

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE.

The meeting was called to order by Chairman Representative Robert Tomlinson at 3:30 pm on April 4, 2002 in Room 527-S of the Capitol.

All members were present except:

Representative John Edmonds
Representative David Huff
Representative Carlos Mayans
Representative Gene O'Brien
Representative Ralph Ostmeyer
Representative Jene Vickery

Committee staff present:

Bill Wolff, Legislative Research
Ken Wilke, Legislative Revisor
Mary Best, Administrative Assistant

Conferees appearing before the committee:

Ms. Linda DeCoursey, Kansas Insurance
Department
Mr. Larry Magill, Kansas Association of
Insurance Agents
Mr. Bill Curtis, Kansas Association of School
Boards

Others attending:

See Attached Guest List

SCR 1623 - Urging the study of insurance scoring reports.

Mr. Larry Magill came before the committee to give Proponent Testimony on the above mentioned bill. A copy of the testimony is (Attachment # 1) attached hereto and incorporated into the Minutes by reference.

Mr. Magill discussed the problems with credit scores being used by businesses as the basis of approving or denying underwriting of insurance and rating purposed. He explained how there are circumstances that could greatly alter a credit report to the negative, such as pre-approved credit cards not being used, the number of credit inquiries, difficulties caused by health problems or disputed bills to name a few.

He related to the committee that approximately two dozen states are considering bills this legislation restricting the use of credit information for insurances purchases or already have done so. At least three states have passed legislation with bills still alive in a number of states. His testimony also held suggested amendments assisting in cleaning up the bill and language.

Mr. Magill stood for questions. Questions were asked by Representatives Phelps and Boston.

Ms. Linda DeCoursey, Kansas Insurance Department, offered Proponent Testimony to the committee. A copy of the testimony is (Attachment # 2) attached hereto and incorporated into the Minutes by reference. Ms. DeCoursey supported Mr. Magill's testimony and stated the Kansas Insurance Department was in favor of a study to review the issue more closely. She let the committee know the NAIC is also "stepping up its efforts on this matter, and appointed a new Credit Scoring Working Group to focus specifically on issues relating to the use of credit scores and credit history in the insurance underwriting and rating process." Ms. DeCoursey stood for questions. There were no questions. The public hearing on **SCR 1623** was closed.

SB 654 - Municipalities: insurance, group-funded municipal pools.

Mr. Bill Curtis, Kansas Association of School Boards, came before the committee to offer

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE

April 4, 2002

Proponent Testimony on the above mentioned bill. A copy of the testimony is (Attachment # 3) attached hereto and incorporated into the Minutes by reference.

Mr. Curtis related to the committee that the reason **SB 654** was introduced was to permit public sector pools the same flexibility in paying reinsurance premiums and private sector pools now pay. He related that both pools "operate under the statutory requirement that premium dollars must be allocated in the amount of 70% to the claims fund and 30% to the administrative fund." He stated that the reinsurance premiums are paid from the administrative funds.

Mr. Curtis feels there is a need for this bill after the tragedy of Sept. 11, and that the event has driven reinsurance cost much higher. Mr. Curtis stood for questions. There were none.

Chairman Tomlinson recognized Senator Ruth Teichman, who was briefly attending the meeting to support Mr. Curtis's position. She spoke to the committee urging them to also support the bill and explained her feeling for the need of such bill. Representative Boston had a question.

Ms. Linda DeCoursey, Kansas Insurance Department, came before the committee to offer Proponent Testimony. A copy of the testimony is (Attachment # 4) attached hereto and incorporated into the Minutes by reference.

Ms. DeCoursey explained the technical amendments to the bill, that the Insurance Department had requested. The changes were purely clean up language. She stated the changes were, "that no one uses the June 1, 1994 rates any more. It would be ludicrous to do so ... everyone uses loss costs these days." She continued on to explain that K.S.A. 40-1113c no longer exists. She stood for questions. There were none and therefore the public hearing was closed.

SB 654 was then brought before the committee to work. Representative Grant asked if there was time to bring the bill to the consent calendar. Representative Grant made the motion to pass the bill out favorable for passage. Representative Kirk seconded the motion. A vote was taken and the motion carried.

SCR 1623 had a balloon and Representative Phelps moved to adopt the balloon. Representative Hummerickhouse seconded the motion. The vote was taken and passed. Representative Phelps also made the motion to move the bill out marked favorable for passage as amended. Representative Toelkes seconded the motion. The vote was taken and passed.

The meeting was adjourned. The time was 4:02 p.m.

Testimony on SCR 1623
Before the House Insurance Committee
By Larry W. Magill, Jr.
Kansas Association of Insurance Agents
April 4, 2002

Thank you Mr. Chairman and members of the Committee for the opportunity to appear today in support of SCR 1623. We asked the Senate Financial Institutions and Insurance Committee to introduce this Resolution which calls for a task force to study the use of credit scoring in insurance and report back to the legislature next January.

Since the last legislative session, there has been an enormous increase in the amount of interest shown by the states in regulating the use of credit for insurance underwriting and rating purposes. Approximately two dozen states have considered or are considering bills this legislative session that would restrict the use of credit scores for insurance purchases. At least three states, Washington, Utah and Idaho, have passed legislation with bills still alive in a large number of other states.

Use of credit scoring for insurance rating purposes has hit the headlines in the last two weeks in the attached March 19th front page Wall Street Journal article and a March 12th front page U.S.A. Today article.

The proposed legislation in these states addresses the issue in a number of different ways that range from:

1. Prohibiting underwriting based solely on credit scores
2. Disclosure of the score and a detailed explanation of the factors that determined the score along with information on how to improve the score
3. Prohibiting use of credit scores only on renewal books to non-renew, cancel or raise rates
4. Requiring reporting only when adverse actions are taken and applying the adverse underwriting decisions law
5. Requiring filing and approval by the Insurance Department of the insurance scoring method
6. Requiring insurers to notify consumers that a credit score will be used in underwriting
7. Prohibiting use of credit scores that are in dispute
8. Where a credit score resulted in charging a higher premium, requiring the insurer to run a credit score at subsequent policy anniversaries and reduce the premium if the score improves
9. Limiting the credit score impact to no more than a 20% increase in rate
10. Prohibiting of use of "no-hit" credit reports to raise premiums
11. Prohibiting use of certain factors such as number of credit inquiries, credit difficulties caused by health problems or disputed medical bills, use of particular types of credit cards...

HOUSE INSURANCE

DATE: *April 4, 2002*

ATTACHMENT #1

And the list could go on....

According to a Conning & Company study published in 2001, the proponents of credit scoring have 5 principal arguments:

- There is a strong statistical correlation between credit data and loss ratio. Conning cited studies by Fair, Isaac, The Casualty Actuarial Society and the Virginia Bureau of Insurance.
- The use of credit data enables insurers to make underwriting exceptions for consumers that traditionally would not qualify for preferred or standard programs.
- Credit characteristics are nondiscriminatory.
- Insurance scoring, in combination with other risk characteristics, allows for more objective, consistent and efficient underwriting and pricing decisions.
- Most consumers have good credit.

The use of credit in the underwriting and rating process has increased dramatically, and the practice is commonplace today. A 2001 Conning & Co study found that 92 of the largest 100 personal auto insurers use credit data in underwriting or rating and of those 92 companies, over half have begun doing so since 1998.

The NAIC is currently studying the use of credit scores for the second time. KAIA recognizes that Kansas cannot afford, as a small, storm-prone state with a relatively small premium volume to have an overly restrictive underwriting environment. Nevertheless, we hear the frustration frequently from our members that the credit scoring process is shrouded in secrecy, unpredictable and sometimes inconsistent in its effect.

We hear stories of consumers whose credit score varies dramatically over a short period of time for no apparent reason, of instances where a consumer qualifies for the lowest rated auto policy but is not as desirable a risk for homeowners insurance with the same carrier and the very common problem of not knowing why the score is low and how to improve it.

Last year, when the Realtors requested S.B. 185 and H.B. 2254, we waited to see the results and to determine if we would ask that insurance be amended into the bills. Since then, the insurance industry has been engaged in debate over credit scoring in roughly half the states.

We feel that the timing is right for a study of the entire area of credit scoring in insurance for the following reasons:

- The industry's use of credit scores is evolving as more states consider legislation and the debate over credit develops.
- At the same time, the providers of credit scores are responding to some of the concerns. For example, the attached Wall Street Journal article talks about a

new service being offered by Fair Isaac, one of the credit scoring firms, which will coach a consumer on ways to improve their score for a fee.

- The NAIC is studying the issue and a number of states are still considering legislation.
- Insurance companies, like Progressive, the largest auto insurance writer for independent agents, recently released a paper with a number of credit scoring improvements they would support. We are convinced more companies will join the discussion in a proactive way if SCR 1623 passes.

At this point, KAIA is not convinced that legislation is the only answer. The advantage of the task force that SCR 1623 proposes is that it gives all the stakeholders a chance to sit down around a table and work on solutions in an open give-and-take discussion. This less formal, more participatory process will give us a chance to find some common ground before the 2003 legislative session.

We urge the Committee to take action on the Concurrent Resolution quickly if we are to have any hope of passing it this late in the session. We do have some suggested clean up amendments to clarify the changes made on the Senate floor to the make-up of the Task Force. We would suggest three company representatives, one representing a Kansas domestic property and casualty company, one a foreign P&C stock insurer and one a foreign P&C mutual insurer. This will increase the size of the task force to 12.

We would be happy to answer questions or provide additional information.

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6 **Senate Concurrent Resolution No. 1623**

7
8 By Committee on Financial Institutions and Insurance

9
10 3-15

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12 A CONCURRENT RESOLUTION requesting the Kansas commis-
13 sioner of insurance to study the use of insurance scoring reports within
14 the insurance industry and the need for additional regulation, if any.

15
16 WHEREAS, Insurance is an essential economic tool to protect the
17 assets of Kansas residents and property owners; and

18 WHEREAS, Insurance companies are now using insurance scores in
19 the underwriting of all types of personal and commercial insurance; and

20 WHEREAS, There is extensive evidence that a person's credit is an
21 accurate predictor of their future loss probability; and

22 WHEREAS, Insurance consumers deserve to know and understand
23 the impact their credit and insurance score has on the availability and
24 affordability of their coverage; and

25 WHEREAS, Insurance consumers need to know that an insurance
26 score will be used and to understand how they can positively impact their
27 insurance score; and

28 WHEREAS, The public policy of the State of Kansas may dictate that
29 certain limitations need to be placed on the use of insurance scoring such
30 as prohibiting use of scores on an individual's or business' insurance re-
31 newal, prohibiting use of scores as the sole factor considered or prohib-
32 iting use of scores that are in a legitimate dispute; and

33 WHEREAS, The Kansas Insurance Department may need the au-
34 thority to require the filing of credit or insurance scoring models with
35 protection from public disclosure of proprietary information to allow the
36 department to monitor their proper application: Now, therefore,

37 *Be it resolved by the Senate of the State of Kansas, the House of Rep-*
38 *resentatives concurring therein:* That a task force be formed consisting
39 of ~~4~~ 14 members to include the chair of the senate committee on financial
40 institutions and insurance, the chair of the house committee on insurance,
41 the ranking minority member of the senate committee on financial insti-
42 tutions and insurance *one member appointed by the president of the*
43 *senate; one member appointed by the minority leader of the senate;*

1 *one member appointed by the speaker of the house of representa-*
 2 *tives; one member appointed by the minority leader of the house of*
 3 *representatives; the ranking minority member of the house committee*
 4 *on insurance; the insurance commissioner or the commissioner's desig-*
 5 *nee; two persons, one [person] representing a domestic property and*
 6 *casualty insurance company and one representing a foreign property and*
 7 *casualty insurance company appointed by the insurance commissioner*
 8 *from a list submitted by the Kansas Association of Property and Casualty*
 9 *Insurance Companies; [one person representing foreign stock insur-*
 10 *ance companies appointed by the insurance commissioner from a*
 11 *list submitted by the America Insurance Association, one person*
 12 *representing foreign mutual insurance companies appointed by the*
 13 *insurance commissioner from a list submitted by the National As-*
 14 *sociation of Independent Insurers; two members representing the li-*
 15 *icensed Kansas insurance agents appointed by the insurance commissioner*
 16 *from a list submitted by the Kansas Association of Insurance Agents; and*
 17 *two members appointed by the governor representing the consumer in-*
 18 *terests. The governor shall appoint the chairperson and vice chairperson*
 19 *from the membership of the committee. The chairperson and vice chair-*
 20 *person shall not be of the same political party. Legislative members serv-*
 21 *ing on the task force shall receive pay and allowances as provided for*
 22 *legislative service. All other No task force members shall member shall*
 23 *not receive any compensation, subsistence, mileage or other allowances*
 24 *for serving on the task force or attending any meeting thereof. The task*
 25 *force shall conduct a study of the desirability of regulation of insurance*
 26 *scoring practices for the benefit of Kansas consumers; and*

[delete]

; one person representing a property and
 casualty insurance company appointed by
 the insurance commissioner from a list
 submitted by the Alliance of American
 Insurers; one person representing a
 property and casualty insurance company
 appointed by the insurance commissioner
 from a list submitted by the National
 Association of Mutual Insurance
 Companies;

27 *Be it further resolved:* That a report containing the results of such
 28 study and the task force's recommendations and conclusions emanating
 29 therefrom be transmitted to the speaker of the house of representatives,
 30 the president of the senate, the chair of the house committee on insur-
 31 ance, and the chair of the senate committee on financial institutions and
 32 insurance no later than the convening of the 2003 Kansas legislature; and

33 *Be it further resolved:* That the secretary of state transmit an enrolled
 34 copy of this resolution to the commissioner of insurance.

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Larry Magill

From: Wes Bissett [WBissett@iiaa.net]
Sent: Wednesday, March 20, 2002 3:33
To: Larry Magill
Subject: FW:

The first story is from USA Today (March 12). The second is from the WSJ. Both were front page stories.

HEADLINE: Bad **credit** boosts **insurance** costs

BYLINE: Thomas A. Fogarty

Credit trouble doesn't just make it hard to get a loan. For many, it's increasing the cost of **insurance**.

Two dozen state legislatures are looking at curbing the growing practice of using a customer's **credit** history to predict **insurance** claims. Nearly every auto insurer in the USA has started to assign a score to a customer's **credit** history. Practices vary, but the score is used in deciding to issue a policy, to renew it, or to price it. **Credit** scoring is becoming the norm for home insurers, too. This month, the Washington state legislature became the first to significantly restrict **credit** scoring for **insurance**.

Political backlash is building because of such cases as that of Larry Jackson and his wife, Elizabeth Alexander, of Kirkland, Wash. Last fall, their auto insurer raised their rates 40%. The bump followed six years of accident-free coverage and timely premium payments. But the insurer to factor **credit** scores into pricing decisions; that brought up a bankruptcy filing from seven years ago.

"My wife and I are careful drivers, and our **credit** has not been an issue for a number of years," says Jackson, 45, a mining engineer.

Not in dispute is the ability of **credit** scores to predict broadly the likelihood of future claims by a certain type of customer.

Credit scores work in **insurance** calculations, says Lamont Boyd of **credit**-scoring firm Fair Isaac, because "the vast majority of people tend to do things in a certain way." Thus, he says, those who manage their **credit** well also tend to leave home early enough that they don't have to drive recklessly to get to work on time.

Joe Annotti, spokesman for the National Association of Independent Insurers, says banning the use of **credit** scores by insurers could increase rates for good **credit** risks because insurers could no longer distinguish good risks from bad.

FAIR ISAAC PLANS CREDIT-SCORE HELP, BUT WATCHDOG GROUPS SEE CONFLICT

By RUTH SIMON, Staff Reporter of *THE WALL STREET JOURNAL*

Tuesday, March 19, 2002

SAN RAFAEL, Calif. -- Maybe you were forced to put down a big deposit when you got phone service. You might have ended up paying extra-high rates for auto insurance despite a flawless driving record. Or, maybe you suddenly had trouble finding homeowner's insurance.

In all three cases, the reason could well have been the same: Your credit score wasn't high enough. These days, that score, calculated from your personal financial data using a secret formula, has more influence over your life than ever before.

Increasingly, lenders, merchants and even many insurers consider a customer's credit score a critical tool for predicting whether they'll make money on that customer. The scores are based on complex and closely guarded mathematical formulas, many of them written here by Fair, Isaac & Co.

That gives the little-known California company an influential role in the lives of millions of American consumers. Its scores already play an important part in many insurance decisions, a trend that is drawing increasing scrutiny from regulators. Now, Thomas Grudnowski, Fair Isaac's chief executive since 1999, is leading the company into another potentially controversial business: teaching people how to boost their credit scores and to use them to better advantage.

Starting this spring, Fair Isaac plans to launch the first of a new set of services that would do just that -- for a fee. One of the new services, which will draw on the company's insider knowledge of its own credit-score formulas, will show consumers how certain key financial variables influence their credit scores. For an additional fee, another service would alert consumers to changes in their scores that might indicate that somebody was stealing their financial identity. Yet another fee-based service would show people who want to refinance their mortgages how to get a better interest rate by timing their refinancing to coincide with an increase in their credit score.

Seeking Sales Growth

Mr. Grudnowski is counting on the new services to help spur Fair Isaac's sales growth, which has slowed in recent years as consolidation in the financial industry has reduced the company's traditional customer base. He says he thinks that selling data to consumers could be a \$500 million to \$1 billion market for the company within five years; Fair Isaac had 2001 sales of \$329.1 million.

Some consumer advocates, already critical of the secrecy surrounding Fair Isaac's credit-scoring formulas, are troubled by its planned expansion. Among them is Ed Mierzwinski of the U.S. Public Interest Research Group, who says the company's new services are just another way of charging consumers for something that should rightfully be theirs for free: access to their credit scores. Fair Isaac is being "incredibly greedy," says Mr. Mierzwinski, whose liberal consumer-advocacy group is based in Washington, D.C.

Fair Isaac says that's not the case. "Judging by our consumer response so far, people from all walks of life very much want these new services," says company spokesman Craig Watts.

The new services put Fair Isaac in the unusual position of charging consumers for tips on how to better the very scores that Fair Isaac writes the rules for. But the company says it doesn't see any conflict in that position. It says its models merely use technology to measure the same kinds of risk factors that a lender would weigh in deciding whether to make a loan.

Fair Isaac isn't the only company that develops credit-scoring formulas, but it is by far the market leader. It says that credit scores based on its flagship "FICO" formula are a factor in about three-quarters of all mortgages approved in the U.S.

For years, the company refused to let consumers see their credit scores. Two years ago, when Internet lender E-Loan Inc. began giving consumers free online access to their FICO scores, Fair Isaac urged the

credit-reporting companies that provided the scores E-Loan used to stop doing so. The lender quickly backed down. Fair Isaac says it didn't think consumers should be given their scores without information that would help them understand the numbers. Federal laws require the nation's credit-reporting companies, the sources of much of Fair Isaac's data, to give consumers access to their credit reports for a nominal fee or, in some cases, free of charge. But those laws don't apply to credit scores.

Last year, under mounting pressure from legislators and consumer groups, Fair Isaac launched myfico.com, a Web site that gives consumers access to their personal FICO scores. For a fee of \$12.95, a consumer gets 30 days of online access to his FICO report. So far, the company says, more than one million consumers have paid for the service, which it operates as a joint venture with Equifax Inc., the Atlanta-based credit-reporting company. Myfico.com was introduced roughly five months after California passed a law requiring lenders to disclose, at a reasonable cost, credit scores used in making decisions on home loans.

On the FICO scale, a score of 300 indicates that a consumer is a terrible credit risk, while a score of 850 denotes an ideal borrower. The median score is roughly 720. In addition to their scores, consumers who buy the basic myfico.com service get a copy of their Equifax credit report and a general explanation of the factors that might be holding down their credit scores. Critics say these explanations are too vague to be of much help to consumers.

Partly in response, Fair Isaac, in the next six to eight weeks, plans to upgrade its \$12.95 myfico.com service to include an online calculator that will let consumers see how seven key variables could affect their FICO score. According to a prototype of the new service, a consumer with a 707 score could raise that score by as much as 20 points by paying down \$750 on \$2,230 in credit-card balances. But the prototype's advice isn't always as straightforward. For example, a consumer with a 707 score could either raise or lower that score by 10 points by obtaining a new charge card with a \$3,000 credit limit.

Consumer groups argue that the company should expose the formula itself to public scrutiny. But the company has refused to do so, citing competitive concern, though it says it cooperated with legislators and regulators.

Would banks and other lenders find FICO scores as useful if consumers know how to raise them or know when their scores have peaked? "It's something we've wrestled with a lot," says Mr. Watts, the Fair Isaac spokesman. "Our consistent advice to consumers as to how to improve their scores has been pretty generic."

Fair Isaac says it plans to market its new consumer-oriented services primarily through lenders and financial Web sites. Mr. Watts says about a half-dozen lenders and Web sites are providing access to the myfico.com service. These include Quicken.com and Citibank, a unit of Citigroup Inc.

Increasingly, credit scores are also being used to make business decisions that don't involve lending money. Fair Isaac pioneered their use by insurance companies. Now some auto insurers believe that the scores are a better predictor of a client's propensity to file insurance claims than is the client's driving record. The result: If your credit score goes down, your auto-insurance rate may go up -- or you insurer might choose to drop you.

The insurance industry says various studies have shown that consumers with lower credit scores are more likely to file auto or home-insurance claims, though the industry isn't sure why. That's "the \$64 million question," says Frank McConnell, a Safeco Corp. assistant vice president and its director of personal-insurance lines.

Critics say the use of credit scores by insurers penalizes poor people, immigrants and seniors. Members of these groups, who often pay their bills in cash, may not have credit histories, and thus may not have credit scores. Moreover, they say that the credit reports on which credit scores are based often contain errors. Those reports are compiled by credit-reporting companies that glean their information from lenders, debt-collection agencies, courts and other public and private sources.

Earlier this month, the state of Washington passed a law that would restrict the use of credit-based scores for home and auto insurance. Last week, Utah and Idaho enacted related laws. Credit-scoring legislation also has been introduced in more than 20 other states.

When Washington state insurance commissioner Mike Kreidler held hearings on the issue last year, more than 200 consumers complained that they were denied insurance, were told their policies wouldn't be renewed, or saw their rates increased, based on their credit scores.

One of them was Kathryn Korab, a brokerage-firm manager, who lives in Bellingham, Wash. She says her insurer, Safeco, decided not to renew her auto policy based on her credit score -- which she says dropped because her husband failed to pay some bills after they divorced. Ms. Korab says she subsequently called five other insurers.

"Three wouldn't insure me," Ms. Korab recalls. Two others offered to provide her with coverage, but for more than \$250 a month, compared with the \$63 a month she had been paying. Safeco finally decided to renew Ms. Korab's policy, a month after she testified at one of Mr. Kreidler's hearings.

"I had never had a problem before," says Ms. Korab, who said she had previously renewed with Safeco five times. "I don't equate your driving record to your credit record, and they do."

Safeco, one of the more than 350 insurers nationwide that use Fair Isaac scores, says it doesn't comment on individual cases. It says it no longer uses the scores as the sole basis for dropping existing clients. But it continues to use them to help decide what rates to charge as well as to evaluate new auto-insurance clients and all homeowner's-insurance customers. The Seattle-based insurer says it had declined to renew only 2,000 to 2,500 of its 2.8 million insurance customers because of low credit scores before it reversed that policy. It says it later offered many of those customers coverage.

Using credit scores allows auto insurers to offer better rates to many customers and to extend coverage to some that might otherwise be rejected because of "a less-than-perfect driving record," says Joseph Annotti, an assistant vice president of the National Association of Independent Insurers in Chicago. "Sixty to seventy percent of policyholders are getting a break on premiums" because of their scores, he says.

Fair Isaac says it advises its clients against using credit scores as their sole criterion for accepting or rejecting a client or credit applicant. Nonetheless, Mr. Grudnowski, the company's CEO, says there's no doubt that credit scores are a good predictor of future insurance claims. "That's just a fact," he says.

Uncovering such correlations between consumers' financial profiles and their future behavior has been Fair Isaac's business since shortly after it was founded in 1956 by engineer William Fair and mathematician Earl Isaac. The company produced its first credit score in 1958 for American Investment Co., a St. Louis finance company later acquired by Leucadia National Corp.

Fair Isaac's early credit scores mixed complex mathematics with lower-tech data-gathering methods. Soon after he joined the company in 1974, Larry Rosenberger helped develop a custom credit-score

formula for catalog merchant Spiegel Group Inc. To gather the data for his calculations, Mr. Rosenberger, Fair Isaac's CEO from 1991 to 1999 and now vice president of research and development/analytics, visited Spiegel stores in small Midwestern towns such as Ironton, Ohio. At each stop he used a microfilm camera to photograph 50 to 100 handwritten ledger cards, each containing application and payment data on a Spiegel customer.

In the mid-1980s, Mr. Rosenberger and other Fair Isaac analysts were brainstorming at a neighborhood hamburger joint when they decided to create a new general-purpose credit score that could be used by a multitude of businesses. The formula would be created from data collected by credit-reporting companies, which track payment histories of millions of Americans. After four years of research, Fair Isaac introduced FICO scores in 1989 in partnership with Equifax. They are now offered by all three major credit-reporting companies.

Like the custom formula Fair Isaac created for Spiegel, the FICO formula was developed by comparing past and current financial information on a large sampling of consumers and then using that information to make predictions about future behavior. Fair Isaac won't disclose its exact recipe, but it says a consumer's payment history and debt load account for 35% and 30% of the score, respectively. The other 35% is determined by how long the consumer has had credit, how actively the consumer is looking for new credit and the types of credit the consumer uses.

The key to an individual's FICO score isn't any single piece of information, but how the different variables interact. A missed payment might slash a squeaky clean consumer's FICO score by as much as 100 points. But it might have no effect on the score of a consumer with an already-checkered credit record.

Though it is best known for its FICO product, Fair Isaac has adapted its scores to different markets and different customers. Insurers, for example, don't really care what type of credit a customer uses as long as he pays his bills. Thus, in the specially designed credit-score formula that Fair Isaac sells to insurers, a customer's payment history counts for roughly 45% of the credit score.

"In insurance, things like a severe bankruptcy, a judgment or a tax lien have a greater" impact because they show the consumer engages in risky behavior, explains Fair Isaac Vice President Michael Rapaport.

At Fair Isaac, about 200 computer programmers, mathematicians and researchers, who call themselves "propeller heads," spend their days researching, writing and refining the complex mathematical formulas, or algorithms, that underlie Fair Isaac's credit scores.

Consider one relatively recent challenge: FICO scores penalized consumers who were constantly applying for credit. But as more consumers began visiting multiple lenders in search of the best auto or home loan, Mr. Rapaport told his team to come up with a way to avoid putting savvy shoppers at a disadvantage. Their solution was to count all the loan requests a consumer makes within a 14-day period as a single credit inquiry.

"It improved the score's predictive power by 0.5%," says Luke Van Dijk, Fair Isaac's director of analytics.

Fair Isaac's complex scoring models can be tough for even the company's executives to decipher. Last year, Mr. Grudnowski, the CEO, who earned more than \$800,000 in 2001, was startled to learn that his FICO score was just 705, worse than 55% of all borrowers. He says he was able to raise his score to 780 by canceling a bunch of unused credit cards.

But cutting up unused credit cards wasn't really the reason Mr. Grudnowski's FICO score rose. Among other things, says a Fair Isaac spokesman, factors in his score's improvement included "not taking on additional debt and ... making sure there are no errors on his credit report."



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

April 4, 2002

TO: House Committee on Insurance
FROM: Linda De Coursey, Director of Government Affairs Division
RE: SCR 1623 - Urging the study of insurance scoring reports

Mr. Chairman and members of the Committee:

Thank you for the opportunity to discuss the important topic of the use of credit scoring reports. While legislatures around the country are grappling with the issue of credit scoring, the Insurance Commissioner does agree that it is good to study this issue more carefully.

The NAIC is also stepping up its efforts on this matter, and appointed a new Credit Scoring Working Group to focus specifically on issues relating to the use of credit scores and credit history in the insurance underwriting and rating process. That working group has a very ambitious work plan for 2002, with the ultimate goal of having a model law by the end of 2002. The information gleaned from the NAIC group as to what other states are currently doing with regards to regulating credit scoring will also assist the task force created by SCR 1623.

SCR 1623 urges the study of insurance scoring and the Kansas Insurance Department believes this is a step further in the protection of consumers. We would ask that you pass SCR 1623 as amended favorably for passage.

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HOUSE INSURANCE

DATE: *April 4, 2002*

ATTACHMENT # 2



**Testimony on SB 654
before the
House Committee on Insurance**

by

**Bill Curtis, Associate Executive Director
Kansas Association of School Boards**

April 4, 2002

Mister Chairman and members of the Committee, we appreciate the opportunity to testify today in favor of SB 654. SB 654 was introduced at our request to permit public sector pools the same flexibility in paying reinsurance premiums as private sector pools now enjoy.

Kansas has two pooling statutes, one that deals with the private sector, K.S.A. 44-581 et seq. and K.S.A. 12-2616 et seq., which deals with the public sector. Both pools operate under the statutory requirement that premium dollars must be allocated in the amount of 70% to the claims fund and 30% to the administrative fund. Reinsurance premiums are paid from the administrative fund. Both pooling laws require reinsurance on a per claim basis and on an aggregate basis. In 1995 the private sector pools asked for authority to pay reinsurance premiums before this allocation was made. The problem arose that reinsurance costs were causing many of them to exceed the 30% limit on administrative costs. Public sector pools were not having any problems and consequently did not ask to be included. Hindsight would indicate we should have asked for that authority. In the interest of full disclosure, it should also be pointed out that private sector pools have the authority to pool only for workers compensation. Public sector pools have the authority to pool for workers compensation, property and casualty coverage, and health. KASB is asking for this bill today to initiate a property and casualty pool. KASB has operated a workers compensation pool since 1987.

The need for SB 654 is created by the tragedy of 9/11 and the fact that reinsurance costs are quite high when first starting a pool. The events of last September have driven reinsurance costs much higher for all lines of insurance. It will take some time to build the size of the pool to a level where reinsurance costs are not such a major portion of the administrative fund.

The Kansas Association of School Boards believes the time for starting a property and casualty pool is now. Both availability and affordability are posing ever-increasing problems for school districts in this hardening market. It has been our experience, through the workers compensation pool, that this alternative to the traditional insurance market has been very successful. Thank you for listening to our comments. We would ask the Committee to pass the bill out favorably.

HOUSE INSURANCE

DATE: *April 4, 2002*

ATTACHMENT *# 3*



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

April 4, 2002

TO: House Committee on Insurance

FROM: Linda J. De Coursey, Director of Government Affairs

RE: SB 654 – Municipal pools

Mr. Chairman and members of the committee:

While we will leave the policy determinations up to the legislators on SB 654, we asked the Senate committee to make technical amendments to the bill, and I would like to explain them to this Committee.

Language for municipal pools and work compensation pools are found in Chapter 16 and Chapter 44 of the statutes. SB 654 is proposing the same language found in K.S.A. 44-585 is being implemented into K.S.A. 16-2621. While the statute is opened for proposed changes suggested by SB 654, the amendments we are proposing are purely clean up language.

The changes made to the SB 654 by the Senate begins on line 22:

- 22 Such rates shall either be ~~the rates effective June 1, 1994, or the pro-~~
23 spective loss costs, as defined in K.S.A. 40-~~1113c~~ **955**, and amendments

The same changes to K.S.A. 44-585 is also amended into SB 654.

The reasons for the changes are that no one uses the June 1, 1994 rates any more. It would be ludicrous to do so...everyone uses loss costs these days. K.S.A. 40-1113c no longer exists.

Thank you for allowing me this opportunity to explain the amendments made by the Senate.

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DATE: *April 4, 2002*

ATTACHMENT # *4*