Approved: April 3, 2003
Date

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE.

The meeting was called to order by Chairperson Patricia Barbieri-Lightner at 3:30 on March 13, 2003 in Room 526-S of the Capitol.

All members were present except:

Committee staff present: Bill Wolff, Legislative Research
Ken Wilke, Revisor of Statutes
Renae Hansen, Secretary

Conferees appearing before the committee: **Sandy Praeger**, Kansas Insurance Commissioner
Jerry Wells, Kansas Insurance Commission
Richard Wilborn, Vice President of Government Affairs, Farmers Alliance
Evan McKee, Product Manager, Progressive Companies
Birney Birnbaum, Economist

Others attending: 28 total including some who signed the attached register.

Hearing on:

Sub SB 144- Enacting the Kansas Insurance Score Act.

Proponents:

Sandy Praeger, Kansas Insurance Commissioner, (Attachment #1), presented testimony that told how credit scoring benefits the consumer and in fact lowers the cost of insurance. This bill would allow the Insurance Department to regulate and control the way that insurance companies use credit scores.

Questions were posed by: Representatives Eber Phelps, Cindy Neighbor, Ray Cox, Bob Grant, Scott Schwab, and Nancy Kirk.

Jerry Wells, Kansas Insurance Commission, (Attachment #2), presented a clear and concise explanation of the bill with some side notes that help to simplify what the bill does.

Questions were asked by: Representatives Mary Kauffman, Scott Schwab, and Nancy Kirk.

Richard Wilborn, Vice President of Government Affairs, Farmers Alliance, (Attachment #3), presented testimony that told of Farmers Alliance reluctantly agreeing to the changes that have been made to the original bill that is in fact a watered down version of the wording patterned after that of the NCOIL. It was respectfully asked that an amendment to the wording be considered changing farm owner to one word, farmowner.

Questions were posed by: Chair Patricia Barbieri-Lightner.

Evan McKee, Product Manager, Progressive Companies, (Attachment #4), presented testimony in favor of the bill with noted recommendations for amendments to improve the wording of the bill.

Questions were posed by: Representatives Stephanie Sharp, Ray Cox, and Nancy Kirk.

Written testimony by Jim Harwood, Executive Director, Farmers Insurance was submitted to the committee by Lee Wright , (Attachment #5).

Opponents:

Birney Birnbaum, Economist, (Attachment #6), presented an in-depth study of how and why insurance credit scoring is not good for the consumer. Furthermore, his testimony presented many facts that refuted the industries arguments as to why credit scoring is in-fact a good system for evaluating risk of insuring consumers. Also, included in his testimony were ways to improve **Sub SB 144**.

Questions were posed by: Representatives Ray Cox, Eber Phelps, Bob Grant, Nancy Kirk, and Scott Schwab.

Hearing to continue on March 18, 2003.

Meeting adjourned.

Next meeting March 18, 2003.

HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: March 13, 2003

NAME	REPRESENTING
David Hanson	Ks Insur. Assns/ NAII
Evan McKee	Progressive
Larrie Ann Lower	Alliance of Am. Ins.
Brad Smoot	AIA
JoAnn Bunten	KID
Comm. Sandy Praeger	KID
Jerry Wells	KID
Jarrod Forbes	KID
Keith Bradshaw	Budget
[illegible] Wilbert	Farmers Alliance
Bill Sneed	State Farm
Martha Jane Smith	KMHA
[illegible] Benner	Rep. Mike Burgess
CHRIS STEADHAM	INTERN
Michelle Hamilton	INTERN
LARRY MAGILL	KAIA
Kevin Davis	Am Family

Kansas Insurance Department

Sandy Praeger COMMISSIONER OF INSURANCE

TESTIMONY
ON
Substitute for SB 144

HOUSE INSURANCE COMMITTEE
March 13, 2003

Madam Chair and members of the Committee:

Thank you for this opportunity to visit with you on behalf of the Kansas Insurance Department in support of Substitute for SB 144, a bill regulating use of credit-based insurance scoring. As you know, the Kansas Legislature created a Credit Scoring Task Force, established its membership and set its charge. I want to thank Representatives Garry Boston and Jim Garner for their participation on the Task Force and Mike McGrew for chairing the meetings. Former Insurance Commissioner Sebelius' staff assisted the Task Force by arranging conferees, preparing minutes, providing legal advice and drafting the final report. Thank you as well.

The Task Force reviewed mountains of testimony and information, some of it very technical and complex. For many Task Force participants, this was their first exposure to credit reporting, the Fair Credit Reporting Act and the use of credit information in insurance underwriting. From the hearings, we learned that use of credit information in auto and homeowners insurance is widespread and poorly understood by insurance consumers. We learned that insurers give better rates to lower risks and are constantly looking for factors, which will help identify the risk of their insureds so that they can charge the rate corresponding more closely with their risk. We learned that there is a statistically valid correlation between good insurance score based on credit and the lower likelihood of an insurance loss. And while we have grown accustomed to having rates set on the basis of age or sex or good grades or driving records, these factors are not necessarily better indicators of risk than credit information. We're just more familiar with their usage. We learned that as many or more Kansans will see lower rates from the use of credit-based insurance scoring as will receive higher.

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Date: 3/13/03
Attachment # 1

We also learned that insurance agents are frustrated with the problem of explaining credit scoring to their customers; that insurance consumers do not understand the use of credit information in the setting of insurance rates; that there is great suspicion of how such information is being used by insurers; and that insurers have not adequately explained to their customers and the public how and why credit information is being used.

As a result of these findings, Kansas like some thirty states is investigating regulation of credit-based insurance scoring. The Task Force and KID agree that credit-based insurance scoring should neither be banned nor remain unregulated. (The Task Force concluded that the KID lacks regulatory oversight.) I want to balance the interests of those consumers that benefit from credit-based insurance scoring and those who are concerned or frustrated with its use. I want to keep auto and homeowner insurance available and affordable in Kansas.

Today, Kansas consumers have no state protections from the misuse of credit-based insurance scoring. The bill you have before you, SB 144 contains some technical flaws. We would offer a substitute bill that corrects these problems. With these corrections, the bill will protect Kansas consumers while preserving the personal lines insurance market.

The bill does the following and more:

- Gives the KID jurisdiction over credit-based scoring practices
- Requires notice to consumers when credit scoring is being used and requires an explanation of its use in individual cases
- Requires insurers to file their formulas for using credit-based insurance scoring with the KID for review for unfair discrimination
- Prohibits the use of credit information that is related to identifiable medical debts or identity theft or information relating to income, gender, address, ethnic group, religion, marital status or nationality of the consumer
- Limits the use of certain credit inquiries and "thin files" where little or no credit history exists

- The bill would also require re-rating or underwriting when erroneous credit information is discovered and protect the confidentiality of personal credit information.

These are substantial protections for Kansas consumers. They represent most of what advocates for credit-based insurance scoring want. They give the KID real power over the use of credit-based insurance scoring in this state. For some, the bill goes too far. For others, not far enough. And while we can debate various additions or subtractions from the bill we have proposed, we would do our Kansas consumers a disservice to not take this first opportunity to begin the regulation of this practice.

With regard to those items which are still in dispute, let me say that our office will be available to assist in resolving disputed terms. We will be actively interpreting the language of any legislation you pass. We will be collecting real data on the problems of credit-based insurance scoring (something which has not been done thus far) and we will be monitoring the legislative and regulatory activity in other states. After doing so, and if need be, we will come back before the legislature to adjust and refine our credit-based insurance scoring law. I believe we must begin by enacting the provisions agreed to by our own Task Force. It is important to pass consumer protections giving our agency the tools to regulate the use of insurance scoring. We think that it is especially important that discriminatory practices, if they exist, be exposed and that credit should not be the only factor used in raising rates or denying coverage. There must be other relevant factors that contribute to an adverse action.

Thank you, and I'd be happy to answer any questions.

Sandy Praeger
Commissioner of Insurance

[As Amended by Senate Committee of the Whole]

Session of 2003

Substitute for SENATE BILL No. 144

By Committee on Financial Institutions and Insurance
2-25

AN ACT concerning insurance; relating to the use of credit scores in issuing certain policies.

Be it enacted by the Legislature of the State of Kansas:

Section 1. This act shall be known as the Kansas insurance score act.

Sec. 2. (a) This act shall apply only to personal insurance and not to commercial insurance. A personal insurance policy must be individually underwritten for personal, family or household use. No other type of insurance shall be included as personal insurance for the purpose of this act.

(b) This act shall apply to all personal insurance policies either written to be effective or renewed on or after January 1, 2004.

Sec. 3. As used in this act:

(a) ''Adverse action'' means any of the following in connection with the underwriting of personal insurance:

(1) A denial or cancellation of coverage;

(2) anything other than the best possible rate; or

(3) a reduction or other adverse or unfavorable change in the terms of coverage of any insurance regardless of whether such insurance is in existence or has been applied for.

(b) ''Affiliate'' means any company that controls, is controlled by, or is under common control with another company.

(c) ''Agent'' shall have the meaning ascribed to it in subsection (k) of K.S.A. 2002 Supp. 40-4902, and amendments thereto, unless the context requires otherwise.

(d) ''Applicant'' means an individual who has applied to an insurer to be covered by a personal insurance policy.

(e) ''Commissioner'' means the commissioner of insurance and any authorized designee of the commissioner.

(f) ''Consumer'' means an insured whose credit information is used or whose insurance score is calculated in the underwriting or rating of a personal insurance policy. ''Consumer'' also includes an applicant for a personal insurance policy.

(g) ''Consumer reporting agency'' means any person which, for mon-

House Insurance
Date: 3/13/03
Attachment # 2-1

etary fees, dues, or on a cooperative nonprofit basis, regularly engages, in whole or in part, in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

(h) ''Credit information'' means any credit related information derived from a credit report, found on a credit report itself, or provided on an application for personal insurance. Credit information shall not include any information which is not credit related, regardless of whether such information is contained in a credit report or in an application or is used to calculate an insurance score.

(i) ''Credit report'' means any written, oral, or other communication of information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing or credit capacity which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor to determine personal insurance premiums, eligibility for coverage, or tier placement.

(j) ''Department'' means the insurance department established by K.S.A. 40-102 and amendments thereto.

(k) ''Insurance score'' means a number or rating that is derived from an algorithm, computer application, model, or other process that is based, in whole or in part, on credit information for the purposes of predicting the future insurance loss exposure of an individual applicant or insured.

(l) ''Personal insurance'' means private passenger automobile, homeowners, motorcycle, mobile homeowners and non-commercial dwelling fire insurance policies and boat, personal water craft, snowmobile and recreational vehicle policies. For the strict purposes of this act, personal insurance shall also include individually underwritten policies of farm owners.

Sec. 4. No insurer authorized to do business in the state of Kansas which uses credit information to underwrite or rate risks, shall:

(a) Use an insurance score that is calculated using income, address, zip code, race, religion, color, sex, disability, national origin, ancestry or marital status of the consumer as a factor.

(b) Without consideration of any other applicable underwriting factor independent of credit information and not expressly prohibited by subsection(a), refuse to quote, deny, cancel or refuse to renew any policy of personal insurance solely on the basis of credit information.

(c) Without consideration of any other applicable factor independent of credit information, base an insured's renewal rates for personal insurance solely upon credit information.

(d) Without consideration of any other applicable factor independent of credit information, take an adverse action against a consumer solely because such consumer does not have a credit card account.

Credit information is anything regarding credit found on an application for insurance or found on a credit report.

A **credit report** is created by a credit bureau and contains a consumer's credit activity for a given amount of time.

If this bill becomes law an insurance score will be:

Credit report
— Factors not allowed in Section 4
\+ Traditional underwriting factors
INSURANCE SCORE

*Notice your credit information is only one part of an insurance score

This bill is limited to personal property and casualty lines of insurance for individual and family use. Commercial lines are not considered personal for the purposes of this act.

Farms are traditionally considered a commercial line of insurance, but for the purposes of this act, we have included the farm owner. The intent is to include the automobiles and homes of farmers.

If your credit is the only factor that changes, the company cannot use that against you.

(e) Consider an absence of credit information or an inability to calculate an insurance score in underwriting or rating personal insurance, unless the insurer does one of the following:
(1) Treat the consumer as if the applicant or insured had neutral credit information, as defined by the insurer; or
(2) exclude the use of credit information as a factor and use only other underwriting criteria.

If you do not have enough credit history to have an insurance score, companies cannot use that against you. *(A lack of credit history is commonly referred to as a "thin file".)*

(f) Take an adverse action against a consumer based on credit information, unless an insurer obtains and uses a credit report issued or an insurance score calculated within 90 days from the date the personal insurance policy is first written or notice of renewal is issued.

Companies must use timely credit information

(g) (1) Except as provided in paragraphs (2) and (3), use credit information unless not later than every 36 months following the last time that the insurer obtained current credit information for the insured, the insurer recalculates the insurance score or obtains an updated credit report.
(2) The insurer shall:

(A) Re-underwrite and re-rate the consumer's personal insurance policy, at the annual renewal of such policy, based upon a current credit report or insurance score for such consumer, if requested by the consumer. Such consumer's current credit report or insurance score shall be used if the result of the re-underwrite and re-rate reduces the consumer's rate. Such consumer's current credit report or insurance score shall not be used to increase the consumer's rate. The insurer shall not be found to be in violation of rate filings by adjusting an insured's rate in accordance with this subparagraph. Nothing in this subparagraph shall require an insurer to recalculate a consumer's insurance score or obtain the updated credit report of a consumer more frequently than once in a twelve-month period.

A consumer may request their insurance score to be computed annually. Only a score that benefits the consumer can be used when such a request is made.

(B) Have the discretion to obtain current credit information upon any renewal before the 36 months, if consistent with such insurer's underwriting guidelines.
(3) No insurer shall be required to obtain current credit information for an insured, if:
(A) The insured is in the most favorably-priced tier of the insurer, within a group of affiliated insurers. However, the insurer shall have the discretion to order such report, if consistent with such insurer's underwriting guidelines;
(B) credit was not used for underwriting or rating such insured when the policy was initially written. However, the insurer shall have the discretion to use credit for underwriting or rating such insured upon renewal, if consistent with such insurer's underwriting guidelines; or
(C) The insurer re-evaluates the insured beginning no later than 36

months after inception and thereafter based upon other underwriting or rating factors, excluding credit information.
(h) Use any of the following as a negative factor against a consumer in any insurance scoring methodology or in reviewing credit information for the purpose of underwriting or rating a policy of personal insurance:

(1) Any credit inquiry not initiated by the consumer or any inquiry requested by the consumer for such consumer's own credit information; (2) any inquiry relating to insurance coverage, if so identified on a consumer's credit report; (3) any collection account with a medical industry code, if so identified on the consumer's credit report; or (4) any additional lender inquiry beyond the first such inquiry related to the same loan purpose, if coded by the consumer reporting agency on the consumer's credit report as being from the given loan industry and made within 30 days of one another.

A "hit" occurs when someone looks at an individual's credit history. An insurance company cannot use the following "hits" against a consumer:

1. Anything medical related
2. Anything initiated by the named individual
3. Multiple lending "hits" that occur within a 30 day time frame for the same loan purpose. For example, if you are shopping for a home loan, and you go to numerous mortgage lenders to see who has the best deal, insurance companies cannot use that against you.

Sec. 5. (a) If it is determined through the dispute resolution process set forth in the federal fair credit reporting act, 15 USC 1681i(a)(5), that the credit information of a current insured was incorrect or incomplete and if the insurer receives notice of such determination from either the consumer reporting agency or from the insured, the insurer shall reunderwrite and re-rate the consumer within 30 days of receiving the notice. After re-underwriting or re-rating the insured, the insurer shall make any adjustments necessary, consistent with such insurer's underwriting and rating guidelines.
(b) If an insurer determines that the insured has overpaid the premium, the insurer shall refund to the insured the amount of overpayment calculated back to the shorter of either the last 12 months of coverage or the actual policy period.

If a consumer finds an error on their credit report and follows the Federal Fair Credit Reporting Act process to have it removed and, if that results in a change of a consumer's rate, the insurance company must refund the overpayment to the consumer.

Sec. 6. If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or its agent shall disclose that it may obtain credit information in connection with such application. The insurer shall further notify such consumer that an internal appeal process exists as provided by paragraph (b) of section 7 and amendments thereto. The disclosure shall be made either on the insurance application or at the time the insurance application is taken. Such disclosure shall be either written or provided to an applicant in the same medium as the application for insurance. The insurer need not provide the disclosure statement required under this section to any insured on a renewal policy if such consumer has previously been provided a disclosure statement.

If an insurance company uses insurance scoring they must tell the consumer up front that their credit information will be used.

They must also tell the consumer that the rate quoted can be appealed.

Sec. 7. (a) If an insurer takes an adverse action based upon credit information, the insurer shall provide written notification to the consumer a notice that:

(1) An adverse action has been taken, in accordance with the requirements of the federal fair credit reporting act as set forth in, 15 USC 1681m(a); and
(2) explains the reason for such adverse action.
(b) Each reason must be provided in sufficiently clear and specific language so that a person can identify the basis for the insurer's decision to take such adverse action. **An insurer shall provide a procedure whereby a consumer may review an adverse action based on credit information. Such procedure shall be consistent with the provisions of K.S.A. 40-2,112 and amendments thereto.** The insurer and the insurer's agent shall be immune from any action arising from information provided to the insured through such process. The insurer shall not be found in violation of rate filings by adjusting an insured's rate in such a manner.
(c) The use of generalized terms such as ''poor credit history,'' ''poor credit rating,'' or ''poor insurance score'' shall be deemed not to comply with requirements of this section.

Insurance companies shall provide an appeal process for the consumer and the process must be approved by the Kansas Insurance Department. The purpose of this provision is to ensure that the appeal process is fair and reasonable.

Sec. 8. (a) Each insurer that uses insurance scores to underwrite and rate risks shall file the procedure required by paragraph (b) of section 7, and amendments thereto, and such insurer's insurance scoring models or other insurance scoring processes with the insurance department. A third party may file with the insurance department such third party's scoring models or other scoring processes used on behalf of an insurer. Any filing that includes insurance scoring may include loss experience justifying the use of credit information.
(b) Except for the procedure required by paragraph (b) of section 7, and amendments thereto, any filing relating to insurance scoring models or other insurance scoring processes shall be considered to be a trade secret and confidential under the open records act.

If a company uses insurance scoring, it must file its models and methodology with the Kansas Insurance Department. Again, the Commissioner is charged with determining that the model and methodology is fair and reasonable.

Sec. 9. The commissioner of insurance may conduct research, hold public hearings, make inquiries and publish studies relating to the purpose of this act.

This section gives the Commissioner broad authority to educate the public and insurance agents about insurance scoring and other related topics.

Sec. 10. (a) An insurer shall indemnify, defend, and hold agents harmless from and against all liability, fees, and costs arising out of or relating to the actions, errors, or omissions of an agent who obtains or uses credit information or insurance scores, or both, for an insurer.
(b) The provisions of subsection (a) shall not be available whenever the agent fails to:
(1) Follow the instructions of or procedures established by the insurer; and
(2) comply with any applicable law or regulation.
(c) Nothing in this section shall be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this section.

~~Sec. 11. No credit scoring entity shall provide or sell to any party, other than the insurer, its insurance company affiliates or holding companies, and the insurance agent from whom the inquiry was generated, data or lists that include any information that in whole or in part is submitted in conjunction with credit inquiries about consumers. Such information includes, but is not limited to, expiration dates, information that may identify time periods during which a consumer's insurance may expire, or other nonpublic personal information as defined under the Gramm-Leach-Bliley act, 15 U.S.C. sections 6801 to 6809. The provision of this section shall not preclude the exchange of information specifically authorized under the federal fair credit reporting act, 15 U.S.C. section 1681, *et seq.*, the Gramm-Leach-Bliley act, 15 U.S.C. sections 6801 to 6809 and other applicable federal law. The provisions of this section shall not apply to data disclosed in connection with a proposed or actual sale, merger, transfer or exchange of all or a portion of an insurer's or producer's business or operating unit, including, but not limited to, the sale of a portfolio of contacts, if such disclosure concerns solely consumers of the business or unit and such disclosure is not the primary reason for the sale, merger, transfer or exchange.~~

[Sec. 11. (a) No consumer reporting agency shall provide or sell data or lists that include any information, in whole or in part, which was submitted in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. Such information includes, but is not limited to:

[(1) The expiration date of an insurance policy or any other information that may identify any time period during which a consumer's insurance may expire; and

[(2) the terms and conditions of the consumer's insurance coverage.

[(b) The restrictions provided in subsection (a) of this section do not apply to:

[(1) Any data or list the consumer reporting agency supplies to the insurance agent from whom information was received;

[(2) the insurer for whom such agent acted; or

[(3) such insurer's affiliates or holding companies.

[(c) Nothing in this section shall be construed to prohibit or restrict any insurer from obtaining a claims history report or a motor vehicle report.]

This section mandates that the consumer reporting agencies can only sell credit reports to insurance companies.

This section prevents consumer reporting agencies from selling information to any party that does not have the consumer's permission to have that information.

Sec. 12. Whenever an insurer is found to be in violation of any provision of this act, the commissioner shall proceed under K.S.A. 40-2,125 and amendments thereto.

Sec. 13. The commissioner of insurance is hereby authorized to adopt such rules and regulations as may be necessary to carry out the provisions of this act.

Allows the Commissioner to adopt Rules and Regulations to enforce this act.

Sec. 14. (a) If any provision of this act is declared invalid due to an interpretation of or a future change in the federal fair credit reporting act, the remaining portions of the act shall be deemed to be severable and shall remain in full force and effect.
(b) If any provision of this act or the application thereof to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.
Sec. 15. This act shall take effect and be in force from and after its publication in the statute book.

Farmers Alliance

Insuring Rural America Since 1888

Kansas Insurance Credit Score
Sub S.B. 144
House Insurance Committee
March 13, 2003

Madam Chair and Members of the Committee:

My name is Richard Wilborn. I am the Vice President of Government Affairs for the Farmers Alliance Mutual Insurance Company. Farmers Alliance Mutual Insurance Company is a domestic property and casualty insurance company that has been operating in and committed to Kansas since 1888. We write property and casualty insurance in eight other contiguous States also.

Our vice president of Underwriting had the privilege of serving on the Insurance Credit Scoring Task Force. We strongly believe that the task force recommendations clearly reflect what is best for the insurance consumers and to help maintain a viable insurance industry.

Since the introduction of Senate Bill 144, we have reluctantly agreed to many of the changes that have been proposed, for the sake of compromise. The original bill was patterned after NCOIL. It in itself was a compromise. In particular, we agreed to, including Farmowners to come under the Kansas Insurance Score Act. In Kansas, farm insurance falls under the commercial lines insurance category. By including it in this proposed legislation, farmowners would be subject to the credit scoring rules and regulations that are proposed by this act.

1122 N. Main, P.O. Box 1401 • McPherson, KS 67460
620.241.2200 • fax 620.241.5482 • www.fami.com
Farmers Alliance Mutual Insurance Company • Alliance Administrators, Inc. • Alliance Indemnity Company
Alliance Insurance Company, Inc. • Blakely Crop Hail, Inc. • North Central Crop Insurance, Inc.

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Date
Attachment #

However, we are requesting that the word "farmowners" be one word. The word "farmowners" is recognized as a line of business designed particularly for farmers and ranchers. It also would draw the line between farmowners and other commercial lines. (Page 2, line 27-28).

The whole issue of credit is not new. It has been used for many years.
The bottom line is credit-based insurance scoring has been proven to be one of the most effective tools when coupled with other underwriting criteria to anticipate future losses in a given class of business. The combination of different factors is very powerful and equitable in establishing pricing based on groups of individuals with similar characteristics.

Again, I appreciate the opportunity to appear before you. We appreciated the opportunity to have served on the task force and I respectfully urge you to pass substitute for Senate Bill 144 with the appropriate technical changes.

I will be glad to answer any questions you might have.

Sincerely,

Richard E. Wilborn, CPCU
Vice President, Government Affairs
sl

Session of 2003

Substitute for SENATE BILL No. 144

By Committee on Financial Institutions and Insurance

2-25

10 AN ACT concerning insurance; relating to the use of credit scores in
11 issuing certain policies.
12
13 *Be it enacted by the Legislature of the State of Kansas:*
14 Section 1. This act shall be known as the Kansas insurance score act.
15 Sec. 2. (a) This act shall apply only to personal insurance and not to
16 commercial insurance. A personal insurance policy must be individually
17 underwritten for personal, family or household use. No other type of
18 insurance shall be included as personal insurance for the purpose of this
19 act.
20 (b) This act shall apply to all personal insurance policies either written
21 to be effective or renewed on or after January 1, 2004.
22 Sec. 3. As used in this act:
23 (a) "Adverse action" means any of the following in connection with
24 the underwriting of personal insurance:
25 (1) A denial or cancellation of coverage;
26 (2) anything other than the best possible rate; or
27 (3) a reduction or other adverse or unfavorable change in the terms
28 of coverage of any insurance regardless of whether such insurance is in
29 existence or has been applied for.
30 (b) "Affiliate" means any company that controls, is controlled by, or
31 is under common control with another company.
32 (c) "Agent" shall have the meaning ascribed to it in subsection (k) of
33 K.S.A. 2002 Supp. 40-4902, and amendments thereto, unless the context
34 requires otherwise.
35 (d) "Applicant" means an individual who has applied to an insurer to
36 be covered by a personal insurance policy.
37 (e) "Commissioner" means the commissioner of insurance and any
38 authorized designee of the commissioner.
39 (f) "Consumer" means an insured whose credit information is used
40 or whose insurance score is calculated in the underwriting or rating of a
41 personal insurance policy. "Consumer" also includes an applicant for a
42 personal insurance policy.
43 (g) "Consumer reporting agency" means any person which, for mon-

1 etary fees, dues, or on a cooperative nonprofit basis, regularly engages,
2 in whole or in part, in the practice of assembling or evaluating consumer
3 credit information or other information on consumers for the purpose of
4 furnishing consumer reports to third parties.
5 (h) "Credit information" means any credit related information de-
6 rived from a credit report, found on a credit report itself, or provided on
7 an application for personal insurance. Credit information shall not include
8 any information which is not credit related, regardless of whether such
9 information is contained in a credit report or in an application or is used
10 to calculate an insurance score.
11 (i) "Credit report" means any written, oral, or other communication
12 of information by a consumer reporting agency bearing on a consumer's
13 credit worthiness, credit standing or credit capacity which is used or ex-
14 pected to be used or collected in whole or in part for the purpose of
15 serving as a factor to determine personal insurance premiums, eligibility
16 for coverage, or tier placement.
17 (j) "Department" means the insurance department established by
18 K.S.A. 40-102 and amendments thereto.
19 (k) "Insurance score" means a number or rating that is derived from
20 an algorithm, computer application, model, or other process that is based,
21 in whole or in part, on credit information for the purposes of predicting
22 the future insurance loss exposure of an individual applicant or insured.
23 (l) "Personal insurance" means private passenger automobile, hom-
24 eowners, motorcycle, mobile homeowners and non-commercial dwelling
25 fire insurance policies and boat, personal water craft, snowmobile and
26 recreational vehicle policies. For the strict purposes of this act, personal
27 insurance shall also include individually underwritten policies of ~~farm-~~
28 ~~owners.~~ → farmowners.
29 Sec. 4. No insurer authorized to do business in the state of Kansas
30 which uses credit information to underwrite or rate risks, shall:
31 (a) Use an insurance score that is calculated using income, address,
32 zip code, race, religion, color, sex, disability, national origin, ancestry or
33 marital status of the consumer as a factor.
34 (b) Without consideration of any other applicable underwriting factor
35 independent of credit information and not expressly prohibited by sub-
36 section (a), refuse to quote, deny, cancel or refuse to renew any policy of
37 personal insurance solely on the basis of credit information.
38 (c) Without consideration of any other applicable factor independent
39 of credit information, base an insured's renewal rates for personal insur-
40 ance solely upon credit information.
41 (d) Without consideration of any other applicable factor independent
42 of credit information, take an adverse action against a consumer solely
43 because such consumer does not have a credit card account.

Testimony on SB 144 – Use of Credit Scores in Issuing Certain Policies
Kansas House Committee on Insurance

Evan M. McKee, Product Manager
Progressive Companies
March 13, 2003

Good afternoon. My name is Evan McKee. I am the product manager for Progressive's independent agent produced auto insurance in the state of Kansas. In business since 1937, Progressive today is the nation's fourth largest auto insurer and the largest writer of private passenger auto insurance sold through independent agents. We are represented by more than 30,000 independent agents across the country, and are also a leading provider of insurance for motorcycles, personal watercraft, RVs, and commercial vehicles. In 2002, Progressive wrote $9.45 Billion in net written premium countrywide. In the state of Kansas, we are the sixth largest writer of private passenger auto insurance, with net premiums written of approximately $67 Million in 2002. Over 700 independent agents throughout the state of Kansas represent Progressive.

Progressive is a fast growing and innovative auto insurer that provides a competitive rate for virtually every driver and every risk. Because we can insure virtually all risks, we have to be able to finely and accurately segment risk types in order to provide a fair and accurate price for each individual risk. Insurance scoring is an objective, fair, and predictive tool that improves our ability to segment risks and allows us to offer lower rates to individuals who would otherwise receive much higher rates.

Progressive has worked hard to use credit responsibly and believes companies must exercise leadership in tailoring their use of credit to respond to the concerns that have been raised by consumers, agents and regulators. We support the reasonable regulation of credit, but object to specific provisions in SB144. Specifically:

Section 4 paragraph (e).
This paragraph states that the absence of a credit history or the inability to calculate an insurance score may not be used to the disadvantage of the consumer, and that the insurer must charge a rate that is either based on a "neutral" insurance score or excludes credit information from the calculation altogether. Progressive data shows that consumers with little or no credit history are more likely to have a loss. Such treatment would fail the unfair discrimination prohibitions of KSA 40-953 by knowingly charging a lower rate than the costs reflected in the risk. Additionally, direct marketers, who are allowed under the authority of the FCRA to pre-screen their offers of insurance based on credit information, would be at a decided advantage by avoiding these risks. The local agents and the agent companies would be forced to write these risks at artificially low rates, thus forcing everyone else to pay more to subsidize these risks, and making the rates of these companies even less competitive with the direct marketers.

Progressive would support this provision if the following language, as provided in the NCOIL Model Act, were added back in:

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"Treat the consumer as otherwise approved by the Insurance Commissioner, if the insurer presents information that such an absence or inability relates to the risk for the insurer."

Section 4 paragraph (g) subparagraph (2).

Paragraph (g) relates to the requirements to reevaluate an insurance score at renewal. Subparagraph (1) stipulates that the insurer reevaluate the insurance score no less frequently than every 36 months. This language is acceptable. Subparagraph (2)(A) then adds that at the request of the consumer, the insurer must reevaluate the insurance score as often as every 12 months and must use the outcome if it is to the favor of the insured, but may not use the outcome if it is to the detriment of the insured. This requirement is counter to the tenets of insurance pricing. It would also create an unfair and arbitrary situation by giving preferential treatment to those insureds who ask for a reevaluation. Progressive favors language that provides for consistent and systematic treatment of all insureds, and which allows insurers to follow their filed guidelines.

Section 4 paragraph (h) subparagraph (4).

This paragraph requires that multiple inquiries related to the same loan purpose made within a 30 day period be counted as one. We oppose the language in this paragraph because it is too broad and would be difficult to comply with. We would prefer the language used in the NCOIL Model Act, which reads:

"Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within 30 days of one another, unless only one inquiry is considered." And

"Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within 30 days of one another, unless only one inquiry is considered."

Progressive supports of SB144, but asks that you consider our recommendations for improvement.

I have included two separate handouts that provide additional information on credit scoring. I thank you for the opportunity to speak to you today and welcome any questions you have.

The Use of Credit in Insurance Underwriting

A Briefing for Kansas Legislators from Progressive

March 13, 2003

1. **Why do insurance carriers use credit?**
Credit is a strong independent predictor of future insurable losses. Even after controlling for the impact of other insurance underwriting and rating variables (e.g., previous insurance, accident/violation history), a strong correlation can be demonstrated between credit history and losses. The use of credit provides additional predictive power not offered by other variables and therefore allows risk to be evaluated more accurately and fairly than it otherwise could be. This correlation has been substantiated in independent reviews conducted by: Fair, Isaac & Company, the Virginia Bureau of Insurance, a Tillinghast paper prepared for the National Association of Insurance Commissioners, a paper by James Monaghan (an Actuary), Conning and Company, and the Bureau of Business Research (University of Texas at Austin).

2. **How do insurance companies use credit?**
Progressive uses credit for the same reason it uses any other underwriting variable – to help assess risk. Part of our underwriting process involves calculating an insurance score for each applicant. An insurance score is a measure based on credit data that is specifically designed to be predictive of insurable losses. It is a common misconception that financial credit scores - the same ones a bank or other lender would use - are also used for insurance underwriting. Credit scores predict how likely a consumer is to default on a loan. Insurance scores only predict the potential for insurable losses. The two industries have different objectives and use different measures.

3. **Where do carriers get the data needed for insurance scores?**
Insurance scores are developed from data found in credit reports. Consumer reporting agencies sell scoring services that they have developed based on data from all of their clients to many financial and insurance companies. However, Progressive has chosen to develop its own scores using a scoring algorithm based specifically on Progressive loss data. We believe that this provides our policyholders with the most accurate possible evaluation.

   A credit report includes four categories of information about a consumer:
   a. Identification – name, present and past address and social security number
   b. Derogatory Public Records – bankruptcies, legal judgments and tax liens
   c. Trade Line History – payment history on loans and credit accounts
   d. Inquiries From Credit Providers

   It is important to note that credit reports **do not** include information on gender, race, nationality, income or level of savings and investments.

4. **Aren't these credit reports always full of mistakes?**

4-3

Our data does not support this claim. Of 24 million credit histories that Progressive ordered in a 24 month period, only 31 consumers requested re-orders because of inaccuracies in their credit history. Of those, only 13 had a change significant enough to warrant a lower rate. That's only a tiny fraction of one percent. Furthermore, if credit reports were highly erroneous, then the statistical correlation to future losses would not exist.

As a further safeguard, Progressive does not use any information indicated by a credit report to be disputed by the consumer. (The FCRA includes a process consumers can use to contest possible errors in their credit reports.) We also do not consider credit inquiries from other insurance companies, from a consumer for his or her own review or for promotional purposes (e.g., mailing consumers unsolicited credit card offers).

5. **Do consumers pay higher insurance premiums because credit is used?**
No. On the contrary, when Progressive began using credit, we were able to offer lower rates to about two-thirds of our customers countrywide.

Only those consumers who **consistently** score unfavorably across multiple credit dimensions receive the worst insurance scores. A consumer with a few blemishes on his or her credit report can still get an average, or even above average, score.

6. **Doesn't the use of credit for insurance underwriting unfairly discriminate against the most vulnerable segments of society?**
Since Progressive began using credit history, we have been able to offer coverage to more people in previously underserved and urban areas. And, a 1998 study by the American Insurance Association (AIA) shows that average credit scores are about the same across all income groups. It's a fallacy to assume lower income consumers have worse credit.

7. **How does the use of credit affect independent insurance agents?**
Insurance scoring provides independent agents with an objective, accurate and cost effective tool for underwriting insurance that allows them to compete more effectively with captive and direct writers. We believe that the use of insurance scoring in underwriting will help keep this strong and healthy in the following ways:

- Insurance scoring helps maintain a competitive market that affords independent agents a variety of carriers from which to choose. Carriers will not offer coverage if they cannot price for the risk they take on and credit is becoming an increasingly important tool for evaluating that risk.
- Insurance scoring ensures a level playing field between independent agents and captive agents/direct insurance writers. If credit were banned from underwriting, direct marketers would still have access to credit data and could use it for target marketing – giving them better access to lower risk customers and a significant competitive advantage over the independent agent.
- Insurance scoring gives independent agents access to more markets than they otherwise would have.

8. **Do we need any additional regulation on the use of credit?**

Although we believe that prevailing Kansas and Federal laws are sufficient to govern the pricing of insurance and the use of credit information, Progressive supports reasonable regulation that ensures credit information is used in an actuarially justified manner, that consumer information is protected and that provides for reasonable restrictions. Provisions we support include:

- Not refusing to insure, canceling or non-renewing policies based solely on credit information.
- Not using information contained in a credit report which has been identified in the credit report by the consumer reporting agency as disputed by the consumer and coded as such.
- Not using information contained in a credit report which has been identified by the consumer reporting agency as related to insurance inquiries or non consumer initiated inquiries and coded as such.
- Not using information contained in a credit report which has been identified in the credit report by the consumer reporting agency as related to medical trade lines and coded as such.
- No use of credit information that is arbitrary, capricious, or unfairly discriminatory (i.e., based on a protected class).
- Not disclosing an applicant or insured's personally identifiable credit report information to any non-affiliated third party.
- Recalculating premiums, at the insured's request, upon notice by a credit agency that information provided to the insurer is inaccurate.
- Requirement to file scoring models with insurance departments – Companies should be allowed trade secret protection.
- Upon request of insured, requirement to provide reason codes to explain adverse impacts.
- Requirement to disclose to consumer that credit information will be obtained.

Provisions that we do not support include:

- Ban on use of credit. This would put local agents at a particular disadvantage because prescreening use cannot be banned by states.
- Burdensome operational requirements, such as written consent of consumer or reason codes to every consumer.
- Pricing specifications that are not actuarially based, such as arbitrary rate differentials.
- Treating no-hits/thin files as neutral credit.
- Requiring subjective and arbitrary exceptions to be made.

9. **So what is the bottom line?**

Credit is a fair, objective and accurate tool for insurance underwriting because it is a strong independent predictor of future losses and is based on individual behaviors. While any abuse of credit must be eliminated wherever it exists, banning credit from insurance underwriting, or overly restricting its use, would penalize many consumers by making them pay higher premiums. Since insurance scores reflect long-term consumer behavior with respect to how financial obligations are met, the impact credit has on premiums can be greatly influenced by each consumer.

Credit Scores and Auto Insurance

Progressive Companies

Submitted to Kansas House Committee on Insurance

March 13, 2003

Ins 3-13-03
Attachment 6

Topics Covered

- Overview of Credit Scoring in Auto Insurance
- Why Credit Scoring Is Being Attacked
- Some Common Myths about Credit Scoring
- Ideas on Legislation or Regulation

Credit Scoring Data Flows

Provide Credit Data:	Build Scoring Models:	Run Models against Credit Files:	Deliver Scores to Final User:
* TransUnion * Equifax * Experian	* Fair, Isaac * ChoicePoint * Other Vendors * Company-Specific Models (incl. PGR)	* ChoicePoint * TransUnion * Other Vendors * Company-Specific Report Ordering	* ChoicePoint * TransUnion * Other Vendors * Company-Specific Report Ordering

Most Auto Insurers Now Using Credit

- Either underwriting, rating or both.
- Prescreening for solicitation.
- FCRA specifically allows these uses.
  - State law cannot pre-empt prescreening.
- Some companies using on renewal books.
- By market share, over 90% of auto insurance industry using credit in some way.

What's in a Typical Auto Insurance Credit Score?

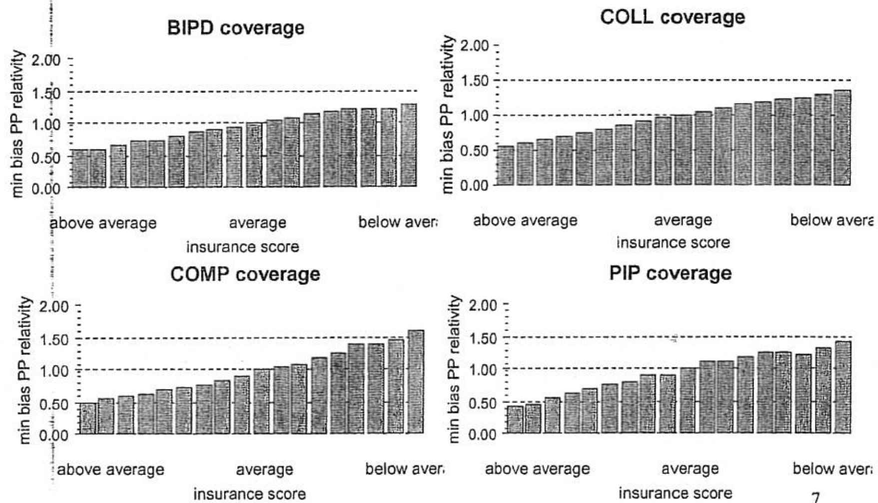
- What IS considered:
  - Length of time consumer has managed credit.
  - History of late payments.
  - Timeliness on current loans/accounts.
  - Proportion of available credit used.
  - Auto, home loan behavior.
  - Consumer-initiated inquiries (other than insurance).
  - Bankruptcies, tax liens, judgments.
- What's NOT considered:
  - Gender
  - Race/Nationality
  - Income
  - Wealth
  - Disability
  - Child support judgments
  - Insurance inquiries
  - Promotional inquiries
  - Disputed items

Various Credit Scores Exist

- Insurance scores not the same as lenders' scores.
- Insurance scores developed by finding correlations between elements of credit history and claims experience – Credit scoring is not just a hunch by insurance companies. It is an underwriting and rating innovation that achieves more accurate pricing.
- Different insurance scores from different insurers

6

Independent Correlation of Claims Costs and Credit Score in All Coverages



Source: Progressive Data

7

Why Does Loss Correlation Exist?

- Why are there similar correlations with age, gender, marital status? We cannot explain these, either, but they are accepted because the data is so clear.
- Cannot give precise explanation, but probably has to do with people's sense of responsibility, attention to details, risk-taking, "carefulness." Same behavior characteristics show up in both financial affairs and driving.

8

Use of Credit Is a Valid Underwriting/Rating Practice

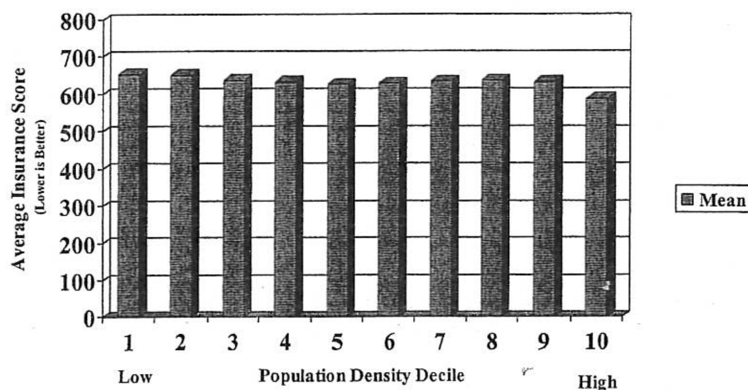
- Data is compelling. Credit is an independent predictor of loss costs.
- Other rating variables also independent predictors and so are still being used – credit is not the strongest nor apt as the "sole" variable.
- More accurate pricing is actuarially sound.
- More accurate pricing is also beneficial to responsible consumers. Without credit scoring, internal subsidies cause most people to pay more than they should.

9

Why is Credit Being Attacked?

- Some companies have taken unpopular actions.
- Misconceptions about credit.
- Lack of adequate information for agents, regulators, and consumers.

Myth: Insurance Scores Discriminate Against Urban Residents



Source: Progressive Data – 3.4 million policies countrywide

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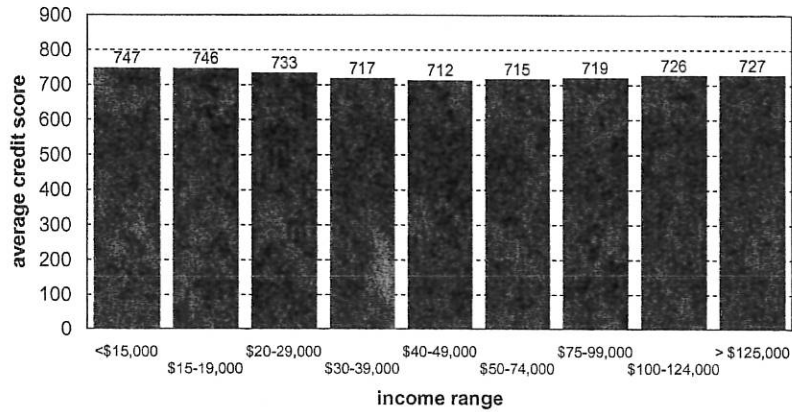
4-#

Myth: Insurance Scores Unfairly Discriminate Against Low Income Consumers



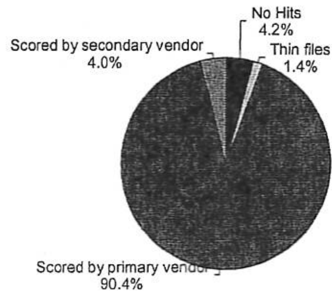
source: 1998 AIA study of 794,000 policies

Lower Prices Are Especially Important in Underserved Communities

- Credit scores allow us to identify lower-cost customers that traditional underwriting overlooks.
  - Lack of prior insurance or prior nonstandard.
- Progressive has continued strong urban growth since we began using credit.

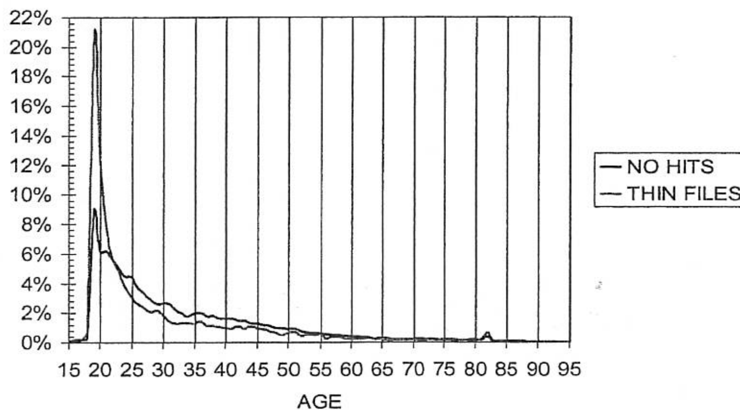
Myth: Many People Have No Credit History

- "No Hit"
  - No credit report
- "Thin File"
  - Insufficient data on file to calculate a score
- Minimized by:
  - Using Social Security number
  - Using a secondary credit vendor
  - Using a prior address



Source: Progressive Data

Myth: No-Hits Often Occur with Seniors



Source: Country-wide Progressive Quotes November 2001

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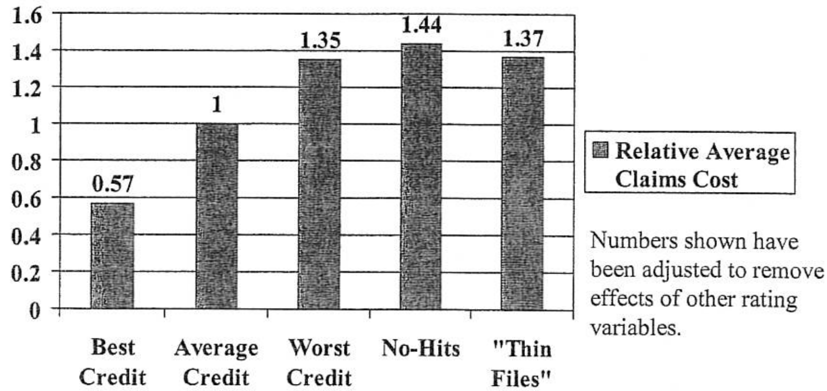
Myth: No-Hits Deserve "Neutral" Treatment



Numbers shown have been adjusted to remove effects of other rating variables.

Source: Progressive Data

Myth: Consumers Cannot Control Their Credit Score

- All the variables used in the score are the direct result of consumer choices and behaviors.
- Score reflects a pattern of behavior – One or two late pays have a minimal impact on score.

Regulatory Ideas We Can Support

- No refusing to insure, canceling or non-renewing policies based solely on credit information.
- Not using information contained in a credit report which has been identified in the credit report by the consumer reporting agency as disputed by the consumer and coded as such.
- Not using information contained in a credit report which has been identified by the consumer reporting agency as related to insurance inquiries or non consumer initiated inquiries and coded as such.
- Not using information contained in a credit report which has been identified in the credit report by the consumer reporting agency as related to medical trade lines and coded as such.
- No use of credit information that is arbitrary, capricious, or unfairly discriminatory (i.e., based on a protected class).

Regulatory Ideas We Can Support
(Cont.)

- Not disclosing an applicant or insured's personally identifiable credit report information to any non-affiliated third party.
- Recalculating premiums, at the insured's request, upon notice by a credit agency that information provided to the insurer is inaccurate.
- Requirement to file scoring models with insurance departments – Companies should be allowed trade secret protection.
- Upon request of insured, requirement to provide reason codes to explain adverse impacts.
- Requirement to disclose to consumer that credit information will be obtained.

Regulatory Ideas We Oppose

- Ban on use of credit. This would put local agents at a particular disadvantage because prescreening use cannot be banned by states.
- Burdensome operational requirements, such as written consent of consumer or reason codes to every consumer.
- Prohibitions on certain types of information in the credit score.
- Pricing specifications that are not actuarially based, such as arbitrary rate differentials.
- Requirements that the insurers evaluate the accuracy of credit information.
- Treating no-hits/thin files as neutral credit.
- Requiring subjective and arbitrary exceptions to be made.

Summary – Please Support the Responsible Use of Credit

- Use of credit in auto insurance is widespread and legal.
- Use of credit is actuarially sound and fair to consumers. On average, drivers with lower claims costs get lower rates.
- Many "underserved," traditionally nonstandard risks, are getting lower rates because of their good credit.
- Preserves independent agent level playing field with direct writers.
- Despite complaints about some methods of using credit, there are responsible business practices for credit that are acceptable to regulators and consumers.
- Additional regulation/legislation, if any, should be targeted at specific undesirable practices.

FARMERS

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March 11, 2003

Substitute for SB 144 Re: Credit Scoring
Written Testimony by Jim Harwood – Executive Director
Farmers Insurance
March 13, 2002

Madame Chairman and members of the House Insurance Committee.

Farmers Insurance appreciates the opportunity to provide our written comments in **support** of the Kansas Insurance Department's proposed legislation on credit scoring in it's current form, Substitute for SB 144.

Farmers Insurance is a property and casualty company that has been operating in and committed to Kansas consumers since 1930. In 2002, we had the honor of participating as a member of the Governor's Task Force on Credit Scoring. Farmers believes the conclusion and recommendations reached by the Task Force clearly reflect the best interests for our customers and all insurance consumers.

Farmers strongly supports the use of credit based insurance scoring to augment the other underwriting and rating tools available to an insurance company. Ultimately, as an organization, our goal is to make available a wide range of insurance products and product features that are important in our customers lives at a cost that is based on the likelihood of future losses. Credit based insurance scoring models have been proven to have a strong correlation to future losses and, when used in combination with other underwriting factors allow us to more accurately and equitably offer customers the best possible insurance value.

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Farmers does not use credit based insurance scoring exclusively when evaluating a risk. We consider a multitude of factors including driving record (for auto insurance) and claims history, in addition to a credit based insurance score, when evaluating an applicant. The use of driving records has varied success rates in identifying risks, as each state has its own rules as to what is actually reflected on a motor vehicle report. Accurate loss records are also valuable in helping us place customers within our rating structures.

The most effective tool the industry has, the use of a credit based insurance score, has been shown to appropriate risk characteristics, and is the best predictor of future losses. Once again, the combination of these factors is a powerful tool in equitably establishing pricing based upon groups of individuals with similar characteristics and likelihood of future losses. It should also be noted that credit based insurance scores create the opportunity for substantive discounts or lower rates than would otherwise be possible for the majority of consumers. To deny consumers this opportunity by banning the use of, or watering down the amount of discount by placing substantial restrictions on the use of these scores is unfair to consumers who are deserving of a better rate that reflects their reduced likelihood of future loss.

To date, we have been actively involved with this issue through the Credit Scoring Task Force, discussions with the Insurance Department, industry representatives and agent groups to help construct the bill you have before you. Through the hard work and efforts of these interested parties and the leadership of the Department of Insurance, we believe it is legislation that reflects a balanced approach and appropriately considers all sides of this important consumer issue.

We remain committed to assisting this committee as an information resource for dealing with this and other insurance bills throughout the session.

A

Testimony of Birny Birnbaum

Before the Kansas House Insurance Committee

March 13, 2003

Thank you for the opportunity to speak about insurance credit scoring generally and about SB 144 in particular. My recommendation to you is to prohibit the use of insurance credit scoring for underwriting and rating personal lines insurance and I will discuss why this is reasonable and necessary. In the event you decide to allow insures to continue to use consumer credit information for underwriting and rating personal lines insurance, I will offer a few suggestions to strengthen the consumer protections in SB 144. As it currently stands, SB 144 is quite weak at protecting consumers from unfair practices involving consumer credit information.

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**

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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 Caused by Economic, Medical Catastrophes – Loss of Job, Dread Disease, Divorce
   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 – **There is NO FREE LUNCH!**
   ii. Profoundly Un-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
   ii. Where Were the Rate Decreases When Insurers Started Using Credit Scoring?

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. Recent Texas Poll Survey
    iii. Why Are Agents Against Credit Scoring?
    iv. 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

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 SB 144

First, it is worth noting how many restrictions and prescriptions are necessary for the use of credit as an underwriting or rating factor. Given the tremendous regulatory resources necessary to enforce SB 144 and, given the many concerns with credit scoring reflected in SB144, one would think that there are some powerful reasons for allowing insurers to use insurance credit scoring. But, in fact, there are no such powerful reasons. All the industry has is an alleged correlation. Surely that cannot be enough to justify the use of insurance scoring.

Second SB 144 will not benefit consumers because of lack of enforcement. Some of the provisions are simply unenforceable, while others would require a commitment of regulatory resources that you will be unable to provide.

Third, the definition of adverse action needs improvement. It must be crystal clear than any consumer who fails to receive the most favorable treatment because of information in his or her credit or other consumer report must be given adverse action notice. Incredibly, many insurers have failed to give adverse action notices to all new business applicants who got some quote no matter how high that quote was – all based on a terrible misreading of the FCRA.

SB 144 does not adequately address this problem. The definition of adverse action is slightly lacking because it seems to revolve around <u>change</u> from a current situation instead of an offer from the insurer of something other than most favorable provisions because of credit information. We suggest the following definition.

> Any action by the insurer to offer a consumer other than the most favorable underwriting action, price, terms of coverage, rating tier, or other feature of the personal lines insurance policy upon initial application or renewal by the consumer.

And this definition of adverse action must be accompanied by the requirement that insurers must provide notice of adverse action whenever an adverse action is taken in whole or in part because of information in a consumer credit report or other consumer report, as that term is defined in the FCRA.

We did not include payment plan in the definition of adverse action. In fact, the law should state a clear prohibition against the use of any consumer credit information or information in any consumer report to condition the eligibility of a payment plan. An insurer is never in a position to provide coverage without payment. And the purpose of the payment plans is to make insurance – including insurance required by the state – available and affordable. Insurers' use of credit scoring is intended to identify the most profitable business. While this is a rational act on their part, the consequences conflict with the public policy goals of making insurance available and affordable to the entire population.

Fourth, any prohibitions or limitations on insurance credit scoring or factors included in insurance scoring should include underwriting, tier placement, terms and conditions of the policy and price of coverage. If you don't cover all aspects of the insurance transaction, then you invite insurers to game the system by shifting activities from rating to underwriting.

Fifth, several sections of the bill prohibit the sole use of credit scoring for certain actions by the insurer. Unfortunately, this is meaningless. Actually, it is worse than meaningless because it appears to promise a consumer protection when, in fact, none are created. Insurers can get around the "sole" limitation every easily and in ways that do not accomplish the consumer protections you seek. For example, one section prohibits an insurer from taking an adverse action solely because a consumer does not have a credit card account. Since insurers use credit scores that consider various credit factors, insurers are already in compliance with this provision, even if the absence of a credit card is 99.9% of the reason for the adverse action.

Sixth, the use of inquiries in credit scoring models should be prohibited. Connecticut has already done this. Trying to micro-manage the use of inquiries in the scoring models continues to leave big holes, but, more important, it is unenforceable. It is unrealistic to expect the insurance department, which already has scarce resources, to be doing anything other than a cursory review of the models and will be unable to intensively investigate the models to see if the limitations are in place.

Seventh, several key consumer protections are missing. First, insurers should be required to obtain credit information from all three credit reporting agencies to ensure full and complete information. Second, insurers should be required to update their models every 24 months to ensure the models reflect the most recent economic conditions. Third, the public disclosures must be much more explicit. Insurers should be required to provide identify the top 5 credit characteristics / factors that prevented the consumer from getting a better score. The disclosure should also include the optimal value for the credit characteristic in the score, the value assigned to the consumer and point impact of the difference on the consumer's score. It is only in this way that a consumer will be in a position to exercise his or her rights under the FCRA.

Eighth, Section 8 provides for the filing of certain information with the insurance commissioner and declares most of that information to be exempt from public disclosure. This is both unreasonable and unnecessary. First, it is imperative that the public has information about how insurers use credit so they can be part of the enforcement process. It is unreasonable to expect the insurance department alone capable of the extensive enforcement associated with this bill. Second, there is no trade secret. The essence of a trade secret claim is that disclosure will provide a competitor with some advantage. In fact, all insurers using credit scoring know what is in the models and how the various credit characteristics affect scores. Many insurers have created their own models, but all the models use basically the same information and credit characteristics. The only folks who don't know about the models are members of the public. Insurers will not be at a competitive disadvantage if details about the model are revealed, but consumers will be

empowered. We suspect that insurers want to keep this stuff secret because of the uproar that will occur from consumers as they learn more about the models.

Ninth, we want to restate the importance of applying all the requirements and prohibitions regarding credit scoring to underwriting and tier placement as well as to rating and coverage denial and cancellation. We have seen how insurers have evaded regulatory oversight of rates by changing underwriting guidelines dealing with credit scores. There is no solution to the problems of credit scoring unless the solution is comprehensive.

Tenths, the protection for agents is necessary and important. I would add that agents should also be protected from company retribution for providing you and the department with information about credit scoring that insurers do not like. We have seen agents fired for testifying about credit scoring and this is not only unfair, but deprives you and the public of a critical source of information about the impact of credit scoring on consumers.

Eleventh, and finally, the legislation should not only require the commissioner to perform studies on insurers' use of credit scoring and the impact of credit scoring on various groups, but should require the commissioner to include the perspectives of all stakeholders, including consumers. The industry has vast resources to provide studies and assistance to the department; consumer views are typically not included unless the regulator aggressively seeks out those views. We urge you to require the commissioner to do so. In addition, the commissioner should be required to collect data as follows;

> Data Collection and Independent Regulatory Analysis. The Commissioner shall direct statistical agents to collect insurer-specific premium, exposure and loss data broken out by raw credit score and credit score category assigned to consumer in addition to other data categories required in approved statistical plans. As soon as such data are available to perform an actuarially credible and/or statistically significant analysis, the Commissioner shall perform an analysis of the correlation of credit information to frequency and severity of claims and to other underwriting and rating factors both permitted and prohibited.

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.

Resolution Unanimously Adopted by the Board of Directors of the National Association of State Farm Agents, Inc.

The National Association of State Farm Agents, Inc (NASFA) hereby resolves that we are opposed to any insurance company using credit scoring for the purpose of property and casualty underwriting and rating. We believe credit scoring is part of a marketing scheme designed to curtail market share, avoid rate regulation and it improperly emphasizes credit as an underwriting characteristic without sufficient demonstration of its reliability for underwriting purposes. There is tremendous opportunity to mischaracterize potential insureds and inadvertently or intentionally illegally discriminate. We further support legislation to prohibit credit scoring for the purpose of property and casualty underwriting and rating.

Spring 2003 Issue of *Exclusive Focus*, the Official Publication of the National Association of Professional Allstate Agents, Inc.

There is another thing that NAPAA (National Association of Professional Allstate Agents) very leery of credit scoring: Insurance credit scores have proven to be a moving target. We have seen scores on the same risk change almost weekly. How can a score that changes that frequently be an accurate indicator of future risk?

Regardless of whether insurance credit scoring is truly predictive, is it good public policy to apply one set of unrelated data to another? Will lenders include claim/ticket history in their credit history matrix? Will employers and landlords demand to see the applicant's insurance credit scores before hiring or renting? If insurance companies can use seemingly unrelated data, why can't others?

So, what is the truth about credit scoring? NAPAA believes the use of credit has a disparate impact upon several segments of the American public. Therefore, we find it discriminatory and totally unacceptable at this time.

Factors Involved in Credit Score and the Correlation to Income

From Fair, Isaac, as reported in the December 4, 2001 article "How Your Credit History Affects Your Auto and Home Insurance Premiums," posted on Insure.com

Past payment history (approx. 35%)
How you've paid your credit bills in the past, if your bills have been paid on time, items in collection, the number of "adverse public records" (bankruptcy, wage attachments, liens), and the number and length of delinquencies or items in collection.

Table 796: If your income is under $10,000, you are 10 times more likely to have a debt payment 60 or more days overdue than if your income is $100,000 or greater.

Amount of credit owed (approx. 30%)
How many accounts, what kind of accounts, and how close you are to your credit limits.

Table 796: If your income is $10,000 or less, you are 16 times more likely to have debt exceeding 40% of family income than if your income is $100,000 or greater.

Table 817: 46.4% of families with incomes under $10,000 almost always pay off their credit card balances compared to 72.0% of families with income greater than $100,000.

Table 817: 33.8% of families with incomes under $10,000 hardly ever pay off their credit card balances compared to 14.1% of families with income greater than $100,000.

Length of time credit established (approx. 15%)
How long you have had credit accounts and how long you have had specific accounts.

New credit (approx. 10%)
Number and proportion of recently opened accounts, the number of credit inquiries, and the reestablishment of positive credit history after payment problems.

Types of credit established (approx. 10%)
The number and activity of various types of credit accounts including credit cards, retail store accounts, installment loans, and mortgages.

Table 794: If your income is $100,000 or more, you are 9 times more likely to have a real-estate secured loan than if your income is under $10,000.

SAMPLE REPORT

Personal insurance credit inquiry for John Doe

PROGRESSIVE®

With your permission, Progressive reviews selected information from your credit history when you request a quote for insurance. Your rate is based on many factors: the car you drive, where you live, the amount and type of coverage you select, your driving and claims history, and your payment and credit history.

	You	Average
Experience you have with managing credit		
Months you have managed credit	48 Months	96 Months
Age at which you first established credit	16	21
Number of times a payment was past due more than 30 days	4	1
Current payment status of installment loans and revolving accounts		
Number of loans and accounts with a satisfactory current payment record	2	5
Number of credit card accounts currently past due more than 30 days	0	0
Use of available credit		
Percent of available credit limit currently being used on revolving accounts	88%	35%
Percent of available credit limit currently being used on all open accounts	70%	56%
Months since your most recent auto loan was made	12 Months	4 Months
Credit inquiries you initiated in the past 25 months	5	4
Insurance Credit Score	116	100

Your payment and credit history information was obtained from Experian. More detailed information can only be obtained by you by calling Experian at 1-888-397-3742. You may order a copy of your credit report free of charge.

Definitions

Installment loans have fixed terms with regular payments, such as a car loan, home loan, student loan, or personal loan. Revolving accounts have varying payments depending on the balance of the account. This includes all major credit cards and cards from department stores.

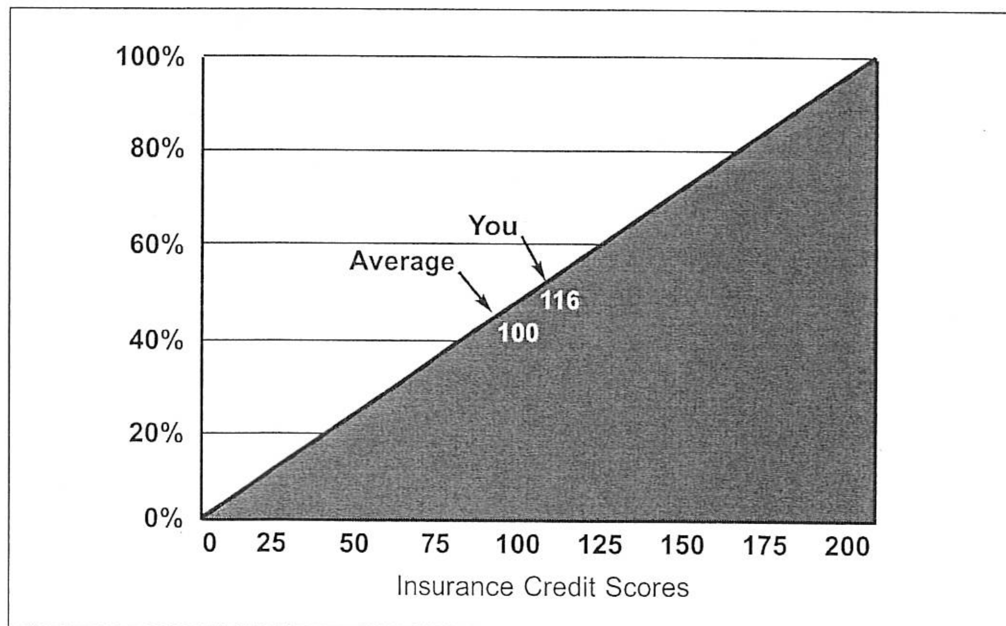
SAMPLE REPORT

Personal insurance credit inquiry for John Doe

How your insurance credit score is determined

A lower score is better, as it indicates that you have carefully and consistently managed credit over many years. Consumers who use credit responsibly are statistically less likely to be involved in auto accidents and may be eligible for lower rates. To determine your insurance credit score, we subtract points for items that are better than average and add points for items that are worse than average.

Every consumer starts with the same number of points		**100**
Items better than average:		
First established credit at age 16	-10	
12 months since last auto loan was made	-7	
Total of all better than average items		**-17**
Items worse than average:		
Managed credit for 48 months	18	
2 loans and accounts that are current	8	
88% of available credit in use	4	
5 credit inquiries in the past 25 months	3	
Total of all worse than average items		**33**
Your insurance credit score =		**116**



Consumers who received a quote from Progressive in the past 6 months had an average insurance credit score of 100.

Your insurance credit score is 116 and is lower than 44% of consumers who received a quote from Progressive in the past 6 months, but is higher than the average.

Fair, Isaac US Credit Bureau Risk Score Reason Codes

For NextGen and Classic Risk Scores

This chart lists the score reason codes and associated reason statements for Fair, Isaac's broad-based next generation credit bureau risk scores (NextGen), and the corresponding classic credit bureau risk scores (BEACON,® EMPIRICA,® the Experian/Fair, Isaac Risk Model) and their associated Industry Option℠ scores (Auto, Bankcard, Installment and Personal Finance) across the major US credit reporting agencies.

This chart may be used as a reference when taking adverse action or in customer service when responding to consumers' inquiries as to the reasons for declination.

This list is presented in alphanumerical sequence by assigned NextGen risk score reason code. The legend is as follows:

- A number or alphanumeric code in the column specifies the code associated with the reason statement for that score.
- I/O in the column indicates that the code is only used in one or more classic Industry Options but is not currently used in the classic base model.
- A (w) indicates that the wording has slightly changed from the last published list.
- A blank in the column indicates that the code is not presently delivered with that particular score.
- An asterisk (*) indicates that the code was previously used in the classic risk scores, but will not be used in the NextGen risk scores.

Fair, Isaac has considered concerns of the Federal Reserve Board (FRB) and the Office of the Comptroller of the Currency (OCC) in developing the statements associated with these score reason codes. We believe that the regulatory agencies are likely to be satisfied with these reason codes and associated reason statements. In any event we recommend that Fair, Isaac be consulted whenever changes to score code reason statements are made. If this is necessary, please contact Fair, Isaac's toll-free Credit Bureau Scores Helpline at 1-800-777-2066 or *cbhelp@fairisaac.com*.

Fair, Isaac and Industry Options are trademarks or registered trademarks of Fair, Isaac and Company, Inc., in the United States and/or in other countries. BEACON is a registered trademark of Equifax Credit Information Services, Inc. EMPIRICA is a registered trademark of Trans Union LLC.

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For more information:

phone from US
1-800-777-2066

phone from anywhere
1-415-472-2211

email
cbhelp@fairisaac.com

Web site
www.fairisaac.com

Reason Statement	NextGen Code	Equifax BEACON Code	Trans Union EMPIRICA Code	Experian Experian/Fair, Isaac Risk Model Code
Account payment history is too new to rate	A0	07	07	07
Accounts last reported in delinquent status	A1			
Amount of credit available on revolving accounts	A2			
Amount owed on accounts is too high	A3	01	01	01
Amount owed on bank/national revolving accounts	A4			
Amount owed on collections filed	A5			
Amount owed on delinquent accounts	A6	34	31 (I/O)	34 (I/O)
Amount owed on recently opened accounts is too high	A7			
Amount owed on recently opened bank/national revolving accounts is too high	A8			
Amount owed on recently opened consumer finance company accounts is too high	A9			
Amount owed on recently opened retail accounts is too high	B0			
Amount owed on recently opened revolving accounts is too high	B1			
Amount owed on recently opened sales finance company accounts is too high	B2			
Amount owed on retail accounts	B3			
Amount owed on revolving accounts	B4			
Amount owed on revolving accounts is too high	B5	11	11	11
Amount past due on accounts	B6	21	21	21
Bankruptcy filing reported	D0			
Date of last inquiry too recent	D1		19	
Delinquency on accounts	D2			
Delinquency on recently opened accounts	D3			
Derogatory public record or collection filed	D4	40	40	40
Frequency of delinquency	D5			
Level of delinquency on accounts	D6	02	02	02
Serious delinquency	D7	39	39	39
Serious delinquency, and public record or collection filed	D8	38	38	38
Serious delinquency, derogatory public record, or collection filed	*	22	22	22
Insufficient installment payment history	F0			
Lack of recently established credit accounts	F1			
Lack of recently established revolving accounts	F2			
Lack of recent auto finance loan information	F3	98 (I/O)		
Lack of recent auto loan information	F4		97	98 (I/O)
Lack of recent bank/national revolving information	F5	15 (w)	15 (w)	15 (w)
Lack of recent consumer finance company account information	F6	99 (I/O)	99 (I/O)	99 (I/O)
Lack of recent installment loan information	F7	32	04	32
Lack of recent reported mortgage loan information	F8			
Lack of recent non-mortgage installment loan info	F9			
Lack of recent retail account information	G0			
Lack of recent revolving account information	G1	16	16	16
No mortgage loans reported	G2			
No recent bank/national revolving balances	G3		29 (w)	29 (w)
No recent non-mortgage balance information	G4	17	17	17
No recent retail balances	G5			
No recent revolving balances	G6	24	24	24
Length of time accounts have been established	J0	14	14	14
Length of time auto accounts have been established	J1			
Length of time bank/national revolving accounts have been established	J2			
Length of time consumer finance company loans have been established	J3		98	
Length of time installment loans have been established	J4	25 (I/O)		25 (I/O)
Length of time reported mortgage accounts have been established	J5			
Length of time open installment loans have been established	J6			36 (I/O)
Length of time retail accounts have been established	J7			

Reason Statement	NextGen Code	Equifax BEACON Code	Trans Union EMPIRICA Code	Experian Experian/Fair, Isaac Risk Model Code
Length of time revolving accounts have been established	J8	12	12	12
Time since account activity is too long	J9			
Time since delinquency is too recent or unknown	K0	13	13	13
Time since derogatory public record or collection is too short	K1	20 (w)	20 (w)	20 (w)
Time since most recent account opening is too short	K2	30	30	30
Time since most recent auto account opening is too short	K3			
Time since most recent bank/national revolving account opening is too short	K4			
Time since most recent consumer finance company account opening is too short	K5			
Time since most recent installment loan account opening is too short	K6			
Time since most recent retail account established	K7			
Time since most recent revolving account established	K8			
Time since most recent sales finance company account opening is too short	K9			
Number of accounts currently in delinquent status	M0			
Number of accounts with delinquency	M1	18	18	18
Number of accounts with recent delinquency	M2			
Number of active bank/national revolving accounts	M3			
Number of active retail accounts	M4			
Number of adverse/derog public records	M5			
Number of bank/national revolving accounts with balances	M6	23 (w)		23 (w)
Number of bank/national revolving accounts	M7			
Number of bank/national revolving or other revolving accounts	M8		26 (I/O) (w)	
Number of collections filed	M9			
Number of consumer finance company accounts established relative to length of consumer finance history	N0			37 (I/O)
Number of consumer finance company inquiries	N1			
Number of established accounts	N2	28	28	28 (I/O)
Number of open installment loans	N3			
Number of recently opened consumer finance company accounts	N4			
Number of retail accounts	N5			
Number of retail accounts with balances	N6			
Number of revolving accounts	N7	26 (I/O)		26 (I/O)
Number of revolving accounts with balances higher than limits	N8			
Proportion of balance to limit on auto accounts is too high	P0			
Proportion of balance to limit on delinquent accounts is too high	P1			
Proportion of balance to limit on consumer finance company accounts is too high	P2			
Proportion of balance to limit on retail accounts is too high	P3			
Proportion of balances to credit limits on bank/national revolving or other revolving accounts is too high	P5	10 (w)	10 (w)	10 (w)
Proportion of balances to credit limits on revolving accounts is too high	P6			
Proportion of balance to limit on sales finance company accounts is too high	P7			
Proportion of balances to loan amounts on mortgage loans is too high	P8			
Proportion of loan balances to loan amounts is too high	P9	33	03	33
Proportion of revolving balances to total balances is too high	Q0			
Proportion of balances to credit limits on bank/national revolving accounts is too high	Q1			
Too few accounts currently paid as agreed	R0	19	27	19
Too few accounts with balances	R1			
Too few accounts with recent payment information	R2	31		31 (I/O)
Too few active accounts	R3			
Too few bank/national revolving accounts	R4	03 (w)		03 (w)

Reason Statement	NextGen Code	Equifax BEACON Code	Trans Union EMPIRICA Code	Experian Experian/Fair, Isaac Risk Model Code
Too few bank/national revolving accounts with recent payment information	R5			
Too few consumer finance company accounts with recent payment information	R6			
Too few installment accounts	R7			
Too few retail accounts	R8			
Too few retail accounts with recent payment information	R9			
Too few revolving accounts	S0			
Too few revolving accounts with recent payment information	S1			
Too few sales finance company accounts with recent payment information	S2			
Too many accounts recently opened	T0	09	09	09
Too many accounts with balances	T1	05	05	05
Too many bank/national revolving accounts	T2	04 (w)		04 (w)
Too many consumer finance company accounts	T3	06	06	06
Too many installment accounts	T4			
Too many inquiries last 12 months	T5	08	08	08
Too many recently active accounts	T6			
Too many recently active auto accounts	T7			
Too many recently active bank/national revolving accounts	T8			
Too many recently active consumer finance company accounts	T9			
Too many recently active installment loan accounts	U0			
Too many recently active retail accounts	U1			
Too many recently active sales finance company accounts	U2			
Too many recently opened accounts with balances	U4			
Too many recently opened bank/national revolving accounts	U5			
Too many recently opened consumer finance company accounts	U6			
Too many recently opened installment accounts	U7			
Too many recently opened retail accounts with balances	U8			
Too many recently opened revolving accounts	U9			
Too many recently opened revolving accounts with balances	V0			
Too many recently opened sales finance company accounts	V1			
Too many retail accounts	V2			
Too many revolving accounts	V3			
Too many recently opened bank/national revolving accounts with balances	V4			
Payments due on accounts	X0			46

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REASON CODE LISTING

Code	Positive Characteristics	Code	Negative Characteristics
1	Favorable amount owed on accounts (+)	51	Excessive or unknown amount owed on accounts (-)
2	No recent delinquency (+)	52	Recent delinquency (-)
3	Presence of revolving credit accounts (+)	53	Absence of revolving credit accounts (-)
4	Favorable number of accounts with outstanding balances (+)	54	Too many accounts with balances (-)
5	Favorable number of finance accounts (+)	55	Too many finance company accounts (-)
6	Favorable number of recent credit checks (+)	56	Too many recent credit checks (-)
7	Favorable number of new accounts (+)	57	Too many new accounts (-)
8	Proportion of revolving balances to revolving credit limits is favorable (+)	58	Proportion of revolving balances to revolving credit limits is too high, or no revolving credit accounts (-)
9	Favorable amount owed on revolving accounts (+)	59	Unfavorable or unknown amount owed on revolving accounts (-)
10	Favorable length of revolving credit history (+)	60	Insufficient length of revolving credit history (-)
11	No past delinquency or favorable length of time since last delinquency (+)	61	Delinquency date too recent (or date unknown) (-)
12	Favorable length of credit history (+)	62	Insufficient length of credit history (-)
13	No current or past delinquencies (+)	63	Delinquency (-)
14	Favorable time since last derogatory public record or collection (+)	64	Recent derogatory public record or collection (-)
15	Minimal or no past due balances (+)	65	Past due on balances (-)
16	Favorable payment history (+)	66	Delinquency, derogatory public record or collection (-)
17	Absence of collection accounts (+)	67	Presence of collection accounts (-)
18	Favorable number of revolving accounts with balances (+)	68	Too many revolving accounts with balances (-)
19	Favorable time since last credit check (+)	69	Date of last credit check too recent or unknown (-)

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TRANS UNION
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REASON CODE LISTING

Code	Positive Characteristics	Code	Negative Characteristics
20	Favorable time since most recent account established (+)	70	Insufficient time since most recent account established (-)
21	Favorable number of installment loan accounts (+)	71	Unfavorable number of installment loan accounts (-)
22	Favorable number of installment loan accounts with outstanding balances (+)	72	Too many installment loan accounts with outstanding balances (-)
23	Favorable time since most recent installment loan established (+)	73	Insufficient time since most recent installment loan established (-)
24	Favorable number of accounts with large high credit amounts (+)	74	Too many accounts with high credit amounts (-)
25	Proportion of loan balances to installment loan amounts is favorable (+)	75	Proportion of loan balances to installment loan amount is too high (-)
26	Favorable number of real estate accounts (+)	76	Unfavorable number of real estate accounts (-)
27	Favorable number of new finance company accounts (+)	77	Too many new finance company accounts (-)
28	No delinquency ever on installment loans (+)	78	Poor installment loan delinquency(-)
29	Favorable percentage of open revolving accounts to all other accounts (+)	79	Unfavorable percentage of open revolving accounts to all other accounts (-)
30	Favorable number of accounts (+)	80	Presence of delinquency, public record or collection (-)
31	No delinquency on open revolving accounts (+)	81	Delinquency on open revolving accounts (-)
32	Favorable length of time since most recent finance company account opened (+)	82	Finance company account opened recently (-)
33	Favorable number of accounts (+)	83	Unfavorable number of accounts (-)
34	Favorable length of time since most recent retail account opened or no retail accounts present (+)	84	Unfavorable length of time since most recent retail account opened (-)
35	No finance company accounts or no recently active finance company accounts (+)	85	Unfavorable number of recently active finance company accounts (-)
36	Favorable number of recently active accounts (+)	86	Unfavorable number of recently active accounts (-)
37	Favorable number of revolving or open accounts (+)	87	Unfavorable number of revolving or open accounts (-)

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38	Number of adverse public records (+)	88	Number of adverse public records (-)

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B

Insurers' Use of Credit Scoring for Homeowners Insurance in Ohio

A Report to the Ohio Civil Rights Commission

From Birny Birnbaum, Consulting Economist

January 2003

1. Executive Summary

Insurance companies in Ohio have increasingly used consumer credit information – in the form of insurance credit scoring – to determine if they will offer a consumer a residential property insurance policy and how much to charge for the policy offered. Insurance credit scoring is the use of mathematical formula to translate information in a consumer's credit report into a numerical value. Insurance credit scoring is now used by the majority of Ohio insurers for residential property insurance and is used in a variety of ways – for underwriting (including rating tier selection), rating (or premium development), coverage eligibility, marketing, and payment plan eligibility. Table 1 below lists the major writers of residential property insurance in Ohio and their use of consumer credit information as of November 2002.

Insurers typically file little information about their use of consumer credit information with the Ohio Department of Insurance. Consequently, there is little public information available about insurers' use of consumer credit information in Ohio. This occurs because most insurers use consumer credit information for underwriting. Underwriting is generally the insurers' process of determining whether or not to offer coverage to a consumer and, if offered, what type of coverage and what type of rate level or market tier to offer. Insurers' underwriting practices are codified in rules called underwriting guidelines. These guidelines are not typically filed with the Ohio Department of Insurance and the Department has historically not requested them from insurers.

In contrast to underwriting guidelines, insurers do submit rate filings to the ODOI. The rate filings contain base rates and rating rules. Rating is the process of developing a premium for a specific consumer based upon that consumer's personal or property characteristics using the base rate, rating factors and rating rules in the rate filing.

Historically, insurers had two or three rate levels or rating tiers. The preferred rates had the most restrictive underwriting guidelines and the lowest rates. The standard rates had slightly less restrictive underwriting guidelines and somewhat higher rates. The non-standard rates had the least restrictive underwriting guidelines and much higher rates. It was common for insurers to have a separate insurance company for each rate level. Stated differently, each insurance company had one set of rates and represented one tier.

6-20

Use of Credit Information for Homeowners Insurance by Ohio Insurers

Insurer	Use	Notes
State Farm	None	Underwriting based primarily on claims history.
Nationwide	Eligibility	Agent sees only "eligible" or "ineligible" on rating screen.
Allstate	Rating	Per 4/30/01 filing, credit used for Financial Stability Rating Class. Discounts range from 0% to 47% -- nearly 2:1 potential spread. Different factors for tenants and condo policies. Tenant spread is 0% to 60%.
Cincinnati	Pay Plan	Full annual premium payment required based on credit
Westfield	Rating	Tier selection
Grange Mutual	Rating	Per 7/1/99 filing, discounts of 0%, 2%, 5%. Currently uses three tiers, which may vary from percentages in 99 filing.
Farmers	Rating	Per 2/16/02 filing, discounts range from 0% to 72% -- nearly 4:1 potential rate difference based on credit score.
Erie	None	Underwriting based primarily on claims history
Liberty Mutual	None	Underwriting based primarily on claims history and type of dog. Offers discounts for university- and employer-affiliation.
Motorist Mutual	Eligibility	
Central	Eligibility, Rating	Credit Score cutoff used to determine eligibility and/or tier selection.
Travelers	Rating	Tier selection.
State Auto	Eligibility	
Ohio Casualty	Rating	Nine tiers based on credit.
Encompass	Eligibility, Rating	Had four tiers based on credit. Agent now sees acceptable / unacceptable.

With the advent of insurance scoring, many insurers have increased the number of rate levels or rating tiers to 20 or more, with multiple rating tiers being written (or sold) in one insurance company. In some cases, the rules governing eligibility (or assignment of a consumer) for rating tiers are still contained in underwriting guidelines and, consequently, not filed with the ODOI and not available to the public. In other cases, the rules are part of the rating manual, where the insurance score is the last factor applied to the premium in the rate development and the insurance score (or the insurance score in combination with other factors, such as claim history) determines the rating tier factor applied to the premium. If the rating tier is applied as a rating factor, then the rate filing includes information about the rating tier eligibility and rate differential by rating tier.

Our review of filings at the Department revealed information about only three insurers' use of insurance credit scoring – Allstate, Farmers and Grange Mutual. Farmers' use of credit scoring has the greatest potential impact on consumers – nearly a 4:1 difference in rates between best and worst credit scores. Allstate's use of credit information also has a major impact – nearly a 2:1 impact between best and worst credit scores for homeowners and 2.5:1 for tenants insurance. We believe the Grange Mutual information, found in a 1999 filing, is out of date. Based upon our interviews, we also believe that Westfields' and Travelers' use of credit information has a large impact on Ohio consumers.

The insurance industry argues for use of the insurance credit scoring with claims of a correlation between consumer credit information and risk of claims. The "correlation" means that certain credit characteristics can "predict" which consumers are more likely to have an insurance claim. The industry relies upon a number of its own secret studies to support this claim. There has been no meaningful opportunity for independent review or analysis of these studies because the underlying data are never made available to independent reviewers (where independent is defined as someone not in the employ of the insurance industry). Other information that is available to the public contradicts and calls into question the alleged correlation.

In addition, consumer organizations have argued that credit scoring itself is correlated to certain underwriting or rating factors that are prohibited, such as race. The industry argues that use of credit scoring does not discriminate or have disparate impact on poor and minority populations. Again, the industry relies upon its own secret studies. Other data and information strongly suggest insurers' use of credit has a disparate impact on poor and minority populations. Finally, the industry argues that, since race is not a factor considered in the credit scoring models, that even if credit scoring has a disparate impact on protected classes, such a result is fair insurance discrimination and not unfair discrimination.

Based upon all the available information, it is our opinion that insurers' use of insurance credit scoring for underwriting, rating, marketing and/or payment plan eligibility very likely has a disparate impact on poor and minority populations in Ohio. Consequently, it is our opinion that insurers' use of insurance credit scoring makes insurance less available and/or more expensive for poor and minority populations in Ohio.

2. Introduction: Insurance Concepts

In this section, we discuss basic insurance terminology and concepts.

2.1 Types of Insurance

There are many types of insurance sold. The types of insurance are generally broken down into two major categories: life/health (L&H) and property/casualty (P&C). Life/health coverages include life, health and disability insurance. Property/casualty coverages are generally broken into personal and commercial lines. Personal lines are those coverages purchased by individuals, including private passenger automobile and homeowners insurance. Commercial lines are those coverages purchased by businesses and include commercial multi-peril (property and liability), medical malpractice, workers' compensation, and commercial automobile insurance. This report focuses on residential property (homeowners) insurance.

Residential property insurance is considered a "lines" of insurance. Within each line are a variety of coverages. For residential property insurance, the consumer typically selects one of the major coverages. An important characteristic of coverages is whether they provide first party or third party coverage. First party coverage pays for personal injury or property damage to the insured. Third party coverage pays for personal injury or property damage that the insured causes to a third party.

Residential property insurance is a broader term for insurance most people know as homeowners insurance. The coverages age:

> *Dwelling* – This is first-party coverage. This coverage pays for damage to your house. An important factor for dwelling coverage is whether the coverage is for replacement value or actual cash value. The replacement value policy pays the replacement cost of the home, while the actual cash value policy only pays the actual market value of a home. If a $100,000 home is totally destroyed, for instance, but costs $125,000 to rebuild, the replacement value policy would pay $125,000 but the actual cash value policy would only pay $100,000.
>
> *Personal property* – This is first-party coverage. This coverage pays either the actual cash value or replacement cost of your personal property (excluding autos) that are damaged, stolen, or destroyed.
>
> *Liability* – This is third-party coverage. This coverage pays the other person (the third party) if you cause injury to the person or the person's property.
>
> *Medical Payments* – This is third-party coverage. This coverage pays the other person (the third party) for medical expenses incurred from an injury on your property.

Loss of use – This is first-party coverage. This coverage pays for your living expenses, including rent, during the time your house is being repaired.

A *Homeowners policy* refers to a multi-peril policy that provides all five coverages. A *Dwelling, or Fire,* policy normally provides only the dwelling coverage. A *Renters* policy normally provides all coverages other than dwelling.

2.2 Types of Insurers

Insurance companies that sell private passenger automobile and homeowners insurance differ based on the type of *ownership* of the company and the method of *sales*.

The two main types of ownership are stock companies and mutual companies, but there are others. Stock companies are publicly owned companies whose stock generally trades in one of the stock markets. Stock companies are owned by their shareholders – the purchasers of the company's stock. Allstate is a stock company. Mutual companies are owned by their policyholders. State Farm Mutual Automobile Insurance Company is a mutual company.

Insurers also differ by how they sell their policies. *Direct writers* do not use agents to sell their policies. Two examples are USAA and GEICO. These companies sell insurance over the phone through sales representatives. Most insurers, however, sell their policies through agents. *Captive agent* insurers sell their policies through agents who only sell for that company. State Farm, Farmers, and most Allstate agents are captive agents. *Independent agent* insurers sell their policies through independent agents that represent more than one insurer. Progressive, SAFECO and Travelers are examples.

2.3 Market Segments

Most insurance markets consist of several submarkets: preferred, standard, nonstandard, residual, and surplus lines. *Preferred* companies have the lowest rates and sell to the consumers perceived to represent the lowest risk. *Standard* companies sell to consumers perceived to represent average risks. *Nonstandard* companies have the highest rates of these three types of companies and sell to consumers perceived to represent the highest risk. The preferred, standard and substandard markets are known collectively as the "voluntary market" or the "admitted market." Those consumers unable to obtain coverage in these three markets must turn either to a residual market mechanism or to surplus lines companies.

Residual market mechanisms were created to provide some type of insurance to those consumers who could not obtain it in the voluntary market. Most states have some residual market for private passenger automobile insurance. The automobile insurance residual markets are typically called "insurance plans" or "risk pools." For residential property insurance, some states have "FAIR" plans, which are similar in structure to automobile insurance risk pools. Most FAIR plans were created in the 1960's and 1970's following the incidence of urban riots and charges of insurance redlining. A number of

coastal states now have property insurance residual markets for catastrophe events, including hurricane and earthquake. These residual markets are relatively new, some having been created in the last few years.

Not all states have residual market mechanisms and many of those that do limit the types of coverages available. Residual market mechanisms operate in one of two ways. In some, consumers are insured through a pool with state-set rates and all insurers share the profits or losses from all such policies. Alternatively, these consumers are assigned to an insurance company that must accept the risk at a state-set rate and the profit or loss on the policy. Consumers normally pay higher rates in a residual market and receive limited benefits.

Surplus lines carriers, also known as "off shore" and "non-admitted" insurers, are not regulated by the state. These insurers are permitted to insure only those consumers who are unable to purchase coverage in the admitted market. These insurers present several disadvantages to the consumer. Rates are usually much higher than admitted companies, policy forms are not regulated, no state guaranty coverage is provided if the company goes broke, and the absence of solvency regulation increases the chances that the company will be unable to pay its claims.

Most insurance "companies" are really a group of insurance companies. Normally, an insurer group owns preferred, standard, and nonstandard companies with correspondingly higher rates. Each of the companies in the insurer's group has decreasingly restrictive underwriting guidelines. When a consumer goes into State Farm, for instance, he or she may be placed in State Farm's preferred company if the consumer meets the most restrictive underwriting guidelines. Otherwise, State Farm will insure the consumer in either its the standard company or substandard company, or deny coverage altogether.

For most consumers, auto and homeowners coverage is obtained in the standard and preferred markets. These two markets normally sell the large majority of insurance policies in a state. For consumers forced into the substandard, residual, or surplus lines markets, however, insurance is unavailable in the standard and preferred markets. The insurance availability problem includes both the inability to obtain insurance at all and the inability to purchase insurance in the standard and preferred markets.

2.4 Underwriting Guidelines

Underwriting is the process by which an insurer determines whether it will accept or reject an applicant and, if acceptable, at what price. *Underwriting guidelines* are the standards on which the insurer makes the underwriting decision. Insurers provide underwriting guidelines to insurance agents (or sales representatives for direct writers) for the agent to make the initial decision as to whether to offer coverage and at what price. An underwriter in the insurer's home office reviews applications to ensure they meet the underwriting guidelines. Insurers also use underwriting guidelines to determine whether the company will renew an existing policy.

Underwriting guidelines range from very detailed and objective written rules (*e.g.* limitations on insuring homes under a specified value) to broad and subjective forms of guidance for the agent or underwriter (e.g. limitations on insuring consumers with "bad morals"). Some of the more common underwriting guidelines for auto and homeowners insurance are listed in the following table:

Top Underwriting Guidelines
For Auto and Homeowners Insurers

Auto	Homeowners
Credit history	Credit history
Driving experience	Made previous homeowners claim
Cancelled/refused by another company	Minimum coverage / value of the home
No prior insurance	Age of home
Age	Location of the home
Occupation	Lifestyle
Residential stability	Marital status
Employment stability	Employment stability
Not-at-fault accidents and claims	
Marital status	
Purchase of other insurance	
Previous insurer was nonstandard	
Type of car	

Not all discrimination is wrong or illegal. Some discrimination is clearly proper, like refusing to sell homeowners insurance to the class of consumers who have been convicted of arson. Other discrimination is clearly *improper*, like refusing to sell to the class of African-American consumers. Those practices in the middle require a two-step analysis. First, does the underwriting guideline violate broad public policy? Is the guideline simply a surrogate for another prohibited characteristic? Second, does the underwriting guideline identify a characteristic of the consumer, vehicle or property that is demonstrably and uniquely related to risk of loss? The second test typically requires detailed insurance data upon which to perform statistical and actuarial analyses. The data must be sufficiently detailed to enable the analyst to identify the unique contribution of the underwriting guideline or rating factor in question. Identifying the unique contribution is necessary to ensure that the underwriting guideline is simply not correlated (i.e., a surrogate) for another known underwriting guideline or rating factor – including prohibited rating factors. Such an analysis enables the analyst to determine whether the practice *unfairly* discriminates against consumers who do not satisfy the underwriting guideline.

Finally, the *ways* insurers use underwriting guidelines to discriminate is not limited to the mere denial of coverage. Insurers use underwriting guidelines to discriminate against consumers in the following ways:

- Refusal to sell a policy at all.
- Charging a higher premium for the same coverage.
- Refusal to sell a replacement value policy.
- Requiring higher deductibles.
- Exclusion of specific coverages.
- Different benefits for the same price.
- Poorer service.
- Paying less for similar claims
- Conditioning payment plan eligibility

Underwriting guidelines are important because they determine both the availability and affordability of insurance to groups of consumers. Insurance data are critical in the review of underwriting guidelines because the data will show whether the underwriting guideline properly identifies a group of consumers for whom the expected costs of the transfer of risk are higher or lower.

2.5 Rating Factors and Premium Calculations

Calculating a premium for auto and homeowners insurance is a two-part process. First, the underwriting process determines the *base rate* for the coverage. The base rate for each company will differ, as will the base rate for the different insurers within the company group. Thus, the base rates between Allstate and State Farm will differ, but the base rates between State Farm's preferred and substandard companies will also differ.

Second, the premium calculation involves the application of a series of rating factors to the rate base. *Rating factors* are the factors that change the base rate because the insurer or state has determined that the factor represents a difference in risk. For instance, a brick home represents a lower risk for fire than a wood frame house, so a discount factor is applied to the base rate for brick homes. Rating factors can cause the rate to increase (*surcharges*) or decrease (*discounts*).

Rating factors differ by state and by insurer. Common rating factors for auto insurance include coverage amount, territory (usually county of residence), use of car (pleasure only, business use), age of drivers, type of car, amount of deductibles, surcharges, and various discounts. Common rating factors for homeowners insurance include coverage amount, territory (usually county), type (brick or frame), amount of deductibles, and various discounts.

2.6 Rate Standards

Rates are developed to meet both legal and *actuarial* standards. In some instances, the legal and actuarial standards differ. When that occurs, the legal standards take precedence.

The common legal standard is that rates must be just, reasonable, adequate, not excessive and not unfairly discriminatory for the risks to which they apply. Rates satisfy that standard if the rate is a sound estimate of future costs of coverage offered and if consumers of the same class and essentially the same hazard are offered the same rates.

Rates are generally developed by actuaries working for, or on behalf of, insurance companies. A certified actuary is a person who is a member of the Casualty Actuary Society, but membership is usually not mandatory. Membership in the CAS is based upon passing a series of tests. It is important to point out that membership in the CAS does not impart consistent or good judgment to actuaries. Two actuaries analyzing the same data can, and often do, come up with widely divergent rate results. While ratemaking is a complex subject and activity, a consumer advocate can often identify the key ratemaking assumptions and question those assumptions.

2.7 Rate and Risk Classifications

The ratemaking analysis first produces *average statewide rate change indications by coverage*. For example, the ratemaking analysis may initially produce a 5% average statewide increase for bodily injury liability. The insurer then selects the average statewide rate change by coverage it will use or proposes to use. It is common for insurance companies to select rate changes significantly different from the actuarially indicated rate changes. There is generally little or no explanation provided by insurance companies for their selection of rates significantly different from the actuarially indicated rates.

The statewide average rate change is then *distributed to the various risk classifications*, such as different driver classes, increased limits factors and rating territories. If some parts of the state (rating territories) have better than average loss experience for a particular coverage, these rating territories should get a lower rate change than the statewide average for that coverage. Of course, if one rating territory gets a lower than average rate change, another rating territory must get a higher-than-average rate change.

Failure to reflect differences in costs among risk classifications, as well as attempting to charge different rates based upon a rating factor that is unrelated to differences in costs, is *unfair discrimination*. However, it is important to point out that an actuarially sound rate must be legal. For example, insurance companies are prohibited from discriminating on the basis of race, religion or national origin. Thus, even if cost differences based upon these characteristics could be demonstrated, it would be illegal and actuarially improper to treat consumers differently based upon any of these prohibited characteristics. States legislatures routinely pass laws expressing public policy regarding the nature of insurance

risk classification. It is important to mention this because risk classifications are not natural or pre-ordained; rather, there are many ways of grouping consumers for the purposes of ratemaking that are fair.[1]

3. Insurers' Use of Consumer Credit Information and Credit Scoring

Credit reports are one type of "consumer report" whose use is covered by the Fair Credit Reporting Act. Other types of consumer reports used by insurers include motor vehicle reports and claims history reports. Although insurers have looked at consumer credit reports for many years, the use of credit reports to produce an insurance credit score is relatively new. According to one of the credit scoring model vendors, insurers used consumer credit reports as early as the 1970's to identify consumers who posed high likelihood of fraud or arson. The first insurance credit scoring models were developed in the early 1990's by Fair, Isaac and Company, the company that had developed credit scoring models for lenders. The original credit scoring models predicted the likelihood of a loan default. The original <u>insurance</u> credit scoring models predict likelihood of an insurance claim. Scoring models have since been developed by Fair, Isaac and ChoicePoint to predict frequency of claims, likelihood of a consumer renewing a policy and likelihood of a response to direct marketing.

Allstate was an early user of insurance credit scoring, utilizing a model for automobile insurance in 1994. Adopting of insurance credit scoring was slow through 1990's, but grew exponentially by the end of the century. Today, almost every insurer uses some form of credit scoring for private passenger automobile insurance and the vast majority of insurers use it for residential property insurance.

Insurers use insurance credit scoring for a variety of purposes, including underwriting for overall eligibility, underwriting for rating tier eligibility, as a rating factor, determining payment plan eligibility and pre-screening for direct marketing.

Under a provision of the FCRA, as amended effective in 1997, insurers can obtain a list of consumer based upon certain credit characteristics without the consumers' permission, as long as the insurers provide a firm offer of insurance to the consumers on the list. That firm offer is subject to other insurer underwriting guidelines. This activity is called pre-screening and has been subject to virtually no oversight by insurance regulators.

A consumer credit report contains a listing of information about some of a consumer's credit activity, including a list of accounts (or trade lines), payment history, amount owed on a particular date, account credit limit, late payments, delinquencies, defaults, bankruptcies, other so-called public records, liens and some personal information. An insurance credit score is a value generated by applying a mathematical model to the specific characteristics of a consumer's credit report. See Appendix 1 for a number of descriptions and examples of insurance credit scoring and for resources on the FCRA.

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[1] See Appendix 1 for a listing of documents and resources for each section of this report.

Insurance companies in Ohio have increasingly used consumer credit information – in the form of insurance credit scoring – to determine if they will offer a consumer a residential property insurance policy and how much to charge for the policy offered. Insurance credit scoring is the use of mathematical formula to translate information in a consumer's credit report into a numerical value. Insurance credit scoring – or insurance scoring, for short – is now used by the majority of Ohio insurers for residential property insurance and is used in a variety of ways – for underwriting (including rating tier selection), rating (or premium development), coverage eligibility, marketing, and payment plan eligibility. Table 1 below lists the major writers of residential property insurance in Ohio and their use of consumer credit information.

Insurers typically file little information about their use of consumer credit information with the Ohio Department of Insurance. Consequently, there is little public information available about insurers' use of consumer credit information in Ohio. This occurs because most insurers use consumer credit information for underwriting. Underwriting is generally the insurers' process of determining whether or not to offer coverage to a consumer and, if offered, what type of coverage and what type of rate level or market tier to offer. Insurers' underwriting practices are codified in rules called underwriting guidelines. These guidelines are not typically filed with the Ohio Department of Insurance and the Department has historically not requested them from insurers.

In contrast to underwriting guidelines, insurers do submit rate filings to the ODOI. The rate filings contain base rates and rating rules. Rating is the process of developing a premium for a specific consumer based upon that consumer's personal or property characteristics using the base rate, rating factors and rating rules in the rate filing.

Historically, insurers had two or three rate levels or rating tiers. The preferred rates had the most restrictive underwriting guidelines and the lowest rates. The standard rates had slightly less restrictive underwriting guidelines and somewhat higher rates. The non-standard rates had the least restrictive underwriting guidelines and much higher rates. It was common for insurers to have a separate insurance company for each rate level. Stated differently, each insurance company had one set of rates and represented one tier.

With the advent of insurance scoring, many insurers have increased the number of rate levels or rating tiers to 20 or more, with multiple rating tiers being written (or sold) in one insurance company. In some cases, the rules governing eligibility (or assignment of a consumer) for rating tiers is still contained in underwriting guidelines and, consequently, not filed with the ODOI and not available to the public. In other cases, the rules are part of the rating manual, where the insurance score is the last factor applied to the premium in the rate development and the insurance score (or the insurance score in combination with other factors, such as claim history) determines the rating tier factor applied to the premium. If the rating tier is applied as a rating factor, then the rate filing includes information about the rating tier eligibility and rate differential by rating tier.

Use of Credit Information for Homeowners Insurance by Ohio Insurers

Insurer	Use	Notes
State Farm	None	Underwriting based primarily on claims history.
Nationwide	Eligibility	Agent sees only "eligible" or "ineligible" on rating screen.
Allstate	Rating	Per 4/30/01 filing, credit used for Financial Stability Rating Class. Discounts range from 0% to 47% -- nearly 2:1 potential spread. Different factors for tenants and condo policies. Tenant spread is 0% to 60%.
Cincinnati	Pay Plan	Full annual premium payment required based on credit
Westfield	Rating	Tier selection
Grange Mutual	Rating	Per 7/1/99 filing, discounts of 0%, 2%, 5%. Currently uses three tiers, which may vary from percentages in 99 filing.
Farmers	Rating	Per 2/16/02 filing, discounts range from 0% to 72% -- nearly 4:1 potential rate difference based on credit score.
Erie	None	Underwriting based primarily on claims history
Liberty Mutual	None	Underwriting based primarily on claims history and type of dog. Offers discounts for university- and employer-affiliation.
Motorist Mutual	Eligibility	
Central	Eligibility, Rating	Credit Score cutoff used to determine eligibility and/or tier selection.
Travelers	Rating	Tier selection.
State Auto	Eligibility	
Ohio Casualty	Rating	Nine tiers based on credit.
Encompass	Eligibility, Rating	Had four tiers based on credit. Agent now sees acceptable / unacceptable.

Our review of filings at the Department revealed information about only three insurers – Allstate, Farmers and Grange Mutual. Farmers' use of credit scoring has the greatest potential impact on consumers – nearly a 4:1 difference in rates between best and worst credit scores. Allstate's use of credit information also has a major impact – nearly a 2:1 impact between best and worst credit scores for homeowners and 2.5:1 for tenants insurance. We believe the Grange Mutual information, found in a 1999 filing, is out of date. Based upon our interviews, we also believe that Westfield's' and Travelers' use of credit information has a large impact on Ohio consumers.

4. Why Insurers Use Consumer Credit Information and Credit Scoring

Insurers use insurance credit scoring because insurers are permitted to obtain and use consumer credit and other reports for insurance underwriting pursuant to the FCRA and because, according to insurers, insurance credit scoring is predictive of the likelihood of a consumer making an insurance claim.

Insurers argue that their use of insurance credit scoring benefits consumers in many ways. They argue that, because insurance credit scoring is predict of claims, insurers can offer lower rates to consumers with good credit scores and higher rates to consumers with poor credit scores. From an actuarial perspective, this allows fairer pricing than without credit scoring. Insurers argue that if credit scoring is prohibited, high cost customers will be subsidized by low-cost customers.

Insurers also claim that insurance scoring allows them to write more business than they would otherwise be able to because they are better able to price business that they would otherwise be to uncertain about to write.

Insurers claim that their use of insurance credit scoring promotes competition in insurance markets because it allows more and smaller insurers to write more types of business. See Appendix 1 for a list of many statements by insurers and insurance trade associations on how they use consumer credit information and the benefits to consumers. The following, taken from a brochure produced by the American Insurance Association, is representative.

> An insurance score uses information from your credit report to predict how often you are likely to file claims, and/or how expensive those claims will be. The way you handle your credit says a lot about how responsible you are. Insurance companies want to reward responsible people by offering them better insurance products and by charging them lower rates. That's why insurance scores are so useful.
>
> It is important to understand that an insurance score is not the same thing as a credit score. Both are derived from the information found in your credit report, but they predict very different things. A credit score predicts how likely you are to repay a loan or other credit obligation. When you are applying for a loan or some other form of credit, the bank will consider your credit history as well as other factors in determining whether you are likely to repay your debt. While banks and other lenders will look at your income when making decisions, insurers *do not.*
>
> When you apply for insurance, the insurance company orders credit information from one or more of the three major U.S. credit bureaus. This information is entered into a computer program that generates an insurance score. Most of these programs, or "models," look at things like payment history, collections, credit utilization and bankruptcies. For example, if you have never been late paying your mortgage, you will probably have a better score than a person who pays late.

If you have "maxed out" credit cards, that will negatively affect your score. When you apply for coverage and your insurance company orders your score, the credit bureau will make a note in your file that the insurance company looked at the record.

What does my credit history have to do with how I drive my car?

Having a good insurance score does not necessarily mean you are a good driver or a more responsible homeowner. However, research has shown that consumers with better insurance scores generally file fewer claims and have lower insurance losses. That is not to say that all people with low insurance scores are higher risks. For instance, if you add a 16- or 17-year-old driver to your auto insurance policy, your premiums will very likely increase. This is because, as a group, younger drivers have more claims and losses than those with more experience. That does not mean that all 17-year-olds are bad drivers. Research shows, though, that drivers in that age group are more likely to have losses, so they pay more in premiums.

It's the same thing with insurance scores- research shows that people with certain patterns of behavior in their credit history are more likely to result in losses for the insurance company. As a result, they pay higher premiums, or, in extreme cases, they might have trouble getting insurance from some companies.

What kinds of things affect my insurance score?

Insurance scores are based on information like payment history, bankruptcies, collections, outstanding debt and length of credit history. For example, regular, on-time credit card and house payments affect a score positively, while late payments affect a score negatively.

Payment History,
Bankruptcies,
Collections
Length Of Credit History
Amount O Outstanding Debt
New Applications For Credit
Types Of Credit In Use
Credit Report Information Used In Insurance Scores

Do credit-based insurance scores discriminate against certain ethnic or income groups?

No. Insurance companies do not consider the following information in the calculation of your insurance score:

Income	Ethnic group	Religion
Gender	Marital status	Nationality
Disability	Address	Public assistance
Sources of income		

4.1 Other Reasons Why Insurers Might Use Credit Scoring

Consumer advocates suggest a number of additional reasons why insurers use insurance credit scoring.

First, credit scoring allows insurers to price based on the profitability of the consumer, as opposed to pricing based on expected risk of loss. This rationale assumes that credit scoring is correlated to profitability.

As shown above, important consumer credit characteristics are related to the income level of the consumer. Thus, credit scoring is, for insurers, an easy and quick method of underwriting and rating by consumer income. And insurers have apparently determined than underwriting and rating by income is the key to greater profitability.

At a hearing before the Florida Insurance Commissioner's Task Force on Insurance Credit Scoring, Progressive Insurance stated that the four most important factors it uses to determine the premium for a consumer are the consumer's prior bodily injury limits, whether the consumer had prior insurance, the credit score and driving record. Three of the four factors are strongly related to the consumer's income.

The Georgia Insurance Consumer's Advocate described the problem with rating based on income in a letter commenting on a recent Allstate filing to the Georgia Insurance Commissioner. The Advocate wrote the following about a surcharge Allstate wanted to charge consumers who only purchased minimum limits liability private passenger auto insurance coverage.

> This is another rating factor we believe has no potential for loss prevention or encouraging consumers towards less risky behavior. Further, we believe it is counter to the public policy declaration by the General Assembly that effective January 2001, $25,000 is sufficient to meet the state financial responsibility requirements. It doesn't make sense that the legislature should set the minimum requirements and then an insurance company can penalize consumers for complying. Clearly, a consumer's decision to purchase higher coverage is based on individual motivations and has little behavioral impact on risky activity.
>
> Finally, it appears the proposed rating factor could have a disproportionate impact on less-affluent consumers by shifting greater premium responsibility to lower limit consumers and away from the more-affluent, higher-limit consumers. Less affluent folks who purchase lower limit insurance may do so in order to be financially responsible with their other debts and obligations.

The fact is that, while profitability and risk of loss are related, they are not the same. Two consumers may pose the same risk of loss, but present different profitability to the agent and insurer. The consumer who only wants to insure one vehicle at the minimum limits will be less profitable than the consumer who wants to insurer multiple vehicles at high limits and who wants property and life insurance. Many insurers simply do not want to write insurance for the poorest consumers.

The emphasis on rating factors that are largely income-related should be quite troubling to policymakers and consumers. But the problem is exacerbated with credit scoring because credit scoring enables insurers to move away from pricing based upon risk to pricing based upon what the market will bear. The second additional reason suggested by consumer advocates is that credit scoring has allowed insurers to revolutionize the risk classification process.

Instead of three rating tiers (or price levels) – preferred, standard and non-standard, insurers utilize credit scoring to create literally dozens of rating tiers. This proliferation of rating tiers is possible only because of credit scoring's numerical scale. As credit scoring becomes more widely used, consumers will be identified for higher rates because of their place on the credit scoring scale.

Writing in *American Agent and Broker*, New York agent Charles Wells writes that, "Over the past couple of years, we have seen more people put into nonstandard auto not only because of their driving records, but also for lack of financial prowess." We used to think about nonstandard auto markets as the home for bad drivers. But with the advent of credit scoring, there are now more nonstandard drivers – an increase unrelated to the overall number of accidents.

Third, some insurers are moving to credit scoring as a defensive measure. Insurers often act with a herd mentality and that appears to be the case with credit scoring also. Some insurers fear that failure to use credit scoring will result in adverse selection against their companies.

Fourth, insurers' use of credit scoring can allow insurers to avoid rate regulation in some states. Through the introduction of numerous rating tiers based on credit scores and determination of tier eligibility through underwriting, insurers can easily raise rate levels without making a rate filing. In most states, insurer changes to underwriting guidelines receive no scrutiny. Consequently, an insurer could simply raise the cutoff score for rating tier eligibility by, say, ten points, and effectively create, say, a 10% rate increase without any regulatory oversight.

Fifth, for some larger insurers, the use of credit scoring is seen as the tool to transition from an insurance company to a financial services company. The use of credit scoring enables an insurer to develop a book of insurance customers most likely to purchase other financial products, including life insurance, retirement products and traditional banking products.

Sixth, credit scoring can be used to preclude certain types of customers – redlining – by using credit for prescreening purposes. The FCRA allows insurers to get mailing lists of consumers based on credit characteristics without the permission of consumers.

Seventh, credit scoring can also be used for redlining by developing models that predict policy retention, thereby allowing insurers to focus marketing efforts on consumers least likely to shop around for insurance and most likely to stay with the same insurer.

5. Why Is There a Correlation Between Credit History and Claims Experience?

Insurers answer this question in the following way. Although they do not know exactly why insurance credit scores are predictive of claims, they are convinced that this relationship exists. And while it is often comforting to be able to explain why such a relationship exists, an explanation – or in more technical terms, a demonstration of causality – is not necessary. The industry argues that we don't know why bad credit "causes" higher claims, but the correlation is there. The industry further argues that, according to actuarial standards of practice, a demonstration of correlation is sufficient because a demonstration of causality may be impossible.

When pushed for an explanation, the insurance industry explains the correlation to result from individual responsibility. The argument goes something like: A consumer with a good credit score is financially responsible and a consumer who manages his or her financial assets well is likely to manage their other assets – home and car – well.

In our view, the industry rationale for the use of credit scoring is inadequate and the financial responsibility explanation amounts to a 'blaming the victim" strategy. These issues, along with the problems with credit scoring, are discussed in detail in the next sections below.

6. Unfair Discrimination – the Question of Correlation

The industry argues that their use of credit scoring is fair. From an actuarial and insurance regulatory perspective, insurers argue that the use of insurance credit scoring is fair because there is a statistical relationship between scores and risk of loss. The industry points to a variety of studies performed either by the scoring modelers (like Fair, Isaac), insurers themselves or insurance trade associations. None of these studies has been independently reviewed – where independence means by someone not employed by insurers and reviewed means verification of data, methodology and results. Review also means analysis to identify whether insurance credit scoring is correlated with other rating factors – permitted or prohibited – such that the correlation between credit scoring and risk of loss is, in fact, a spurious correlation..

Credit is unlike other rating factors in terms of the regulator's evaluation of the relationship between credit information and risk of loss. There has been no independent analysis of the alleged correlation because the only entities who have access to both the insurance data and the consumer credit information are the scoring vendors and insurers. This is a radical departure from regulatory practice. With any other rating factor, the information necessary for a regulator to evaluate an alleged relationship to risk of loss is available through statistical reporting. Thus the regulator can collect the insurance information and do an independent analysis – this is not possible with credit scoring and regulators have taken the word of the industry when they claim there is a correlation.

The "evidence" supporting the correlation claim comes almost exclusively from insurers, insurer trade associations and credit scoring vendors who refuse to divulge the methodology of their studies, details of the study results and/or the underlying data for independent verification. For those studies about which some information is known, the industry claims become more suspicious. For example, Fair, Isaac continues to bring out the Tillinghast "study" as support for the correlation – even though the NAIC Credit Reports subgroup dismissed the "study" as "counterproductive and misleading."

The industry cites a study by the Virginia Bureau of Insurance to support both the correlation claim and the claim that credit scores are not correlated with race or income. This study consisted of Fair Isaac providing the Virginia Bureau with average credit scores for a number of ZIP Codes and then the Department analyzed the average credit scores versus race and other demographic factors. The shortcoming of this study is that there is no verification of the credit scores and Fair Isaac was in a position to create the desired outcome with the data it provided to the Department. The industry, however, fails to mention this caution in the report:

> The Bureau has concerns about the long-term effect that the use of credit scores may have on Virginia consumers. As the number of insurers that use credit history as an underwriting tool increases, there may be an increase in the number of consumers that will be refused coverage, cancelled, non-renewed, or charged higher premiums due to their adverse credit history.

The industry studies are also suspect because they generally rely upon a univariate analysis with loss ratios as the dependent variable. Stated differently, the studies simply relate one variable – credit score – to loss ratio. This type of analysis is insufficient to determine if credit history is actually related to loss ratio or really just related to other rating factors which have a demonstrated relationship to risk of loss. The univariate loss ratio analysis of credit history is insufficient because such an analysis is predicated on the assumption that all other relevant rating factors are reflected in the premium (e.g. denominator of the loss ratio) and that these factors are accurately priced. This is simply not the case. Rather, a multivariate analysis focusing on exposures and claims is necessary. Multivariate means that other rating factors are included, so the unique contribution of credit history (if any) to explaining risk of loss is identified.

There is a growing body of information casting doubt on the insurers' correlation claim. For example, if consumers who have filed for bankruptcy in the past five years are far more likely to have claims that consumers who have not filed for bankruptcies, then we would expect an increase in loss ratios if the number of bankruptcies increases dramatically. Personal bankruptcies did increase dramatically during the 1990's, yet private passenger auto insurance loss ratios *declined.* The following data show a *negative* correlation – just the opposite of the positive correlation claimed by the insurance industry.

Year	Private Passenger Auto Countrywide Incurred Losses to Earned Premium	Countrywide Non-Business Bankruptcies	Private Passenger Auto Florida Incurred Losses to Earned Premium	Florida Bankruptcy Cases Filed
1985	75.9%	297,885		
1986	73.8%			
1987	71.1%	473,000		
1988	72.0%	526,066		
1989	73.8%	580,459		
1990	73.6%	660,796	68.0%	
1991	68.6%	812,685	66.8%	43,400
1992	66.8%	899,840	76.4%	52,400
1993	67.1%	852,306	72.1%	46,600
1994	67.6%	788,509	70.1%	41,900
1995	66.8%	806,816	69.6%	43,400
1996	66.7%	989,172	64.3%	51,900
1997	62.7%	1,263,006	60.6%	67,400
1998	62.4%	1,379,249	61.4%	76,400
1999	65.2%	1,352,030	69.7%	79,200

Another blow to the correlation claim comes from a recent study by the nation's largest mortgage insurers, MGIC Investment Corp, which evaluated thousands of home loans during the 1989 to 1991 recession. The study found that some borrowers with the best Fair, Isaac (FICO) scores faced more serious risk of delinquency and foreclosure than borrowers with the poorest FICO scores because local economic conditions are the most important factor in determining likelihood of delinquency and foreclosure. Consumers with high credit scores in a region with weak economic conditions were more likely to encounter problems than are consumers with lower scores in a region with stronger economic conditions.

The revelations from this study are a major blow to the correlation claim because the credit scoring models are developed on a national basis. But, economic conditions vary greatly by geographic region. For example, surveys of mortgage delinquencies by the Mortgage Bankers Association of America show major differences across the country. In the fourth quarter of 2000, for example, delinquencies in the South were almost 60% higher than in the West.

Insurers argue that a simple correlation is sufficient justification for the use of any characteristic of the consumer, vehicle or property as an underwriting or rating factor. But the existence of a correlation between a rating factor and risk of loss does not mean that insurers should be always permitted to use that characteristic underwriting or rating. We don't permit race as a rating factor, but there is a correlation between race and risk of loss for life insurance. There must be more to a rating factor than simple correlation to justify its use – particularly when it is something as enormous as consumer credit information. The issues of risk classification are discussed further below.

7. Unfair Discrimination – Disparate Impact Upon Protected Classes

Insurers also argue that there is no evidence that insurance credit scoring has a disparate impact on poor and/or minority consumers. The industry points to three studies supporting this claim – the American Insurance Association study on credit scoring and income, the Virginia Bureau Insurance study of credit scoring by ZIP codes and Progressive's study of credit scores by ZIP Codes grouped by minority population.

The "study" by the American Insurance Association that concludes that credit scores are relatively constant over different income classes. Again, the industry will not provide the information necessary for an independent researcher to replicate the results of the study. But the reliability of the insurers' studies must be strongly questioned because of the large amount of evidence – and common sense – contradicting the insurer studies' conclusions.

On the issue of credit scoring versus income and race, the Executive Vice President Peter McCorkell of Fair, Isaac admitted that credit scoring has a disparate impact on by race and income:

> ***Doesn't scoring result in higher reject rates for certain minorities than for whites?***
> Again, the short answer is, "Yes," but it is the wrong question. The question ought to be: "Does credit scoring produce an accurate assessment of credit risk regardless of race, national origin, etc.?" Studies conducted by Fair, Isaac, and Company, Inc. (discussed in more detail below) strongly suggest that scoring is both fair and effective in assessing the credit risk of lower-income and/or minority applicants. Unfortunately, income, property, education, and employment are not equally distributed by race/national origin in the United States. Since all of these factors influence a borrower's ability to meet financial obligations, it is

unreasonable to expect an objective assessment of credit risk to result in equal acceptance and rejection rates across socioeconomic or race/national origin lines. By definition, low-income borrowers are economically disadvantaged, so one would not expect their score distributions to mirror those of higher-income borrowers.

In its 1999 National Consumer Credit Survey, Freddie Mac found:

> Having a poor credit record is a relatively common problem in today's society. Using the combined results from the CCS (i.e., African-Americans, Hispanics and Whites) we estimate that:
>
> 30% of these groups have "bad" credit records
> 13% of these groups have "indeterminate" credit records
> 57% of these groups have "good" credit records
>
> Credit problems persist across income groups. We estimate that:
>
> 36 % of consumers with incomes under $25,000 had "bad" credit records
> 33 % of consumers with incomes of $25,000 to $44,999 had "bad" credit records
> 25 % of consumers with incomes of $45,000 to $64,999 had "bad" credit records
> 22 % of consumers with incomes of $65,000 and $75,000 had "bad" credit records
>
> Minority borrowers are more likely than white borrowers to experience credit problems. For African-Americans we estimate that:
>
> 48% of African Americans have "bad" credit records
> 16% of African Americans have "indeterminate" credit records
> 36% of African Americans have "good" credit records
>
> For Hispanics we estimate that:
>
> 34% of Hispanics have "bad" credit records
> 15% of Hispanics have "indeterminate" credit records
> 51% of Hispanics have "good" credit records
>
> For Whites, in contrast, we estimate that:
>
> 27% of Whites have "bad" credit records
> 12% of Whites have "indeterminate" credit records
> 61% of Whites have "good" credit records

It is unclear how the quality of credit histories can vary by income and race, but insurance credit scoring has no disparate impact by income and race.

Statistics from the 2000 Statistical Abstract of the United States reveal that credit characteristics vary not only by age and income but vary over time within age and income segments. Table 792 – *Financial Assets Held by Families by Type of Asset: 1992 to 1998* shows the ownership of any financial assets varies dramatically by age and income. The ownership of financial assets is related to the ability of a family to withstand an economic or medical catastrophe.

Table 796 – *Ratios of Debt Payments to Family Incomes: 1992 to 1998* shows higher ratios of debt payments to family income and higher ratios of families with payments 60 or more days due for younger and lower income families. The table also shows how these ratios – both of which figure prominently in insurance credit scores – vary over time.

Table 817 – Usage of General Purpose Credit Cards by Families: 1992 to 1998 shows that younger and poorer families are much less likely to pay off credit card balances each month and far more likely to hardly ever pay off the balance than older or more affluent families. Again, these characteristics – which vary by age and income – figure prominently in insurance credit scores

8. Problems with Credit Scoring – Blaming the Victim

Insurers often argue that credit scores predict insurance claims because credit scores measure a consumer's financial responsibility. This is not the case. A credit score, or an insurance score, is a product of the presence (or absence) of both positive and negative factors. A consumer can have a bad credit score even though he or she has no negative information (bankruptcy, delinquency) on his or her credit report. Rather, a consumer can get a bad credit score – with resulting higher auto and homeowners insurance rates – because of the absence of "positive" factors – the absence of a real-estate secured loan, the absence of certain other types of credit, the absence of credit information.

Equating "financial stability" or "financial responsibility" with a good credit score is not only factually incorrect, it represents the insurers' contemptible practice of blaming the victims of insurers' use of consumer credit information. Several studies have shown that the major causes of bankruptcy are economic or medical catastrophes in the consumer's family – job loss, dread disease, divorce – and not "financial irresponsibility." Further, insurers' use of consumer credit information further discriminates against certain groups of consumers who live in certain areas because the financial institutions used by these consumers – pay day loans, check cashing, rent to own – do not report to credit bureaus and, consequently, the consumer credit reports are missing information. Again, it is important to stress that a bad credit score can result from the absence of positive information as well as the presence of negative information.

The inherent unfairness of insurance credit scoring – and the demonstration of the blaming-the-victim strategy – is illustrated by the impact of the September 11 terrorist attacks. After the September 11 attacks, tens of thousands of people working for airlines or travel support industries lost their jobs – throughout the country. Many of these people lost their health insurance in addition to their paycheck. Clearly, many of the newly unemployed started charging more on their credit cards, encountered more financial strain. Many will likely be delinquent on some credit cards or loans or file bankruptcy because they lost their jobs. And these people – indirect victims of a terrorist attack – will also face higher auto and homeowners insurance premiums. Did these people become worse drivers because they lost their jobs? The answer is clearly no. But this kind of unfair treatment of consumers at the hands of credit scoring repeats itself again and again.

When asked to explain why credit scoring predicts losses, insurers argue that a consumer's credit history describes the consumer's management of financial resources and someone who manages his or her financial resources well is less likely to have insurance claims. This is a classic case of blaming the victim. Studies have shown that the major reason why consumers file for bankruptcy is because of a major economic or medical event – such as losing a job or a family member getting a dread disease. For example, *The Washington Post* has reported a recent study concluding a majority of consumers experience financial problems as a result of a catastrophic economic event. In a study by Harvard law professor Elizabeth Warren, about 600,000 personal bankruptcies in 1999 were estimated to be caused by illness or injury to a family member coupled with insufficient or no health insurance coverage.

A December 2001 article in *insurer.com* reported that more than 725,000 laid-off workers had lost their health insurance since March 21, 2001. Again, these victims of an economic recession will face financial stress not only because they have lost their income, but also because they lost their most important safety net – health insurance. Yet, these victims of economic conditions will be further penalized with higher auto and homeowners premiums.

Consumers who are the victims of identity theft suffer higher insurance premiums because of credit scoring. Typically, identity thieves use the stolen information to commit financial crimes, such as check or credit card fraud. In over half of the reported cases of identify theft, the victim did not notice the theft for at least a month after theft occurred. This means that victims of identify theft will suffer higher insurance premiums before they can repair the damage to their credit reports.

The bottom line is that insurers' use of credit scoring is inherently unfair to consumers. Credit information is gathered primarily for purpose of evaluating credit worthiness, not insurance issues.

Credit info generated by consumers for purposes other than insurance:
- decision to seek another credit card
- decision to use one or more credit cards
- decision to pay in cash or get a loan
- decision to get a gas station card
- decision to pay in cash or use charge cards
- decision to rent or buy

Credit information is impacted by things beyond control of consumer:
- Bank decisions to lower or tighten credit standards
- Terrorist attacks
- Recession/Inflation/Overall Economic Conditions

9. Problems with Credit Scoring – Reliability of Models and Data

The credit scores can vary dramatically depending upon which credit reporting agency provided the credit information. It is important to note that consumers can suffer not only from the presence of inaccurate information in their credit files, but also from the *absence* of accurate information in the credit files. The best credit scores depend not only on the absence of negative information – bankruptcies and delinquencies – but also on the presence of positive information – certain types of credit and payment history. Thus, the validity of credit scores relies upon complete, as well as accurate information. This is a significant issue because the three major credit reporting agencies do not have identical information for all consumers. Consequently, a consumer's credit score can vary significantly depending upon which credit reporting agency provided the credit information. At a hearing before the Georgia Insurance Commission on insurers' use of consumer credit information, a representative of the credit scoring model vendor ChoicePoint stated that, "Our score ranges from 300 to almost a thousand, so it's almost a 700-point range, but you could have a hundred, a hundred-and-fifty point change from bureau to bureau depending on variances in the data." A recent study by the Consumer Federation of America further documented the disparity of scores across credit bureaus.

The problem with incomplete data was highlighted in 1999 when the Federal Trade Commission and federal banking regulators discovered that some consumer lenders were not reporting account information to the credit reporting agencies because they did not want competitors to market to their customers. The practice of withholding data skews credit scores. Lenders withholding data accounted for 50% of the credit card market.

The reliance on credit reports by insurers is also unfair to lower-income consumers because many low-income consumers utilize non-traditional financial institutions that do not report to credit reporting agencies – such as rent-to-own and payday loans. Thus, lower-income consumers are penalized because their credit activity does not show up in the credit reports used by insurers.

Credit scores can be manipulated by people familiar with the scoring models. In a two-part series, Kenneth R. Harney described a service called "rapid rescoring" that, for a fee, helps consumers improve their credit scores by simply gaming the system. The articles cite an example of a woman who improved her credit score from 580 to 780 – from bad to "A-plus" – without any change in her behavior. The article cited one rapid rescorer who helped consumers raise their scores simply by shifting credit card debt from one card to many cards, "That may mean transferring the $900 balance on a $1,000 limit credit line to another with a $10,000 limit. The $900 on the $1,000 limit account is treated as a negative by the FICO score model. But the same $900 on a $10,000 limit card looks like a responsible management of credit."

The bottom line is that credit scores can be manipulated without any change in the consumer's behavior. This is exactly what an insurance rating factor should NOT be. The rating factor should provide an incentive for the consumer to pursue less risky behavior, not an incentive to manipulate the rating factor.

10. Problems with Credit Scoring – Punishing Consumers for Banks' Decisions

Another example of the unfairness of credit scoring to insurance consumers comes from California where the state legislature passed a law in 2001 prevent banks from inducing college students into unsupportable credit card debt. The sponsor of the bill applauded passage for "recognizing that something must be done to stop the credit card industry from preying upon young people in college." The legislation prohibits the distribution of free gifts to college students who apply for a credit card and will require debt education in college and university orientation.

As the California law points out, consumers should not be punished for the business decisions of banks. In 1990, banks sent out one billion credit card offers. By 1997, the number of offers had grown to 3.7 billion. Clearly, lenders were encouraging consumers to take on credit cards and credit card debt. In fact, most credit card offers are accompanied by notes telling consumers that "It's a good idea to carry more than one Master Card®" or "Do not hesitate to accept this card just because you already carry a credit card from another bank. . . . it costs you nothing to accept." We now know that it does cost you something to accept because your credit score – and your auto and homeowners insurance premium – may go up because you have more credit cards than the credit scoring models view as ideal.

11. Problems with Credit Scoring – Violating Insurance Principles

Insurers' use of consumer credit information – particularly in the form of credit scoring – is not only inherently unfair, but violates basic risk classification principles.

Risk Classification Issues.

Insurers don't charge the same rate or same premium for everyone – consumers are grouped into different risk classifications for purpose of allocating premium required by the insurer to individual consumers. In theory, this process is guided by the American Association of Actuaries' "Risk Classification Statement of Principles"

The statement is somewhat is self-serving to the industry because it essentially provides an actuarial justification for what the industry does. The standards are very broad. However, we can show that insurers' use of credit scoring conflicts with these industry standards for risk classification.

The document offers three reasons for risk classification:

1. Protect insurance system financial soundness by preventing adverse selection
2. Be fair, meaning that a statistical correlation exists and that prices reflect costs
3. Permit economic incentives to operate, meaning incentives for insurers to sell insurance at a profit.

The document notes that competition for the lower risks will be the most intense

When the document refers to availability of coverage, it is only from the perspective of insurers and means insurers' ability to charge differently for whatever risk classes are created.

The document discusses a number of operational considerations including:

- Absence of ambiguity – definition of classes should be clear and objective, no ambiguity should exist concerning the class to which the risk belongs, and the classes should be collectively exhaustive and mutually exclusive.
- Manipulation – system should minimize the ability to manipulate or misrepresent a risk's characteristics so as to affect the class to which it is assigned.
- Measurability – variables used for classification should be susceptible to convenient and reliable measurement

The document also notes that hazard reduction incentives are desirable but not necessary and that a causal relationship between the rating factor and losses is not necessary

Finally the document discusses public acceptability of risk classification schemes and offers the following. Risk classification systems should

- Not differentiate unfairly among risks
- Be based upon clearly relevant data
- Should respect personal privacy
- Should be structured so that risks tend to identify naturally with their classification.

As we have seen, insurance credit scoring as an underwriting or rating factor does not meet at least three of the public acceptability guidelines. Moreover, we have also shown that insurance credit scoring also fails even the standards for a rating factor because the use of credit history is ambiguous, subject to manipulation and not susceptible to reliable measurement.

The decisions about what factors, what characteristics of the consumer, to use for purposes of assigning premium is probably the most important insurance decision. And there is no natural of God-given set of rating factors and risk classifications. There are many ways to cut up the pie – to group consumers for purposes of assigning premium – that would meet industry standards.

As a society, we have decided, at least for private passenger automobile and residential property insurance, that we do not want everyone paying the same rate – an average premium for every driver – nor do we want the other extreme of consumers completely paying for their accidents out of pocket – the pay-as-you-go system. Rather, as a society, we have decided that some risk classification is desirable.

We believe these should be the guiding principles for risk classification:

1. To roughly assign premium to consumers in relation to expected costs of that consumer on the system. Avoid adverse selection and promote general fairness. As a society we don't do average pricing nor pay as you go. Don't need credit history to avoid adverse selection or to ensure industry financial stability.
2. Promote loss prevention – absolutely key!
3. Promote beneficial competition and limit selection competition. Selection competition as a market failure.
4. Promote fairness and availability, which often means broader risk classifications than desired by the industry.
5. Understandable to the Public – we think that consumers are more likely to treat insurance companies fairly when it comes to claims if they feel that the insurance company has treated them fairly when it comes to charging premiums. It seems logical that folks who are the victims of redlining or who have been charged higher prices because of credit history or things that are unrelated to their driving are more likely to inflate claims.

Insurance credit scoring clearly does not meet the reasonable standards for an underwriting or rating factor because there is no overall benefit to the system – in fact,

there is a net cost to the system – and there is no loss prevention associated with the credit history risk classification.

The ability of a rating factor to promote loss prevention is essential. One of the goals – perhaps the most important goal – of a risk classification system is provide incentives to consumers to pursue less risky behavior and avoid more risky behavior. By providing such incentives – such as surcharges for speeding or discounts for installing anti-theft devices or wind resistant construction – individual consumers benefit through lower rates and society benefits through lower loss of life and property.

Credit scoring fails this essential test of a rating factor because it provides no incentive to the consumer for loss prevention. Insurers use of credit scoring simply redistributes premium from one group of customers to another. In fact, insurers' use of credit scoring adds cost to the overall system because insurers must pay for obtaining consumer credit reports and for licensing credit scoring models.

The insurer claim that insurance scoring allows them to write more business should be view with great skepticism. The same claim could be made for any rating factor and was probably used to justify using age and value of home as rating factors – that age and value of the home preserved the loss ratio in preferred tier and allowed placement of risks more appropriately in standard and non standard tiers. Insurers used these rating factors for years until fair housing groups sued insurers because the use of these rating factors/underwriting guidelines was unfairly discriminatory to poor and minority communities. Insurers stopped using these guidelines and acknowledged that, as a result, they would write more business in poor and minority communities.

12. Conclusion: Ohio Homeowner Insurers/ Use of Credit Scoring Likely Has Disparate Impact on Poor and Minority Populations in Ohio

Based upon all the available information, it is our opinion that insurers' use of insurance credit scoring for underwriting, rating, marketing and/or payment plan eligibility very likely has a disparate impact on poor and minority populations in Ohio. Consequently, it is our opinion that insurers' use of insurance credit scoring makes insurance less available and/or more expensive for poor and minority populations in Ohio.

Appendix 1

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No. 791. Flow of Funds Accounts—Assets of Households: 1980 to 1999

[As of December 31 (6,563 represents $6,563,000,000,000). Includes nonprofit organizations]

Type of instrument	Total (bil. dol.)							Percent distribution		
	1980	1985	1990	1995	1997	1998	1999	1980	1990	1999
Total financial assets	**6,563**	**10,100**	**14,963**	**21,834**	**27,628**	**30,583**	**34,948**	**100.0**	**100.0**	**100.0**
Deposits	1,517	2,484	3,265	3,366	3,807	4,165	4,338	23.1	21.8	12.4
Foreign deposits	-	8	13	23	42	42	45	-	0.1	0.1
Checkable deposits and currency	251	342	409	505	445	461	442	3.8	2.7	1.3
Time and savings deposits	1,203	1,941	2,477	2,388	2,725	2,924	3,013	18.3	16.6	8.6
Money market fund shares	62	193	365	449	595	738	838	0.9	2.4	2.4
Credit market instruments	425	849	1,503	1,885	1,873	1,781	1,960	6.5	10.0	5.6
Open-market paper	38	35	63	48	59	63	69	0.6	0.4	0.2
U.S. Government securities	166	270	529	822	721	552	659	2.5	3.5	1.9
Treasury issues	160	251	462	700	511	391	347	2.4	3.1	1.0
Savings bonds	73	80	126	185	187	187	186	1.1	0.8	0.5
Other Treasury	88	171	335	515	325	204	160	1.3	2.2	0.5
Agency issues	5	19	67	122	209	162	312	0.1	0.4	0.9
Municipal securities	104	346	574	458	464	475	528	1.6	3.8	1.5
Corporate and foreign bonds	30	77	192	448	521	581	596	0.5	1.3	1.7
Mortgages	87	120	144	109	109	109	110	1.3	1.0	0.3
Corporate equities [1]	875	1,058	1,807	4,122	5,690	6,339	8,009	13.3	12.1	22.9
Mutual fund shares	46	198	468	1,265	2,057	2,501	3,104	0.7	3.1	8.9
Security credit	16	35	62	128	215	277	319	0.2	0.4	0.9
Life insurance reserves	221	264	392	566	665	718	772	3.4	2.6	2.2
Pension fund reserves [2]	971	2,087	3,462	5,768	7,894	9,079	10,360	14.8	23.1	29.6
Investment in bank personal trusts	265	384	552	803	943	1,001	1,117	4.0	3.7	3.2
Equity in noncorporate business	2,154	2,607	3,230	3,640	4,172	4,395	4,630	32.8	21.6	13.2
Miscellaneous assets	74	133	224	292	312	327	339	1.1	1.5	1.0

- Represents zero. [1] Only those directly held and those in closed-end funds. Other equities are included in mutual funds, life insurance and pension reserves, and bank personal trusts. [2] See also Table 846.

Source: Board of Governors of the Federal Reserve System, *"Federal Reserve Statistical Release, Z.1, Flow of Funds Accounts of the United States"*; published: 10 March 2000; <http://www.bog.frb.fed.us/releases/Z1/20000310/data.htm>.

No. 792. Financial Assets Held by Families by Type of Asset: 1992 to 1998

[Median value in thousands of constant 1998 dollars (13.1 represents $13,100). Constant dollar figures are based on consumer price index data published by U.S. Bureau of Labor Statistics. Families include one-person units; for definition of family, see text, Section 1, Population. Based on Survey of Consumer Finance; see Appendix III. For definition of median, see Guide to Tabular Presentation]

Age of family head and family income	Any financial asset [1]	Transaction accounts [2]	Certificates of deposit	Savings bonds	Stocks [3]	Mutual funds [4]	Retirement accounts [5]	Life insurance [6]	Other managed [7]
PERCENT OF FAMILIES OWNING ASSET									
1992, total	90.2	86.9	16.7	22.3	17.0	10.4	39.6	34.9	4.0
1995, total	91.0	87.0	14.3	22.8	15.2	12.3	45.2	32.0	3.9
1998, total	92.9	90.5	15.3	19.3	19.2	16.5	48.8	29.6	5.9
Under 35 years old	88.6	84.6	6.2	17.2	13.1	12.2	39.8	18.0	1.9
35 to 44 years old	93.3	90.5	9.4	24.9	18.9	16.0	59.5	29.0	3.9
45 to 54 years old	94.9	93.5	11.8	21.8	22.6	23.0	59.2	32.9	6.5
55 to 64 years old	95.6	93.9	18.6	18.1	25.0	15.2	58.3	35.8	6.5
65 to 74 years old	95.6	94.1	29.9	16.1	21.0	18.0	46.1	30.1	11.8
75 years old and over	92.1	89.7	35.9	12.0	18.0	15.1	16.7	32.6	11.6
Less than $10,000	70.6	61.9	7.7	3.5	3.8	1.9	6.4	15.7	(B)
$10,000 to $24,999	89.9	86.5	16.8	10.2	7.2	7.6	25.4	20.9	4.9
$25,000 to $49,999	97.3	95.8	15.9	20.4	17.7	14.0	54.2	28.1	3.9
$50,000 to $99,999	99.8	99.3	16.4	30.6	27.7	25.8	73.5	39.8	8.0
$100,000 and more	100.0	100.0	16.8	32.3	56.6	44.8	88.6	50.1	15.8
MEDIAN VALUE [8]									
1992, total	13.1	2.6	12.6	0.7	9.1	18.3	16.0	3.5	22.8
1995, total	16.5	2.3	10.6	1.1	9.6	21.2	18.1	5.3	31.9
1998, total	22.4	3.1	15.0	1.0	17.5	25.0	24.0	7.3	31.5
Under 35 years old	4.5	1.5	2.5	0.5	5.0	7.0	7.0	2.7	19.4
35 to 44 years old	22.9	2.8	8.0	0.7	12.0	14.0	21.0	8.5	25.0
45 to 54 years old	37.8	4.5	11.5	1.0	24.0	30.0	34.0	10.0	39.3
55 to 64 years old	45.6	4.1	17.0	1.5	21.0	58.0	46.8	9.5	65.0
65 to 74 years old	45.8	5.6	20.0	2.0	50.0	60.0	38.0	8.5	41.3
75 years old and over	36.6	6.1	30.0	5.0	50.0	59.0	30.0	5.0	30.0
Less than $10,000	1.1	0.5	7.0	1.8	14.0	6.0	7.5	3.0	(B)
$10,000 to $24,999	4.8	1.3	20.0	1.0	10.0	26.0	8.0	5.0	30.0
$25,000 to $49,999	17.6	2.5	14.5	0.6	8.0	11.0	13.0	5.0	15.0
$50,000 to $99,999	57.2	6.0	13.3	1.0	15.0	25.0	31.0	9.5	32.0
$100,000 and more	244.3	19.0	22.0	1.5	55.0	65.0	93.0	18.0	100.0

B Base figure too small. [1] Includes other types of financial assets, not shown separately. [2] Checking, savings, and money market deposit accounts, money market mutual funds, and call accounts at brokerages. [3] Covers only those stocks that are directly held by families outside mutual funds, retirement accounts and other managed assets. [4] Excludes money market mutual funds and funds held through retirement accounts or other managed assets. [5] Covers IRAs, Keogh accounts, and certain employer-sponsored accounts. [6] Cash value. [7] Includes personal annuities and trusts with an equity interest and managed investment accounts. [8] Median value of financial asset for families holding such assets.

Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, January 2000, and unpublished revisions.

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No. 793. Flow of Funds Accounts—Liabilities of Households: 1980 to 1999

[As of December 31 (1,426 represents $1,426,000,000,000). Includes nonprofit organizations]

Type of instrument	Total (bil. dol.)							Percent distribution		
	1980	1985	1990	1995	1997	1998	1999	1980	1990	1999
Total liabilities	1,426	2,326	3,679	4,982	5,708	6,206	6,841	100.0	100.0	100.0
Credit market instruments	1,374	2,236	3,554	4,783	5,438	5,910	6,467	96.4	96.6	94.5
Home mortgages	905	1,408	2,461	3,252	3,698	4,058	4,480	63.5	66.9	65.5
Consumer credit	355	604	805	1,123	1,264	1,332	1,429	24.9	21.9	20.9
Municipal securities	17	81	87	98	115	127	137	1.2	2.4	2.0
Bank loans, n.e.c. [1]	28	31	18	57	67	73	65	2.0	0.5	1.0
Other loans	55	79	101	160	191	204	219	3.8	2.7	3.2
Commercial mortgages	15	33	83	92	104	117	137	1.0	2.2	2.0
Security credit	25	51	39	79	131	153	222	1.7	1.1	3.3
Trade payables	14	24	69	103	120	126	133	1.0	1.9	1.9
Unpaid life insurance premiums [2]	13	15	16	18	19	17	19	0.9	0.4	0.3

[1] Not elsewhere classified. [2] Includes deferred premiums.

Source: Board of Governors of the Federal Reserve System. *"Federal Reserve Statistical Release, Z.1, Flow of Funds Accounts of the United States"*; published: 10 March 2000; <http://www.bog.frb.fed.us/releases/Z1/20000310/data.htm>.

No. 794. Financial Debt Held by Families by Type of Debt: 1992 to 1998

[Median debt in thousands of constant 1998 dollars (19.9 represents $19,900). See headnote, Table 792]

Age of family head and family income	Any debt	Home-secured debt [1]	Installment	Other lines of credit	Credit card balances [2]	Other residential property	Other debt [3]
PERCENT OF FAMILIES HOLDING DEBTS							
1992, total	73.2	39.1	46.0	2.3	43.7	5.7	8.4
1995, total	74.5	41.0	45.9	1.9	47.3	4.7	8.5
1998, total	74.1	43.1	43.7	2.3	44.1	5.1	8.8
Under 35 years old	81.2	33.2	60.0	2.4	50.7	2.0	9.6
35 to 44 years old	87.6	58.7	53.3	3.6	51.3	6.7	11.4
45 to 54 years old	87.0	58.8	51.2	3.6	52.5	6.7	11.1
55 to 64 years old	76.4	49.4	37.9	1.6	45.7	7.8	8.3
65 to 74 years old	51.4	26.0	20.2	(B)	29.2	5.1	4.1
75 years old and over	24.6	11.5	4.2	(B)	11.2	1.8	2.0
Less than $10,000	41.7	8.3	25.7	(B)	20.6	(B)	3.6
$10,000 to $24,999	63.7	21.3	34.4	1.2	37.9	1.8	7.0
$25,000 to $49,999	79.6	43.7	50.0	2.9	49.9	4.1	7.7
$50,000 to $99,999	89.4	71.0	55.0	3.3	56.7	7.7	12.2
$100,000 and more	87.8	73.4	43.2	2.6	40.4	16.4	14.8
MEDIAN DEBT [4]							
1992, total	19.9	50.2	5.3	2.3	1.1	28.5	2.9
1995, total	23.4	54.9	6.4	3.7	1.6	31.9	2.1
1998, total	33.3	62.0	8.7	2.5	1.7	40.0	3.0
Under 35 years old	19.2	71.0	9.1	1.0	1.5	55.0	1.7
35 to 44 years old	55.7	70.0	7.7	1.4	2.0	40.0	3.0
45 to 54 years old	48.4	68.8	10.0	3.0	1.8	40.0	5.0
55 to 64 years old	34.6	49.4	8.3	4.9	2.0	41.0	5.0
65 to 74 years old	11.9	29.0	6.5	(B)	1.1	56.0	4.5
75 years old and over	8.0	21.2	8.9	(B)	0.7	29.8	1.7
Less than $10,000	4.1	16.0	4.0	(B)	1.1	(B)	0.6
$10,000 to $24,999	8.0	34.2	6.0	1.1	1.0	34.0	1.3
$25,000 to $49,999	27.1	47.0	8.0	3.0	1.9	20.0	2.2
$50,000 to $99,999	75.0	75.0	11.3	2.8	2.4	42.0	3.8
$100,000 and more	135.4	123.8	15.4	5.0	3.2	60.0	10.0

B Base figure too small. [1] First and second mortgages and home equity loans and lines of credit secured by the primary residence. [2] Families that had an outstanding balance on any of their credit cards after paying their most recent bills. [3] Includes loans on insurance policies, loans against pension accounts, borrowing on margin accounts and unclassified loans. [4] Median amount of financial debt for families holding such debts.

No. 795. Percent Distribution of Amount of Debt Held by Families: 1995 and 1998

[See headnote, Table 796]

Type of debt	1995	1998	Purpose of debt	1995	1998	Type of lending institution	1995	1998
Total	100.0	100.0	Total	100.0	100.0	Total	100.0	100.0
Home-secured debt	73.3	71.9	Home purchase	70.4	68.1	Commercial bank	35.1	32.6
Installment loans	11.8	12.8	Home improvement	2.0	2.0	Savings and loan	10.8	9.6
Credit card balances	3.9	3.8	Investment, excluding real estate	1.0	3.2	Credit union	4.5	4.2
Other lines of credit	0.6	0.3	Vehicles	7.5	7.5	Finance or loan company	3.2	4.2
Other residential property	7.5	7.4	Goods and services	5.7	6.0	Brokerage	1.9	3.7
Other debt	2.8	3.7	Investment real estate	8.2	7.8	Real estate lender	32.7	35.9
			Education	2.7	3.4	Individual lender	5.0	3.4
			Other loans	2.4	1.9	Other nonfinancial	0.8	1.3
						Government	1.3	0.6
						Credit and store cards	3.9	3.8
						Other loans	0.9	0.7

Source of Tables 794 and 795: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, January 2000, and unpublished data.

No. 796. Ratios of Debt Payments to Family Income: 1992 to 1998

[In percent. Constant dollar figures are based on consumer price index data published by U.S. Bureau of Labor Statistics. Families include one-person units; for definition of family, see text, Section 1, Population. Based on Survey of Consumer Finance; see Appendix III. For definition of median, see Guide to Tabular Presentation]

Age of family head and family income (constant (1998) dollars)	Ratio of debt payments to family income						Percent of debtors with—					
	Aggregate			Median			Ratios above 40 percent			Any payment 60 days or more past due		
	1992	1995	1998	1992	1995	1998	1992	1995	1998	1992	1995	1998
All families	14.1	13.6	14.5	16.1	16.1	17.6	10.9	10.5	12.7	6.0	7.1	8.1
Under 35 years old	16.5	17.1	16.6	16.6	16.9	17.4	10.5	11.0	11.8	8.3	8.7	11.1
35 to 44 years old	17.8	16.6	17.0	19.0	18.1	19.4	11.6	9.2	11.6	6.8	7.7	8.4
45 to 54 years old	14.6	14.6	16.3	16.1	16.6	17.8	10.2	10.4	11.6	5.4	7.4	7.4
55 to 64 years old	11.4	11.5	12.9	14.5	14.0	16.7	14.3	14.5	13.9	4.7	3.2	7.5
65 to 74 years old	7.8	6.9	8.5	10.6	12.2	13.9	7.8	7.8	17.5	1.0	5.3	3.1
75 years old and over	3.4	2.9	3.9	5.0	3.4	8.9	8.7	8.9	20.9	1.8	5.4	1.1
Less than $10,000	16.8	19.5	19.4	19.5	15.4	20.3	28.4	27.6	32.0	11.6	8.4	15.1
$10,000 to $24,999	14.8	16.1	16.2	15.3	17.7	17.8	15.5	17.3	19.9	9.3	11.3	12.3
$25,000 to $49,999	16.5	16.2	17.4	16.3	16.6	18.1	9.6	8.0	13.8	6.3	8.6	9.2
$50,000 to $99,999	15.3	16.0	17.4	17.0	16.9	18.3	4.4	4.2	5.7	2.2	2.7	4.5
$100,000 and more	10.7	8.7	10.0	13.7	11.1	13.1	2.2	1.7	2.1	0.5	1.3	1.5

Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, January 2000, and unpublished data.

No. 797. Household Debt-Service Payments as a Percentage of Disposable Personal Income: 1980 to 1999

[In percent. As of end of year. Seasonally adjusted. The household debt-service burden is an estimate of the ratio of debt payments to disposable personal income. Debt payments consist of the estimated required payments on outstanding mortgage and consumer debt]

Year	Total	Consumer	Mortgage
1980	12.41	7.99	4.42
1981	12.34	7.62	4.72
1982	12.33	7.47	4.85
1983	12.33	7.46	4.88
1984	12.83	7.80	5.03
1985	13.74	8.29	5.44
1986	14.18	8.50	5.69
1987	13.71	7.92	5.79
1988	13.34	7.58	5.77
1989	13.51	7.57	5.94
1990	13.24	7.11	6.14
1991	12.56	6.51	6.05
1992	11.70	6.03	5.67
1993	11.59	6.13	5.46
1994	12.01	6.52	5.49
1995	12.70	7.05	5.65
1996	13.09	7.44	5.65
1997	13.17	7.47	5.70
1998	13.29	7.57	5.72
1999	13.51	7.58	5.93

Source: Board of Governors of the Federal Reserve System, "Household Debt Service Burden;" published: 24 March 2000; <http://www.bog.frb.fed.us/releases/housedebt/default.htm>.

No. 798. Banking Offices by Type of Bank: 1980 to 1999

[As of December 31. Includes Puerto Rico and outlying areas. Covers all FDIC-insured commercial banks and savings institutions. Commercial banks include insured branches of foreign banks. Data for 1980 include automatic teller machines which were reported by many banks as branches]

Item	1980	1985	1990	1994	1995	1996	1997	1998	1999
All banking offices	(NA)	82,367	84,332	81,135	81,273	82,466	83,514	84,332	85,404
Number of banks	(NA)	18,033	15,192	12,641	12,002	11,478	10,945	10,483	10,238
Number of branches	(NA)	64,334	69,140	68,494	69,271	70,988	72,569	73,849	75,166
Commercial banks	53,172	57,660	62,710	65,055	65,827	66,733	68,691	69,873	71,142
Number of banks	14,434	14,407	12,377	10,489	9,972	9,553	9,165	8,794	8,598
Number of branches	38,738	43,253	50,333	54,566	55,855	57,180	59,526	61,079	62,544
Savings institutions	(NA)	24,707	21,622	16,080	15,446	15,733	14,823	14,459	14,262
Number of banks	(NA)	3,626	2,815	2,152	2,030	1,925	1,780	1,689	1,640
Number of branches	(NA)	21,081	18,807	13,928	13,416	13,808	13,043	12,770	12,622

NA Not available.

Source: U.S. Federal Deposit Insurance Corporation, *Statistics on Banking*, annual and *The FDIC Quarterly Banking Profile Graph Book*.

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No. 815. Consumer Credit Outstanding and Finance Rates: 1980 to 1999

[In billions of dollars, except percent (349.4 represents $349,400,000,000). Estimated amounts of seasonally adjusted credit outstanding as of end of year; finance rates, annual averages]

Type of credit	1980	1985	1990	1993	1994	1995	1996	1997	1998	1999
Total	349.4	593.2	789.3	839.2	960.7	1,096.0	1,182.4	1,234.1	1,300.5	1,395.4
Revolving	55.1	124.7	238.6	310.0	365.6	443.2	499.5	531.3	560.7	596.0
Nonrevolving [1]	294.3	468.5	550.7	529.2	595.1	652.8	682.9	702.8	739.8	799.4
FINANCE RATES (percent)										
Commercial banks:										
New automobiles (48 months) [2]	14.32	12.91	11.78	8.09	8.12	9.57	9.05	9.02	8.72	8.44
Other consumer goods (24 months)	15.48	15.94	15.46	13.47	13.19	13.94	13.54	13.90	13.74	13.39
Credit-card plans	17.31	18.69	18.17	16.83	16.04	15.90	15.63	15.77	15.71	15.21
Finance companies:										
New automobiles	14.82	11.98	12.54	9.48	9.79	11.19	9.83	7.12	6.30	6.66
Used automobiles	10.10	17.58	15.99	12.79	13.49	14.48	13.53	13.27	12.64	12.60

[1] Comprises automobile loans and all other loans not included in revolving credit, such as loans for mobile homes, trailers, or vacations. These loans may be secured or unsecured. [2] For 1980, maturities were 36 months for new car loans.

Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, monthly.

No. 816. Credit Cards—Holders, Numbers, Spending, and Debt, 1990 and 1998, and Projections, 2000

[The complete publication including this copyright table is available from the U.S. Government Printing Office and the National Technical Information Service]

No. 817. Usage of General Purpose Credit Cards by Families: 1989 to 1998

[General purpose credit cards include Mastercard, Visa, Optima, and Discover cards. Excludes cards used only for business purposes. All dollar figures are given in constant 1998 dollars based on consumer price index data as published by U.S. Bureau of Labor Statistics. Families include one-person units; for definition of family, see text, Section 1, Population. Based on Survey of Consumer Finance; see Appendix III. For definition of median, see Guide to Tabular Presentation]

Age of family head and family income	Percent having a general purpose credit card	Median number of cards	Median new charges on last month's bills	Percent having a balance after last month's bills	Median balance [1]	Percent of cardholding families who—		
						Almost always pay off the balance	Sometimes pay off the balance	Hardly ever pay off the balance
1989, total	56.0	2	$100	52.1	$1,300	52.9	21.2	25.8
1992, total	62.4	2	100	52.0	1,100	53.0	19.6	27.4
1995, total	66.4	2	200	56.0	1,600	52.4	20.1	27.5
1998, total	67.5	2	200	54.7	1,900	53.8	19.3	26.9
Under 35 years old	58.3	2	200	71.6	1,500	39.0	22.5	38.5
35 to 44 years old	71.3	2	200	62.5	2,000	46.5	19.1	34.4
45 to 54 years old	75.3	2	200	59.2	2,000	48.2	22.7	29.1
55 to 64 years old	76.0	2	200	48.8	2,300	61.0	20.1	18.9
65 to 74 years old	71.2	2	200	33.9	1,000	74.0	14.9	11.1
75 years old and over	50.8	1	100	16.7	700	86.3	7.8	5.9
Less than $10,000	23.2	2	100	64.0	900	46.4	19.9	33.8
$10,000 to $24,999	50.8	2	100	56.9	1,200	52.3	19.3	28.4
$25,000 to $49,999	73.2	2	100	58.2	1,700	48.3	20.5	31.2
$50,000 to $99,999	89.6	2	200	55.9	2,400	53.9	20.2	25.9
$100,000 and more	97.9	2	800	36.4	3,100	72.0	13.8	14.1

[1] Among families having a balance.

Source: Board of Governors of the Federal Reserve System, unpublished data.

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Comments of Birny Birnbaum
On Behalf of the Center for Economic Justice
Before the National Conference of Insurance Legislators

November 21, 2002

Proposed Model Law Regulating Insurers' Use of Consumer Credit Information in Personal Lines Insurance

Thank you for the opportunity to testify before the Property Casualty Committee today. And as requested, I will direct my comments towards the proposed model law. I do want to preface my comments with a statement of our position on insurance credit scoring. We oppose it and strongly believe the practice should be prohibited. I would like to go into some of the reasons for that position and hope that one of the committee members might ask me a question following my prepared testimony.

With regard to the proposed model law regulating insurers' use of consumer credit information, there are three overriding reactions. First, our thanks to the legislators and agents who have worked diligently to address the many problems associated with insurance credit scoring. The models before NCOIL are clearly an improvement over the current market practice.

Second, we are struck by the how many restrictions and prescriptions are necessary for the use of credit as an underwriting or rating factor. Given the tremendous regulatory resources necessary to enforce the proposed model and given the many concerns with credit scoring reflected in the model, one would think that there are some powerful reasons for allowing insurers to use insurance credit scoring. But, in fact, there are no such powerful reasons. All the industry has is an alleged correlation. Surely that cannot be enough to justify the use of insurance scoring.

Third, the proposed model – or any statute or regulation attempting the things in the proposed model – will not benefit consumers because of lack of enforcement. Some of the provisions are simply unenforceable, while others would require a commitment of regulatory resources that legislators will be unable to provide.

Regarding the three proposals – the proposed model, the proposed substitute and Representative Eiland's amendments – the proposed substitute generally improves upon the proposed model with some notable exceptions. And Representative Eiland's proposed amendments are much needed, although some fine-tuning is necessary.

I will work down section by section from the proposed substitute.

The changed title is an improvement. I suggest adding Insurers' Use of Consumer Credit Information to the title and the purpose. The revised purpose better captures the broader intent of the model.

Personal Insurance might be defined as a personal auto or residential property or personal inland marine insurance policy.

The definition of adverse action is slightly lacking because it seems to revolve around change from a current situation instead of an offer from the insurer of something other than most favorable provisions because of credit information. We suggest the following definition.

> Any action by the insurer to offer a consumer other than the most favorable price, terms of coverage, rating tier, payment plan or other feature of the personal auto or residential property insurance policy upon initial application or renewal by the consumer.

Throughout the model, the actions of insurers are generally described as underwriting and rating. For clarity and completeness, we suggest inclusion of tier selection, terms of coverage and payment plan eligibility to go along with underwriting and rating.

The definition of credit information is somewhat circular. The key word in the concept is credit and that is also the key word in the definition. Credit information should be defined as any information from a consumer credit report as defined by the FCRA and then add specific exemptions for purposes of the model for things like CLUE and MVR.

The original definition of credit report is much better than the proposed definition. The definition of insurance score should describe the purposes as underwriting, tier selection, rating, terms of coverage, pay plan eligibility.

Section 5

This section describes various prohibitions regarding underwriting and rating risks. To this list should added tier selection and determining terms of coverage. This section should also include a provision prohibiting the use of consumer credit information to condition pay plan eligibility. The use of insurance scores for pay plan eligibility is illogical, unnecessary and contrary to public policy. It is illogical because the scoring models are purportedly developed to predict claims and not payments. Insurers go to great lengths to distinguish insurance scoring from credit scoring. It is unnecessary because insurers are never in a position to offer coverage without payment. It is contrary to public policy because the availability of payment plans is essential for insurance availability.

Subsection A prohibits the use of several types of information / consumer characteristics. However, the information in credit reports could easily be correlated with these prohibited characteristics. In fact, an econometrician could easily develop a scoring model that predicts income, race, gender or age based upon information in the credit reports. It is of limited value to prohibit consideration of certain factors if there are easily available proxies for those factors.

Further, what is the public policy for prohibiting consideration of these factors? And why doesn't that same public policy apply to credit scoring itself?

Subsections B and C prohibit use of credit as the sole factor for an adverse action and specifically defines tier placement not to be cancellation, denial or nonrenewable. First, prohibiting something as the sole factor is not meaningful. An insurer could use, for example, credit and vehicles valued at less than $50,000 to avoid the prohibition literally but not

substantively. Second, where is the consumer protection if the insurers' use of credit results in an offer for very high cost insurance is the worst rate tier with no pay plan? This subsection allows insurers to effectively decline coverage without literally doing so. And it worsens the current situation by purporting to provide consumers with protections that, in fact, do not exist.

Subsection D attempts to prohibit adverse actions based upon absence of a credit card. Again, the "sole" language enables an insurer to effectively avoid the prohibition. For example, an insurer could deny coverage if there was no credit card and a vehicle valued at less than $50,000.

In Subsection E, paragraph 1 removes the substance of restriction because regulators are unable to perform independent review of the studies presented by insurers. Credit is unique in this regard because regulators collect data on other underwriting and rating characteristics through designated statistical agents and authorized statistical plans. See the discussion below for a requirement on data collection that would allow regulators to perform the type of independent review envisioned by this section. In addition, this section envisions yet additional work and necessary resources for regulators. We fear the likely result from overtaxed regulators will be routine approval of restrictions based upon thin credit files.

Subsection F seems to provide a very big window for new business credit reviews. We found Subsection G confusing and could not figure out the exact intent.

The restrictions in Subsection H are very good. We again raise the issue of how difficult enforcement will be for state regulators. Private lawsuits are the logical means of enforcing these provisions. Again, we ask what are the benefits of credit scoring that warrant the use of an underwriting and rating factor that elicits such restrictions and concerns? A simple correlation is not sufficient benefit to either consumers or the insurance system.

The dispute resolution in Section 6 is excellent and we support it.

Section 7 deals with initial notification regarding use of credit information. We support Representative Eiland's proposed amendments. These amendments go to the heart of informing a consumer how credit is used in the underwriting, rating, and tiering process. The type of information suggested by Representative Eiland informs consumer in a manner that encourages consumers to engage in less risky behavior and, consequently, to reduce overall claim costs.

Section 8 provides for adverse action notification. Such notification must be strengthened to better inform consumers of the precise aspects of their credit reports. For example, compare the difference between a consumer being uprated and told the reason was two at-fault claims versus being told the reason was too many retail accounts. The first reason is specific and understandably related to claim costs. The second reason is non-specific and not understandably related to claim costs. The standard industry explanations are inadequate.

The consumer disclosure requirements in the Fair Credit Reporting – and those in the proposed credit insurance model are based upon the notion that an error in the credit report wrongly resulting in an adverse action against the consumer will be the incorrect presence of some negative information in the credit report. For example, if a consumer is denied a loan or

insurance coverage because of a recent bankruptcy, then the consumer is entitled to review the credit history to see if a bankruptcy has been incorrectly reported. Then the consumer can correct the false information and reverse the adverse action.

This consumer disclosure framework is wholly inadequate for insurance scoring because a consumer's insurance score is determined as much – if not more – by the presence or absence of positive factors as it is by the presence or absence of negative factors. A consumer's credit score can be low (i.e., bad) even if there are no negative factors, such as bankruptcies, public records, delinquencies or late payments. A poor insurance score can arise from the absence of certain types of credit (e.g., no real estate-secured loan), the types of credit (e.g., loans from a finance company lead to a lower score than the same loan from a bank and a retail credit card leads to a lower score than a bank credit card), and/or the absence of credit activity or credit information (e.g., a consumer typically pays in cash, has only one credit card or uses financial institutions that don't report payment activity to credit bureaus, such as check-cashing, payday lending and/or rent-to-own businesses).

With insurance scoring, the traditional form of FCRA adverse action disclosure is insufficient because; one, most consumers don't know their credit history is used for underwriting and/or rating; two, even if consumer did know their credit history was being used, the insurer typically does not explain how it is being used or what aspects of the credit report led to the adverse action; and, three, even if the insurer provided the specific reasons, the consumer is unable to determine if information that could have helped the score is missing. Consequently, adverse action and other credit-related disclosure requirements for insurers must be far broader than those set out in the FCRA.

The trade secret exemption to public disclosure in Section 9B is far too broad. It closes much of what is open today. There is no evidence that public disclosure of what insurers do with credit information has harmed any insurer or vendor.

We also recommend the following language for data collection:

> Data Collection and Independent Regulatory Analysis. The Commissioner shall direct statistical agents to collect insurer-specific premium, exposure and loss data broken out by raw credit score and credit score category assigned to consumer in addition to other data categories required in approved statistical plans. As soon as such data are available to perform an actuarially credible and/or statistically significant analysis, the Commissioner shall perform an analysis of the correlation of credit information to frequency and severity of claims and to other underwriting and rating factors both permitted and prohibited.

Section 10 provides for indemnification of agents and insurers. We are unclear of how this section will work. What happens if a bunch of consumers are overcharged because of faulty calculations? Do they have any recourse?

Thanks for the opportunity to comment on the proposed model.