Rating Factor Must Be More Than Simple Correlation and Credit Fails Any Other Criteria

4. Suggestions to Strengthen AB 194

1. Except as otherwise provided in subsection 2, an insurer shall not:
(a) ~~Request or require an applicant or policyholder to provide a copy of his consumer report to the insurer; or~~

<u>*Consumers do not provide credit reports – they are developed and distributed by a credit reporting agency, such as Experian or Trans Union. Also, FCRA permits insurers to obtain reports without permission if an existing customer and FCRA permits insurers to obtain mailing lists based on credit without permission*</u>

~~(b)~~ Use any information included in the consumer <u>credit</u> report of an applicant or policyholder as a basis for determining whether to issue, cancel, renew or <u>determine</u> ~~increase~~ the premium for ~~the renewal of~~ a policy <u>or condition eligibility for a payment plan</u>.

<u>*Many types of consumer reports other than credit history – CLUE reports, MVR reports. Need to limit it consumer credit report, defined as report containing information on consumer credit transactions, credit payments, credit lines.*</u>

2. The provisions of this section do not apply to a contract of surety insurance issued pursuant to chapter 691B of NRS or any commercial or business policy.

3. As used in this section, "consumer <u>credit</u> report" means any written, oral or electronic communication of information that:
(a) Concerns the credit worthiness, credit standing, credit capacity, <u>or credit transactions</u> ~~character, general reputation, personal characteristics or mode of living~~ of a person; and

<u>*Too broad because personal characteristics likely include permissible rating factors, such as age, gender. Suggest that section reference a consumer credit report and limit it to credit worthiness, credit standing, credit capacity, credit payments, credit transactions.*</u>

(b) Is intended to be used by an insurer, in whole or in part, as a basis for any decision in connection with a transaction relating to insurance.

<u>*Good – important that covers underwriting, rating, and payment plans.*</u>

<u>**The provisions of this section shall be liberally construed towards the protection of consumers and away from insurers' use of consumer credit information in the determination of eligibility for a policy or policy provisionis, premium determination and eligibility for payment plans.**</u>

Qualifications of Birny Birnbaum

Birny Birnbaum is a consulting economist whose work focuses on community development, economic development and insurance issues. Birny has served as an expert witness on a variety of economic and actuarial insurance issues in California, New York, Texas and other states. Birny serves as an economic adviser to and Executive Director for the Center for Economic Justice, a Texas non-profit organization, whose mission is to advocate on behalf on low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance. Birny has authored reports on insurance markets, insurance credit scoring, insurance redlining and credit insurance abuses for CEJ and other organizations. Birny serves on the National Association of Insurance Commissioners Consumer Board of Trustees.

Birny has worked on insurance credit scoring issues for over 11 years as both an insurance regulator and consumer advocate. Birny has recently authored a report on insurance credit scoring for the Ohio Civil Rights Commission and served on the Florida Insurance Commissioner's Task Force on Credit Scoring.

Birny served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Birny provided technical and policy advice to the Commissioner of Insurance and performed policy research and analysis for the Department on a variety of topics. His particular areas of insurance expertise include:

- Homeowners and Automobile Insurance Availability and Affordability
- Evaluation of Underwriting and Rating Factors
- Data Strategy, Collection and Analysis
- Analysis of Insurance Markets and Availability
- Review of Rate Filings and Rate Analysis
- Loss Prevention/Cost Drivers
- Regulatory Policy and Implementation

Prior to coming to the Department, Birny was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issue. OPIC is a Texas state agency whose mission is to advocate on behalf of insurance consumers. Prior to OPIC, Birny was a consulting economist working on community and economic development projects. Birny also worked as business and financial analyst for the Port Authority of New York and New Jersey. Birny was educated at Bowdoin College and the Massachusetts Institute of Technology.