Approved: April 30, 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 20, 2003 in Room 527-S of the Capitol.

All members were present except: Excused: Representative Cindy Neighbor.

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

Conferees appearing before the committee: **Brad Smoot**, American Insurance Association
Dave Hanson, Lawyer, Glenn, Cornish, Hanson & Karns

Others attending: Twenty five total, some of whom signed the register.

It was decided to discuss **Sub SB144**, several conferees were present to expand on some of the topics that some of the members had questions. In addition, a representative of the Consumer Data Information Association will be here next Tuesday to discuss the Fair Credit Report Act.

Brad Smoot, American Insurance Association, (Attachment #1), addressed the question of whether credit scoring by its nature would have a disproportionate impact on lower income individuals. This report addressed one company and its consumers to track that idea. They found that lower income did not have an affect on their credit scores, and in fact in some cases people with lower income had better credit score than people with higher income or people in the middle. Additionally, during testimony it was suggested that more would benefit from using credit scoring. Dave Hanson is here today to discuss that issue. Third issue raised had to do with identity theft. Under federal law, if you believe that someone has stolen and used your credit, and that things on your credit report are in error, as a result of that if you protest that, it becomes a disputed data on your report, and under the bill you have in front of you that disputed data cannot be used by the insurance carrier in preparing an insurance score.

Questions were posed by: Representatives Nancy Kirk, Eber Phelps, Bob Grant, and Stephanie Sharp.

Dave Hanson, Lawyer, Glenn, Cornish, Hanson & Karns, (Attachment #2), discussed the issue of the anecdotal information on how many people are benefitting from credit based insurance scoring. Information was attached from Farmers Alliance. According to the data presented 56.7% of their customers could be positively impacted by the use of credit scoring, 31.9% would see no impact, and only 11.3% would face a potential higher rate.

Questions were posed by: Representatives Nile Dillmore, Patricia Barbieri-Lightner, Scott Schwab, Eber Phelps, Ray Cox, Mike Burgess, Nancy Kirk, and Bob Grant.

Discussion was closed on **Sub SB144** for this meeting.

Representative Nile Dillmore moved to approve the minutes of February 11, 13, 18, 20, and 25, seconded by Representative Mario Goico, passed unanimously.

Meeting adjourned.

Next meeting scheduled for March 25, 2003.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: March 20, 2003

NAME	REPRESENTING
Bill Sneed	State Farm
Lee Wright	FARMERS INS
BILL YANEK	Kansas Assn of REALTORS
Lorrie Ann Lower	Alliance
LARRY MAGILL	KAIA
Jameson McBride	Mortgage Protection
John Schmidt	TITLE MIDWEST, INC.
Rebecca Rice	Federico Consulting
[illegible] Hubbard	Title Midwest
JoAnn Bunten	KID
Terry Wells	KID
[illegible]	KID
Jeff Bottenberg	State Farm
John Peterson	Ks Land Title Coa
Brad Smoot	AIA
Chris Wilson	KBIA
Martha Jean Smith	KMHA
David Hanson	Ks Insur Assns / NAII

American Insurance Association

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STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

On the Lack of Correlation Between Income and Credit Score Whether Tested Against the Average or Median Score

March 1999

In December 1998, the Market Conduct and Consumer Affairs Subcommittee of the National Association of Insurance Commissioners (NAIC) conducted a public hearing on Urban Insurance Marketplaces. The Subcommittee focused on credit scoring in the business of insurance and its impact on insurance availability, affordability, accessibility and other conditions affecting consumers in urban insurance markets.

Insurers' freedom to use credit scoring as a tool to underwrite and price premium for new applicants for insurance or to evaluate insurance renewals has been hampered by unfounded fears that credit scoring operates unfairly. For example, it has been speculated that credit scoring might discriminate against populations distinguishable by income. The concern is that lower income populations fare poorly when credit scoring is used to evaluate their insurance risk characteristics.

The American Insurance Association (AIA) testified at the NAIC hearing with the benefit of member company analysis of this issue. The precise objective of the AIA company analysis was to determine the extent to which credit score is correlated with income. AIA presented important, new evidence that credit scores do *not* unfairly discriminate against or even negatively impact lower income groups. Indeed, research revealed that the lowest income groups have the highest average credit score.

Commissioner Steven Larsen (MD) questioned AIA Assistant General Counsel Michael Lovendusky whether the presentation of the data by "average score" might be enhanced by a presentation of the data by "median score by income group". AIA returned to its member company investing resources to test the utility of credit scoring for consideration of this inquiry. AIA is pleased to share with the National Association of Insurance Commissioners additional information on the data used to test the fairness of using credit scoring on a variety of individuals from all income levels; the nature of the statistical analysis; and the analytical results. The analysis concluded that *credit score is not significantly correlated with income* for the AIA company's policyholders.

The Data Underlying The Study

Since 1995, the AIA company has used a credit scoring model in conjunction with other underwriting criteria. This credit scoring model was developed by Fair, Isaac and Company, Inc. It uses an individual's detailed credit history to predict his or her relative loss performance.

The credit scoring model uses characteristics from the credit history such as public notices (e.g. bankruptcies, tax liens), credit account trade line (e.g. date opened, delinquency, payment due, balance) and additional credit inquiries. It makes no use or reference to personal characteristics such as income, net worth, ethnicity and location. The model was

House Insurance
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Attachment # 1

developed with data from over a dozen insurers using over 1.4 million policies representing over $1.5 billion in earned premium and nearly $900 million in incurred losses. Each acceptable characteristic was evaluated as to its correlation to loss ratio and the most predictive characteristics were weighted so that the sum of the weighted characteristics is a score predicting expected loss ratio performance. The model calculates a score that ranges from 200 to 997 with 200 representing risks with the worst expected loss performance and 997 representing risks with the best expected loss performance.

The analysis was based on the Equifax PLS Credit scores for Homeowners and Personal Auto policyholders in force from 1995 through 1997. Thus it includes a broad spectrum of policyholders of varying ages, geographical areas, rating classes and incomes. Estimated income information was obtained from Axciom's Consumer Infobase™ product in terms of nine ranges: Under $15,000, $15-19,000, $20-29,000, $30-39,000, $40-49,000, $50-74,000, $75-99,000, $100-124,000 and $125,000 or more. Both credit score and estimated income information was available for approximately 470,470 policies.

The Analysis of Income With Credit Score

A linear regression of credit score versus income computed the associated statistical parameters that measure correlation. The coefficient of correlation (R), which measures the linkage or connection between credit score and income, was calculated. A coefficient of correlation of 0% represents no correlation or linkage; a coefficient of 100% represents full correlation or linkage. The coefficient of correlation between credit score and income for the policyholders was only **2.5%**, demonstrating the absence of any significant correlation.

The following table displays the income distribution for the 470,470 policyholders.

INCOME DISTRIBUTION

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INCOME RANGE	FREQUENCY	PERCENT	CUMULATIVE PERCENT
< $15,000	27,939	5.9%	5.9%
$15,000-$19,999	23,554	5.0%	10.9%
$20,000-$29,999	50,830	10.8%	21.7%
$30,000-$39,999	56,688	12.0%	33.8%
$40,000-$49,999	55,723	11.8%	45.6%
$50,000-$74,999	109,201	23.2%	68.9%
$75,000-$99,999	66,945	14.2%	83.1%
$100,000-124,999	41,300	8.8%	91.9%
$125,000 or more	38,290	8.1%	100.0%

The Results of the Analysis of Income With Credit Score

The analysis concluded that *credit score is not significantly correlated with income* for the AIA company's policyholders. This conclusion is based on the standard statistical tests of correlation. To the extent that there is a correlation, lower incomes are associated with **higher** credit scores. Based on the information available for company policyholders, there is **no** evidence that credit scores unfairly discriminate against lower income groups. The analytical results are displayed graphically below. 4

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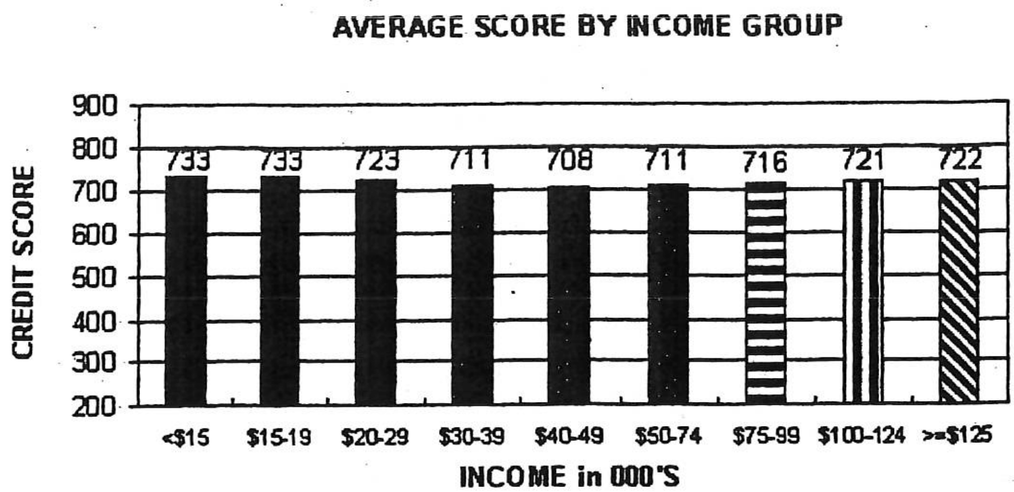

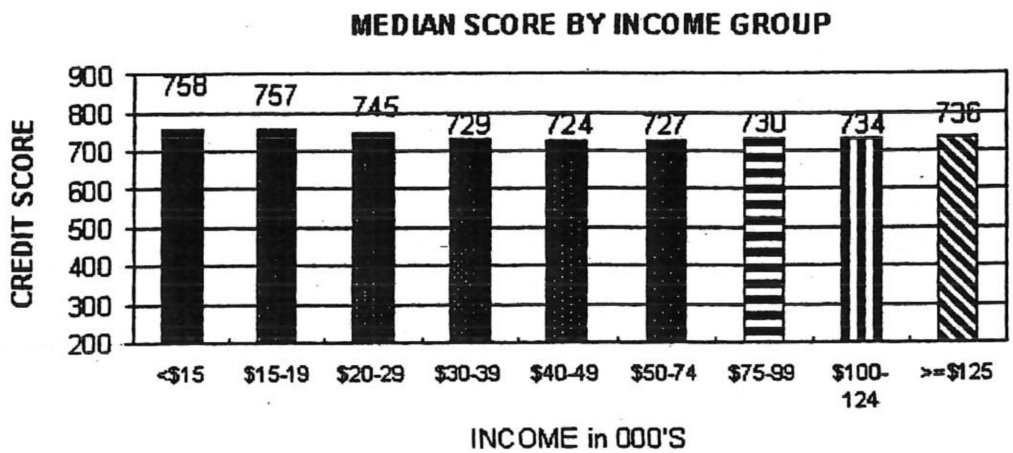

The above two charts display the average and median credit scores for each of the nine income ranges. **These charts clearly show that neither the average credit score nor the median credit score vary significantly across the income groups for the AIA company's policyholders. In addition, the variation in score is not monotonic. In other words, as income increases, score does not always increase or always decrease. Income does not have a clear impact on credit score. In fact, the lowest income groups have the highest average and median credit score.**

How This Information Is Improved Over That Published in 1998

The information used for the current analysis was improved in several significant ways from that used for the 1998 AIA testimony. The updated information reflects the following:

· The score information was refreshed to obtain a better percentage of matching records. This had a minor impact on the average score versus the income chart. The chart shows the same pattern as the 1998 chart.

· The median score versus income chart is entirely new. It addresses concerns that use of average score may be misleading. Average score is not misleading; the median score chart displays the exact same pattern as the average score chart.

· The income distribution table was modified to include only those policyholders for whom the company had both credit score and income information. The 1998 information included

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all policyholders for which the company had income information even if it did not have credit score. The change has virtually no impact on the distribution but makes the data underlying the table completely consistent with the data underlying the charts. The company changed the number of policies cited to 470,470, which represents the policies for which it had both score and income. The 1998 information referenced 700,000 policyholders for which the company had income data.

· The coefficient cited in the statistical test section for the updated scores was updated. It changed from 4.2% to 2.5%. Both numbers indicate no significant correlation. This paper is rhetorically improved to clarify that it cites the coefficient of correlation; the 1998 testimony mistakenly referred to "the coefficient of determination."

· The AIA company policyholder information is not derived from all of its policyholders but from those underwritten from its independent agency distribution system.

Implications for Public Policy

Credit history is a source of affordable, objective information that is useful to insurers, readily available in the market, and beneficial to consumers. Insurers are expressly authorized to use credit history pursuant to the federal Fair Credit Reporting Act. This federal law also expressly bars inconsistent state regulation. The use of credit scoring for underwriting and pricing of personal lines insurance is relatively new. There is no evidence of market misconduct on the part of insurers using credit scoring. Such misconduct would be discoverable and punishable under existing state unfair trade practices laws. For these reasons, insurance use of credit history should not be hampered with new or special state regulation, since the mere proliferation of inconsistent state regulatory treatments will add costs and uncertainties to the use of credit history that undermine its cost-effectiveness for insurers and consumers alike.

AIA represents 387 property and casualty insurers doing business throughout the United States. AIA members wrote $66.8 billion in direct premium -- more than 24% of the market -- in the United States in 1997, the most recent year for which data is available. In particular, AIA members wrote $18.4 billion (30%) in homeowners' and $11.3 billion (10%) in private passenger automobile premiums. The AIA participates extensively in NAIC discussions on the use of credit history for insurance, and cooperated with regulators notably in the formulation of the NAIC white paper on *Credit Reports and Insurance Underwriting* (1997). For more information about insurance industry interest in use of credit history, please contact

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March 20, 2003

Representative Patricia Barbieri-Lightner
House Insurance Committee Chair
Room 115-S
Statehouse
Topeka, KS 66612

Madam Chair:

We appreciate the opportunity to present information on Substitute for Senate Bill 144. As there were questions as to how many people may be benefitting from credit based insurance scoring, we have attempted to obtain information responsive to those inquiries. Attached is a copy of a letter from Bruce E. White, Vice President of Underwriting at Farmers Alliance, one of our domestic insurers. Mr. White served on the Task Force and had previously submitted information to the Task Force reflecting the experience of Farmers Alliance. As indicated by Mr. White in his follow-up letter, his interpretation would be that 56.7% of Farmers Alliance customers could be positively impacted, while 31.9% would see no impact and the remaining 11.3% could be negatively impacted.

Also attached is an excerpt from the attachment to the testimony last week from Evan McKee with Progressive Insurance indicating in section 5 that when Progressive began using credit, they were able to offer lower rates to about two-thirds of their customers countrywide.

Also attached is a copy of a statement submitted to the NAIC Market Conduct and Consumer Affairs (D) Committee by NAII in December, 2001 regarding the use of credit information wherein they reported on pages 7-8 that they had surveyed a cross-section sampling of NAII personal lines insurers, who responded that their estimated ranges of policyholders paying lower premiums as a result of credit information ranged from 50% up to 98% of their total auto or homeowners policyholders.

We hope this information is helpful to your deliberations.

Respectfully,

David A. Hanson

DAVID A. HANSON

House Insurance
Date: 3/20/03
Attachment # 2

4. **Aren't these credit reports always full of mistakes?**
Our data does not support this claim. Of 18 million credit histories that Progressive ordered in an 18 month period, only 28 consumers requested re-orders because of inaccuracies in their credit history. Of those, only 12 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?**

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FarmersAlliance

Insuring Rural America Since 1888

March 19, 2003

David A. Hanson
Glenn, Cornish, Hanson & Karns, Chartered
Suite 800
800 SW Jackson
Topeka, KS 66612-1259

Farmers Alliance Credit Data

Dear David:

Thank you for your help with sharing the attached information. I believe that you will find it helpful and informative to support our issues surrounding the use of credit scoring.

I have attached the following documents:

- My statement regarding Farmers Alliance policy count impact given to the Kansas Credit Scoring Task Force on November 25, 2002.
- Farmers Alliance Tiered Auto Vehicle Tier Distribution Chart/Graph
- Farmers Alliance Credit Score Distribution Chart/Graph - Homeowners Policies
- Farmers Alliance Credit Score Distribution Chart/Graph - Automobile Policies

I feel that these documents, and the data contained, support the position that credit scoring for Farmers Alliance has produced a neutral or positive result for the majority of our consumers. Also, Farmers Alliance has written more business in the states where we have implemented our tiered automobile program using among other factors, credit scoring.

The Vehicle Tier Distribution Chart/Graph provides compelling data that credit scoring is not negatively impacting a large percentage of Farmers Alliance customers. Only 11.3% of our 2002 customers are priced in our Standard (10.1%) and Sub-standard (1.2%) tiers. Our Farmers Alliance definition of these two pricing tiers would be considered below average. Credit scoring is only one of many factors that could require a customer to be priced in our Standard of Sub-standard tiers. Other factors such as vehicle type, driving records, loss experience, etc. can position a customer into one of these tiers. Our Premier and Preferred tiers are priced for our

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above average customers and our Select tier would be considered an average customer. My interpretation of this data would be that 56.7% (18.2% Premier & 38.4% Preferred) of our customers have the opportunity to be positively impacted by credit scoring. I would also interpret that 31.9% of our customers that fall into our Select tier have neither a positive nor a negative impact on their insurance premiums as a result of insurance scoring. The remaining 11.3% (10.1% Standard & 1.2% Sub-standard) of our customers that fall into the bottom two tiers have the possibility that credit scoring could negatively impact their insurance premiums.

I have included the following table to identify for you the credit score requirements for each of our five automobile tiers. If you compare this table with the Credit Score Distribution Chart/Graph you will see that 80-85% of Farmers Alliance customers have scores that would place them in either the neutral or above average pricing tiers.

Farmers Alliance Tiered Automobile Financial Stability Requirements

Tier	Premier	Preferred	Select	Standard	Sub-Stnd
Credit Score	800-999	725-799	625-724	575-624	0-574

I hope that this information is helpful. I would appreciate that the Farmers Alliance information contained with this letter be used only to communicate our position on credit scoring and otherwise be kept confidential. Please let me know if you need any additional information.

Sincerely,

Bruce White

Bruce E. White, CPCU, CIC,
Vice President, Underwriting

Enc

cc: Rick Wilborn
Vice President, Governmental Affairs

FarmersAlliance

Insuring Rural America Since 1888

Statement of Bruce White, Farmers Alliance Companies
Kansas Credit Scoring Task Force
Topeka, KS

November 25, 2002

Farmers Alliance Companies introduced personal automobile tiered rating plans in Colorado, Idaho, Missouri, Montana, North Dakota and South Dakota during 1999 and 2000. The tiered rating plans utilized credit scoring to price existing business and for eligibility on new business. Below is the policy count growth for these six states.

State	Policy Count 12/2000	Policy Count 09/2002	
Colorado	826	1147	
Idaho	1273	1568	
Missouri	448	635	
Montana	1725	2347	
N.Dakota	861	1425	
S. Dakota	1572	2343	
Total	6705	9465	+2760(+41%)

Farmers Alliance Companies plan to introduce personal automobile tiered plans in our remaining three states of Kansas, Nebraska and Oklahoma during 2003 and 2004. Farmers Alliance Companies introduced ultra preferred personal automobile plans in Kansas, Nebraska and Oklahoma during 1999 and 2000. Farmers Alliance Companies has not used credit scoring on existing renewal business in these three states. A primary factor with the introduction of the ultra preferred personal automobile plans was the use of credit for eligibility. The policy count growth during the same period for these three states is listed below.

State	Policy Count 12/2000	Policy Count 09/2002	
Kansas	9403	11142	
Nebraska	2012	2127	
Oklahoma	1095	1483	
Total	12510	14752	+2242(+18%)

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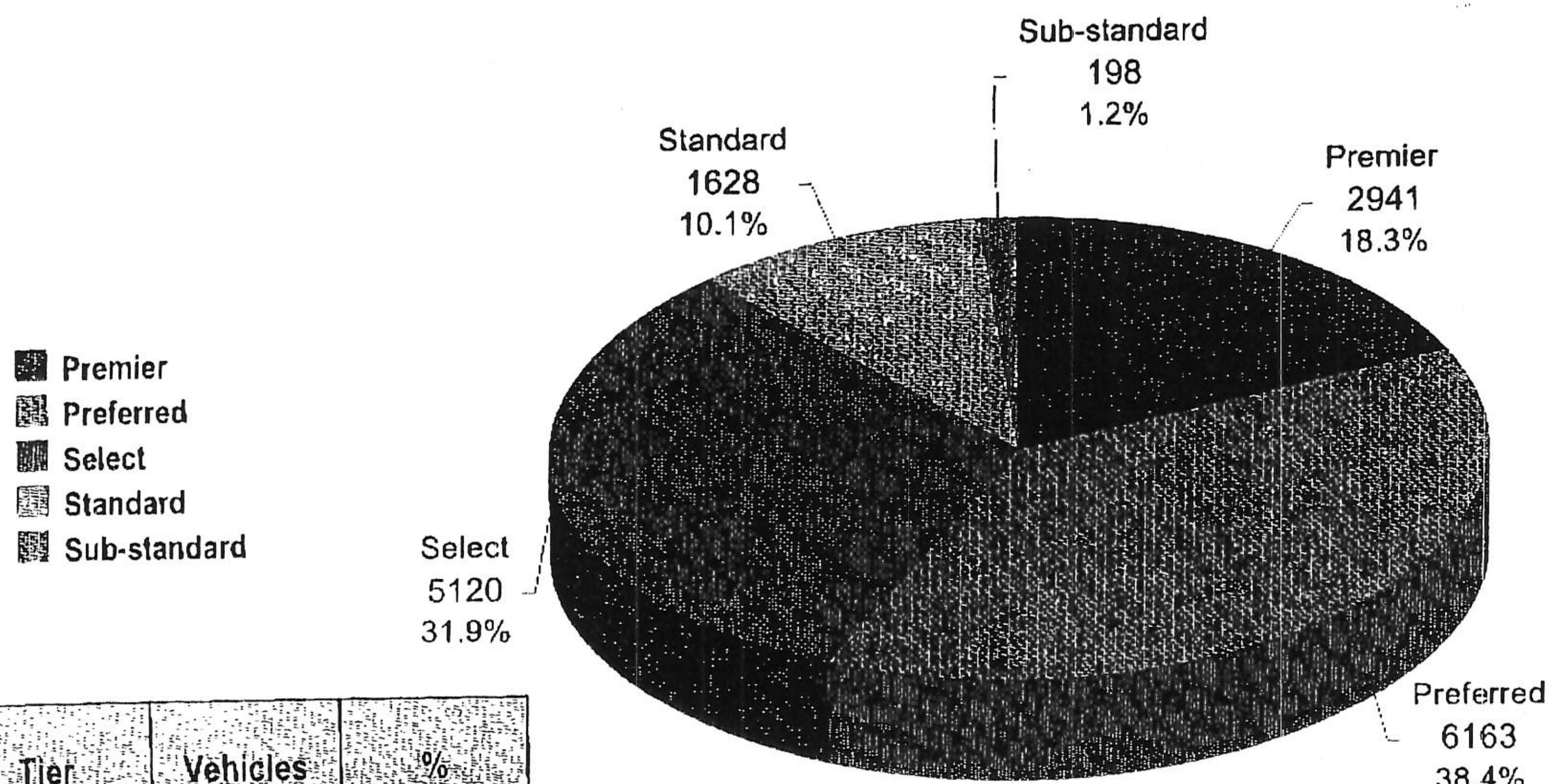
Farmers Alliance - Tiered Auto

Vehicle Tier Distribution - March 2002



Tier	Vehicles	%
Premier	2941	18.3
Preferred	6163	38.4
Select	5120	31.9
Standard	1628	10.2
Sub Standard	198	1.2

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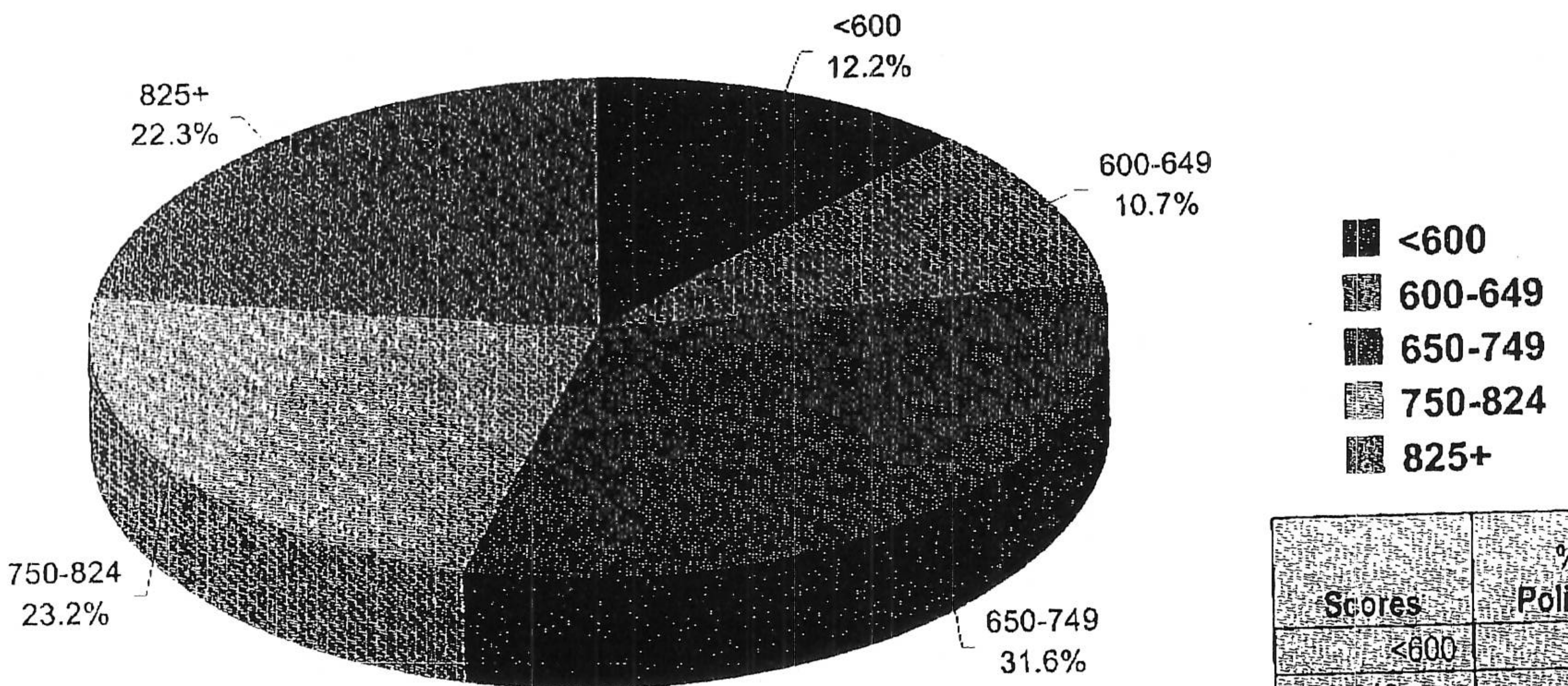
Farmers Alliance

Credit Score Distribution - Choice Point April 2002

Existing Auto Policies (2000 Data)



Scores	% Policies
<600	12.2
600-649	10.7
650-749	31.6
750-824	23.2
825+	22.3

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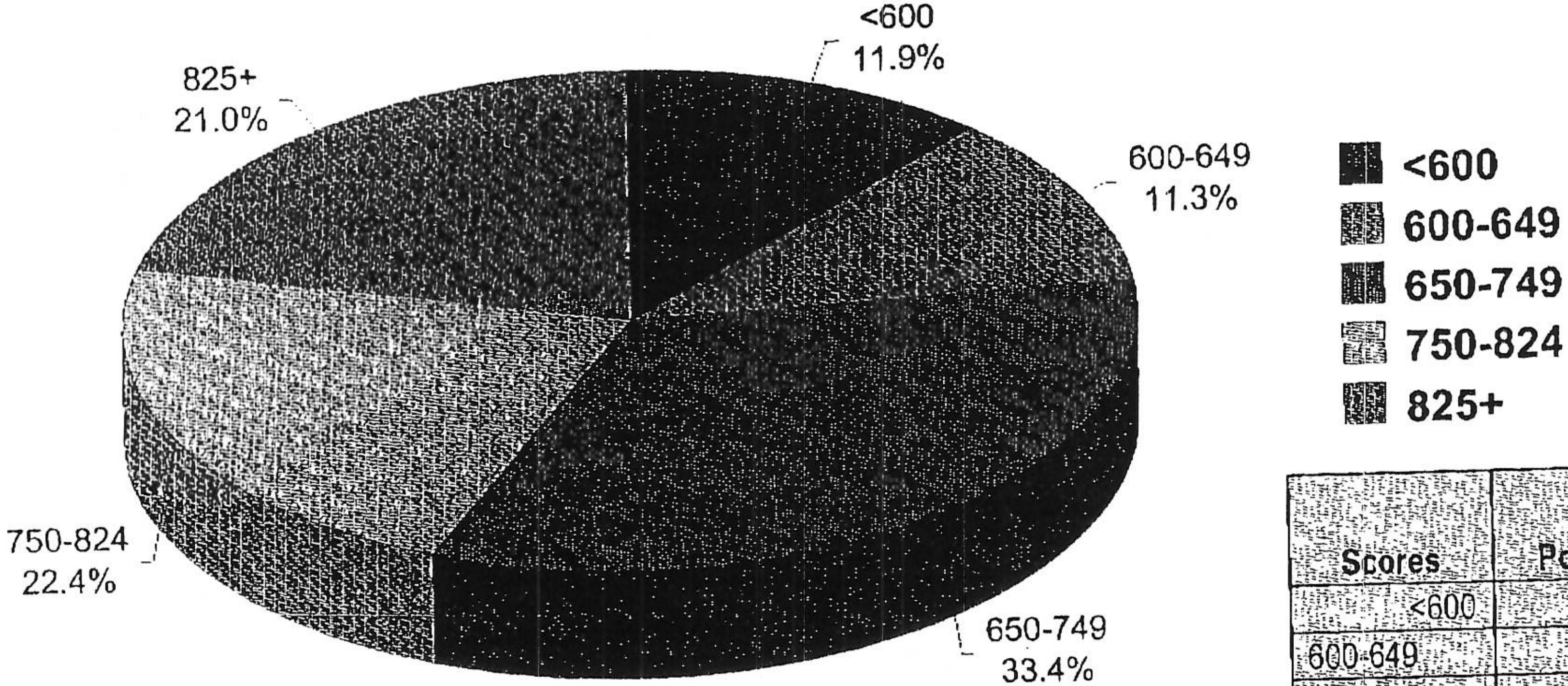
Farmers Alliance

Credit Score Distribution - Choice Point April 2002

Existing Home Policies (2000 Data)



Scores	% Policies
<600	11.9
600-649	11.3
650-749	33.4
750-824	22.4
825+	21.0