DISSENTING STATEMENT OF COMMISSIONER PAMELA JONES HARBOUR

Study of Insurance Scores Pursuant to Section 215 of the Fair and Accurate Credit Transactions Act of 2003 ("FACTA") Commission File No. P044804

Today's Commission report explores the impact that credit-based insurance scores may have on the availability and affordability of automobile insurance. This report responds to a Congressional directive. Section 215 of the Fair and Accurate Credit Transactions Act of 2003 ("FACTA") requires the Commission to conduct a study and issue a report to inform Congress on 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."[1]

I respectfully dissent from this report for several reasons:

- I disagree with the methodology used to generate the report. The data collection and analysis fell short of the Commission's gold standard for rigor and completeness, and did not reflect the agency's best practices. Better alternatives were available and should have been utilized.
- Because I distrust the integrity of the underlying data set upon which the study was based, I also doubt the reliability of any conclusions the report might draw.
- For these and other reasons, the report, with improved methodology, could have more aptly addressed Congress's questions.

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1 Pub. Law 108-159 § 215(a)(3), 111 Stat. 1952, 1985 (Dec. 4, 2003).

In no way do I question the good faith of Commission staff, or of my fellow Commissioners who have approved the submission of today's report. Since 2003, skilled professionals in the Commission's Bureau of Economics have done their best possible work, using the limited data made available to them. Unfortunately, however, I do not believe the efforts of staff were sufficient to overcome incomplete and unreliable data.

Methodological Problems

When Congress created the Federal Trade Commission in 1914, the Commission was equipped with a wide range of research and investigatory tools. In particular, Section 6(b) of the Federal Trade Commission Act broadly empowers the Commission to issue orders to compel, under oath, "reports or answers in writing to specific questions, furnishing to the Commission such information as it may require . . . ."[2]

A statistical study is only as sound as the underlying data. In recent years, the Commission repeatedly has relied on its Section 6(b) powers to acquire comprehensive and credible industry information. The Commission's May 2006 report on gasoline pricing in the aftermath of Hurricanes Katrina and Rita is one noteworthy example.[3] Section 6(b) orders were served on 99 companies in the oil industry, along with an additional 139 Civil Investigative Demands; sworn testimony also was received.[4] In September 2005, the Commission issued a report on pharmacy

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2 15 U.S.C. § 46(b).

3 INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES (May 22, 2006), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf.

4 *Id.* at iv-v.

benefit managers' ownership of mail-order pharmacies;[5] to conduct the underlying study, the Commission had subpoenaed documents and information from nearly 20 industry participants.[6] The Commission's July 2002 study of generic drug entry prior to patent expiration is another example;[7] the Commission subpoenaed documents and information from 78 brand-name and generic drug manufacturers.[8]

In stark contrast, this report relies solely on two sources of information: data the insurance industry was willing to turn over voluntarily, and data that were publicly available. The data from the insurance industry came from a study of credit-based insurance scores that the industry sponsored. Not all of the firms that contributed to the study agreed to have their data forwarded to the Commission. Staff ultimately used a subset of the industry's data that came from five insurance

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5 PHARMACY BENEFIT MANAGERS: OWNERSHIP OF MAIL-ORDER PHARMACIES (Aug. 2005), *available at* http://www.ftc.gov/reports/pharmbenefit05/050906pharmbenefitrpt.pdf.

6 *See id.* at iii-iv.

7 GENERIC DRUG ENTRY PRIOR TO PATENT EXPIRATION: AN FTC STUDY (July 2002), *available at* http://www.ftc.gov/opa/2002/07/genericdrugstudy.shtm (includes link to full report).

8 *Id.* at 3. In addition, the Commission currently is in the early stages of a study on "authorized generic" drugs. The study will rely on data collected pursuant to Section 6(b). Two Federal Register notices have been published, and the study is pending approval by the Office of Management and Budget. *See* FTC News Release, FTC Proposes Study of Competitive Impacts of Authorized Generic Drugs (Mar. 29, 2006), *available at* http://www.ftc.gov/opa/2006/03/authgenerics.shtm; FTC For Your Information: Federal Register Notice Issued on Authorized Generic Drug Study (April 30, 2007), *available at* http://www.ftc.gov/opa/2007/04/fyi07238.shtm (both include links to Federal Register notices). "Based on a preliminary analysis, approximately 80 brand-name drug manufacturers, several authorized generic drug companies, and 100 generic companies will receive Special Orders." 72 Fed. Reg. 25306 (May 4, 2007).

companies.[9] As the Smith letter cited in footnote 9 of the majority's statement confirms, these industry participants never provided the Commission with written verification of the accuracy, authenticity, or representativeness of the data.[10] Moreover, records were stripped of identifying data, such that individual records could not be linked to specific companies. The data cannot be independently verified to determine whether any bias was introduced during the selection process.

The data did not contain critical elements on individual policyholders. For example, staff did not have access to all of the characteristics upon which the insurers based their underwriting tier placements. Nor did staff use street addresses, which would have enabled staff to make better assessments based on geography. Staff's analysis did not incorporate data on actual premiums charged to individual policyholders.

Commission staff then adjusted the insurance industry data, based on multiple layers of assumptions and publicly-available data sources, to create an "FTC database" that was not reflective of any actual insurance company's practices. Staff immediately recognized that the original data set did not accurately reflect the racial and economic demographics of this country. Minorities and poor people were under-represented in the sample provided by the insurance industry. Staff recognized

[9] Appendix C § C.2.

[10] *Compare* Majority Statement at 5-6 ("Yet the companies did provide written assurances of the data's reliability.") *with* Commission letter to Congressman Barney Frank (Dec. 8, 2005) at 4 ("The agency will not be able to independently verify the accuracy of the data received on automobile policies (the "EPIC") data [sic], nor the data expected on homeowners policies. Staff had expected to receive and rely upon written representations from the firms that contributed the data, stating that the data had been selected randomly following a methodology that staff agreed was appropriate. However, because of the reluctance of the firms to identify themselves to the agency and risk being identified publicly, the agency has not been able to receive such written assurances.").

this shortcoming and used "statistical weighting" to make the pool more racially and economically diverse. It would have been vastly preferable to use data reflecting actual insurance policies purchased by a representative sample of U.S. residents.

Appendix C to the report describes how the FTC database was created. Staff needed to make many assumptions to address deficiencies in the original, incomplete data set. Just the first few pages of Appendix C provide the following examples:

- larger firms were under-represented relative to their market share;
- drivers in small states were over-represented;
- important risk variables were missing from the data, including prior claims and territory;
- credit-based insurance scores had never been calculated for many of the policies in the database;
- among policies that had been scored, different companies used different models, which may have varied by state;
- a score was calculated only for the first-named insured on each policy, which may have skewed the results for multi-driver and multi-car households; and
- high-risk drivers likely were under-represented.[11]

Appendix D to the report explains that the data on race were compiled using imperfect data from the Social Security Administration. Race was sometimes recorded using a predicted probability based on the race of persons on a Census block. The Hispanic surname match is also imprecise;

[11] Appendix C, § C.1.

many people who have an Hispanic surname do not report themselves as Hispanic, and vice-versa. There were so few Native Americans in the sample that they were not included in the analysis.[12]

By serving insurance companies with 6(b) orders, Commission staff could have obtained a more accurate and complete data set, which would have provided a strong foundation for staff's complex econometric analyses.

Notably, the University of Texas conducted a study in 2003, which triggered follow-up studies in 2004-05 by the Texas Department of Insurance, addressing the exact issue of using credit-based insurance scores for automobile insurance purposes. The Texas studies were based on a far more detailed data set, including hundreds of characteristics of individual policyholders, as well as actual underwriting decisions by insurance companies. The scope of the Texas data collection – especially its heavy reliance on raw, unbiased data – might have provided a template for the Commission's own data collection efforts.

<u>Substantive Conclusions Drawn By The Study</u>

In light of these significant methodological problems, I cannot endorse the report's favorable view of using credit-based insurance scores to inform decisions related to automobile insurance. I recognize that credit-based insurance scores may be effective predictors of risk under automobile policies. But as the report acknowledges, it is impossible to know *why* this correlation exists, based on the Commission's study alone.

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[12] Appendix D, § D.1.1.

Even using the "best" data the industry had to offer, 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 actual proxy effect might be greater.[13]

Responsiveness of Study to Congressional Inquiry

Congress asked the Commission to conduct a study based on real-world facts. Congress specifically called upon the Commission to study "the extent to which, if any, the use of underwriting systems relying on [credit-based] models could achieve comparable results through the use of factors with less negative impact." Reading between the lines of the report, the answer I take away is, "we don't really know." Rather than answering the question of what insurers actually are doing, today's report discusses at great length whether a theoretical insurer with a nationally-representative, hypothetical book of automobile insurance business might have been able to engage in some form of credit-based insurance scoring in a manner that was not unduly "negative or differential" in its treatment of protected classes.

The report devotes only a few pages to a discussion of alternative scoring models. Commission staff endeavored to create a model that did not "derive predictive power from a relationship with race, ethnicity, and income."[14] Staff tried several different approaches and was

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[13] The report notes that several states (California, Massachusetts, Georgia, Hawaii, Illinois, Maryland, Oregon, and Utah) restrict the use of consumer credit history or credit-based insurance scores in insurance. Report at 19.

[14] Report at 76.

unable, using the available data, to build a model that predicted risk but narrowed the differences in scores among racial and ethnic minority groups.[15]

The report concedes, however, that the FTC's "inability" to build such a model is "by no means definitive. Perhaps someone could develop a model that meets both of these objectives."[16] I suspect that, given a more robust data set, staff might have been able to answer this question more definitively. I also would have preferred to see a more balanced discussion of the benefits and detriments of using credit scores and credit-based insurance scores.

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Congress is faced with difficult policy questions regarding possible racial bias in the insurance industry. Congress asked the Commission to apply its substantial expertise to study one potential problem – the possible use of credit-based insurance scores to disadvantage protected classes – and to report on how consumers actually are being treated in the insurance marketplace.

Had this report been based on the real insurance marketplace – using actual, verifiable data on individual policyholders, from a broad cross-section of insurance companies – reliable answers might have emerged. Staff made their best, good-faith efforts to work with the data they were given. But in the end, I cannot endorse this report due to my grave methodological concerns. This study fell short of the rigorous research and data-collection standards to which the Commission usually adheres.

Section 215 of FACTA requires the Commission to conduct a similar analysis with respect to homeowners' insurance. The Commission should use all available investigative powers, including

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[15] Report at 72.

[16] Report at 80.

6(b) orders, to assemble a more reliable data set – just as it has done in other superbly executed studies involving other critical industries. The study should include a more thorough and balanced discussion of alternative predictors of risk, and their relative costs and benefits.

Finally, this report reminds me how important it is for the Commission to promote financial literacy in poor and ethnic minority communities. Credit scores clearly are affecting decisions outside of the credit context. The Commission should help all consumers to understand the extremely negative impact of paying bills late, making inquiries about credit, using payday lenders, and taking other actions that may reduce their credit scores. More than ever, protecting one's credit score is a critical step toward achieving financial stability and owning a piece of the American dream.