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GOVERNOR

STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF LABOR & ECONOMIC GROWTH
DAVID C. HOLLISTER, DIRECTOR

LINDA A. WATTERS
COMMISSIONER

April 25, 2005

Federal Trade Commission
Office of the Secretary
Room H-159 (Annex Z)
600 Pennsylvania Ave., NW
Washington, DC 20580

Re: FACT Act Scores Study

Michigan was the first state to coordinate regulation of financial institutions, insurance, and the securities industry in one state agency in response to the federal Financial Services Modernization Act of 1999. The Michigan Office of Financial and Insurance Services (OFIS), headed by Linda A. Watters, regulates Blue Cross Blue Shield of Michigan, 31 HMOs, 132 banks, 175 domestic insurance companies, 268 credit unions, 1,300 foreign insurance companies, 1,583 investment advisers, 2164 securities broker-dealers, 6,000 consumer finance lenders, 75,000 insurance agents, and 120,715 securities agents.

OFIS welcomes the opportunity to comment to the FTC as part of its FACT Act study of the effects of credit scores and credit-based insurance scores on the availability and affordability of financial products, including credit cards, mortgages, auto loans, and property and casualty insurance. Since the formation of OFIS in 2000, the agency has responded through its Consumer Services division to complaints against the people and entities OFIS regulates. From its complaint statistics, OFIS can fairly conclude that the use of credit scores in financial transactions involving an extension of credit produce, at least in Michigan, very few and in some years no complaints, while the use of credit scores in transactions that do **not** involve an extension of credit, such as the sale of automobile, home, and other personal lines of insurance, began producing complaints almost as soon as a few insurers began to use credit as a rating factor in the late 1990s, and the complaints have increased exponentially every year since as the practice has spread throughout the insurance industry. At this time, the top ten insurers by volume for both automobile and home insurance in Michigan all use credit scoring in rating, and OFIS complaints on the subject are at an all-time high.

Since Michigan is a “file and use” state for individual home and automobile insurance, insurers file their rating systems and begin to use them, without prior approval from the Commissioner. Unlike most other states but very much like the aim of the FACT Act Scores Study, the Michigan Insurance Code identifies as a specific purpose:

to provide for the continued availability and affordability of automobile insurance and homeowners insurance in this state and to facilitate the purchase of that insurance by all residents of this state at fair and reasonable rates.

To effectuate this purpose, the Michigan Insurance Code has since 1981 provided an exclusive list of the rating factors an insurer may use for individual automobile and home coverage. The use of other factors is prohibited unless the Commissioner approves use after an administrative hearing, at which the insurer must prove the factor meets the statutory threshold. MCL 500.2111. Credit scoring is not among the permitted rating factors, and no insurer has ever requested the administrative hearing required. Rather, insurers have implemented credit scoring in Michigan as part of "premium discount" plans, subject to a different code provision (MCL 500.2110a) that does not mandate a prior administrative hearing.

A more complete legal and factual background on the use of credit scoring in Michigan appears at the Office of Financial and Insurance Services website: www.michigan.gov/ofis by clicking on "Recent Credit Scoring Activity." Available there is the October 1, 2004 Agency Report to the Legislature's Joint Committee on Administrative Rules, that summarizes the history of credit scoring in Michigan (pp 1-7) and responds to the public comment OFIS received during the summer of 2004 on then-proposed administrative rules to ban the use of credit scoring in insurance rating for automobile, home, and other personal lines of insurance and to require insurers to calculate a reduction in base rates, essentially to correct the increase in base rates adopted by each insurer in order to offer premium "discounts." Also available at the website is a December 2002 OFIS report to the Michigan Legislature and public on a 2002 agency study of the practice, which includes in its appendices answers to many of the 21 questions and ancillary questions the FTC posed in Section B of its Notice and Request for Public Comment, Credit-Based Insurance Scores and Property and Casualty Insurance. For example, Appendix C to the 2002 study shows some automobile insurers increasing base rates from over 100 to 200% to fund credit scoring "discounts" of as much as 70%, and home insurers increasing base rates by generally smaller but still substantial percentages. The OFIS website also provides a list of insurers using credit scoring in 2005 that establishes the substantial increase in use of credit as a rating factor from the companies listed in the 2002 appendices. Finally, OFIS has already provided to the FTC actual rate filings from selected major automobile and home insurers in Michigan so that the agency can see exactly how credit is used in rating classification systems here.

OFIS promulgated its insurance scoring administrative rules on March 25, 2005, and they appear in the Michigan Administrative Code, R 500.2151 – R 500.2155, available online at www.michigan.gov/orr, effective April 4, 2005, with compliance dates later in 2005. Some insurance companies and associations have sued the Commissioner over the rules in the Barry County Circuit Court, Case No. 05-156-CZ; but the court has entered no substantive order as these comments to the FTC are being submitted, and the Commissioner is considering compliance actions later this year.

Because Michigan law clearly prohibits the use of credit scoring in underwriting automobile and home insurance (MCL 500.2103, 500.2105, 500.2117, 500.2118), clearly specifies permissible rating factors for each coverage (MCL 500.2111), and also prohibits rates or rating classifications for automobile insurance based on sex or martial status (MCL 500.2111(4), questions of the effect of credit scores on the availability and affordability of essential automobile and home insurance here have focused primarily on whether credit may be used as a rating factor in premium "discount" plans. Under MCL 500.2110a, such discount plans must "reflect reasonably anticipated reductions in losses and expenses."

Several major insurers admitted in the course of the 2004 public hearings and comment period for the administrative rules that credit-based insurance scores are revenue neutral, i.e., that overall premium charged does not change, and the "discounts" based on credit scores that are granted some policyholders are paid for by the other policyholders not receiving the "discounts." These admissions provide a clear answer to the series of questions appearing as B#16 in the FTC notice and request for public comment. The "magnitudes" of the changes in individual costs obviously vary from insurer to insurer, depending upon the magnitude of the discount provided in a particular insurer's premium "discount" plan. An insurer offering a 70% "discount" for a credit-based insurance score is likely giving greater weight to credit as a rating factor than it gives to make, model, and age of vehicle, driving history, claims history, geographical location, or any other of many rating factors included in its rate classification system.

The use of credit-based insurance scores raises a number of issues not fully addressed in the questions the FTC has posed for its study. The first is the validity of using a credit score in any way in a transaction that does not involve an extension of credit. Consumers pay for personal lines insurance products in advance. To support the use of credit in insurance rating, the insurance industry relies upon a series of univariate studies purporting to show a correlation between low credit scores and propensity for loss. The insurance industry paid for all such studies. Most deal only with automobile coverage, and show only a greater frequency of claims from those people with low credit scores. Despite the limitations of these studies, insurers have used their conclusions to rate not just automobile policies, but all personal lines of coverage: home, mobile home, motorcycle, recreational vehicle, and even watercraft. OFIS knows of no recent study including Michigan home coverage data, and knows of no studies at all ever done on the other personal lines of coverage.

The insurance industry typically refers consumers charged higher premiums because of low credit scores and seeking an explanation either to the credit reporting agency or the insurance scoring vendor that sold the credit report, credit score, or insurance score. The consumer becomes responsible for detecting and correcting any errors in his credit history, without knowing the underlying factors used against him. At public hearings last summer, hundreds of Michigan consumers described their time-consuming and often futile efforts to correct errors in their credit reports. Correcting errors in insurance scores is even harder and may well be difficult to impossible since the insurance scoring formulas based on credit are impenetrable except to experts.

Another aspect of credit-based insurance scores missing from the FTC questions is one of timing. Michigan law clearly limits the period of time an insurer may merit rate an insured for an adverse factor. For example, an insurer may not merit rate a policyholder for a violation of the Michigan vehicle code for a period of time longer than that which the secretary of state's office carries points for that violation on the person's motor vehicle record. MCL

500.2111(3)(b). Points for common violations such as speeding typically stay on a person's driving record for two or three years. Even a conviction of fraud against an insurer lasts only 5 years. MCL 500.2103(1)(c). The information in a person's credit report, on the other hand - whether accurate or inaccurate, whether related or not in any way to the business of insurance - has a much longer shelf-life. Obviously, the period of time a person may be charged a higher premium for an adverse rating factor affects the availability and affordability of that product to that person. The bankruptcy that FCRA includes in a consumer's credit report for up to 10 years will likely affect that person's home insurance premiums for eleven years since most consumers pay home insurance premiums annually.

Since most bankruptcies result from catastrophic illness or loss of job, that situation only highlights the unfairness of allowing insurance scoring based on credit. Should a person forced into bankruptcy by catastrophic illness also be charged higher insurance premiums for ten or more years? Of course, the overarching problem is that insurance scoring generally and almost by definition increases the insurance premiums of low-income people, people who have poor credit scores because they have difficulty, for one reason or another, in earning enough money to pay their bills. To be accurate, the FTC study of the effect of credit-based insurance scores on the availability and affordability of insurance products should identify the period of time covered by each type of adverse or favorable credit factor included in each insurance scoring model used in the study.

The Office of Financial and Insurance Services appreciates this opportunity to comment and hopes the FTC will conduct a multivariate study of insurance scoring similar to the smaller studies recently completed by the Texas and Missouri Departments of Insurance. This agency stands ready to supply to the FTC any additional information it may seek.

Respectfully submitted,

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