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Credit Reports and Insurance Underwriting
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I. Introduction

In response to concerns about the use of credit reports in insurance underwriting, in January, 1995, the NAIC charged the Market Conduct and Consumer Affairs (EX3) Subcommittee to “Coordinate with the appropriate committee and draft amendments to the Unfair Trade Practices Act in regard to the use of credit reports as an underwriting tool.” The Credit Reports Subgroup was formed to address this charge. The subgroup held a public hearing June 2, 1995 to obtain information about credit reports and how they are used to underwrite insurance. (A complete record of the testimony can be obtained from the NAIC). The subgroup began compiling information and agreed to draft a white paper to address the issue.

In 1996, the charge to the subgroup was modified to “Complete a study and issue a white paper, including conclusions and recommendations, with respect to the use of credit reports and other indicators as underwriting tools.” The subgroup’s charge was modified to address two issues: Members of the subgroup felt it was more appropriate to recommend action after studying the issue; and to address concerns raised by the Vermont Division of Insurance regarding use of a financial underwriting tool that served as an alternative to credit reports.

The subgroup was initially chaired by Alaska and subsequently by Maryland. Representatives from the states of Alaska, Arkansas, California, Connecticut, Florida, Illinois, Kentucky, Maryland, Missouri, Nevada, Ohio, Oregon, Texas and Vermont and the District of Columbia, have actively participated in the development of the white paper. The subgroup has met at quarterly NAIC National meetings and at interim meetings to consider information and draft the white paper. Interested parties representing consumer groups, the insurance industry and the credit reporting industry, have been involved in this process of developing the white paper. At the subgroup’s October 26, 1995 meeting, a representative of the Federal Trade Commission (FTC) provided information about the Fair Credit Reporting Act (FCRA) and the FTC’s interpretations of the Act. In the process of gathering information about the use of credit reports in underwriting, regulators have attended presentations provided by representatives of Fair, Isaac and Allstate, where information which both companies considered proprietary was presented.

The subgroup has prepared this white paper to provide a balanced view of credit reports and how they are used to underwrite insurance. This does not include any types or lines of insurance where the underlying risk is a credit risk, such as mortgage guaranty insurance and surety insurance. The section of the white paper entitled “Considerations” provides conclusions and items that should be taken into consideration when formulating an opinion or policy regarding the use of credit reports. The “Recommendations” section of the white paper provides a number of recommendations that states may choose to consider.
II. Sources of Information About Consumer Credit History

A. Content of Consumer Reports
The FCRA defines a “consumer report” as: “any written, oral or other communication of any information by a consumer reporting agency bearing on a consumer’s credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer’s eligibility for (1) credit or insurance to be used primarily for personal, family, or household purposes, or (2) employment purposes, or (3) other purposes authorized by the FCRA.”

Credit Reports
Credit reports are typically used by property and casualty insurers for consideration in underwriting personal lines risks. A credit report contains four elements of information: identifying information, trade lines, inquiries, and public record and collection items. Identifying information consists of the consumer’s name, current and prior addresses, social security number, date of birth, and may also contain employment information. Trade lines provide information on credit cards and loans including date reported, date opened, high credit, current balance, type of credit, and the status of the account. Inquiries are requests for information about a consumer’s credit history. The final category of information contained on credit reports is information about judgments, liens, collections, and bankruptcies. Credit reports may also contain a consumer statement section.

An investigative consumer report is a type of consumer report that contains subjective information. The insurance industry commonly refers to these reports as inspection reports. As defined by the FCRA, an “investigative consumer report” means “a consumer report or portion thereof in which information on a consumer’s character, general reputation, personal characteristics or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others whom he is acquainted or who may have knowledge concerning any such items of information. However, such information shall not include specific factual information on a consumer’s credit record obtained directly from a creditor of the consumer or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.”

Consumer reports, as defined by the FCRA, encompass credit reports and investigative reports. The primary focus of this white paper is on credit reports.

B. Credit Report Providers
A consumer reporting agency is defined by the FCRA as “any person which, for monetary 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, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.”
The credit reporting industry consists of approximately 600 credit bureaus, known as affiliates, which cover regional and local market areas. Additionally, there are three nationwide companies: TRW, Trans Union and Equifax. (Included in the appendix are examples of reports that would be provided to consumers and reports that would be provided to business customers).

Most of the 600 credit bureaus have automated their credit report data through a contract with one of the three nationwide companies; however, the credit bureaus are still responsible for their data, including how and when it is used. They also sell to local customers and service consumers. In some market areas there may not be a local credit bureau affiliate and the three nationwide companies will own and manage the credit report data directly.

C. Allowable Uses of Credit Reports
The Fair Credit Reporting Act provides that credit reports may be ordered in five types of situations: insurance underwriting, credit transactions, employment purposes, determining eligibility for a license and a legitimate business purpose. Although the FCRA does not provide a definition of insurance underwriting, the FTC’s interpretation is that underwriting encompasses determining one’s eligibility for insurance. The FTC’s definition of underwriting may differ from that used by the insurance industry. If a consumer goes to an insurer’s office seeking insurance, a subsequent request for a credit report by an insurer would be considered underwriting. FCRA decision notes indicate that there is no permissible purpose to obtain credit report information to evaluate submitted claims.
III. The Use of Credit History in Insurance Underwriting

Much of the discussion regarding credit reports revolves around how insurers writing in certain areas use credit reports. Some insurers maintain that the use of credit reports allows them to write more insurance than they would write in the absence of credit reports. Credit reports are ordered to facilitate an underwriting decision. Logically, this means that if certain conditions are met, the insurer will write the coverage. Therefore, the credit report is ordered to determine whether to write insurance.

Other insurers maintain that the use of credit reports will not necessarily increase or decrease the amount of business written but will result in a more fair selection of risk. The rationale for this position is not that the total number of people written increases, although it might, but that the use of credit reports increases fairness because, to a greater extent, those less likely to incur losses are not forced to subsidize those more likely to incur losses.

Historically, there has been an underlying belief by the insurance industry that there is a direct relationship between financial stability and risk. Further, it is argued that there is a direct relationship between credit use and stability, i.e., persons who have favorable credit history are more stable than those who have unfavorable credit history and are, therefore, better risks. The theory is essentially that a good credit history implies job stability and residential stability. If there is such a correlation, then the ordering of a credit report is only one more tool for the underwriter to use in his or her decision. As more insurers believe that the correlation is statistically significant, the use of credit reports is increasing.

Concern has been expressed by some regulators and consumer representatives that use of credit reports may decrease the amount of business written as insurers reject applicants who would otherwise be written. They are concerned that credit reports are used in order to not write in certain areas. They believe additional regulation may be necessary to correct abuses.

Other regulators believe that if an insurer is deciding whether it will write in a certain geographic area, removing an underwriting tool may create a disincentive for it to enter the market. Insurers will enter a market only when they are comfortable they can underwrite, make a profit, and exit the market if the results are poor. Underwriting restrictions are not conducive to expanding the market. These regulators believe that the premise that credit reports are used not to write in certain areas may be flawed. They believe that regulators should consider the potential harm that may be caused to the market they are trying to assist, before imposing restriction.

Detailed information about the number of complaints and any changes in the level of complaints received by Insurance Departments with respect to credit reports is not available. Most state insurance departments and the NAIC Complaints Database System (CDS) do not currently have a category to track complaints related to the use of credit reports in underwriting because at the time the CDS was created complaints related to the use of credit reports were not captured by many states.
Selected consumer complaints filed with the Consumer Protection Division of the Texas Department of Insurance were submitted as an exhibit with testimony provided by the Office of Public Insurance Counsel at the June, 1995 public hearing. The complaints addressed the issues of accuracy of data, arbitrary application of the credit report, pre-application disclosure, abusive misuse of credit history, post-application disclosure, loss correlation, economic circumstances affecting credit history, and pre-screening. A sample of the complaints which address these issues is included in the appendix.

In Missouri, insurers are required to file underwriting guidelines for homeowners insurance with the Insurance Department. Missouri has been comparing filed homeowner underwriting guidelines to actual practices and there have been some discrepancies in the disclosure of credit report use.

The following sections contain specific examples of how consumer reports are being used to underwrite life and health and property and casualty insurance.

A. Life and Health

As reported by the American Council of Life Insurance (ACLI) and the Health Insurance Association of America (HIAA), life and health insurers do not use credit reports of the type that are used to establish a person’s eligibility for credit, but instead may use a more comprehensive report, commonly referred to as an inspection report, in evaluating the insurability of an applicant. According to the definitions in the FCRA, this would be considered an investigative consumer report.

An inspection report may contain information on smoking, alcohol and drug use, driving record, occupation and duties, income, avocation, criminal record, or other aspects of the proposed insured’s insurability. A person’s finances are an important factor in assessing eligibility for life insurance.

Inspection reports may be ordered from an outside vendor or developed internally through telephone conversations with proposed insureds. Insurers use inspection reports as a tool not only to verify that information provided to the agent on the application is accurate and complete but also to elaborate on certain information, such as occupational duties.

A life insurer’s decision whether to order an inspection report is typically based on the amount of insurance applied for by the applicant, with some insurers varying the threshold amount by the age of the proposed insured. The ACLI reported that results of a recent survey published in On the Risk found that for most insurers the threshold amount is $100,000 and for many other insurers an inspection report will not be ordered unless the amount of insurance applied for exceeds $250,000 or $500,000. These requirements are usually documented in an insurer’s underwriting guidelines. The ACLI suggested that insurers may use lower thresholds at higher applicant ages because older persons tend to have more significant health histories. Insurers may use lower thresholds at younger ages as applicants may have a greater prevalence of substance abuse, poor driving records, and hazardous avocations.
An additional reason for ordering an inspection report can be a need to elaborate on or verify information that has been developed from other sources during the application process. In the case of a proposed insured who owns a business, the insurer may seek a more detailed report of the viability of the business. Information from inspection reports is often verified by re-questioning the proposed insured or by obtaining corroborative information from other sources. The information is combined with the other information that has been obtained, and the application is evaluated based upon the total picture. The ACLI stated that the trend over the past decade has been toward higher threshold amounts for ordering an inspection report and confining these reports to interviews with the proposed insured.

According to the ACLI, most life insurers obtain the majority of inspection reports from an outside agency; however, some insurers develop inspection reports internally by telephoning the proposed insured directly. When an inspection report is ordered from an outside agency, the insurer may request that the agency merely interview the proposed insured, typically by telephone, or may request a more detailed investigation. If the investigation includes an interview or interviews with one or more persons other than the proposed insured, the inspection report comes under the FCRA definition of an investigative consumer report. The ACLI stated that the procedures a life insurer follows in deciding whether to obtain an inspection report and in evaluating the risk significance of information contained in a report are described in underwriting manuals and other documents.

The HIAA reports that credit reports are generally not used in the major medical market for either group or individual coverages. As very little underwriting is performed for group insurance, credit reports are of limited value. Some insurers may use a Dun and Bradstreet type report in the small group market to verify the financial viability of the employer. For individual major medical policies, the HIAA was unaware of any use of credit reports, particularly as the additional cost of a credit report makes its use prohibitive in this highly competitive market.

The HIAA also provided information regarding the practices of its members related to disability income policies. For disability income policies, insurers writing group coverage (groups of 10 or more) do little or no risk analysis thus credit reports are not ordered. Insurers issuing disability income policies in small groups (2 to 10 lives) will evaluate the medical history of individual employees before issuing coverage. For individual policies, medical history, an applicant’s income and occupational duties are also reviewed. The HIAA stated that “while it is possible that insurers are using credit reports for small group and individual cases, it is much more likely that these insurers are using the inspection reports described earlier which may include credit information. Since the purpose of disability income coverage is to replace lost income, insurers must have the ability to verify income and occupational duties.”

B. Property and Casualty - Commercial Lines

Significant differences exist between personal lines coverage and commercial lines. The Credit Reports Subgroup, although focusing its efforts on personal lines, would be remiss to omit the impact of credit reports on the commercial lines area.

Commercial insurance risks often include a greater component of credit risk than a typical personal insurance exposure. There is an inherently greater credit risk existing with commercial
accounts, which are written under deductible reimbursement arrangements or any account that has the potential for a large amount due as a result of a retrospective rating plan.

Credit reports have been used for many years in underwriting commercial insurance. These reports provide data on an applicant’s financial position including assets and liabilities, earnings, accounts receivable and payable, inventory, working capital, sales, pension assets and liabilities, savings plans, collateral, facilities, bill-paying speed, and other items in addition to data also typical of personal credit reports used in personal lines insurance underwriting, e.g., bankruptcy, tax liens, foreclosures, repossessions and late credit payment. Commercial insurers claim to have validated the relationship between credit reports and loss experience; that credit problems reliably predict the erosion of machinery maintenance, safety programs and compliance with Occupational and Health and Safety Administration (OSHA) standards.

The use of credit reports in commercial lines underwriting can be viewed as a method to aid in determining the risk and rating the risk, given the content of the report. Commercial lines insurers use credit information as one of various underwriting tools to determine whether to issue a commercial policy. According to the American Insurance Association (AIA), seldom is a credit report the only information used in commercial lines underwriting. The use of credit scores rather than reports in underwriting is more typical to personal lines underwriting, but may be used to some degree in underwriting commercial insurance applicants.

C. Property and Casualty - Personal Lines

Credit reports are used for both new business and renewal business and have also been used in some cases where an insurer chooses to re-underwrite a book of business. Practice differs among insurers as to how credit characteristics are evaluated and their relative weight among underwriting information.

The subgroup received a detailed example of how one insurer has used credit history. This insurer stated that it began using credit reports almost 20 years ago. Following a large number of total fire losses to dwellings, the claims investigations revealed that a number of those suffering losses were going through some type of financial distress such as mortgage delinquency or imminent foreclosure. In response, for a period of several months, prior claims were reviewed to determine any similarities. Ultimately, this insurer began ordering credit bureau reports on all new business applications throughout the state. Today, this insurer continues to order credit reports when underwriting new business applications and finds the reports helpful when re-underwriting policies that have been in force less than six years when there have been several theft or vandalism claims or if there is an indication of financial distress without reasonable explanation (such as addition of a second mortgagee, repeated late premium payments, or a substantial reduction in coverage to save premium costs.) On policy applications the consumer is provided notice, near the insured’s signature, that credit reports are used in the underwriting process.

This insurers’ underwriters have found information in all sections of credit reports to be helpful. The identifying information is used to confirm information from the application, such as the insured’s address. The public records section also confirms information and details severe financial problems such as bankruptcy and foreclosure. This insurer stated that “applicant
misrepresentations about this information would be important to us.” The inquiry record section provides insight into those individuals shopping for credit or the amount of credit recently granted. The payment section is used to determine long-term payment history and whether or not financial obligations are being met. Information about applicants with past problems that have improved is also considered important. This insurer also stated that “over the years, we have had some concerns about whether individual underwriters consistently apply credit bureau report information to each application underwritten. We believe this concern is being addressed through scoring of credit bureau reports, which does provide objective consistency to the process.”

The states of Arkansas, Maryland, North Carolina and Texas have, either through surveys, requests for underwriting guidelines or market conduct examinations, obtained information as to how credit reports are used by personal lines insurers. Information obtained from a North Carolina report on residential property insurance availability illustrates how one insurer explained to its agent how it used a credit report in canceling a policy. The following explanation was provided: “We have received the credit information on the above subject insured. Due to information provided in the credit report, we are unable to provide coverage on this risk. Some of the factors used in determining eligibility are accounts referred to collection bureaus, accounts overdue by 90 days or more, repossessions, judgments, frequent job changes, certain self employment jobs, garnishments against wages and high debt to income ratios.”

The Maryland Insurance Administration requested information from 19 insurers as part of the Auto Reform Legislation, effective in 1995. The legislation required major insurers to submit marketing plans as to how they make auto insurance available in the city of Baltimore. From the marketing plans submitted by 19 insurers, the Maryland Administration reported that 5 insurers use credit reports in some manner as part of the underwriting selection process, one insurer uses credit reports only to verify prior address/garaging, and 13 insurers do not use credit reports at all in the underwriting process for private passenger auto.

The Arkansas Insurance Department, in response to numerous consumer complaints and legislative inquiries, surveyed property and casualty writers in their state. The Arkansas report containing the results of the survey, The Use of Credit Related Information in the Underwriting of Homeowners and Automobile Insurance in the State of Arkansas, is included in the Appendix. Sixty-two insurers, representing 87 percent of Arkansas’ personal lines written premium, responded to the survey. Sixty percent of those insurers rely to some degree on the use of credit reports or credit related information to underwrite.

Arkansas insurers were asked to list the specific areas of interest on a credit report which would affect the underwriting decision. Bankruptcy was viewed by more insurers as the primary area of interest, followed by delinquent payments. Most insurers considered judgments and liens as the secondary area of interest. If an applicant was considered clearly an acceptable risk based upon criteria directly related to the risk, but the credit report is less than acceptable, 41 percent of insurers indicated that they either would refuse or may refuse to write the business: 18 percent would refuse to insure, while 23 percent may refuse to insure. The 23 percent responding to this question indicated they would consider the reasons for the criteria given on the credit report for an explanation or extenuating circumstances, such as medical hardship, divorce or loss of an income provider. Sixty-five percent of insurers do not use credit reports in underwriting personal
automobile insurance, while the remaining 35 percent used credit reports identically for both auto and homeowners.

Arkansas insurers were questioned regarding declinations and nonrenewals that resulted from the use of credit reports. Although many insurers were unable to calculate this information, those that did reported declinations based upon credit reports ranged from none to 57 percent of all applications, and for nonrenewals results ranged from none to 11 percent. As far as consistency of use, 43 percent of insurers order a credit report for every new business application. Insurers were also requested to furnish written underwriting guidelines pertaining to credit reports. Sixty-seven percent of the insurers do not have any guidelines or had vague guidelines.

In 1993, the Office of Public Insurance Counsel obtained underwriting guidelines that accounted for 79 percent of the standard automobile insurance market in Texas. Results of review of the underwriting guidelines found that 25 percent of the Texas market specified that an applicant’s credit history is considered in the application process. However, the Texas report stated that the number of insurers that routinely check credit was probably much higher. Many of the insurers’ guidelines would not allow acceptance if a driver had a poor credit history including bankruptcy, repossessions, or credit refusals. Some of the references noted in the underwriting guidelines included, “People who do not pay their bills or have a poor credit history may be more likely to intentionally cause losses. They may also represent an increased risk of theft because they cannot adequately protect their property” and “In addition to an MVR [Motor Vehicle Report] and vehicle inspection, a credit report is required for all self-employed applicants except doctors and lawyers.”

A review was conducted of underwriting guidelines used by Texas insurers which comprised 92 percent of 1992 homeowners written premium in Texas. Among the findings were that 22 percent of the insurers restricted sales based upon a consumer’s credit history. Unacceptable risks included applicants with a poor credit history, history of bankruptcy in the past three years, and a “financially distressed” person.

**Scoring Models**

One recent trend in the interpretation of credit reports has been the use of scoring models. A score is derived by passing credit report data through a software algorithm, which reduces numerous data into a single score.

Fair, Isaac, a third party vendor which provides such a model, provided the following information regarding the development of its models:

The scoring models are developed from the policy records of a variety of insurance companies whose structure and performance reflect the industry as a whole. These records contain earned premium and incurred losses for a specific period of time (e.g. 1/1/93 to 12/31/93). Each record is matched to a policyholder’s credit report as of the beginning of the time period (e.g. 1/1/93), providing a database which contains credit report attributes and subsequent earned premium and incurred losses. Credit reports, earned premium and incurred loss data from up to four time periods are typically assembled in the database. These scoring models have been developed with data from
over a dozen companies and over 1.4 million policies representing over $1.5 billion in earned premiums and nearly $900 million in incurred losses.

Potentially predictive characteristics are extracted from the public record (e.g., bankruptcies, tax liens), credit account trade line (e.g., date opened, delinquency, payment due, balance), and additional credit inquiry sections of the credit report. Characteristics such as income, net worth, ethnicity, and location are not evaluated or used in any way.

The predictive value of each acceptable characteristic is evaluated as to its correlation to loss ratio and the most predictive characteristics are weighted as to their predictive value so that the sum of the predictive characteristic weights is a score predicting expected loss ratio performance.

The scoring models are installed as software at the Equifax and Trans Union credit bureaus. Any insurance company can test and validate the scoring models on its own book of business. The insurance company merely assembles policy records containing earned premium and incurred losses for a specified time period and the credit bureau matches these records to the credit reports as of the beginning of the period and computes the score as of that date. The incurred losses, earned premiums and loss ratios are tallied for a number of score ranges.

Any insurance company with a permissible purpose can order a score based on consumer credit information from either Equifax or Trans Union to assist them in underwriting a new applicant or an existing policyholder. The score as well as the four specific reason codes explaining the score are provided directly to the insurer.

On August 18, 1995 representatives of the subgroup attended a day long meeting at Fair, Isaac which explained the model development process and demonstrated the software used to develop scoring models. In addition, each subgroup member was mailed an 83 page binder that explains the model development process in detail and contains examples of predictive characteristics, score cards and validation reports for insurers that have tested the models on their book of business. A complete set of reason codes available for use by an insurer was also provided. Fair, Isaac will provide a copy of this binder to any interested insurance department.

Although recognizing the concern of one state to engage in a more detailed review of its scoring models, Fair, Isaac has resisted making its intellectual property available for review by states whose open records or trade secret laws cannot provide appropriate protection of its proprietary business interests. Fair, Isaac has stated that it is willing to disclose this proprietary information to states able to provide the appropriate legal protection of its proprietary interests.

**Approach Used by Allstate Insurance Company to Evaluate Credit History**

Allstate Insurance Company provided the following information regarding its use of credit reports:

Allstate Insurance Company assesses financial stability based on information from credit reports in most states as part of its auto and property underwriting process. Although procedures and processes may vary from state to state depending on regulatory and
market conditions, as a general rule Allstate orders credit reports on all new business auto and property applicants as described below. Allstate does not receive or consider an applicant’s income in this process. Allstate does not consider the number of credit accounts held by an applicant or the amount of credit extended. Allstate gives no consideration whatsoever to financial stability information in its rating process.

Only serious evidence of financial instability within the past five years could cause an applicant to be rejected by Allstate Insurance Company on the basis of information contained in a credit report. Examples of financial instability include unsatisfied or unresolved judgments, more than one of any of the following in excess of or equal to $100: charge-off, collection, or an amount past due more than 120 days (Allstate does not consider paid collections and accounts). In addition, the first such charge-off, collection, repossession, or amount past due more than 120 days is not considered by Allstate and would not cause someone to be rejected by Allstate Insurance Company. Exceptions may be made where appropriate in all states where this underwriting tool is used. In many states, Allstate’s formalized process permits applicants with unacceptable financial stability to be accepted if such applicants satisfy other underwriting criteria. Moreover, applicants with exemplary credit reports might be accepted even though they otherwise would be rejected. These criteria can vary by state, and Allstate continuously strives to refine these criteria and make modifications where needed. Allstate Indemnity Company does not consider financial stability for auto applicants, which means that no one can be denied auto insurance with the Allstate family of companies in any state solely because of financial instability.

Allstate Insurance Company has expressed a willingness to share additional information with any insurance department that has attended a presentation and has the authority, under relevant laws, to maintain the data as confidential. Allstate Insurance Company is willing to make its presentation to any interested insurance department.
IV. Issues

A. Rating and Underwriting

Underwriting is the process of establishing the level of risk that will be assumed by the insurer. This can be accomplished by accepting, rejecting or shifting the risk to another insurer or policy type. This includes the use of deductibles, elimination periods, coinsurance, or coverage reductions. Rating is the process of establishing the premium to be charged. A rating factor is used in developing an insured's premium to obtain an adequate premium based on the loss cost differential of a particular class of insureds.

Many personal lines insurers are using applicants' credit and financial history as an underwriting tool to determine whether to decline coverage and, in some instances, which company will insure the risk. Unfavorable credit history may be the sole or primary underwriting factor in determining whether to accept or decline an application or place the insured in a substandard insurer.

The insurance industry maintains that credit history is a statistically proven predictor of expected losses. If such claims are true, the industry should be able to adequately price a risk using a credit based rating factor. On the other hand, if there is an unsupported correlation, then use as an underwriting criterion may be suspect.

The regulatory requirements in states differ significantly for underwriting criteria and rating factors. Historically, there generally need not be statistical support for underwriting criteria, although states generally do have authority under unfair discrimination laws to require appropriate supporting documentation for underwriting criteria that are alleged to be unfairly discriminatory. However, many states do not require that underwriting guidelines be filed and/or approved. This has severely hampered regulatory attempts to obtain statistical support and information regarding the use of credit history in personal lines underwriting and rate-making. However, several options may be available to regulators including requiring insurers to develop rating factors based on credit history if the company chooses to use it as a rating factor, compelling insurers to provide this information through their rate and form filings, or reviewing the information through market conduct examination.

Although several states have indicated that companies have recently submitted rate filings that propose using credit history or credit scoring for rating purposes, it can be argued that credit history is used for rating even if it is not used in a formal rate-making process. This occurs when a consumer, after the use of credit history as an underwriting factor, is offered coverage in a non-preferred company or rating tier instead of a preferred company or rating tier. Some argue that the application of credit history as a rating factor might prove beneficial to the insurance buying public. It would require insurers to provide actuarial and statistical support for the use of credit history. In many states this supporting data would be available for public inspection. In addition, the rating factors would be subject to each state’s rate review and approval procedures. This approach might also require insurers to make insurance available to some applicants who would otherwise be declined.
Most regulators agree that if credit history or scoring is used as an underwriting tool, then it must be subject to applicable state requirements for underwriting guidelines. If credit history or scoring is used as a rating factor, it would be subject to the applicable state requirements for rating factors. For example, state laws allow territorial rating to be used but do not allow territory to be an underwriting guideline.

B. “Fair” vs. Unfair Discrimination in Insurance Underwriting and Rating

Those who argue against, or question, the use of credit history as an underwriting or rating criterion, express concern that the use of credit history is “unfair.” But what does it mean for a rating or underwriting factor to be unfair? The discussion about the use of credit history is similar to discussions about other underwriting guidelines and rating factors, such as the use of genetic testing results in underwriting or rating life insurance. It is therefore important to discuss how “fairness” in underwriting and rating is determined in order to evaluate the “fairness” of insurers’ use of credit history as a rating or underwriting factor. In most cases state laws do not contain clear or uniform definitions of what constitutes unfair. Individual states therefore determine what standards are appropriate for evaluating fairness.

Unfair Trade Practices

In underwriting and rating risks, insurers attempt to ‘fairly’ discriminate - they attempt to group risks into classes of similar risk and charge the same rate to risks of equal hazard. In general, insurers are encouraged to discriminate “fairly.” Insurers discriminate through the use of underwriting guidelines and rating factors. Underwriting standards/guidelines are defined as characteristics of the risk used by the insurer to determine if the insurer will offer insurance. Rating factors are used to determine the price of the insurance. The use of underwriting guidelines and rating factors - whether for determining the risk’s eligibility or determining the premium for an eligible risk - is governed, in part, by unfair discrimination statutes in most states. These statutes generally identify two standards to determine if the use of a rating factor is “fair” or unfair: 1. unfair discrimination between risks of equal hazard; and, 2. unfair discrimination as a matter of public policy. Unfair trade practices laws were enacted to ensure that specific trade practices were demonstrably related to the risk of loss in issuing or servicing the policy.

In some states unfair discrimination statutes allow the use of certain underwriting guidelines, trade practices or rating factors only if supported by sound actuarial principles. In those states it is important that the specific factor in question is demonstrably related to the actual risk of loss or size of expense in issuing and servicing the policy. If the factor does not distinguish between consumers of different risk, then the factor is creating classes of consumers who are treated differently but who have similar expected risk of loss; thus, the use of the factor is unfairly discriminatory. Another theory is that it is important for the statistical and actuarial analysis to determine whether the factor contributes to the explanation of risk of loss beyond the explanation offered by other known factors and that regulators should ensure that the rating factor is not simply a surrogate for some other factor which is already used or is prohibited by statute or rule.
Prohibiting Unfair Discrimination as a Matter Of Public Policy

While many argue that statistical justification should be the standard used to determine what trade practices or rating factors are unfair, others argue that social acceptability or public interest are also important standards by which to judge. In most or all states, certain practices and factors have been prohibited as unfair regardless of whether they relate directly to risk of loss or size of expense. For example, every state has prohibited the use of race, national origin and religion. Many states have also prohibited the use of other factors as a matter of public policy.

The use of credit history for insurance underwriting is an extremely controversial and unsettled issue. There are regulators who accept the fact that the financial stability or credit history of an applicant or insured may be important in the underwriting of a risk, but that safeguards must be instituted to prevent arbitrary use of the financial or credit related information. Some regulators and consumer representatives have expressed their belief that the use of credit history should be prohibited as a matter of public policy. Some have also expressed concern that the use of credit history for underwriting or rating may be a surrogate for prohibited factors, such as race, or for factors already considered, such as age. However, regulators know of no studies in the insurance field that demonstrate that the use of credit history in underwriting an insurance risk has had a disproportionate impact on protected classes although they have been advised that there have been studies of other industries which suggest such an impact.

Insurance industry representatives have argued that it is inappropriate to compare the use of credit reports to genetic testing or to suggest that credit history should be considered in the same class of protection as a person’s race, national origin, or religion. Industry representatives have also questioned why, if credit history is not a surrogate for prohibited factors, insurers should be precluded from using credit history in rating or underwriting. Insurers contend that, for purposes of regulation, a demonstration of a strong correlation between the information contained in credit history and the likelihood of future loss is sufficient to justify the use of credit reports as rating factors. Insurers contend that the question of whether credit reports act as a surrogate for impermissible factors, such as race, is speculative and should not serve as the basis for limiting the ability of insurers to use cost-effective underwriting methods.

Should Insurers Be Permitted to Use Credit History as the Sole Criterion to Make Underwriting Decisions?

Regulators have a number of concerns when an insurer proposes using credit history as the sole criterion when making underwriting decisions. Has the insurer adopted criteria for when and how credit history is used in its underwriting process? If an insurer relies solely upon a scoring system as the sole underwriting criterion, what type of regulatory oversight is provided over the development of the scoring system? If an insurer does not consider other underwriting factors such as construction type, type of dwelling, age, location, and availability of fire and police protection, for homeowners insurance and driving record, model, make and age of car for automobile insurance, then shouldn't the insurer be prohibited from using these variables when considering termination or continuation of coverage? Are there safeguards in place to prevent inaccuracies?
Some insurers are interested in using only credit history to evaluate risks. They assert that just as a multiplicity of states allow different approaches to insurance underwriting so, too, should insurers be permitted to experiment with different approaches to underwriting. They also assert that the value of the sole use of credit scores or reports will be tested best in the market. The correlation between credit history and loss experience is accepted by many insurers as proven, if not fully understood. The more insurers are able to use credit history, the sooner its ultimate value will be demonstrated for consumers, insurers and regulators alike.

Insurers also assert that credit history is used more consistently in the absence of other underwriting tools, and its objective value is less diminished by other factors precisely when it is used solely rather than in conjunction with other underwriting criteria. They point out that those regulators concerned with the subjectivity of underwriting guidelines should encourage the sole use of credit reports or credit scores as a way of instilling greater objectivity into the underwriting process.

Much of the interest in exclusive use of credit history is driven by inadequacies in other underwriting tools. For example, the relative absence of verifiable personal history records for homeowners increases the value of a tool like credit history to property insurers, particularly in situations involving first-time homeowners. Credit history is a source of affordable, objective information readily available in the market that is useful to insurers. To a degree unique to personal lines, the sole use of credit reports or credit scores may offer an efficient way for an insurer to make a threshold decision whether to invest further underwriting resources for any particular application.

However, other insurers do not use credit report information as the sole criteria. In July, 1996, State Farm announced that it will not decline coverage solely on the basis of an applicant’s credit report information. Credit report providers such as TRW do not support the sole use of credit reports to underwrite. Equifax has consistently recommended that credit report information should be used in conjunction with other valid underwriting criterion to make decisions.

C. Relationship of Credit History to Risk of Loss

There still is insufficient data to prove to all regulators’ satisfaction whether credit history, or lack of credit history, are or are not valid indicators, or are related to future property or liability loss. Each state must determine how much, if any, evidence it needs on this issue. Two organizations, Allstate Insurance Company and Fair, Isaac contend that they do have data supporting the correlation of credit history to risk of loss. Fair, Isaac has provided summary descriptions of their analyses of the relationship between the credit history score and risk of loss. However, these analyses have not been independently reviewed. In addition, independent multivariate analysis, a statistical method some regulators view as necessary, has not been performed.

During the final stages of development of this report, regulators agreed to include information supplied by Allstate Insurance Company and Fair, Isaac and Company in the appendix. Regulators have not had an opportunity to review the information provided and do not endorse any of the statements, comments, recommendations or conclusions included in those documents. Allstate authorized regulators to include information it had previously supplied on a confidential
basis to assist regulators in understanding and evaluating Allstate’s use of credit reports for underwriting purposes. Fair, Issac provided a December 10, 1996 report prepared by Tillinghast-Towers Perrin entitled Insurance Bureau Scores vs Loss Ratio Relativities which asserts that the relationship between credit history and loss ratio relativities is very significant.

The existence of a correlation between credit history and risk of loss has been discussed at length. The following are definitions of selected statistical terms: Correlation measures the strength of the linear relationship between two variables. The strength of the relationship varies between 1 if the variables are directly related and -1 if the variables are inversely related. There are a number of techniques for both computing correlation and statistical measures evaluating their significance. Univariate analysis generally refers to a single dependent variable whose unknown value is being predicted from one or more independent variables whose values, attributes and relationship to the dependent variable are known. Univariate analysis can refer to simple descriptive statistics for a numeric variable. This includes measures of central tendency such as the arithmetic mean (average), median (central value), quartiles (1st, 5th, ..95th and 99th percentiles), standard deviation, extreme values, frequency of values, and normality of the variable distributions. In multivariate analysis one is examining the interactions of one or more independent variables upon two or more dependent variables. The specifics of what the measures and descriptive statistics mean depends upon the context and the attributes of the data.

The loss ratio method is in widespread use in the industry. Many regulators accept the loss ratio method in setting rate differentials because it is expedient, easy to use and widely accepted. Both representatives of insurers and third party credit scoring system vendors assert that, through the use of this widely accepted actuarial technique, they have proven a correlation exists between credit history and loss experience. These studies have used the loss ratio on individual policies as the dependent variable and credit history as the predictor. These studies generally show that there is a difference in the average loss ratio between "good credit" policyholders and "poor credit" policyholders. Since recognized risk factors are already realized in the policy premium, the pool of policies should have the same expected loss ratio. Therefore, any differences between the loss ratio for "good credit history" business and "poor credit history" business must be attributable to credit history.

Several regulators are skeptical of the use of the loss ratio method to establish a correlation between credit history and loss experience for a variety of reasons. The soundness of the method rests on the reasonableness of the basic underlying assumptions. The questions that have arisen over the statistical evidence on the correlation between credit history and loss costs are largely questions as to whether those basic assumptions are valid. These regulators cannot accept the concept that existing premium accurately reflects the expected losses based on the prediction of the existing rating variables. There is evidence that the pricing of other risk factors is not 100% complete or accurate. There are literally hundreds of rating factors -- driver class, geographic rating territory, driving experience, age of driver, age of home, various discounts and surcharges. Small errors in pricing a number of these factors could add up to fairly significant overall pricing errors. Some regulators suggest that an unbiased and reasonably precise multivariate analysis is necessary to determine the actual rating factor for the credit history variable and to determine how incorporating credit history should affect the rating factors for the other rating variables.
They ask whether a person’s credit history is truly correlated with future loss experience or whether it is a spurious correlation?

Webster’s Dictionary defines *spurious* as “outwardly similar or corresponding to something without having its genuine qualities.” A measured correlation between two sets of numbers is spurious when a true correlation does not exist. The following example is only included in this paper to explain this concept and says nothing about the correlation of credit history and risk of loss.

Suppose a researcher gathers the following data from a random sample of 1,000 working men and women: annual income, gender, hair color, age, and years in the labor market. The researcher then looks for a correlation between the amount of gray hair on a person’s head and that person’s annual income. Chances are, the researcher will be able to ‘prove’ a correlation between the volume of gray hair on a person’s head and the amount of annual income that person receives, implying that gray hair and income are related in some way. In general, older people tend to have more gray hair than younger people. Older people tend to have been working longer than younger people as well. Therefore, since gray hair is highly correlated with both age and years in the labor market, it will more than likely show a correlation with income as well. However, a slightly more sophisticated statistical model that measures difference in income by age, amount of gray hair and years of service simultaneously will probably conclude that gray hair does not have any predictive power with respect to income after controlling for age and years of service. A simple *univariate* analysis that compares gray hair to income will produce a statistically significant correlation between hair color and income. A *multivariate* analysis that tests for a relationship between income and gray hair, age, and years of experience simultaneously will show that both age and years of service are strong predictors of income, but that hair color has no predictive value when age and years of experience are also included in the analysis. The apparent correlation between gray hair and income is a spurious correlation. In this example, the correlation between age and income and between gray hair and age generated a spurious correlation between gray hair and income. If our test sample was restricted to include only 40 year old males with exactly 20 years of service in identical jobs with identical job performance, hair color would exhibit no measurable correlation with income. Thus, the correlation between gray hair and income is a spurious correlation.

A similar discussion evolved around the use of a driver’s sex in rating personal auto business. Proponents of the use of a driver’s sex in rating auto insurance point out myriad statistical studies that use generally accepted actuarial practices to show that there is a difference in expected loss costs between males and females. Opponents of the use of gender have suggested that the loss cost differences are actually the result of differences in the number of miles driven. Studies by the U.S. Department of Transportation show that there is a significant difference in the number of miles driven between males and females at all levels. Since males tend to drive more miles, they have more exposure to accidents. Therefore, rating plans that use gender are substituting gender for annual mileage in estimating insurance costs because gender is a reasonable proxy for annual mileage. If the annual mileage is already known and accounted for in the rating plan, however, the driver’s gender may not add any new information about potential loss costs. It is argued that if a driver or vehicle characteristic does not add *additional* information about...
potential loss costs, it should not be used. Similar arguments have been made with respect to marital status and, to a lesser extent, driver age. This has led several states to ban the use of sex, age or marital status in auto insurance rating plans, while other states have restricted the use of those factors unless supported by “actuarially sound statistical data.” California law requires that the effect of certain mandatory rating factors (driving record, annual mileage and years of driving experience) must be considered before other optional rating factors such as gender can be employed.

Because many insurers are convinced there exists a proven correlation between credit history and risk of loss, the use of credit history has become more commonplace in the underwriting and rating practices of personal lines insurers. In spite of the industry's confidence, however, the relationship between credit history and risk of loss continues to raise controversy.

Consumer groups and some regulators question the extent and even the existence of a correlation between credit history and risk of loss. Some have argued that even if a correlation exists, a causal relationship should be demonstrated before credit history is allowed as an underwriting tool. In addition, at least one regulator believes that the insurance industry should demonstrate that credit history provides a unique contribution to measuring risk or size of expense, independent of the contributions from other known factors that cannot be measured by other means.

Responses vary, but the industry contends that these demands unfairly single out credit information. Since other underwriting tools are not required to demonstrate a statistical causal relationship, then such a demonstration should not be required for the use of credit history. This view, in turn, leads some regulators to state that perhaps other underwriting tools may be due for regulatory review. Industry representatives generally agree that the “causal relationship” and “unique contribution” tests are irrelevant if a significant correlation to risk of loss exists.

This issue is further complicated because the insurance industry and third-party vendors who have compiled much of the underlying statistical data on the use of credit reports regard the data as proprietary. Consequently public review of the data and debate about its implications has been limited by confidentiality limitations.

Some of the industry representatives that participated in the evaluation of the use of credit reports in insurance underwriting made proposals intended to settle the issue of the relationship between credit history and risk of loss. One insurer brought regulators on-site for a presentation of its statistical data, and has invited technicians (actuaries, statisticians) to return for more in-depth testing. As of this writing, the follow-up visit has not taken place; however, regulators have been working to address some of the outstanding issues through correspondence with this insurer. Requested data has only been supplied to a few states in accordance with their trade secret statutes. These data have not been provided to the NAIC for its discussion and review. Those states that have received information view it as only preliminary. Fair, Isaac has proposed various statistical tests of the correlation of credit reports and loss ratios using validation test data from a variety of insurers to be performed by an independent actuarial firm. It appears this test will not be completed before the presentation of this white paper. Regulators appreciate these good faith efforts and have gained some additional insight from the information provided.
Arizona conducted a narrow review of Allstate Insurance Company’s actuarial support for declining or surcharging risks because of “poor” credit ratings. Results of the review are contained in an October 16, 1995 letter from David Cox to the Arizona Department of Insurance (refer to appendix). Mr. Cox’s review supported Allstate’s contention that there is a correlation between the information in one’s credit report and loss ratio, but the Arizona Department believes that not all issues related to the use of credit history in underwriting have been resolved. It still has questions regarding the use of credit history and credit scoring models by other insurers and is continuing to evaluate the issue within companies during the course of market conduct examinations and in rate and form filing matters.

The relationship of credit history and risk of loss remains unsettled, and the use of credit history remains controversial for the following reasons:

(1) The insurance industry possesses data which it contends proves a correlation between credit history and risk of loss, but it considers the data to be proprietary. Therefore, the data is shielded from public scrutiny; thus, regulators and others believe public skepticism will remain.

(2) Although regulators may have confidence in the way a particular insurer uses credit data, that confidence cannot be automatically extended to other insurers because each company uses credit history in different ways.

(3) There has not been a definite demonstration of causation, which some regulators continue to seek; although industry representatives continue to assert that causation is not required for other underwriting guidelines.

(4) There has been no proof that credit history provides a unique contribution to predicting loss, which at least one regulator continues to desire; although other regulators and the insurance industry believe this is an unfair and unrealistic standard.

(5) Some regulators believe that credit history may be a surrogate for excluding members of an otherwise protected class while industry representatives both deny this view and assert that no evidence has been provided in support of it. Proof may be difficult since the data does not reflect whether an applicant is an member of a protected class.

**D. Should Scoring System Vendors Be Regulated as Advisory Organizations?**

Third party vendors, most notably Fair, Isaac and Company, have developed scoring systems. Developing a scoring system to predict loss costs based on insured credit history suggests to some that these vendors may be acting in the capacity of an advisory organization and may be, in effect, producing a rating class plan based on credit history.

The resolution of this issue is beyond the scope of this paper but states may want to evaluate whether the activities of these vendors should be subject to regulation. For example, should credit based scoring systems be treated as a rating plan, subject to regulatory approval? Can this
practice be considered a form of data sharing which is only permitted through licensed or authorized entities? These are serious questions that should not go unanswered. An argument can be made that the organizations providing the proprietary models, which receive information from insurers, manipulate and analyze that information and provide information back to insurers to use in underwriting and rating, legitimately should be regulated as advisory organizations. A state may want to consider whether they would be considered advisory organizations under appropriate state laws. Most states regulate the activity of advisory organizations.

A potential danger with this approach is that requiring vendors of scoring models to be subject to regulatory constraints may cause them to cease providing this service. In fact, the information provided by Fair, Isaac (credit history underwriting tool), Applied Insurance Research (computer catastrophe models) and others affect millions of consumers on a regular basis. Another possibility is that increased regulation may add to the cost of insurance.

Third party vendors disagree that they should be regulated as advisory organizations. According to Fair, Isaac, they do not develop loss costs, premium rates, manuals, policy forms or filings. Instead, they provide a tool that can be used to rank order consumer credit information with regard to expected loss ratios.

E. Credit Card Ownership As An Underwriting Tool
In Vermont, a carrier that has historically served the substandard automobile market rates applicants’ premiums in part based on the types of credit cards an applicant possesses. The carrier verifies the applicant’s credit card information through a limited access inquiry to a credit bureau. The carrier filed this rating plan with the state and it was deemed accepted. In preparation for reconsideration of the filing, the Vermont Division of Insurance obtained an opinion regarding the actuarial soundness of using credit card ownership in determining risk of loss. The actuarial opinion confirmed a correlation between ownership of a credit card and accident propensity. Due to the narrowness of the review, the opinion could not determine whether a causal relationship exists between the two or whether tier rating based upon the type of credit card owned was sound.

Alaska held a public hearing on the subject and concluded that the credit card provision was unfairly discriminatory because it can be manipulated by the applicant or insured. The Actuarial Standard of Practice #12 on risk classification specifies that classification characteristics “should not be easily manipulated.” Texas is also conducting a review of this issue.

F. Independent Testing/Access to Third Party Proprietary Models
There is increasing use by insurers of proprietary third party products for underwriting and rating consumers. In the case of credit reports, Fair, Isaac has developed two different algorithms, ASSIST for use by Trans Union and the Property Loss Score (PLS) and Casualty Loss Score (CLS) for use by Equifax. Fair, Isaac alleges that the higher the score, the lower the risk of loss posed by the consumer. Other examples of insurers’ use of proprietary third party products include computer catastrophe simulation models provided by a number of vendors and the crime indices in the Insurance Service Office’s (ISO’s) Geographic Underwriting System.
Insurers’ use of proprietary third party products for underwriting and rating pose a problem for regulators who either desire or are required to know what underwriting guidelines are used by insurers and whether those underwriting guidelines possess a unique contribution to explaining risk of loss. For example, a regulator would be in a difficult position if an insurer, writing in an area of strained residential property insurance availability, made a rate filing with a large rate increase and justified that rate increase on the basis of the results of a proprietary computer catastrophe model. Naturally, the regulator would want to examine the model to see that the assumptions and relationships were reasonable, but the provider of the model has a justifiable concern about making public what it considers to be trade secret materials.

In the case of credit history, the Credit Reports Subgroup and some states have tried to obtain information about the Fair, Isaac models. The State of Texas recently requested certain detailed information from Fair, Isaac that Texas believes would demonstrate the unique contribution, if any, of credit history to risk of loss. Fair, Isaac responded that the information was proprietary. (Refer to the appendix for copies of correspondence between the Texas Department of Insurance and Fair, Isaac).

While Fair, Isaac has provided considerable information about its models and about the results of its tests, regulators have not received information in sufficient detail to identify how various items of information from the credit report are actually used to develop the consumer’s score. Thus, regulators do not know what factors are most heavily weighted in determining a consumer’s score. There is no agreement between regulators and industry that multivariate analysis is necessary to prove there is a unique contribution. Regardless of assurances that there are no factors that would permit unfairly discriminatory practices, the inaccessibility to both the factors and the weight given to the factors fails to allay the concerns of regulators and consumer groups.

In the case of credit reports, the use by many insurers of the Fair, Isaac proprietary model illustrates the problems posed to regulators. Progress must be made on balancing regulators’ needs to know about these models with the legitimate proprietary interests of the third party providers. Most, if not all states, have trade secret exemptions to state Open Records Acts. Also, under NAIC model language on examinations, it is generally accepted that all information gathered in the course of an examination that is denoted as work papers are confidential. The third party providers could provide the requested information to states with a trade secret claim. At least in the view of Fair, Isaac, the ability to claim trade secret and exempt the requested information from public disclosure does not seem to be an adequate safeguard.

G. Unfair Application and Use of Credit History in Underwriting

Guidelines, Application, and Interpretation

Insurers must develop objective, verifiable guidelines for the ordering of and interpretation of credit reports. In the absence of such guidelines, an insurer may not be able to achieve a level of internally consistent use of credit history to avoid unfairness or the appearance of unfairness. Any discussion of the issue, however, benefits from an understanding of the context in which consistency is an issue. For example, it would not be reasonable to require different insurers to use the same credit history data in the same way, because it is the very difference between
insurer underwriting strategies that provides insurance markets to the broad variety of consumers. A regulator would probably hold a company to a higher level of consistency within the company more so than among companies. Even within a company, there may be sound reasons for an insurer to use credit history internally in different matters. For example, a single insurer which writes both commercial and personal insurance would use credit history differently for the different lines. There may also be circumstances when an insurer would use credit history differently for the same line. As an example, an insurer which writes personal lines in 50 states might be encouraged to modify its credit standards for insurance applicants in a geographical region suffering an economic downturn, to prevent the wholesale constriction of availability based upon a circumstance beyond the control of the insureds. The context in which the highest standard of consistency probably should be applied is in the decision of whether credit information should be sought uniformly for all consumers. In all circumstances, the decision to use consumer credit information in the underwriting process should be based upon reasonable criteria established by an insurer and consistent with the requirements of the law.

Problems of subjectivity arise when the underwriter has flexibility to ignore or consider elements that comprise the objective structure of the scoring mechanism. For example, a bankruptcy may be the result of a variety of factors including divorce or a medical condition. The decision to weight these two situations differently is subjective if made outside the objective scoring system or without clear and consistent insurer guidelines.

During the course of market conduct examinations, the Missouri Department of Insurance reviewed the application of credit reports in the underwriting process. The findings have indicated that many insurers do not have objective standards as to when to order a credit report. Some insurers order on the basis of self employment, others order when the mortgagor of the property to be covered is an individual as opposed to the traditional lenders, a financial institution or government loan. No insurers that have recently been reviewed had an objective set of guidelines as to when a credit report would be ordered, leaving it instead to the discretion of the underwriter. This could lead to practices of companies subjecting some zip codes to a more strict underwriting review than other zip codes. Regulators may want to require that insurers who use credit reports have objective, documented, and measurable standards for their use.

**Accuracy of Credit Reports**

Most consumer financial transactions in America are facilitated directly by the use of credit report information; insurance is just one of many businesses that use credit history. Logically, the accuracy of credit history data is of critical importance to the businesses that use it, since the data’s very utility is premised on it providing a correct picture of an individual’s financial standing. While all parties agree that it is in everyone’s best interest that credit reports are as accurate as possible, various studies have indicated different results of the accuracy of credit reports.

A representative of the FTC, speaking to regulators on October 26, 1995, stated that the FTC is only able to estimate the accuracy of credit reports based upon the volume of complaints it receives. The number of complaints has been decreasing, thus the FTC assumes that the accuracy of credit report information is improving. The FTC does not monitor or require credit reporting agencies to keep records of complaints. This will affect the accuracy and credibility of the data.

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as to the number of complaints. No one knows if the numbers are accurate or not. In response to FTC allegations that Equifax violated the Fair Credit Reporting Act by failing to assure maximum possible accuracy of consumer credit information, in August 1995 the FTC entered into a consent agreement with Equifax. As part of the consent agreement, Equifax has agreed to maintain reasonable procedures to assure maximum possible accuracy of the information contained in its consumer reports. In 1991, the FTC entered into a similar agreement with TRW.

H. Consumer Treatment/Remedies

Impact On Existing Policyholders
Some companies have expressed an interest in using credit reports to underwrite renewals for insureds who were not subject to credit report underwriting with the initial application. Advocates for this approach believe the practice would be beneficial even when the credit information pre-dates the initial application.

Some regulators and consumer groups have expressed objections to this use of credit information. These critics argue that when a policyholder has filed no claims and has an otherwise exemplary record, it would be punitive to nonrenew for credit problems that pre-date the initial underwriting period.

At least one insurer, however, has stated that this practice has resulted in policyholders obtaining a renewal when they otherwise would have been nonrenewed for a non-credit underwriting reason. Further, some industry representatives maintain that to ignore credit history, even when it pre-dates the initial underwriting, discriminates against the lower risk policyholders.

The NAIC’s Improper Terminations Model Act offers some protection for insureds whose policies have been in effect for at least five years. The Act, adopted by the NAIC in 1995, provides that such policies can only be nonrenewed for certain enumerated reasons or by providing 90 days advance notice. These protections, and perhaps others, may be appropriate for insureds that have a verifiable track record in the form of claims history to counterbalance any past credit problems.

Written Notification of Adverse Decision
The Fair Credit Reporting Act requires written, oral or electronic notification when an adverse action is taken. However, a representative of the FTC noted that it is recommended, in order to ascertain compliance with the FCRA, that written notice be provided to the consumer in the event of an adverse decision based upon a credit report. If a state does not have a law that mandates written notification in the event of an adverse underwriting decision, state regulators have no mechanism to require or verify that the consumer receives such notification.

Providing the Consumer the Specific Reason for Adverse Decisions
The subgroup heard testimony and anecdotal comments that applicants frequently are not given the specific reason for an adverse underwriting decision based on credit reporting agency information. The FCRA requires that a consumer must be notified of any type of adverse action
taken based on information received from a Credit Reporting Agency\(^1\). However, the FCRA does not require stating specific reasons, only that the adverse action is based in whole or in part on information contained in a consumer report from a consumer reporting agency and provide the name and address of the consumer reporting agency making the report. The NAIC Model Insurance Information and Privacy Protection Model Act requires that consumers be advised of the specific reason for an adverse underwriting decision.

A letter, received in October, 1995 by the Arkansas Insurance Department from the FTC responding to a request for specific information regarding FCRA notification requirements, states that nothing in the FCRA makes it unlawful for an insurance company to disclose the contents of a credit report to the person on whom that report was obtained, regardless of whether the information disclosed caused that person to be denied for insurance. The letter also noted that insurers, unlike creditors in the Equal Credit Opportunity Act, are not required to disclose to consumers the specific reasons for denying insurance; however, the FTC does encourage insurers to disclose this information.

It is not uncommon for applicants to simply be told that “due to your credit report” or “because your score was too low” insurance is not available. In both instances, there is concern that since a consumer has no specific reason for denial or termination to dispute, the consumer cannot contest an insurer’s action and the system fails. States that do not regulate underwriting guidelines and states that have not adopted the NAIC Model Insurance Information and Privacy Protection Act may not have the statutory enforcement tools necessary to ensure disclosure and recourse to consumers of the use of credit reports by insurers. Under the FCRA, it is not unlawful for insurers and producers to disclose to consumers the specific reasons for their decision. It is noted that the NAIC Model Insurance Information and Privacy Protection Model Act provides immunity from suit when the disclosure is pursuant to the Act and not disclosed or furnished with malice or willful intent to injure any person.

I. Impact on FAIR Plans

Fair Access to Insurance Requirement (FAIR) Plans, established in the late 1960’s to address concerns of urban consumers regarding the lack of access to property insurance, currently exist in 29 states and the District of Columbia. FAIR plans were intended to provide coverage to consumers who could not obtain property insurance through the voluntary market. FAIR plans do not use credit reports as part of the underwriting process. As such, it is conceivable that as more insurers writing in the standard market require a favorable credit history as part of their criteria, more consumers with poor credit, all other criteria being favorable, may be forced to seek coverage from the FAIR plan. However, a consumer with favorable credit history, meeting other underwriting criteria, may be able to return to the voluntary market.

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\(^1\) The types of “adverse action” that trigger the notification requirements of Section 615(a) of the FCRA (i.e., that the action was based on information contained in a consumer report from a consumer reporting agency) are denials of, or increased charges for, credit or insurance for personal, family, or household purposes, or denials of employment.

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J. Insurance Industry Statement of Principles Regarding the Use of Consumer Credit Information

In response to regulator concerns about the use of consumer credit information in underwriting, representatives of insurance companies and trade associations developed and presented a Statement of Principles to be considered by insurers in the use and application of consumer credit information. The following Statement of Principles are offered for the reader’s consideration:

1. Information from consumer credit reporting agencies should continue to remain available to insurers for use in the insurance underwriting process.

2. Information from consumer reporting agencies should remain available to influence and support positive as well as adverse underwriting decisions.

3. The decision to use consumer credit information in the underwriting process should be based on reasonable criteria established by an insurer and consistent with the requirements of state law.

4. In addition to meeting the existing Fair Credit Reporting Act notice requirements to consumers, insurers should consider the feasibility of giving consumers additional opportunities to obtain more specific information as to the reasons for coverage denial based on information in a consumer credit report.

5. An insurer and/or agent should inform a person seeking to obtain coverage that consumer credit information may be considered as part of the underwriting process.

6. The nonexistence of consumer credit information should not be used as a sole basis to deny coverage.

7. Credit bureaus providing consumer credit information to the insurance industry must meet all FCRA requirements making every reasonable effort to maintain high standards of data security, data accuracy and timeliness throughout the reinvestigation or dispute/resolution process.
V. Assuming Personal Responsibility for One’s Credit Report

Because each credit report is personal in nature, it should be important to every person to take charge of his or her own credit history. If a person believes his or her credit report contains inaccuracies, that person should take steps to correct it. If a person’s credit history contains blemishes, that person should take steps to modify his or her behavior to improve one’s record. The following information is intended to help individuals take charge of correcting and improving their own credit history. Readers are advised that changes made to the Fair Credit Reporting Act have placed new duties on credit bureaus, users and furnishers of information. A list of those new duties is included in the appendix to this report.

A. How Credit Bureaus Work and What a Credit Report Covers

Credit reporting agencies, often called credit bureaus, gather or evaluate information on credit users and sell that information in the form of credit reports to credit grantors, such as banks, finance companies, and retailers. Credit bureaus keep records of consumers’ debts and how regularly these debts are repaid. They gather information from creditors who send computer tapes or other payment data to credit bureaus, usually on a monthly basis, showing what each account-holder owes or has paid. The data show if payments are up-to-date or overdue, and if any action has been taken to collect overdue bills. The credit bureau adds this data to existing information in consumer files, creating a month-by-month history of activity on consumer accounts.

Credit bureaus cooperate with each other, passing information on to other bureaus when people move, for example. But, as businesses, they also compete for subscribers (credit grantors), who judge credit bureaus on the completeness of their records and the quality of their service.

Contrary to myth, a credit bureau neither tracks all aspects of one’s personal life nor evaluates credit applications. Credit bureaus are simply organizations that collect and transmit four principal types of information. They are:

- **Identification and employment data:** Name, birth date, address, Social Security number (if made available by consumer), employer, and spouse’s name are routinely noted. The bureau also may provide other information, such as employment history, home ownership, income, and previous address, if a creditor requests it.

- **Payment history:** The consumer’s account record with different creditors is listed, showing how much credit has been extended and how it has been repaid. Related events, such as referral of an overdue account to a collection agency, may be noted as well.

- **Inquiries:** Credit bureaus are required to maintain a record of all creditors who have requested one’s credit history in the past six months. They normally include such creditor inquiries in an individual’s credit file for at least this length of time.
• Public record information: Events that are a matter of public record and are related to credit worthiness, such as bankruptcies, foreclosures, or tax liens, may also appear in a credit report.

B. How Consumers Can Check Their Credit History

Even if a person has not been denied credit, he or she may wish to find out what information is in one’s credit file. Some financial advisors suggest that consumers review their credit reports every three or four years to check for inaccuracies or omissions. This could be especially important if a person is considering making a major purchase, such as buying a home. Checking in advance on the accuracy of information in one’s credit file could speed the credit-granting process.

To find which credit bureaus have a person’s file, check the Yellow Pages under Credit Bureaus or Credit Reporting Agencies for the phone numbers and addresses of the bureaus in the locality. Copies of credit reports can also be obtained from: Equifax Credit Information Services, Inc. Post Office Box 740241, Atlanta, GA 30374-0241, telephone 800-685-1111, FAX 404-612-3150; Trans Union Corporation, Trans Union Consumer Relations, 760 West Sproule Road, Post Office Box 390, Springfield, PA 19064-0390, telephone 800-851-2674, FAX 610-933-1200; and TRW, TRW Complimentary Report, Post Office Box 8030, Layton, UT 84041-8030.

Some states are especially helpful to their residents in this regard. For example, Maryland law requires agencies to furnish upon request a free yearly copy of a consumer’s credit file and to investigate complaints within 30 days. In addition, the law requires the major credit reporting agencies (Equifax, Trans Union and TRW) to provide consumers with a toll free telephone number to access these agencies. If problems persist, consumers can call Maryland’s financial regulation department for assistance. In general, in any state, either the Banking Commissioner, the Commissioner of Financial Regulation or the Attorney General’s Office is set up to provide consumers with assistance.

When contacting a credit bureau, all identifying information, such as one’s full name, Social Security number, current address, former addresses for the most recent five years, and spouse’s name (if applicable) should be provided. Ordinarily, a credit bureau will charge $5 to $15 per request for credit file information. If one has been denied credit, he or she is entitled to the credit report free. To get a complete credit picture, one could ask all local credit bureaus if they maintain a file.

An individual who is married probably has an individual credit file separate from his or her spouse’s file. These files may contain identical or different information, depending on whether the individuals have shared or separate accounts. It may be helpful for married individuals to review and compare credit history together.

Credit information on accounts opened before June 1, 1977 that are shared by a husband and wife often are reported only in the husband’s name. However, creditors must report the credit history individually, in the name of each spouse, if they are asked to do so. Newer accounts should be reported on an individual basis automatically. If one finds this not the case, he or she should consider if it is to their advantage to write to the creditor and request that the account be reported in both names.

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C. How Consumers Can Correct Errors

One’s credit file may contain errors that can affect one’s chances of obtaining credit in the future. Under the Fair Credit Reporting Act, a person is entitled to have incomplete or inaccurate information corrected without charge.

If one disputes information in his or her report, the credit bureau must re-investigate it within a “reasonable period of time,” unless it believes the dispute is “frivolous or irrelevant.” To check on the accuracy of a disputed item, the credit bureau will ask the creditor in question what its records show. If the disputed item is on the public record, the credit bureau will check there instead. If a disputed item cannot be verified, the credit bureau must delete it. If an item contains erroneous information, the credit bureau must correct the error. If the item is incomplete, the bureau must complete it. For example, if a file showed accounts that belong to another person, the credit bureau would have to delete them. If it showed that a consumer was late in making payments but failed to show that he or she was no longer delinquent, the credit bureau would have to add information to show that the payments are now current. Also, at the consumer’s request, the credit bureau must send a notice of the correction to any creditor who has checked a consumer’s file in the past six months.

If the reinvestigation does not resolve the dispute, the Fair Credit Reporting Act permits an individual to file a statement with the credit bureau explaining his or her side of the story. Unless the statement is deemed frivolous, the credit bureau must include this explanation or a summary of it with one’s report each time it is sent out.

D. Recourse for Consumers With Poor Credit History

Before creditors will give a person credit, they look at how he or she has paid bills in the past. Negative information in one’s credit file may lead creditors to deny credit. Information that is considered negative includes late payments, repossessions, accounts turned over to a collection agency, charge-offs (accounts viewed as a “loss” by a creditor), judgments, liens, and bankruptcy.

A poor credit history that is accurate cannot be changed. There is nothing that anyone can do to require a credit bureau to remove accurate information from a credit report until the reporting period has expired. However, this does not necessarily mean that one will be unable to obtain credit during the period. Because creditors set their own credit-granting standards, not all of them look at credit history in the same way. Some creditors may look only at more recent years to evaluate a person for credit, and they may grant an applicant credit if his or her bill-paying history has improved. Before applying for credit, it may be useful to contact creditors informally to discuss their credit standards.

If a person cannot obtain credit based on his or her own credit history, he or she may be able to do so if someone who has a good credit history co-signs a loan. Or a person may be able to obtain a small loan or a credit card with a low dollar limit by using his or her savings account as collateral. If one pays promptly and his or her creditor reports to a credit bureau, this new information will improve the loan recipient’s credit history.
E. Where Consumers Can Find Low Cost Help

If a person cannot resolve his or her credit problems alone or needs additional assistance, that person may want to contact a Consumer Credit Counseling Service (CCCS). This is a non-profit organization with more than 280 offices located in 44 states that counsels indebted consumers. CCCS counselors will try to arrange a repayment plan that is acceptable to the consumer and his or her creditors. They also will help the consumer to set up a realistic budget and plan expenditures. These counseling offices, which are funded by contributions from credit-granting institutions, are offered at little or no cost to consumers. The CCCS office nearest to a person can be found by checking the White Pages of the local telephone directory or by calling or sending a self-addressed stamped envelope to:

National Foundation for Consumer Credit
8701 Georgia Avenue, Suite 507
Silver Spring, Maryland 20910
(301) 589-5600

In addition, non-profit counseling programs are sometimes operated by universities, military bases, credit unions, and housing authorities. They are likely to charge little or nothing for their assistance. One can also check with a local bank or consumer protection office to see if it has a listing of reputable, low-cost financial counseling services. However, consumers need to be leery of credit repair firms that promise to delete accurate credit file information.

For brochures on credit reporting laws or related matters, such as “Building a Better Credit Record,” “Credit Billing Blues,” “Credit and Older Americans,” “Scoring for Credit,” “Solving Credit Problems,” and “Women and Credit Histories,” write to or call:

Public Reference
Federal Trade Commission
6th & Pennsylvania Avenue NW
Washington, DC 20580
202-326-2222
VI. Regulatory Actions

A. NAIC Insurance Information Privacy and Protection Model Act

The NAIC Insurance Information Privacy and Protection Model Act was developed in response to recommendations by the federal government’s Privacy Study Commission. In 1970, Congress passed the Fair Credit Reporting Act which regulates the relationship between credit granting institutions and credit reporting agencies. In 1974, the federal government also enacted the Federal Privacy Act. Applicable only to federal agencies, the Act protects the disclosure of information collected and maintained by all federal agencies. Included in the Act was a provision to create the Privacy Protection Study Commission to determine the need to extend the privacy protection established in the Federal Privacy Act to private industry. This commission made seventeen recommendations regarding privacy in the insurance industry. Included in these recommendations were the need for an insurance consumer to obtain and correct information in an insurance company’s files, and the requirement that an applicant be notified how an insurer uses personal information in the underwriting process.

The purpose of the model Act is to establish standards for the collection, use and disclosure of information gathered in connection with insurance transactions by insurance institutions, agents or insurance support organizations; to maintain a balance between the need for information by those conducting the business of insurance and the public’s need for fairness in insurance information practices including the need to minimize intrusiveness; to establish a regulatory mechanism to enable natural persons to ascertain what information is being or has been collected about them in connection with insurance transactions and to have access to such information for the purpose of verifying or disputing its accuracy; to limit disclosure of information collected in connection with insurance transactions; and to enable insurance applicants and policyholders to obtain reasons for any adverse underwriting decisions.

The Act applies to life and health insurance as well as to property and casualty insurance, but is limited to personal lines by the definition of an insurance transaction. Rights granted by the Act in the case of property and casualty insurance extend to: natural persons who are the subject of information collected, received or maintained in connection with insurance transactions and applicants, individuals or policyholders who engage in or seek to engage in insurance transactions.

Among the protections that impact the use of credit reports is the requirement that a “Notice of Insurance Information Practices” be furnished to the consumer. This applies to the collection of personal information, which means any individually identifiable information gathered in connection with an insurance transaction from which judgments can be made about an individual’s character, habits, avocations, finances, occupation, general reputation, credit, health or any other personal characteristics. In the event that personal information is collected from persons other than the individual(s) proposed for coverage, in connection with applications, renewals, policy reinstatement or change in benefits, the notice should state: (1) whether personal information may be collected from persons other than the individual(s) proposed for coverage; (2) the types of personal information that may be collected and the types of sources and investigative techniques that may be used to collect such information; (3) the types of
disclosures of such information; (4) description of the rights provided by this Act; (5) that
information obtained from a report prepared by an insurance support organization may be
retained by the insurance support organization and disclosed to other persons.

The Act also provides for access to recorded personal information and requires that consumers
be provided procedures for amending, correcting or deleting inaccurate personal information. In
addition, in the event of an adverse underwriting decision, an insurer is required to provide the
consumer with a summary of rights and advise the consumer of the specific reasons(s) or advise
the consumer that such information will be provided upon written request. An adverse
underwriting decision applies to any of the following actions with respect to insurance
transactions involving insurance coverage which is individually underwritten: (a) declination; (b)
termination; (c) failure of an agent to apply for insurance coverage with a specific insurance
institution which the agent represents and which is requested by an applicant; (d) in the case of
property and casualty insurance coverage: (1) placement by an insurance institution or agent of a
risk with a residual market mechanism, an unauthorized insurer or an insurance institution which
specializes in substandard risks; or (2) the charging of a higher rate on the basis of information
which differs from that which the applicant or policyholder furnished; or, (e) in the case of life
and health insurance coverage, an offer to insure at other than standard rates.

B. State Legislation/Actions
A survey of NAIC members was conducted in late 1995 to ascertain legislation in effect or
bulletins issued by members that either directly or indirectly address the use of credit reports in
underwriting. Forty-three members responded to the survey and the results can be found in the
appendix. Among the reported state actions on the use of credit reports are:

- Arkansas statute prohibits automobile insurers from refusing to insure risks or continue to
  insure risks based solely on knowledge of an insured’s credit history
- Hawaii statute that no standard or rating plan for auto be based upon a consumer’s credit
  bureau reports
- Louisiana statute that prohibits termination of an auto policy because of bankruptcy
- Maine FCRA establishes permissible purposes for consumer reports, standards for
  preparation and procurement of investigative consumer reports, establishes consumer
disclosure standards, requirements on correcting inaccurate information, requirements on
users of consumer reports, penalties, etc.
- Montana statute that an insurer for auto or homeowners may not refuse to insure or to
  continue to insure, charge a higher rate or limit the scope of coverage based solely upon
credit history unless related to the risk of the insured
- New York law requires an insurer to notify the consumer of adverse action taken in reliance
  on the credit report
- Oregon law prohibits the use of underwriting guidelines that treat individuals with
  “essentially the same degree” of risk differently.
- Texas prohibits the use of an underwriting guideline unless it is actuarially sound
• Virginia establishes certain requirements for insurers that non-renew private passenger automobile insurance policies and homeowner insurance policies based on the insured’s credit report. The insurer must give notice that the decision is based on a consumer report. If the consumer disputes the accuracy of the report, the homeowners policy may not be non-renewed until 30 days (45 for automobile) after the accuracy of the credit report has been verified and communicated to the insured.

• Washington bulletin provides that any insurer using any lifestyle factors, such as credit reports, must submit sound actuarial supporting analysis for all plans, discounts, surcharges, rating rules, rating tiers and rating factors to the department by December 1, 1995.

Also included in the appendix of this report are results of research conducted by the American Insurance Association into measures addressing credit reports in underwriting that have been submitted to state legislatures. The document indicates whether the proposed legislative action has passed, failed to pass or is still under consideration.

In 1993, three states, Arkansas, New Jersey and Ohio, proposed legislation on consumer credit reports. The Arkansas law, which prohibits the use of credit reports as a sole underwriting criterion for automobile insurance was enacted. In 1994 legislation was introduced in Illinois, New Jersey, Ohio, and Virginia and Washington. None of the legislation passed.

In 1995, the states of Arkansas, Connecticut, Delaware, Louisiana, Maryland, Missouri, Montana, New Jersey, New Mexico, and Virginia all proposed legislation. Montana passed legislation that would prohibit automobile and homeowner insurers from denying, canceling, failing to renew, or limiting coverage or benefits based solely upon an individual’s credit history. Virginia passed legislation prohibiting insurers and agents from refusing to renew an insurance policy for an owner-occupied dwelling based on certain discriminatory factors, including the use of credit history.

During 1996, the states of Missouri, Oklahoma, and Florida are considering additional action. The state of Florida is finalizing its adoption of Rule 4-125.004 that will require Florida insurers to establish a procedure that they will follow in the use of credit reports in insurance underwriting. Additionally, the rule requires insurers to maintain evidence of compliance with the procedure. Compliance with the procedure will be checked during market conduct examinations. This rule will also require insurers to provide written notice to consumers if their application is denied based on credit information. The notice will advise the consumer how they may obtain a copy of the credit report and the specific item in the credit report which resulted in the denial of insurance. The scope of the rule is limited to personal lines automobile and homeowners insurance. Massachusetts passed legislation, effective January 1996, amending laws regulating consumer reporting agencies to expand consumers’ rights and delineate agencies and users responsibilities.

In 1996, legislation was also introduced in the states of Delaware, Florida, Kentuckuy, Maryland, Missouri, New York, South Carolina and Tennessee. However, the legislation failed to pass in all these states, except Florida where the proposed legislation was withdrawn. (Refer to the appendix for a complete summary of actions.)
Other state regulatory agencies can assist or may have assisted consumers with credit reports. For example, in Maryland, the State Division of Financial Regulation has adopted a regulation which offers consumers greater protection than provided by the FCRA. These protections include requiring companies to provide consumers free credit reports and requiring that errors be corrected within 30 days.

C. Federal Fair Credit Reporting Act

The FCRA, enacted in 1970, was designed to protect the privacy of information in consumer reports and to ensure that information supplied by consumer reporting agencies is accurate. Although not required by the FCRA, many insurers do provide the applicant with a written disclosure which advises the applicant of his or her rights under the Act. The FCRA further provides that any user of a consumer report which bases a decision to deny or charge more for insurance wholly or partly on information contained in a consumer report must disclose this fact to the applicant and provide the applicant the name and address of the consumer reporting agency making the report. One reason for requiring this disclosure is that some consumer reports may contain errors. The disclosure allows the applicant to obtain a free copy of the report and check it for accuracy. The FCRA requires that this disclosure be written, oral or electronic. Under the FCRA, a consumer reporting agency is required to disclose information, excluding medical information, in its file to the individual upon request.

A number of modifications to the FCRA were enacted by Congress in 1996 (H.R. 3610; P.L. 104-208). Pre-screening is now permissible. Prescreening, which can be likened to prospecting or target marketing, occurs when a consumer reporting agency provides lists of consumers to their customers (banks, credit card issuers, finance companies, etc.) based on specific customer criteria. To obtain these lists, a customer will request that the consumer reporting agency select those consumers from its database that meet specific criteria. Some of the information that is available in the databases includes consumers’ addresses, family structure, dwelling type, age, median income, as well as public record information. The FTC has interpreted the FCRA to allow prescreening for credit purposes but not for insurance underwriting or employment purposes. Prescreened lists are allowed as long as all consumers selected in prescreening receive a firm offer of credit. Since this offer was deemed to be a benefit to consumers, prescreening for credit was allowed in the FCRA.

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2 “Firm offer of credit” means any offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer report on the consumer, to meet the specific criteria used to select the consumer for the offer, except that the offer may be further conditioned on one or more of the following:

1. The consumer being determined, based on information in the consumer’s application for the credit or insurance, to meet specific criteria bearing on credit worthiness or insurability, as applicable, that are established -
   (A) before selection of the consumer for the offer; and
   (B) for the purpose of determining whether to extend credit or insurance pursuant to the offer.

2. Verification -
   (A) that the consumer continues to meet the specific criteria used to select the consumer for the offer, by using information in a consumer report on the consumer, information in the consumer’s application for the credit or insurance, or other information bearing on the credit worthiness or insurability of the consumer; or
   (B) of the information in the consumer’s application for the credit or insurance, to determine that the consumer meets the specific criteria bearing on credit worthiness or insurability.
VII. Considerations

A. The use of credit reports in underwriting could be considered as part of the broader issue of insurance availability and affordability. Credit reports can be used to expand availability by giving insurers another tool to obtain a comfort level about applicants; they can also be used to restrict availability by giving insurers another tool to reject consumers. While the federal Fair Credit Reporting Act restricts the use of credit reports for some purposes, it specifies insurance underwriting as one of the purposes for which that information can be used. Nevertheless, each state may regulate the use of credit reports in a manner not contrary with other Federal and State law.

B. The threshold question of whether a state should categorically prohibit the use of credit reports in particular for personal lines as an “inherently” unfair trade practice raises broad social policy and equity issues of the sort that typically are addressed through the legislative process. Regardless of any underwriting value credit reports may provide, a state legislature may deem their usage to be per se unfair (discriminatory) and thus improper as a matter of social policy.

C. There is continuing controversy about the correlation between credit history and risk of loss.

D. There are numerous questions about the manner in which credit history is used, ranging from what kinds of consumer safeguards should be in place to correct erroneous reports to what standards should be in place to evaluate services that score or otherwise rank individual consumer reports.

E. The FCRA requires oral, written or electronic notification to the consumer of an adverse action (underwriting decisions) based upon consumer reports, but the notification need not be specific as to the reason for the adverse action. The FCRA only requires that insurers must: 1) notify the consumer of the consumer’s right to obtain a free copy of the consumer report on which the adverse action was based from the consumer reporting agency that provided the insurer with the report and of the consumer’s right to dispute the accuracy or completeness of any information in the report with that agency; and, 2) notify the consumer that the consumer may, within 60 days from the date of transmittal of the notice of adverse action, request that the insurer disclose the nature of the information upon which the action is based. The insurer has 60 days from the date of receipt of the request to respond. Furthermore, the state law preemptions in the FCRA appear to prohibit states from imposing more specific requirements related to the disclosure of the reason or reasons for the adverse action.

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(3) The consumer furnishing any collateral that is a requirement for the extension of the credit or insurance that was -

(A) established before selection of the consumer for the offer of credit or insurance; and
(B) disclosed to the consumer in the offer of credit or insurance.

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F. When an insurer considers the type of credit card a consumer holds (ex. gold card) to determine eligibility for preferred rates, the consumer may be unaware that they must have certain types of credit cards to be eligible for the best possible rate.

G. If a consumer is not aware of the use of consumer credit information or a scoring model and is not provided the specific reason for declination, the consumer will not know what corrective action must be taken to be eligible for the insurance coverage.

H. As with any underwriting or rating factor, if credit history is used as an underwriting guideline or as a rating factor, the population in the Fair Access to Insurance Requirements (FAIR) plan in a state may change to some degree.

I. By their very nature, credit scoring systems contain a significant amount of proprietary and confidential information. Those states which operate under a liberally applied public records law will need to consider how much deference should be accorded to claims of proprietary interest.

J. If in fact the scoring models are a good tool to select those consumers who have not been previously written, then the tool can be used as easily to determine which consumers not to write.

K. Many insurers do not have established guidelines to determine when to order a credit report or how to evaluate a credit report.

L. There are concerns that insurers may use credit reports or credit information as the sole underwriting tool to determine insurability, discounting more traditional factors.

M. Credit information is used differently by vendors of underwriting tools and by insurers. While one insurer’s use of credit history may be “fair,” this does not guarantee that all insurers use of credit history will be “fair.”

N. Unfair Trade Practices Statutes may provide a framework that can address unequal applications of credit reports.

O. It is important to recognize that the FCRA was written in 1970 when few people envisioned the rapid growth and sophisticated computerization of credit reporting and especially credit scoring. The FCRA does not specifically address the use of credit scoring systems. In recent years there have been annual attempts to amend the FCRA. Perhaps those efforts should also include amendments related to the use of credit history and credit scoring in insurance underwriting. At a minimum, insurance regulators should support efforts to improve the credit reporting industry’s accuracy and complaint handling records.

P. Some insurers assert that credit history is a greater predictor of future losses than the traditional underwriting factors. Based upon this statement, those insurers should not be allowed to rely upon these factors at the time of termination or cancellation.
Q. There have been differing opinions about the accuracy of credit reports. Given the questions surrounding the accuracy of credit reports, regulators are concerned if incorrect information is relied upon as the sole basis for an underwriting decision.

R. Relying solely upon credit reports to make underwriting decisions presupposes that credit is risk-related.

S. Lower risk policyholders should not be subsidizing higher risk policyholders. If a jurisdiction determines that credit history is indeed a valid predictor of future loss probability, restrictions placed upon its use may lead to subsidization of premiums.
VIII. Recommendations

A. To the extent they have authority to do so, state insurance departments may want to look at two more focused issues with respect to the use of credit reports: whether there is a demonstrable relationship between credit history and risk of loss, and whether credit reports are used in a fair and consistent manner in the underwriting process.

B. If used, credit information should be applied consistently within a company within a book of business, but each company should be able to decide whether or not to use credit history or whether to use a credit factor in rating.

C. States may want to consider revising state laws to regulate entities that develop credit scoring as advisory organizations.

D. An insurer should not be permitted to cancel or nonrenew a policy solely due to an adverse credit history even if it initially underwrites the policy based solely on credit history.

E. Insurers must develop objective, verifiable guidelines for the ordering of and interpretation of credit reports.

F. In order for an applicant to be able to correct erroneous information, it is necessary to know what information causes the risk to be unacceptable. States may want to consider legislation to require that the insurer provide the applicant with clear and specific reasons why the risk is unacceptable. Any scoring program that cannot allow for production of this information should be unacceptable. The NAIC Insurance Information and Privacy Protection Model Act requires that a specific reason be provided and provides protections for amending, correcting and altering an insurers’ action.

G. States may want to consider legislation to afford temporary protection to an applicant who complains that the credit report is inaccurate. The NAIC Model Improper Terminations Model Act provides for advance notice of cancellation or nonrenewal; however, the amount of notice may be inadequate for correcting a credit report.

H. Individual state insurance departments should modify their complaints systems to capture consumer complaints related to the use of credit reports. The NAIC Complaints Database System (CDS) should also be modified to track this information.

I. An individual state insurance department may choose to accept a scoring model without further review or may require that the insurer using such a model be required to furnish evidence (the algorithm and underlying data upon which it was based) of the correlation of credit history to risk of loss. If a scoring model is used, it should be based upon a correlation of credit to risk of loss.
J. Individual Insurance departments may want insurers to adhere to the *Insurance Industry Statement of Principles Regarding the Use of Consumer Credit Information* (refer to Section IV, Part G).

K. Regulators should use existing market conduct authority to determine if the use of credit reports in certain circumstances results in unfair or improper practices or results in unfair discrimination in the availability or affordability of insurance.

L. Regulators can use the Unfair Trade Practices Act, along with market conduct examinations, to determine unfair use of all underwriting tools used by insurers, including consumer credit information.

M. Interested states should continue communications with Allstate Insurance Company and Fair, Isaac to attempt to resolve the issue of correlation.

N. A state may choose to require insurers to provide consumers with a written notice when an adverse determination is based upon credit information.

O. The underwriter of an insurer who uses a scoring model should not have the ability to override the result unless the insurer has clear and consistent guidelines for such overrides.

P. The industry should take steps to educate consumers about the scoring process.
Appendix
First National Bank
987 Any Road
Anytown, Anystate 12345

Betty G. Consumer
123 Any Street
Anytown, Anystate 12345

Former Address: 4321 First Ave. Anytown, Anystate 45678

SSN 123-45-6789

Spouse’s Name: Robert R.

Present Employer and Address
XYZ Corporation 987 Main Street, Anytown, Anystate 12345

Position Income $3,500/mo.

Emp. Date 10/81

Date Verified 12/94

Former Employer and Address
ABC & Associates 456 Second Drive, Anytown, Anystate 12345

SAMPLE LISTING OF ACCOUNTS ON EQUIFAX CREDIT FILE

<table>
<thead>
<tr>
<th>COMPANY NAME</th>
<th>ACCOUNT NO.</th>
<th>WHOSE ACCT.</th>
<th>DATE OPENED</th>
<th>MONTHS REVIEWED</th>
<th>DATE LAST ACTIVITY</th>
<th>HIGH CREDIT</th>
<th>TERMS</th>
<th>ITEMS AS OF DATE REPORTED</th>
<th>DATE REPORTED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charter Bank VISA</td>
<td>8624550</td>
<td>J</td>
<td>06/91</td>
<td>30</td>
<td>03/95</td>
<td>6000</td>
<td>$20</td>
<td>R1</td>
<td>04/95</td>
</tr>
<tr>
<td>FFB Mortgage (Real Estate Mortgage)</td>
<td>664938456292</td>
<td>J</td>
<td>03/86</td>
<td>36</td>
<td>03/86</td>
<td>61K</td>
<td>776</td>
<td>57.3K</td>
<td>II</td>
</tr>
</tbody>
</table>

EXPLANATION (from left to right, starting at top of credit data)

Company name: identifies the business that is reporting the information.
Account number: your account number with the business reporting the account information.
Whose Account: indicates who is responsible for the account; I is individual and J is joint.
Date Opened: the month and the year the account was opened.
Months Reviewed: number of months that the account payment history has been reported.
Date of Last Activity: this date could be either the date of last payment or, where there is no balance, the date of the last charge.
High Credit: the highest amount charged or the credit limit.
Terms: represents the number of installments or monthly payments.
Items as of Date Reported:
  Balance: the amount on the account at the time of the report.
  Past due: indicates any amount past due at the time of report.
  Status: lists the type of account (open, revolving or installment. Timeliness of payment refers to your payment history on the account: 1= current; 2=30 days late, etc.)

Date: of last account update

SAMPLE LISTING OF ACCOUNTS ON TRW CREDIT FILE

<table>
<thead>
<tr>
<th>ITEM</th>
<th>ACCOUNT NAME</th>
<th>DESCRIPTION</th>
<th>STATUS/PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Charter Bank VISA</td>
<td>This revolving loan was opened 06/91 and has unspecified repayment terms. You have contractual responsibility for this account and are primarily responsible for its payment.</td>
<td>As of 04/95 this account is current and all payments have been made on time.</td>
</tr>
<tr>
<td>2</td>
<td>FFB Mortgage 180 Wild Basin Rd Austin, TX 78746 ACCT# 664938456292</td>
<td>This conventional real estate loan was opened in 1986 and has 30 year repayment terms. You are obligated to repay this joint account. The original loan amount of this account is $61,000</td>
<td>As of 1995 this account is current and all payments have been paid on time. Your balance as of 04/95 is $57,370. Your scheduled monthly payment is $776. The last payment reported to TRW was made 04/95.</td>
</tr>
</tbody>
</table>

see next page
SAMPLE LISTING OF ACCOUNTS ON TRANS UNION CREDIT FILE

THE FOLLOWING ACCOUNTS CONTAIN INFORMATION WHICH SOME CREDITORS MAY CONSIDER TO BE ADVERSE. THE ADVERSE INFORMATION IN THESE ACCOUNTS HAS BEEN PRINTED IN >BRACKETS< FOR YOUR CONVENIENCE TO HELP YOU UNDERSTAND YOUR REPORT. THEY ARE NOT BRACKETED THIS WAY FOR CREDITORS. (NOTE: THE ACCOUNT # MAY BE SCRAMBLED BY THE CREDITOR FOR YOUR PROTECTION.)

>NONE<

THE FOLLOWING ACCOUNTS ARE REPORTED WITH NO ADVERSE INFORMATION

CHARTER BANK VISA - # 8624550
  REPT'D   04/95  BALANCE:   $520
  OPENED   06/91  MOST OWED:
  STATUS AS OF 04/95: PAID AS AGREED

REVOLVING ACCOUNT
INDIVIDUAL ACCOUNT

FFB MORTGAGE - # 6648938456292
  REPT'D   04/95  BALANCE:  $57,370
  OPENED   03/86  MOST OWED: $61,000
  STATUS AS OF 04/95: PAID AS AGREED

CONVENTIONAL REAL ESTATE LOAN
JOINT ACCOUNT

COMPOSITE OF PUBLIC RECORD INFORMATION & INQUIRIES INTO THE CREDIT FILE
SMALL CLAIMS CT. CASE #SC1001 PLAINTIFF: ANYWHERE APPLIANCES. AMOUNT $225 PAID 4/4/82
ADDITIONAL INFORMATION: REF. SMALL CLAIMS CT. CASE #SC1001--05/30/82 SUBJECT SAYS CLAIM PAID UNDER PROTEST.
APPLIANCE DID NOT OPERATE PROPERLY

**********COMPANIES THAT HAVE REQUESTED YOUR CREDIT HISTORY**********
  01/12/94  Main Bank  11/02/92  Big Town Department Store
  03/02/93  National Bank  09/24/91  City Women's Clothes Store
The TRW
Credit Profile Report

Files on over 180 million credit active consumers nationwide are maintained in the TRW database. Your inquiry initiates a search of this database which produces an applicant’s credit history—the TRW Credit Profile report. An illustration and description of a sample Profile report follow.

1 A code which identifies the TRW or Credit Bureau office nearest to the consumer’s current address. Use for consumer referrals.

2 Consumer’s name and address including time frame reported and source. U= Update Tape, I= Inquery, and M= Manual Data.

3 Consumer’s previous addresses with source, in order of date reported. Up to two may display.

4 Consumer’s Social Security number.

5 Consumer’s year of birth.

6 Spouse’s first name initial.

7 Employer’s name and address as reported via subscriber inquiry as of the dates shown.

8 Previous employer’s name and address as reported via subscriber inquiry as of the dates shown.

9 Other Social Security numbers reported on the consumer’s file. An asterisk denotes any social not matching the inquiry. Display is in descending order based on number of occurrences reported.

10 AKA—Alternate surnames such as aliases, maiden or previous surnames associated with the consumer’s file and used in the search process.

Nickname—Nickname(s) associated with the consumer that were used in the search process.

11 FACS+ Summary: contains messages related to the FACS+ fraud prevention services. Optional with CHECK keyword on inquiry.

12 Profile Summary contains 16 significant calculations from the Profile report. Optional; contact your TRW representative.

13 Risk model score: generated if you use TRW’s credit risk models. Optional with RM keyword on inquiry.

14 Public records: court name, reference number, filing date, plaintiff, court code, amount and type of public record. Public record information consists of bankruptcies, liens and judgments against a consumer.

15 An asterisk preceding public record information or a tradeline indicates that information may need further review.

16 Reporting subscriber’s name.

17 Consumer’s account number.

18 Reporting subscriber’s number.

19 KOB (Kind of Business Code) describes a subscriber’s business. The first letter designates an industry. The second character more narrowly defines a subscriber’s business.

20 Type of account.

21 Terms of account.

22 Code describing consumer’s association to the account per the Equal Credit Opportunity Act.

23 Date the account was opened.

24 Balance date: the date balance information was extracted from the subscriber’s accounts receivable file.

25 Date of consumer’s last payment on the account.

26 The amount of the loan or credit established.

27 Indicates if the amount is an original loan (O), credit limit (L), high balance (H), charge-off (C) or unknown (blank).

28 Current balance on the account.

29 Payment amount the consumer is scheduled to pay on the account.

30 Status date: the date the account status was reported to TRW.

31 The amount past due for the account.

32 Account status comments indicate the payment condition of the account as of the status date.

33 The consumer’s payment history during the past 24 months. The codes reflect the status of the account for each month and are displayed for balance reporting subscribers only.

C Current
N Current account/zero balance reported
1 30 days past the due date
2 60 days past the due date
3 90 days past the due date
4 120 days past the due date
5 150 days past the due date
6 180 days past the due date
-Dash No history reported for that month.
Blank No history maintained; see account status comment.
<table>
<thead>
<tr>
<th>Spouse Name and Social Security Number</th>
<th>Previous Address</th>
<th>Subscriber Number and Password</th>
<th>Consumer's Name</th>
<th>Current Address</th>
<th>Social Security Number</th>
<th>Year of Birth</th>
<th>Type Terms and Amount</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Credit Profile**

- **TRW**
- **TS:** 3122250X1J CONSUMER, JONATHAN QUINCY 548603388
- **NAME:** NANCY CHRISTINE 526102333
- **ADDRESS:** CA-10655 NORTH BIRCH STREET/BURBANK CA 91502
- **PA:** 1314 SOPHIA LANE APT #3/SANTA ANA CA 92708, Y-1951 T-04048060
- **E-AXR HARDWARE/2035 BROADWAY SUITE 300/LOS ANGELES CA 90019

**Inquiry Information**

- **PAGE 1 DATE:** 8-31-93 **TIME:** 11:23:14 **HP26 V205**

**Computer Information**

- **JONATHAN QUINCY CONSUMER**
  - 10655 BIRCH STREET
  - BURBANK CA 91502
  - RPTD: 12-89 TO 5-93 U

**Consumer Identifying Information**

- **1314 SOPHIA LANE #3**
  - SANTA ANA CA 92708
  - RPTD: 11-84 U
  - 235 EAGLE POINT BLVD
  - BUFFALO NY 14202
  - RPTD: 2-84 U

- **AKA:** SMITH
- **NICKNAME:** JACK

**FACS+ Summary**

- **PERSON:** ISSUED SSN IS DECEASED ON FACS+ FILE
- **DOB:** 1-10-1951 **DOD:** 6-30-1993
- **INPUT SSN:** ISSUED 1965-1966
- **FROM 5-01-93 # OF INQS WITH THIS SSN=8**
- **818.555.1212**

**Profile Summary**

- **PUBLIC RECORDS----1**
  - FAST DUE AMT----8956
  - INQUIRIES----2
  - SATIS ACCTS----1
  - INSTALL BAL----$34,478
  - SCH/EST PAY----$1,000
  - INQS/6 MOS----1
  - NOM DEL/DRG----2
  - R ESTATE BAL----N/A
  - R ESTATE PAY----N/A
  - TRADELINES----5
  - TRADELINES----5
  - REVOLVING BAL----$437
  - REVOLVING AVAIL----73%
  - PAID ACCTS----1
  - OLD TRADE----5-82

**Risk Model**

- **NATIONAL RISK SCORE = 185**

**Public Records**

- **PUBLIC RECORDS:**
  - **REP#: 7505853**
  - **PLAINTIFF:** ALLIED COMPANY
  - **CO**: SFA CT SANTA ANA
  - **10-19-89**: 3019999
  - **$1,200**
  - **JUDGMENT SAT**

**Subscr# KOB Type Term ECOA Last Pay Month Pay $Fast Due In Prior Mos**

<table>
<thead>
<tr>
<th>SUBSCR#:</th>
<th>KOB</th>
<th>TYPE</th>
<th>TERM</th>
<th>ECOA</th>
<th>LAST PAY</th>
<th>MONTH PAY</th>
<th>$Fast Due</th>
<th>IN Prior Mos</th>
</tr>
</thead>
<tbody>
<tr>
<td>3562A01732534685</td>
<td>16</td>
<td>B</td>
<td>60</td>
<td>2</td>
<td>8-90</td>
<td>23</td>
<td>432,225</td>
<td>O</td>
</tr>
<tr>
<td>1139999</td>
<td>18</td>
<td>19</td>
<td>20</td>
<td>21</td>
<td>22</td>
<td>18</td>
<td>13</td>
<td>20</td>
</tr>
</tbody>
</table>

**Confidential**
34 Indicates the consumer’s collateral against this account. Balloon payment information (date and $ amount) or ‘sold to’ creditor name may appear, if provided by a subscriber.

35 Special comments reported by a subscriber or consumer to distinguish accounts which may require special handling.

36 Two amounts may display. Indicates the account has a $1,600 (L)imit and the (H)ighest balance was $1,285.

37 Monthly payment estimated, indicated by the ‘E’ directly after the monthly payment amount, calculated by TRW based on reporter’s formula. A scheduled monthly payment is indicated if there is no ‘E’.

38 For third party collection agency tradelines, the name of the credit grantor who placed the account with the collection agency displays.

39 Inquiries: indicate a Profile report was received on that date by the subscriber listed. Inquiring subscriber name, number and KOB are shown. Type, terms and amount may display and are from the subscriber’s inquiry input.

40 Name, address and telephone number of TRW office or Credit Bureau nearest to the consumer’s current address. Use for consumer referrals. Display is elective; contact your TRW representative.

Please contact your local TRW representative or call Customer Support at (800) 854-7201 for more information.
TRANS UNION CREDIT REPORT FIELDS

1. Inqury Information
Subscriber inquiry information is displayed at the top of the report. On every Trans Union Credit Report the inquiring subscriber’s Trans Union-assigned code, name, market area where the file resides within the Trans Union system, date the file was created, and inquiry date and time (central time zone) of the inquiry are displayed.

2. Demographic Information
Helps you verify consumer identification by providing:
- Consumer’s name, plus any known aliases.
- Current address and date reported.
- Up to two previous addresses, date reported on first previous address.
- Social security number.
- If available, date of birth, telephone number and most current employer, one previous employer, including addresses, position, income and date employment was verified, reported and/or hired.

Special Messages
Highlights specific credit file conditions that may include:
- Suspected fraud, as indicated by TRANS ALERT or HAWK.
- Presence of consumer statement.
- No subject found.

3. **A TRANS ALERT message appears when the input address, SSN or surname does not match what is on file; or when a minimum of four inquiries have been made against the file within the last 60 days.**

4. **HAWK messages (optional) appear if address, phone number or SSN have been used in suspected fraudulent activity; or if the information is inappropriate on an application, such as a commercial or institutional address; or if the SSN has not been issued by the Social Security Administration or is that of a deceased person as reported by the Social Security Administration.**

Model Profile
Displays unbiased predictive scores to project a consumer’s future credit risk. Other scores available estimate income, project recovery dollars and predict insurance risk.

5. Risk score factors are displayed numerically or in text. Up to four factors are disclosed with EMPIRICA, NEW DELPHI, PATROL and ASSIST. These factors are displayed in order based on their relative impact on the final score.

6. ***ALERT*** appears after model profile heading when MOP 7 or greater, a negative public record or a collection is present on the file.

7. ***NEW DELPHI*** predicts the likelihood of an applicant becoming bankrupt within the next 12 months.

Credit Summary
Provides a “snapshot” of all activity on the consumer’s credit report.
- Available as an option covering either total file history or 12-month file history.
- “Total File History” or “12 Month History” will print in the upper right hand corner of the credit summary depending on the option chosen.

From left to right, headers in the first row read as follows:
- Total number of public records.
- Total number of collection accounts; accounts with a Kinds-Of-Business (KOB) code of “Y”.
- Total number of accounts with a current manner of payment (MOP) 2 or greater.
- HISTORICAL NEGATIVE: Derived from the payment pattern flick Display ed in t-i-i format.
- Negative Total number of times MOP 2 or greater ratings have historically occurred. Excludes current MOP.
- Total number of trades. TRD value is the sum of RVL, INST, MTG and OPN values.
- Total number of revolving and/or check credit accounts (Account types “R” and “C”).
- Total number of installment accounts (Account type “I”).
- Total number of mortgage accounts (Account type “M”).
- Total number of open accounts (Account type “O”).
- Total number of inquiries.

From left to right, headers on the second row read as follows:
- Highest amount ever owed on an account.
- Maximum credit amount approved by credit grantor.
- Balance owed as of the date verified.
- Amount past due as of the date verified or closed.
- From the “TERMS” field on the account; subscriber-reported monthly payment.
- Percent of credit available for revolving, check credit and open accounts. Field is calculated by subtracting balance from credit limit divided by credit limit.
- Totals for second row headers are included for: Revolving, Installment (Mortgage, Open and Closed with Balance accounts not shown on sample report).

*Note: Fields with dollar amounts will display K= Thousands, M=Millions.

Public Record
Public record information is maintained on a consumer’s file in compliance with the Fair Credit Reporting Act (FCRA). This information is obtained from county, state and federal courts and provides notification of:
- Civil judgements or tax liens reported for the consumer over the past 7 years.
- Bankruptcies the consumer has filed during the past 10 years.
- Public record information includes the source, type of public record, date the public record was reported to the credit bureau, any liabilities, the ECOA designator; (see the “codes page” that follows for more details) court location, any assets and the date the public record was paid (if applicable). Also lists the docket number, the plaintiff and attorney involved in the case.
CREDIT REPORT

1 DUNCAN, ELIZABETH*2 9932, WOODBINE, CHICAGO, IL 60693*3 10 N. CAMINO, OAKLAND, CA 94583*5 001-01-0418**

TRAN UNION CREDIT REPORT

<FOR> <SUB NAME> <MIT SUB> <INFILE> <DATE> <TIME>
(I) D248 ABC DEPT STORE 06 CH 4/74 12/15/95 09:36CT

<SSN> 002-02-2222 <BIRTH DATE> 2/53

<TELEPHONE> 555-4212

<CURRENT ADDRESS> 9932 WOODBINE, #9B CHICAGO, IL 60693

<DATE RPTD> 11/93

<FORMER ADDRESS> 10 N. CAMINO, OAKLAND, CA 94583

<DATE RPTD> 2/92

<CURRENT EMPLOYER AND ADDRESS> MARRIOTT HOTELS CONCIERGE

8638 GRAND, ANYTOWN, IL

32500Y 11/94 11/94 11/91

SPECIAL MESSAGES

TRANS ALERT: INPUT SSN DOES NOT MATCH FILE SSN***

HAMP ALERT: INPUT SSN ISSUED: 1936 - 1950; STATE: NH

FILE SSN NOT ISSUED BY SOCIAL SECURITY ADMINISTRATION***

MODEL PROFILE

NEW DELPHI ALERT: SCORE 6775: 26, 03, 06, 25 ***

CREDIT SUMMARY

TOTAL FILE HISTORY

REVOLVING: $500 $1000 $100 $20 $990

INSTALMENT: $16.0K $12.4K $1974 $282

TOTALS: $16.5K $1000

PUBLIC RECORDS

SOURCE DATE LIAB ECOA ASSETS DOCKET#

TYPE COURT LOC PLAINTIFF/ATTORNEY

Z 4932059 6/95M $13.0K 0 94058521

CIVIL JUDGMENT CHICAGO, IL R. SMITH/D. WINSLOW

COLLECTIONS

SUBNAME SUBCODE ECOA OPENED CLOSED $PLACED CREDITOR MOP

ACCOUNT# VERIFIED BALANCE REMARKS

ADVANCED COL Y 999C004 1 1/95 1/95F $2500 ARC BANK 091

12945 12/95A $1000 MAKING PAYMENTS

TRADES

SUBNAME SUBCODE OPENED HIGH CRED TERMS MAX DEX PASTDUE 1-12 MOP

ACCOUNT# VERIFIED CREDLIM PASTDUE AMT-MOP PASTDUE REMARKS

ECOA COLLATR/L/LOANTYPE CLSD/PD BALANCE REMARKS

AMERICAN BK B 6661001 5/94 $16.0K 60M282 12/95 $543232111111 705

9876543210 12/95A $1974 1974 05 11111111

I NISSAN MAXIMA $12.4K 19V 2/3 0

FILENED D 3847002 4/91 $500 MIN20 111111111111111 R01

2212345678 12/95A $1000 111111111111

C CREDIT CARD $100 48V 0/0 0/0

INQUIRIES

DATE SUBCODE SUBNAME DATE SUBCODE SUBNAME

12/15/95 DCH248 ABC DEPT STORE 12/15/95 DPC9999 TEST BANK

END OF CREDIT REPORT - SERVICED BY:

TRANS UNION CORPORATION 810-524-2222

PO BOX 390, SPRINGFIELD, PA. 19064

47
COLLECTIONS
Identifies consumer accounts that have been transferred to a professional debt-collecting firm.
Collection information includes the name of the collection agency providing information, consumer's account number with the collection agency, collector's Kind-of-Business designator and Trans Union assigned reporting subscriber number (all collection agency subcodes begin with a "Y"), the ECOA designator (see the "codes page" that follows for more details), date the amount was charged off by the original creditor, date the information was verified along with an indicator code (see the "codes page" that follows for more details), date the item was turned over to a collection agency, original dollar amount of collection, the balance owed as of date verified or closed, name of the original creditor, and an explanation of current account status as reported by the collection agency.

TRADES
Provides an on-going historical and current record of the consumer's buying and payment activities.
• Trades are available sorted by most derogatory followed by date verified or vice-versa.
• Payment pattern is available displaying either 12 or 24 months.

Trade information includes the following:
Abbreviated name of creditor grantor with whom consumer has an account.
Consumer's account number with the credit grantor.
ECOA indicates responsibility for paying the account;
(see the "codes page" that follows for more details).
Credit Grantor's Kind-of-Business designator and Trans Union-assigned reporting subscriber number (see the "codes page" that follows for more details).
Collateral for an installment loan or type of loan.
Date the account was opened.
Date of last activity on the account; (see the "codes page" that follows for more details).
Date an account was closed or paid out.
Highest amount ever owed by the consumer on that account.
Maximum amount of credit approved by credit grantor.
Balance owed as of date verified or closed.
Number of payments, payment frequency, and dollar amount agreed upon.
Amount past due as of date verified or closed.
Explanation of dispute or account credit condition, as reported by the credit grantor.
Date on which the maximum level of delinquency for that account occurred.
Dollar amount of consumer's maximum delinquency and the manner of payment rating at the time.
Manner of payment (MOP) for the 12 most recent months. Payment pattern reads from the left to right, with the most recent verified entry on the left of the first line. The pattern then works its way back in time. There are six different characters that may appear in the payment pattern. These are MOP values 1 through 5 and X, which are those reported by the credit grantor. The X is inserted by Trans Union if the following conditions occur:
• Automated data was not received from the credit grantor for that month.
• The account is reported as disputed by the consumer. In this case, an X is placed in the left-hand (most recent) position and the three next most recent values are changed to an X. This is done to ensure full compliance with the Fair Credit Billing Act.
• Any MOP other than 1 through 5 was received; for example, 00, UR or UC.

Manner of payment for the 12 months preceding those reported under PAYPAT 1-12. (See 43 for explanation.)
• 4 - column display; describing payment history.
• MO-Number of months reviewed
  30 = Number of times over 30 days late
  60 = Number of times over 60 days late
  90 = Number of times over 90 days late

Type of account (R, I, M, O, C) and manner of payment code at which the account is currently reported; (see the "codes page" that follows for more details).

INQUIRIES
Displays which companies have viewed the consumer's credit file over the last 2 years. Includes date the inquiry occurred, inquiring subscriber's Trans Union-assigned account number and name.
• Available in a one or two column display.
• If two column, inquiries are displayed either left to right or top to bottom, by date.

"REPORT SERVICED BY"
Identifies the Trans Union bureau owning or servicing the credit report. This information directs consumers to the appropriate location.

FIELDS NOT DISPLAYED IN SAMPLE REPORT
CONSUMER STATEMENT, when provided, will appear at the bottom of the report.

MISCELLANEOUS STATEMENTS may appear at the end of the report to provide relevant information that does not meet criteria for inclusion in other sections.

LOOK identifies subscriber's name, complete address and telephone number if available for quicker, easier referral.

OPTIONAL MODELS AVAILABLE
EMPIRICA predicts the likelihood of an applicant becoming delinquent within the next 24 months.
NEW DELPHI predicts the likelihood of an applicant becoming bankrupt within the next 12 months.
REWARD rank orders delinquent accounts by estimated repayment dollars within 6 months.
TIE estimates individual consumer income.
PATROL measures the likelihood of a consumer carrying required collateral insurance.
ASSIST rank orders insurance consumers on the basis of the predicted loss ratio for a score range group.
When the 12-month payment pattern option is selected instead of the 24-month pattern, the headers in the trade section display in a slightly different format.

| 1 | Abbreviated name of credit grantor with whom consumer has account. |
| 2 | Consumer’s account number with the credit grantor. |
| 3 | ECOA indicates responsibility for paying the account; (see the "codes page" that follows for more details). |
| 4 | Credit grantor’s Kind-Of-Business designator and TRANS UNION-assigned reporting subscriber number; (see the “codes page” that follows for more details.) |
| 5 | Collateral for an installment loan or type of loan. |
| 6 | Highest amount ever owed by the consumer on that account. |
| 7 | Date the account was opened. |
| 8 | Maximum amount of credit approved by credit grantor. |
| 9 | Date of last activity on the account; (see the “codes page” that follows for more details). |
Trans Union Credit Report Codes

ECOA INQUIRY AND ACCOUNT DESIGNATORS
A Authorized user of shared account
C Joint contractual liability
I Individual account for sole use of customer
M Account for which subject is liable, but co-signer has liability if the maker defaults
P Participant in shared account which cannot be distinguished as C or A
S Account for which subject is co-signer and becomes liable if maker defaults
T Relationship with account terminated
U Undesignated
X Deceased

DATE INDICATORS
A Automated
C Closed
D Declined
F Repossessed/Written Off/Collection
I Indirect
M Manually Frozen
N No Record
P Paid Out
R Reported
S Slow Answering
T Temporarily Frozen
V Verified
X No Reply

MOP CURRENT MANNER OF PAYMENT
00 Not rated, to new to rate, or approved but not used
01 Pays as agreed
02 30-59 days past the due date
03 60-89 days past the due date
04 90-119 days past the due date
05 120 days or more past the due date
07 Paying or paid under Wage Earner Plan or similar arrangement
08 Repossession
8A Voluntary repossession
8D Legal repossession
8P Paying or paid account with MOP 08
8R Repossession; redeemed
09 Charged off to bad debt
9B Collection account
9P Paying or paid account with MOP 09 or 9B
UC Unclassified
UR Unrated

KINDS OF BUSINESS CLASSIFICATION
A AUTOMOTIVE
B BANKS AND S&L
C CLOTHING
D DEPARTMENT, VARIETY AND OTHER RETAIL
E EMPLOYMENT
F FINANCE, PERSONAL
G GROCERIES
H HOME FURNISHINGS
I INSURANCE
J JEWELRY, CAMERAS AND COMPUTERS
K CONTRACTORS
L LUMBER, BUILDING MATERIAL, HARDWARE
M MEDICAL & RELATED HEALTH
N CREDIT CARD AND TRAVEL/ENTERTAINMENT COMPANIES
O OIL COMPANIES
P PERSONAL SERVICES OTHER THAN MEDICAL
Q FINANCE COMPANIES, OTHER THAN PERSONAL FINANCE COMPANIES
R REAL ESTATE AND PUBLIC ACCOMMODATIONS
S SPORTING GOODS
T FARM AND GARDEN SUPPLIERS
U UTILITIES AND FUEL
V GOVERNMENT
W WHOLESALE
X ADVERTISING
Y COLLECTION
Z MISCELLANEOUS

A CONFIDENTIAL REPORT—FOR INTERNAL USE ONLY
The information contained herein is intended for the exclusive use of the inquirer based upon his representation that the inquiry is for a legitimate permissible purpose as defined in the Fair Credit Reporting Act. All information has been obtained from sources reasonably believed to be reliable, but the accuracy of which is not guaranteed. The inquirer agrees to indemnify and hold harmless the reporting bureau from any damages arising out of any improper use of this information, and it is furnished in reliance on that indemnity. The inquirer agrees to hold all information contained herein in strict confidence, and not to reveal it to any one, including the subject of the report except as required by state law.

Your local Trans Union credit bureau is:

Form No. TCRE-003 1/96 50K Printed in U.S.A.

A member of The Marmion Group of companies

TRANS UNION
Solutions From The Company That Listens

555 West Adams Street
Chicago, Illinois 60661-3601
1-800-899-7132
SAMPLE NCF REPORT

EQUifax - NATIONAL CREDIT FILE REPORT

Quoteback: #227986357
Account: 88654-0A
GENERAL MUTUAL INSURANCE OF GEORGIA
Requestor: K. KIDD

SEARCH INFORMATION
Name: AALRED, JOHN A
Address: 942 PEACHTREE RD ATLANTA GA 30302
Fmr Add: 410 COOSEN DR SAN JOSE CA 95119

SUBJECT IDENTIFICATION
Name: AALRED, JOHN A
A/K/A: AALRED, JACK
Address: 9422 PEACHTREE RD ATLANTA GA 30302
Fmr Add: 410 COOSEN DR SAN JOSE CA 95119
Fmr Add: 45 KENNEDY DR DETROIT MI 55103

SUMMARY
Bankruptcies: YES (07/90)
Assets: $88,842

Public Records: YES
Outstanding Opening Date of Trade: 11/82
Liabilities: $96,317

Collection Items: YES
Latest Reporting Date of Trade: 11/95
Exempt: $5,273

High Credit Range: $250-5000
Latest File Activity: 11/07/95

Type of Item: BANKRUPTCY
Date Filed: 11/92
Type: PERSONAL
Date Verified: 01/94

File Established: 08/15/77
Debtor: JOHN AALRED
Status: DISCHARGED (CHAPT. 11)
Case Number: VS50530

PUBLIC RECORDS/LEGAL ITEMS
Date Filed: 07/90
Case Number: 812461

Firm/Woc: LOCKHEED, MARIETTA, GA
Amount: $26,667

Former: Position: ENGINEER
Account: 845374962538
Date Left: 09/92
Date Released: 11/93
Date Discharged: 01/94
Status: SATISFIED
Customer: John A. Aalred
Case Number: 552391

Plaintiff: JOHN AALRED
Defendant: MEMORIAL HOSPITAL

COLLECTION ITEMS
Amount: $459
Balance: $845374962538
Balance Date: 11/94
Credit Grantor: Dr. Gerald Kopp

** CONSUMER STATEMENT IN FILE **

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SAMPLE NCF REPORT (cont'd)

--- TRADE ACCOUNT ACTIVITY ---

<table>
<thead>
<tr>
<th>Date</th>
<th>Current</th>
<th>High</th>
<th>Now</th>
<th>Past</th>
<th>Terms or Mos</th>
<th>Date</th>
<th>Acct Firm</th>
<th>Rev</th>
<th>Opened</th>
<th>Type</th>
<th>Name &amp; No</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/95 R2/LATE 30-60</td>
<td>250</td>
<td>185</td>
<td>50</td>
<td></td>
<td>81</td>
<td>11/82</td>
<td>INDIV J C PENNEY</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Last Activ.: 10/95  *4010600007*

Times Late: by 30 Days: 4  by 60 Days: 3  by 90 Days: 1
Prev Delinq.: 11/93-R2/Late 30-60  04/93-R2/Late 30-60  12/92-R4/Late 90-120
SUBJECT STATES ACCOUNT SLOW DUE TO JOB TRANSFER

10/95 R1/ON TIME  5000  700  70  51  08/89 JOINIMOS  *26460000045*

11/95 12/LATE 30-60  1000  750  50  50  6  09/91 INDIV HFC  *4010604434*

Times Late: by 30 Days: 1  by 60 Days: 0  by 90 Days: 0
SUBJECT STATES MERCHANDISE OR SERVICE UNSATISFACTORY

07/90 ACCOUNT INCLUDED IN BANKRUPTCY  01/85 JOIN L&H PLUMB  801450009458

--- CONSUMER STATEMENT ---

Date Filed:  02/94  Purge Date:  02/02

ALL OF MY RECENT FINANCIAL AND LEGAL PROBLEMS ARE A RESULT OF MY SEPARATION FROM MY WIFE. WE ARE RECONCILED AND ARE SEEKING MARITAL AND FINANCIAL COUNSELING.

--- INQUIRY HISTORY ---

<table>
<thead>
<tr>
<th>Inv. Date</th>
<th>Member No.</th>
<th>Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/07/95</td>
<td>906010000732</td>
<td>CITICORP</td>
</tr>
<tr>
<td>10/20/95</td>
<td>40106000027</td>
<td>J C PENNEY</td>
</tr>
<tr>
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Prepared by: NATIONAL CREDIT FILE SYSTEM  
Equifax Services, Inc.

If you have questions, contact:  Refer consumers to:
Equifax Response Center  Equifax Consumer Service Center  
P.O. Box 740036  P.O. Box 105108  
Atlanta, Georgia 30374-0006  Atlanta, Georgia 30348-5108  
Telephone: 1-800-456-6432  Telephone: 1-800-456-6004

NCF is a Service mark of Equifax Services Inc., Atlanta, Ga.
Selected Consumer Complaints Filed with the Consumer Protection Division of the Texas Department of Insurance

- Consumer’s homeowners insurance was “nonrenewed” due to a bad credit report. The credit report reflected a federal tax lien which had been paid in full for several years. The insurance company insisted on the lien being removed and would not back down even with consumer’s proof of payment. Thus, consumer’s home became uninsured. Document ED 232399.

- Consumer’s house was paid for, and his homeowners insurance premiums had been paid for the upcoming year. However, due to an adverse credit report, the insurer canceled his insurance with a four sentence explanation regarding his credit rating. There was nothing that the Texas Department of Insurance could do to help this consumer. Document ID 252016.

- Consumer was solicited by an insurer on several occasions before he decided to switch insurers. Consumer paid $450 to insurer to cover the premiums on his home and auto policies, and allowed his existing policies to lapse. About a month later consumer received a premium notice and a cancellation notice on the same day. After investigating the situation, consumer was told that the cancellation was due to a bad credit report. Consumer was never informed that this was part of the process, and had no idea at the time of the complaint whether the information on the credit report was correct or not. The insurer stated that this disclosure is on their application, and consumer was informed. Consumer wrote again to verify that he was not informed, and further that he never received a copy of an “application form.” Document ID 224107.

- Consumer applied for insurance. After receiving her policy, she found that it was not issued for amount of time she had requested (1 year) and did not have the coverage (minimum liability) which she had requested. Consumer returned the policy to the insurer. Consumer later discovered that the insurer had filed a negative report with a credit bureau regarding unpaid premiums on this policy. After consumer’s complaint to the Texas Department of Insurance, the insurer said they would retract the remark from the consumer’s credit report. There was no mention why they would not write her policy for the minimum liability coverage she requested. Document ID 2332409.

- Consumer was informed by his mortgage company that his homeowners insurance had been canceled due to a bad credit report. Consumer never received notice of the cancellation and was shocked because he paid the premiums in advance. Consumer stated his agent and mortgage company had been informed of the cancellation and reason but he had not. Consumer also stated that he did not appreciate the fact that this was public knowledge to everyone but him. The insurer defended its actions by stating that they don’t get the actual report, so they don’t know what’s on the report, rather they use an algebraic number assigned to the report. The insurer refunded consumer’s premiums and closed their file. Meanwhile consumer now has this “public knowledge” hanging over his head in a very small community where he is trying to run a business. Document ID 241769.

- Consumer’s application for auto insurance with an insurer was rejected due to her credit history. Consumer has a superior driving record which entitled her to a 15% discount with
her former insurer. The insurer stood by its decision not to insure consumer. Document ID 252487.

- Consumer complains that her renters insurance was canceled due to a negative credit report. Consumer explained that her husband had been caught in the “job crunch” which wiped them out financially. However, they are getting back on their feet and need insurance. The insurer stood by their decision citing a correlation between poor credit history and claims made. Document ID 238726.

- Consumer phoned an insurer for a quote while he was shopping around for auto insurance. The agent requested social security number in order to verify drivers license numbers which consumer provided. Consumer later received notification that they would be unable to write him due to a negative credit report. Consumer never signed an application. All this communication was over the phone. Consumer did not authorize a credit check nor was he told one would be performed. The insurer did not respond except to say that they regularly use credit reports. Document ID 257686.
The Use of Credit Related Information in the Underwriting of Homeowners and Automobile Insurance in the State of Arkansas

Lee Douglass
Insurance Commissioner

Arkansas Insurance Department
For many Arkansans, insurance in all of its various types (life, health, homeowners and automobile) is a required purchase. No one can discount the importance of life insurance to provide for a family's well being upon the death of the insured. Health insurance is seen as the pathway for access to necessary health care. Automobile and homeowners insurance is not only necessary to protect material possessions, but also to provide protection for individuals who may be injured due to the actions of another. Lenders require borrowers to secure the purchase of a home or an automobile by obtaining insurance that protects the lender's interest in the house or the car. As it relates to automobiles, there is also a statutory requirement for citizens to obtain coverage for liability purposes of at least $65,000 combined single limits. Insurance, today, more so than in the past, is an integral part of a consumer's financial program. When a consumer is denied coverage or is only offered limited insurance coverage, the consumer is faced with the real possibility of not being able to operate his or her vehicle on the streets of Arkansas or not being able to purchase a home. Again, insurance is an important element of a consumer's financial safeguard.

Insurers have for many years used information regarding a consumer's financial standing as part of its underwriting process. More recently, however, insurers have placed greater emphasis on the financial information than on other elements of its underwriting guidelines. The issue becomes the significance or weight that should be placed on credit or financial information in the underwriting of insurance. Should only credit or financial information be relied upon to the exclusion of all other traditional underwriting criteria? Should credit or financial information ever be the sole reason for refusing to insure or to continue the insurance for an individual? What standards or guidelines exist to make certain that all consumers are treated fairly in the gathering of the credit information and the ultimate use of the information in the underwriting process? What protection does the consumer have that the information relied upon is accurate? Will the consumer have the opportunity to challenge the information, have it corrected if wrong, and then have the insurance coverage issued or reinstated? Are there forms of insurance in which the use of credit or financial information should not be utilized in the underwriting process?

The need for this survey was precipitated by the increase in complaints from citizens of this State who have been denied insurance or had their insurance canceled or nonrenewed for reasons related to "credit" worthiness, credit history or other credit related issues. The Arkansas Insurance Department has also received legislative inquiries regarding use of such information.
The Department initially contacted the two hundred and twenty seven (227) property and casualty insurers licensed to do business in the State of Arkansas to determine which companies were actively marketing policies in the State of Arkansas. If a responding company indicated that it was actively writing, that company was sent a copy of the survey form for response. From the initial contact the Department determined that of the two hundred and twenty seven (227) companies, one hundred and twenty four (124) or fifty five percent (55%) were not actively writing any policies. The information in this report is based upon the responses of the remaining one hundred and three companies who are writing 100% of the automobile and homeowners insurance in this State.

**Companies Actively Writing in Arkansas**

- **Do Not Write Automobile and/or Homeowners**: 55%
- **Writing Automobile and/or Homeowners**: 45%

Sixty percent (60%) of those companies actively writing homeowners and/or personal auto in the State of Arkansas rely to some degree on the use of credit reports or credit related information to underwrite applicants.

**Use of "Credit Reports"**

- **Not Utilizing Credit Reports**: 40%
- **Utilizing Credit Reports**: 60%
QUESTIONS AND RESPONSES

1. What credit reporting agency does your company use to support its underwriting of automobile and homeowners insurance?

Sixty-two (62) companies, representing eighty-seven percent (87%) of Arkansas' personal lines written premium, responded as utilizing credit reports for underwriting purposes. The majority of these companies use Equifax Insurance Services. However, other agencies used are Trans Union Credit Corporation, TRW, DAC Services, CSC Credit Services, Credit Bureau Reports, Inc. and Reliable. Additionally, some companies obtain these services from more than one agency.

Observation: The reliance upon the credit reporting agencies underscores the need to make certain the information is reliable, accurate and timely.

2. List, in descending order of importance, the specific areas of interest in the credit report which would affect your company's underwriting decision. (62/62)

The specific areas of interest relied upon vary among the responding companies. Those areas included are Property Loss Scores, public records, employment records and the number of credit inquiries in recent months.
Property Loss Score (PLS) is a service mark of Equifax, Inc. The PLS relies upon statistical principles to determine the expected loss ratio and claim frequency that an insured will produce. Information shown in the public record section includes bankruptcies, foreclosures, repossessions, liens/judgments and delinquent payments. Insurers see all of these as indicators of financial stability.

### Areas of Interest

- **Bankruptcy**: 66
- **Delinquent Payments**: 23
- **Foreclosures**: 21
- **Repossessions**: 7
- **Judgments/Liens**: 5
- **Fraudulent Information**: 13
- **No Specific**: 0

**Observation**: Bankruptcies and judgments/liens are generally the most observed information of a consumer report. However, beyond that information there is no consistency in the information that is reviewed. This is of concern because it would lead one to believe there is no consistency within the industry as to what "financial" information is important and which is not.

3. **If an applicant is otherwise clearly an acceptable risk based upon criteria directly related to the risk being accepted, but the credit report is less than acceptable, would you refuse to accept the risk based upon the credit report? (62/62)**

Of those insurers utilizing credit reports, fifty-nine percent (59%) answered "No", meaning that the company would accept the risk even with the "bad" credit information. However, forty-one percent (41%), nearly half of the companies, answered that they might or would refuse to write the business even though applicants were otherwise an acceptable risk [eighteen percent (18%) “Yes” and twenty-three percent (23%) “Maybe”]. Those responding as “Maybe” indicated they would look at the reasons for the criteria given on the report. This might include recent medical hardships, divorce or loss of an income provider.
4. Does your company utilize the information found in the credit reports differently for personal auto than for homeowners insurance? (62/62)

The majority of the companies, sixty-five percent (65%), do not utilize credit reports for personal auto insurance. Thirty-five percent (35%) use the reports identically for both lines.

**Observation:** While a majority of the insurance companies responded that they did not use credit reports or financially related information in underwriting personal auto insurance, it was clear that those companies that wrote a majority of the business in the State of Arkansas were utilizing some type of credit report or financially related data in the underwriting of automobile insurance. Those companies utilizing credit reports in the underwriting of auto write a substantial majority of the personal lines auto business. Since the initial survey, at least one of those companies has reconsidered its position and has ceased using credit reports or financially related data as an underwriting tool.

5. **Provide the percentage of applications which were denied due to credit report information.** (39/62)

Answers varied from zero percent (0%) to fifty-seven percent (57%). Thirty-seven percent (37%) of the companies could not provide this data because the information is not tracked. Additionally, one company responded it had no applications denied because it does not obtain credit information prior to binding.

6. **Provide the percentage of policies nonrenewed due to credit report information.** (39/62)

Most answered zero percent (0%) due to the fact they do not order credit reports on renewals. However, of those companies which did, answers ranged from zero percent (0%) to as much as eleven percent (11%). As with the application information, there were a number of companies who were unable to provide this information because it is not tracked.
7. *Provide the percentage of cancellations due to credit report information.*

(39/62)

Fifty percent (50%) had no cancellations based on credit report information, seventeen percent (17%) have answers ranging from less than one percent (1%) to fourteen-point-two percent (14.2%), and thirty-three percent (33%) could not provide the data.
8. *Are credit reports utilized on every new business application? (39/62)*

Fifty-seven percent (57%) of the responding companies do not order credit reports on every application. Forty-three percent (43%) order credit reports one-hundred percent (100%) of the time.

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9. *Provide the company’s written underwriting guidelines pertaining to credit reports. (39/62)*

Sixty-seven percent (67%) of the companies do not have any guidelines or have marginal guidelines. The marginal guidelines provided included language such as “do not submit an application if there is evidence of bad credit”. However, there was no supporting definition of “bad credit”.

**Observation:** It is of paramount concern to the Department that the insurance industry, which is relying more and more on the use of credit related information, would have no standards, guidelines, or other measurable inducements that the information relied upon by the individual company was the same for all applicants, and that information was applied in a like or similar manner in all cases. Insurers not having established guidelines leaves open the question as to whether all applicants are treated the same in the underwriting process and also, whether the information reviewed was the same for all applicants. Without an accepted definition of "good" or "bad" credit, it raises questions as to how subjective an underwriter may be in defining this concept. Again, with the extent of the subjectivity being unknown, it is impossible to determine whether it is being fairly and equitably applied.
10. Define "good/bad credit", "unacceptable risk", and "financial stability". Provide the formalized standards adopted by your company for determining each. (49/62)

This question was asked as a follow-up to previous information obtained from companies. In all parts of our survey these terms were used in relation to credit report guidelines. Responses varied as follows:

1. The company relies upon the negative remarks provided by Trans Union.

2. The company rates the report from 1 to 9 with 3-9 meaning anything from 60 days past due to other negative factors. These factors are often checked with the insured for an explanation. The application may be acceptable depending upon the insured’s response.

3. The company relies upon PLS scores using scores of greater than 620 as acceptable. Those scoring less than 620 are referred to underwriting for further evaluation. Other companies rely upon PLS scores but did not provide their standard.

4. The company defines "good" as "someone who pays their bills on time without a bankruptcy, lien, bad debts, collection items or past dues". However, the company had no formal written standard.

5. The company indicated if one or more "negative factors" are shown on the report the application is subject to declination. However, the company did not indicate what the "negative factors" are or how they are determined.

6. The company assigns points using “Credit Report Point Score Criteria” (See Exhibit 1). This company did not provide information on how the points are established or what the points mean.

7. The company looks at the date of activity of past dues, repossessions and their reasons, bad debts and court judgments and compares this to other information, such as age of the dwelling, general upkeep and job stability, to determine acceptability.

8. Eighty-seven percent (87%) of the surveyed companies did not provide a definition or have a formal standard. A company explained it did not use the terms “good” or “bad” but used “acceptable” or "unacceptable" instead. However, that company neglected to provide a working definition of “unacceptable”.

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11. Provide the ruling from the Federal Trade Commission (FTC) prohibiting your company from revealing to an insured the exact information contained within the credit report used as a basis to deny coverage. (18/49)

This question was prompted by consumer complaints and the Department's concern that consumers were not being given the specific information on which their denial of coverage was based. Instead, insurers told consumers that FTC Regulations prohibit the insurers from releasing the information and referred the consumer to the reporting agency.

Ten companies confirmed that no specific instructions had been received from the FTC regarding release of the information. One company indicated the credit reporting agency had cautioned the insurer not to reveal the specifics; five other companies stated they comply literally with Section 615(a) of the Fair Credit Reporting Act in that they provide only the name and address of the reporting agency. Release of the information was governed by company policy for at least one insurer. One company specifically stated it had been instructed by the FTC not to divulge any information; however, written documentation was not provided.

The Department contacted the FTC asking for confirmation that revealing the specifics is prohibited. The FTC could not find where the Fair Credit Reporting Act prohibited such action (See Exhibit 2).

12. Is occupation a factor in ordering a credit report? If so, provide documentation and written guidelines. (49/62)

This question was prompted by previous responses from insurers. Some companies order credit reports based on the occupation of the insured, primarily self-employed applicants to verify financial stability.
SUMMARY

The Arkansas Insurance Department conducted this survey from a market conduct perspective. It was important to determine the extent to which insurers are making use of "credit" related information, whether consumers were or are being denied coverage, were being offered reduced coverage, or were having coverage terminated based solely on the use of credit related information. From this market conduct perspective we wanted to know if there existed guidelines within individual companies, or within the insurance industry as a whole, which assure consumers and regulators that there are no activities which could be deemed to be unfairly discriminatory trade practices. Nothing in the information this Department received has alleviated all of our concerns.

The Department first attempted to determine which insurers are using credit reports. We initially surveyed all licensed property and casualty insurers. From that initial survey, 227 insurers responded to our survey. 124 insurers responded that they are not writing homeowners and/or private passenger auto insurance in the State. 62 insurers stated that they were actively writing these lines. Those 62 companies received a second survey. While the number of insurers responding to our survey is relatively small, the companies utilizing credit reports represent 87% of personal lines business written in the State. Even though the percentage of companies using credit reports is low, the high volume of total Arkansas business written by these companies demands that we know how this credit information is being used.

Once we determined the extent to which credit reports were used, our concerns centered on the specific information in the credit reports which was of interest to insurers. Although responses from insurers indicated that evidence of bankruptcy, liens and/or judgments were of primary concern, there was little evidence to indicate that most insurers looked beyond the fact that credit problems exist to determine the reason for the credit problems.

There are a wide variety of opinions as to the accuracy of the information in credit reports. Even if the error rate is as low as ten percent (10%) or fifteen percent (15%), that still means ten to fifteen percent (10 - 15%) of applicants for insurance could be denied coverage based on this incorrect information. Since most insurers do not disclose to the applicant the specific information contained in the credit report which resulted in coverage being declined or nonrenewed, consumers are at a real disadvantage. Simply providing the consumer a copy of the credit report is not adequate notice of the reason for denial.

How insurers use credit reports in underwriting is important. Are they doing it for cancellation, non-renewals, or all new business? This is important because if a person is a "good" credit risk but has a worse than average loss history, does the company write the
risk? The reverse could also be asked. If a person has a bankruptcy but otherwise has a better than average loss history, does an insurer cancel or nonrenew the policy due to the bankruptcy or does the company write based upon the acceptable loss history? This is a very real question considering information this office has received showing that companies want to cancel policies based solely on credit reports or financially related information. If a company issues a policy based solely on the credit report or financially related information, should the company be permitted to cancel or nonrenew a policy based on any reason other than a significant change in the credit report or other financially related data? Should a company be able to nonrenew or cancel a person based on loss history when the company originally wrote the risk based solely on a credit report or other financially related information? These, this Department believes, are very real questions for which there appears to be no clear answer.

This Department asked companies to clarify their use of the terms "good", "bad" and "acceptable" credit. Unfortunately, it became clear to this office that companies do not have a clear definition of these terms, however, the companies will not accept someone who has "bad" credit. This means credit underwriting appears to be very subjective and the concerns of this office remain about the possibility of unfairly discriminatory practices in the use of these credit reports and financially related information. Without having a clear indices of what constitutes bad, poor, good or acceptable credit, industry is in a difficult position to defend itself in the use of these terms. There are many other questions that are raised by the results of our preliminary survey:

? Should a company’s use of credit information be a part of their underwriting guidelines and, therefore, be filed with the Department for approval?

? Are there consistencies in the scoring systems used and how is the data utilized in the scoring system verified?

? Is there any uniformity between one reporting agency and another in information gathered and reported? One credit reporting agency may have nine variables and another four. Upon what variables are insurance companies to rely? The insurance companies do not appear to have any uniform standards or guidelines.

? What does a consumer, who is required by law to have auto insurance, do when he/she has been denied coverage due to credit report information? Where does that individual go for coverage? Are they now a substandard risk due to credit information rather than driving record?

? Does the use of credit reports drive up the cost of coverage for some people because they can no longer get a preferred policy but can only get a standard or nonstandard policy which generally costs more and generally has limited benefits?
These are all questions for which the Department does not have answers but which we have determined require further study. Arkansas Code Ann. §23-66-317 addresses the use of credit reports for personal auto insurance; however, the results of our survey indicate the issues are more complicated than those addressed by our present law.
# EXHIBIT 1

## CREDIT REPORT POINT SCORE CRITERIA

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*Paid or satisfied records are excluded.*

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68
October 13, 1995

BY FAX AND MAIL

Ms. Becky Harrington
Senior Analyst
Property & Casualty Division
Arkansas Insurance Department
400 University Tower Building
1123 South University Avenue
Little Rock, Arkansas 72204

Dear Ms. Harrington:

Your August 4, 1995 letter to David Medine was referred to me for reply. I apologize for the delay in responding. You write that your agency has been conducting a survey concerning the use of credit reports by insurance companies for underwriting homeowner and personal auto insurance. Several companies have responded that for reasons of confidentiality, they do not disclose to insurance applicants the contents of any credit report that might have caused the company to deny coverage. Instead, these insurers refer the rejected applicant to the consumer reporting agency from whom they obtained the report for the specific details of the report that led to the denial of coverage. You ask whether an insurance company would violate the Fair Credit Reporting Act ("FCRA") by disclosing to a rejected applicant the specific information in a credit report that caused the denial.

There is nothing in the FCRA that makes it unlawful for an insurance company to disclose the contents of a credit report to the person on whom that report was obtained, regardless whether the information disclosed caused that person to be denied insurance. Some of the major consumer reporting agencies have had provisions in their contracts with report users prohibiting those users from disclosing to consumers the information in their credit reports, although I understand this policy might have changed.

Insurers, unlike creditors under the Equal Credit Opportunity Act, are not required to disclose to consumers the specific reasons for denying insurance. However, we would encourage insurers to disclose this information, especially if the denial was based on information obtained from a consumer
reporting agency, as this would better enable consumers to readily identify and correct any inaccurate information being reported about them.

I hope this information is helpful to you. This is an informal staff opinion and is in no way binding on the Commission.

Sincerely,

Ronald G. Isaac
August 11, 1995

Lamont Boyd
Senior Marketing Representative
Fair, Isaac
120 North Redwood Drive
San Rafael, CA 94903-1996

By Mail and Fax (415) 444-5032

Re: Request for Information to Demonstrate the Relationship of Credit Histories to Risk of Loss for Personal Lines Insurance Coverages

Dear Mr. Boyd:

Several insurers in Texas rely upon a Fair, Isaac product in underwriting certain personal lines coverages. The Fair, Isaac product in question is an algorithm which predicts the likelihood of insured loss based upon a consumer’s credit history. When we asked these insurers for evidence of the relationship between credit history and risk of loss, they referred us to articles written by Fair, Isaac and/or Equifax employees about the Fair, Isaac products. I am writing you to request that Fair, Isaac provide the Department with certain information we feel necessary for us to, one, understand how a consumer’s credit history is used in the underwriting process and, two, perform an independent analysis of the relationship of credit histories to risk of loss as implemented in the Fair, Isaac underwriting tools supplied to insurers operating in Texas.

Before I describe the specific information request, I want to emphasize the importance of the Department obtaining the information necessary to understand exactly how the Fair, Isaac product uses credit histories for underwriting and to evaluate the relationship between a consumer’s credit history and risk of loss. Texas law requires that, upon request by the Department, insurers must report their underwriting guidelines to the Department. An insurer who uses the Fair, Isaac product is using an applicant's credit history as an underwriting guideline. However, because Fair, Isaac treats the algorithm as a proprietary model, the insurer is unable to explain how a consumer’s credit history is applied as an underwriting guideline. An insurer cannot evade its statutory responsibilities because it uses a third party's product for underwriting.
In addition, Texas law prohibits the use of underwriting guidelines which unfairly discriminate "between individuals of the same class and essentially the same hazard in the amount of premium, policy fees, or rates charged for any policy or contract of insurance...." (Texas Insurance Code, Article 21.21-8, effective September 1, 1995). If insurers rely upon underwriting algorithms provided by a third party, such as Fair, Isaac, the insurer is still responsible for demonstrating that the discrimination based upon the underwriting algorithm is justified. When asked about the evidence in support of the use of credit histories as an underwriting tool, insurers have referred the Department to articles written by Fair, Isaac and/or Equifax employees. These articles do not provide sufficient evidence to demonstrate the unique contribution, if any, of credit histories to risk of loss. If Fair, Isaac is unwilling to provide the relevant information necessary to test this relationship and if insurers have no other support for the use of these guidelines, then the insurers could be prohibited from using these credit history algorithms as underwriting guidelines in Texas.

I understand that you will view some of the information requested below as proprietary to Fair, Isaac and a trade secret. If the Department receives a request for any information provided by Fair, Isaac pursuant to this letter’s request and claimed as a trade secret, the Department will seek the opinion of the Attorney General of Texas whether the requested information is a trade secret or not. The Department will not release the requested information while the Attorney General’s opinion is pending. Based in large part upon the Attorney General’s opinion, the Department will decide whether to release the requested information or not. If the information provided by Fair, Isaac is a trade secret, then the documents provided by Fair, Isaac are exempt from the Texas Open Records laws and the Department will not release the documents and/or data. Even in the instance where the Department determines the requested information is not a trade secret and intends to release the information, the Department would provide Fair, Isaac with sufficient notice to allow Fair, Isaac to seek judicial relief before any information is released.

Fair, Isaac has offered, in the past, to allow state insurance department personnel to visit the Fair, Isaac offices to review certain information Fair, Isaac deems relevant to this issue. Such an approach is not an alternative to Fair, Isaac providing the Texas Department of Insurance with the requested information. It is necessary that Fair, Isaac provide the requested information so the Department may make an independent analysis of the relationship between credit history and risk of loss.
Request for Information

1. Please provide a complete description of any underwriting decision-making algorithms provided by Fair, Isaac to insurers operating in Texas which make use of a consumer's credit history as a data input. Please describe fully any information other than credit histories which are part of the decision making algorithms. Please describe all assumptions and relationships embodied in the algorithm.

2. Please provide complete descriptions, including methodologies, of any and all studies performed by Fair, Isaac to verify that credit histories are related to risk of loss. Please identify all known insurance risk factors which these studies may have included to isolate the unique contribution of credit histories to risk of loss.

3. Please provide a complete description of the data employed by Fair, Isaac in developing the decision-making algorithms which rely upon credit histories as an input and all data used by Fair, Isaac to test the relationship of the credit histories to risk of loss. Please provide a complete description of any policy, premium or loss records employed in your analysis, including the name of the insurer, the time period of the experience, the type of exposure (earned or written), the type of losses (paid, incurred, loss adjustment), and any other characteristics of the consumer, vehicle or property provided by the insurers. Please provide record layouts, record counts and data formats.

We ask that you provide the requested information by September 6, 1995. Please contact me at (512) 305-7194 if you have any questions. Thank you for your assistance in these matters.

Sincerely,

Birny Bimbaum
Associate Commissioner for Policy and Research

cc
Commissioner Bomer
Alicia M. Fechtel, Texas Department of Insurance
Don Switzer, Texas Department of Insurance
Mary Keller, Texas Department of Insurance
Edna R. Butts, Texas Department of Insurance
Philip Presley, Texas Department of Insurance
VIA MAIL AND FAX

Mr. Birny Birnbaum
Associate Commissioner for
Policy and Research
Texas Department of Insurance
P.O. Box 149104
Austin, TX 78714-9104

Subject: Your Request of August 11, 1995

Dear Mr. Birnbaum:

I have been asked to respond to your letter of August 11, 1995, to Lamont Boyd of Fair, Isaac requesting Fair, Isaac to turn over essentially all information relating to our development of algorithms predicting insurance risk using credit history as an input.

For the reasons stated below, we are unable to comply with those requests as made. However, we again repeat our offer to provide you with information which, we believe, demonstrates the validity of our findings of such relationships. As you acknowledge in your letter, we have previously offered you a full-day session at our offices—where we have maximum availability of access to people and data that might prove of interest. Five members of the NAIC working group accepted that invitation last month and, I believe, found the session to be very useful in considering the use of credit history information in insurance underwriting. Since then, senior staff from our insurance division have traveled to Little Rock to meet with Ron Sheffield of the Arkansas DOI and I’m sure they would be willing to go to your offices as well.

We cannot provide you with “all data used by Fair, Isaac to test the relationship of the relationship of the credit histories to risk of loss” because that data is not ours to give. The data used in our analysis was provided by various insurers and consumer reporting agencies pursuant to agreements which require us to maintain the confidentiality of that information. We can provide you with information which should satisfy any reasonable concerns as to the statistical validity and representativeness of that data, but we are legally precluded from acceding to your request as made.

You also requested a “complete description of any algorithms which use credit history as a data input,” and “complete descriptions, including methodologies of all studies performed by Fair, Isaac” regarding the relationship between credit history and risk of loss. As you acknowledge, those requests encompass proprietary technology which is of great value to Fair, Isaac and which is protected primarily as
trade secrets. Your proposal that we disclose that technology now subject to a later determination by the DOI and other state agencies as to whether the trade secret status will be respected is unreasonable and unacceptable to Fair, Isaac.

Finally, the stated purpose for the requested disclosures is to enable the Texas DOI to "make an independent analysis of the relationship between credit history and risk of loss." I'm sure the Texas DOI has fine statistical and analytic talent available to it—as do most of our clients in the insurance and credit industries. Fair, Isaac is a successful business primarily because we have demonstrated over nearly 40 years that we can consistently find predictive value in data that eludes others. This is why we believe it is necessary and appropriate for us to show you—as we have repeatedly offered—the relationships we have discovered in this data, rather than simply turning over the data (if we were free to do so) for an "independent analysis."

We want to work with you and other insurance regulators to address your understandable concerns in this area. However, doing that requires establishing a cooperative dialogue rather than unilateral demands for unreasonable disclosure without adequate safeguards. I urge you to have your staff contact Mr. Boyd to discuss how we might provide you with the same assistance your counterparts in other states have found to be so valuable.

Very truly yours,

[Signature]

Peter L. McCorkell
Senior Vice President and
General Counsel

PLM:cah
cc: Lamont Boyd
    Joette Rea
    Robert Willis, Esq.
September 21, 1995

Peter McCorkell
Senior Vice President and General Counsel
Fair Isaac
120 North Redwood Drive
San Rafael, CA 94903-1996

By Mail and Fax (415) 492-9381

Re: Request for Information to Demonstrate the Relationship of Credit Histories to Risk of Loss for Personal Lines Insurance Coverages

Dear Mr. McCorkell:

We have received your letter dated September 8, 1995 in which you decline to provide the information requested in my August 11 letter about the above-captioned topic. However, we believe the Department’s request for information is both reasonable and necessary. We believe you may have misinterpreted some of the statements in that letter. Therefore, we write to clarify and repeat our request for information.

First, we believe our request to be reasonable. We did not ask you to provide "all data used by Fair, Isaac to test the relationship of the credit histories to risk of loss" as you write in your letter of September 8. We asked you to provide a description of the data you employed in developing your underwriting support tools. Please see question 3 of page 3 of my letter.

We did request complete descriptions of underwriting decision-making algorithms which use credit history as an input and any and all studies performed by Fair, Isaac to verify that credit histories are related to risk of loss. However, it is incorrect to characterize my letter as a proposal for Fair, Isaac to "disclose that technology now subject to a later determination by the DOI and other state agencies as to whether the trade secret status will be respected . . . ." The fact is that the Department simply may not release any information which is subject to the trade secret exemption of the Open Records Act. We described the process by which we would respect your claim, but the ultimate decision about a trade secret claim would be made in a court of law, not by the Department.

Second, we are not asking you to turn over data for an independent analysis at this time. We have asked you to describe your algorithm and testing of that algorithm. Such descriptions would be the means by which Fair, Isaac would show the Department the
relationships you have discovered in the data. We have seen the information provided by Fair, Isaac in several forums as well as attended a detailed presentation by Mr. Boyd in St. Louis. It is clear that the information you have already provided does not answer the questions posed by the Department in my August 11 letter. We are not "making unilateral demands for unreasonable disclosure without adequate safeguards."

In your letter, you offered to send senior Fair, Isaac staff to visit with us in Texas. We would welcome such a visit if you will bring, among other things, the information requested in my August 11 letter.

Finally, I ask you to review the last paragraph of page 1 and the first paragraph of page 2 of my August 11 letter for our explanation of the importance of our request to Fair, Isaac. Texas law describes certain requirements for the identification and use of underwriting guidelines in Texas. Insurers may not evade statutory requirements by using a third party's product which has a proprietary claim attached to it. This issue is not unique to Fair, Isaac. For example, an insurer could not avoid justifying a large homeowners rate increase by referring to the results of a proprietary computer catastrophe simulation model as the basis for the increase. We understand the tension between a third party's concern over proprietary information and the regulator's need to carry out legislative requirements. That is why we explained our process regarding trade secret claims in such detail.

We ask you to reconsider your September 8 response in light of my further explanation. Please let us know by September 28 of your intent to respond or not. If I can provide any further explanation or clarification, please give me a call at (512) 305-7194. Thank you for your assistance in these matters.

Sincerely,

Birny Birnbaum
Associate Commissioner for Policy and Research

cc
Commissioner Bomer
Alicia M. Fechtel, Texas Department of Insurance
Don Switzer, Texas Department of Insurance
Mary Keller, Texas Department of Insurance
Edna R. Butts, Texas Department of Insurance
Philip Presley, Texas Department of Insurance
October 24, 1995

Birny Birnbaum  
Associate Commissioner for Policy Research  
Texas Department of Insurance  
P.O. Box 149104  
Austin, TX 78714-9104

Subject: Your Request for Information to Demonstrate the Relationship of Credit Histories to Risk of Loss for Personal Lines Insurance Coverages

Dear Mr. Birnbaum:

Peter L. McCorkell has asked me to reply to your letter to him of September 21, 1995 which you wrote to clarify and repeat the request for information contained in your letter of August 11, 1995 regarding the above captioned topic. Pursuant to your letter of September 21, 1995, which in some respects differs from your letter of August 11, 1995, we understand you to now be requesting: (1) a description of the “underwriting decision-making algorithms which use credit history as an input and (2) any and all studies performed by Fair, Isaac to verify that credit histories are related to risk of loss” along with (3) a description of the data Fair, Isaac employed in developing these algorithms. Please accept the following as response to your September 21, 1995 letter.

(1) Description of the “algorithms which use credit history as an input”

Fair, Isaac is the developer of the predictive models (or “algorithms”) used in scoring services available to personal lines (automobile and homeowner) insurers who purchase data from consumer reporting agencies (under the tradenames “Property Loss Score” or “PLS”, and “ASSIST” all of which are at times collectively hereinafter referred to as the “Products”).

The Products developed by Fair, Isaac do not constitute underwriting guidelines, and Fair, Isaac does not define or determine how these predictive tools are to be specifically used by an insurer. The Fair, Isaac Products are only tools which may be used by insurers to varying degrees and use of the Product’s predictive indices is not equivalent to making an underwriting decision.
The algorithms in the Products consist of tables of "attributes" for various "characteristics" in which each attribute is assigned a numerical value (which may also be referred to as a "Score Weight") so that for any applicant the sum of the attribute values can be added to provide a total score. A "characteristic" is a subject about which information is obtained regarding a personal lines insurance applicant. An "attribute" is one of the particular and exclusive values or responses for a given characteristic.

All characteristics in the algorithms in the Products come from the trade line, public record and inquiry sections of the consumer report. None of the Products uses income, net worth, gender, race, marital status, religion, nationality, or geographic location as a characteristic in an algorithm. The specific characteristics used in the algorithms in the Products and the weighting of them have been developed over decades and at great expense and are proprietary trade secrets of Fair, Isaac. Exhibit 1 contains a list of the reason codes generated by the algorithm in the PLS Product based on the score computed. Exhibit 2 contains a list of the reason codes generated by the algorithm in the ASSIST Product based on the score computed. These reason codes display the make up of the constituent characteristics in the algorithms in these Products.

(2) Description of the “studies performed by Fair, Isaac to verify that credit histories are related to risk of loss”

Fair, Isaac has conducted several studies to evaluate whether information obtained from consumer reporting agencies is useful for insurance underwriting in that it is relevant to the determination of personal automobile and property insurance risk.

Specifically in research conducted in 1992 and 1993, Fair, Isaac evaluated a nationwide sample of personal lines automobile insurance policy information obtained from 11 insurance companies. Fair, Isaac's research into the relevance of credit report information to insurance risk began with a sampling of over 100,000 policies with claims and 300,000 policies without claims. For research purposes, Fair, Isaac obtained archived credit report data from 7/89, 1/90, 7/90 and 1/91.

Following each credit report date, Fair, Isaac computed the claims and earned premium for a period of up to 12 months. Fair, Isaac then assembled the credit report information and the claims and earned premium into a single database.

Using this database, Fair, Isaac evaluated the correlation of credit report attributes with subsequent loss ratio performance over a period of up to 12 months. Among the many factors which Fair, Isaac has found to be statistically predictive of automobile insurance risk, three examples are:

1. Number of trade lines (accounts) that were 60 or more days delinquent in the last 24 months
2. Number of adverse public records (i.e. Bankruptcies, Liens, Judgments)
3. Number of accounts in collection

The tables and graphs attached as Exhibit 3 show the correlation between these credit characteristics and private passenger automobile loss ratio. It should be noted that the vast majority of policyholders have no delinquencies, no adverse public records, and have no accounts in collection. The figures are shown for the following 5 separate sub-populations of the automobile book of business:

1. Non-standard
2. Standard with minimum liability limits
3. Standard with above-minimum liability limits
4. Preferred with minimum liability limits
5. Preferred with above-minimum liability limits

Fair, Isaac also conducted similar research in 1992 on personal lines property policies, using a nationwide sample of information obtained from 8 insurance companies. Fair, Isaac's research into the relevance of credit report information to property insurance risk began with a sampling of over 90,000 property policies with claims and 400,000 property policies without claims. For research purposes, we obtained archived credit report data from 5 dates between 1/1/88 and 12/31/90. Following each credit report date, Fair, Isaac computed the claims and earned premium for a period of up to 12 months. Fair, Isaac then assembled the credit report information and the claims and earned premium into a single database.

For the property research, Fair, Isaac evaluated the correlation of credit report attributes with subsequent loss ratio performance over a period of up to 12 months. Among the many factors which Fair, Isaac has found to be statistically predictive of property insurance risk, three examples are:

1. Number of trade lines (accounts) that were 60 or more days delinquent in the last 24 months
2. Number of adverse public records (i.e. Bankruptcies, Liens, Judgments)
3. Number of accounts in collection

The tables attached as Exhibit 4 show the correlation between these credit characteristics and personal lines property loss ratio. The figures are shown for the following 3 separate sub-populations of the property book of business:

1. HO-3
2. HO-4
3. HO-6

(3) Description of the data Fair, Isaac employed in developing the Products

Fair, Isaac utilized data gathered and supplied by and belonging to 11 insurance companies with personal automobile books of business and 8 insurance
companies with personal lines property books of business and consumer reporting agencies to develop and validate the Products.

The companies which provided data for model development were chosen as a representative sample of personal lines automobile and property insurance companies, ranging from national to regional companies and from independent agency companies to direct writers. It was important that the data being used for development be representative of the many companies currently marketing personal lines products.

As you've already seen, the data collected from these companies included earned premiums and incurred losses for each policy record during the performance windows outlined above and compared to archived consumer credit information for those same policyholders.

Fair, Isaac received this data from the various suppliers, under written agreements, which state that: the data is and remains the property of the supplier; the data must be maintained by Fair, Isaac in confidence; and; disclosure of the data to third parties is prohibited.

As you see, certain of the information requested in your letter isn’t Fair, Isaac’s to give and Fair, Isaac is party to contractual arrangements with the suppliers of the information sought which contractually restrict Fair, Isaac from disclosing such information.

Within the proprietary and contractual constraints noted in this correspondence, we have earnestly responded to the concerns outlined in your September 21, 1995 letter and trust you will find this information helpful in your evaluations.

Sincerely,

Joette J. Rea
Senior Counsel

PLM:drc
cc: Lamont Boyd, CPCU, AIM
    Senior Marketing Representative
    Insurance Division
    Peter L. McCorkell, Senior Vice President
    and General Counsel
The David Cox Company
Consulting Actuary

October 16, 1995

The Honorable Chris Herstam
Director of Insurance
Arizona Department of Insurance
2910 North 44th Street, #210
Phoenix, AZ 85018

Dear Mr. Herstam:

The purpose of this letter is to summarize my January, 1995, review of Allstate’s actuarial support for declining or surcharging risks because of a “poor” credit rating.

My review relied upon information Allstate provided in response to a December 1994 Subpoena Duces Tecum. This material is considered by Allstate to be a confidential trade secret and was used without audit or verification on my part.

Although some insurers have begun using credit reports to evaluate the acceptability of applications for personal automobile and homeowners insurance, credit history has not been approved for use as a rating variable for these coverages in Arizona. Additionally, the legal and actuarial basis for the use of credit history in insurance is still in question.

Allstate Insurance Company uses credit reports to underwrite new applications for private passenger automobile insurance and rejects applications considered to be unacceptable. Allstate Indemnity Company does not underwrite on the basis of credit insurance and will accept an applicant regardless of adverse credit history.

Credit reports are not being used by either company in the direct determination of auto insurance rates. However, an otherwise acceptable policyholder turned down for coverage due to a poor credit record in Allstate Insurance Company will have a higher rate if written in Allstate Indemnity Company. Therefore, from the point of view of an applicant for auto insurance, credit history would appear to be a “rate related underwriting rule” since a higher or lower rate could result from its use.

In using credit reports, Allstate relies upon the failure to pay debts in a timely manner. Accumulation of wealth is not directly considered. According to Allstate, rich or poor, a person’s credit record is based primarily on personal responsibility and not wealth.

For homeowners, Allstate does “...not place consumers in a higher rated company or surcharge them if their credit history does not meet our criteria for preferred or lower rates.” In spite of this statement, Allstate does appear to underwrite homeowners on the basis of credit report. Unlike auto, Allstate does not write homeowners insurance through two insurance companies and therefore does not have the means to place applicants with a poor credit report in a higher rated company. According to Allstate, credit reports are ordered on about 30% of new homeowners applicants and applicants with “unacceptable” credit are declined.

The data, methods and assumptions used by Allstate have not been presented for the purposes of rate making. Data standards applicable to underwriting are not defined in Arizona.
In my opinion, Allstate has provided persuasive actuarial support that credit history is substantially correlated to loss ratio in both automobile and homeowners. However, the studies provided have some weaknesses and leave open areas of public concern. Important areas of concern include the strength and reliability of the correlation over time and location, the impact of varying economic conditions, the impact on currently existing rating and underwriting practices, and the incidence of credit history error.

It is possible for example, that the relationship of credit history to loss exhibited in broad statistics from many states may apply differently to Arizona’s unique economic and cultural makeup. Furthermore, credit history seems to depend heavily on economic conditions and cycles. A local economic downturn or plant closing may trigger many adverse credit reports but would not necessarily cause a surge in auto insurance losses.

Fairness in underwriting and rating is a more general public policy concern. Although Allstate provided a demonstration that credit history is statistically predictive of loss, Allstate provided no convincing logical relation as to the reason for this relationship. While a logical relation to risk is an important public policy concern, I do not find that Arizona’s rate making and underwriting standards nor the actuarial standards of practice require that such a relationship be demonstrated.

In Arizona the use of race, religion or ethnic origin is prohibited in the rating and underwriting of insurance. Allstate provided no investigation of the racial, religious or ethnic implications of the use of credit reports in selling insurance. Allstate’s avoidance of the use of accumulated wealth should, however, lessen any perceived link to race, religion or ethnic group.

All of the other companies that reported using credit histories in underwriting did so in conjunction with services provided by Fair-Isaac. Fair-Isaac did not reveal to the Arizona Department of Insurance sufficient information upon which to make an evaluation. It is my belief, however, that the correlation of credit history and loss documented by Allstate for both auto and homeowners are generally prevalent to varying degrees throughout our society and could be similarly documented by other companies if they conducted the necessary research.

It has been a pleasure working with you on this important project. If you have any questions or comments please feel free to call.

Sincerely,

[Signature]

David B. Cox, FCAS, MAAA
Consulting Actuary
<table>
<thead>
<tr>
<th>State</th>
<th>Do you have a law that regulates the use of credit reports in underwriting (including cancellations, nonrenewals, declinations, etc.) or have you issued a bulletin?</th>
<th>Citation to the statute, rule or bulletin?</th>
<th>Are you currently drafting a law or rule? Please provide a copy of the draft with your response.</th>
<th>Do you have a law that indirectly regulates the use of credit reports (like requiring underwriting guidelines to be actuarially sound)? If so, please provide a citation.</th>
<th>Do you have a departmental policy about using credit reports for underwriting purposes?</th>
<th>To which lines of business does the statute, rule or bulletin apply?</th>
<th>Briefly explain what your statute, rule or bulletin does.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
</tr>
<tr>
<td>Alaska</td>
<td>no</td>
<td>no</td>
<td>21.36.210 - limits on cancellation; 21.39.030 - Making of rates; 21.36.420 - Premium increases on automobile insurance policy; 21.36.120 - Unfair discrimination in rates; 21.36.150 - Procedures as to undefined practices</td>
<td>no</td>
<td>no</td>
<td>all P&amp;C</td>
<td>The use of credit may not be unfairly discriminatory</td>
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<tr>
<td>Arizona</td>
<td>not directly</td>
<td>no</td>
<td>A.R.S. 20-383 prohibits insurers from charging rates that are unfairly discriminatory. Additionally, the use of credit reports in underwriting would fall under the definition of supplementary rate information. (A.R.S. 20-381(3))</td>
<td>no</td>
<td>no</td>
<td>all P&amp;C</td>
<td></td>
</tr>
<tr>
<td>Arkansas</td>
<td>yes</td>
<td>23-66-317</td>
<td>yes</td>
<td>yes</td>
<td>auto by statute</td>
<td>auto by statute</td>
<td></td>
</tr>
<tr>
<td>California</td>
<td>yes - for personal auto</td>
<td>1861.03</td>
<td>no</td>
<td>yes - personal auto “good driver”</td>
<td>1861.025</td>
<td>any line sold to ‘natural persons’</td>
<td>Allows use of a credit report in connection with the underwriting of insurance involving the consumer.</td>
</tr>
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<td>Colorado</td>
<td>Colorado Consumer Credit Reporting Act will be effective 11/1/96.</td>
<td>12-143.103(c)(III)</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>any line sold to ‘natural persons’</td>
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<tr>
<td>Connecticut</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<td>Delaware</td>
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<td>no</td>
<td>no</td>
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</tr>
<tr>
<td>D.C.</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>yes</td>
<td>HRS 433331:10C-207; 431:10C-409</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>motor vehicle</td>
<td>to ensure that no standard or rating plan shall be based on a person’s credit bureau rating</td>
</tr>
<tr>
<td>Idaho</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>Illinois</td>
<td>no</td>
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<td>no</td>
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</tr>
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<td>Indiana</td>
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<td>no</td>
<td>no</td>
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<td>Iowa</td>
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<td>no</td>
<td>no</td>
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<td></td>
</tr>
<tr>
<td>Kansas</td>
<td>no</td>
<td>no</td>
<td>yes - KSA 40-2404 and KSA 40-2,112</td>
<td>no</td>
<td>all lines</td>
<td>all lines</td>
<td>KSA 40-2,112 “adverse underwriting decisions; furnishing reasons.” (A) in the event of an adverse underwriting decision, the insurance company, health maintenance organization or agent responsible for the decision shall either provide the applicant, policyholder or individual proposed for coverage with the specific reason or reasons for the adverse underwriting decision in writing or advise such persons that upon written request they may receive the specific reason or reasons in writing.</td>
</tr>
<tr>
<td>State</td>
<td>Law/Rule Description</td>
<td>Residency Requirement</td>
<td>Underwriting Requirement</td>
<td>Disclosures Requirement</td>
<td>Purpose</td>
<td></td>
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</tr>
<tr>
<td>Louisiana</td>
<td>The only law in our statutes, prohibits the insurer with regard to automobile liability insurance from terminating, etc because of bankruptcy. If an insurer does this, it is considered an unfair trade practice.</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>automobile</td>
<td></td>
<td></td>
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<tr>
<td>Kentucky</td>
<td></td>
<td>no</td>
<td>no</td>
<td>Kentucky requires underwriting guidelines to be in written form, filed with the Department and uniform in use.</td>
<td>all personal lines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maryland</td>
<td></td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>homeowners</td>
<td></td>
<td></td>
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<tr>
<td>Maine</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>all personal lines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michigan</td>
<td></td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>homeowners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mississippi</td>
<td></td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>homeowners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missouri</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>homeowners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Montana</td>
<td>yes</td>
<td>no</td>
<td>33-18-210</td>
<td>follow statute</td>
<td>automobile, homeowners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nebraska</td>
<td></td>
<td>no</td>
<td>rating systems include underwriting rules to extent necessary to determine applicable rate; Rating systems shall not produce premiums which are excessive, inadequate, or unfairly discriminatory. &amp;44-5001; 44-5015; 44-5019 Nebraska Property and Casualty Rate and Form Act.</td>
<td>currently under review</td>
<td></td>
<td></td>
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<tr>
<td>New Hampshire</td>
<td>Regulation/rule - automobile insurance law/statute - small group health insurance</td>
<td>Unwritten department policy</td>
<td>Unwritten department policy</td>
<td>P&amp;C, A&amp;H</td>
<td>Unsubstantiated information developed by credit or character investigations should not be relied upon in determining the reasons for refusal to write, refusal to renew or cancellation actions taken by insurers. Information developed by such investigations may be considered only if that information has been validated by a responsible secondary source.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>1995 Status</td>
<td>1996 Status</td>
<td>1997 Status</td>
<td>Notes</td>
<td></td>
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<td>----------------------------------------------------------------------</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>New Mexico</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>(in 1995 session a bill was introduced and died. In 1997 session, another bill is planned for introduction.)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New York</td>
<td>yes</td>
<td>General Business Law (GBL) Sections 380-a, 380-b, and 380-I.</td>
<td>no</td>
<td>Insurance law sections 2301, 2302, 2303, 2304, 2324, and 4224. These sections require that rates not be excessive, inadequate or unfairly discriminatory. Certain information must be submitted in support of rating plans. Use of credit reports must be relevant to the risk being underwritten and the supporting information must be in the rating plan. The GBL applies to personal lines. Ins. law article 23 applies to all lines unless exempted by sec 2302. Section 4224 applies to life and A&amp;H. Section 380-b of the GBL places restrictions on the dissemination of consumer reports, as defined in section 380-a(a)-1. Reports can be disseminated in connection with the underwriting of insurance. Section 380-c places restrictions on the preparation and/or procurement of investigative reports. Section 380-l requires users of consumer reports to advise the consumer of adverse action taken in reliance on the report.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North Dakota</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oklahoma</td>
<td>no</td>
<td>36&amp;1204 Unfair methods of competition and Unfair or deceptive trade practices</td>
<td>yes</td>
<td>P&amp;C only There shall not be discrimination in favor of particular persons having substantially like insuring risk and exposure factors or expense elements in the terms or conditions of any insurance contract or in the rate or amount of premium charged.</td>
<td></td>
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<tr>
<td>Oregon</td>
<td>no</td>
<td>ORS 746.600 to 746.690</td>
<td>no</td>
<td></td>
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<tr>
<td>Pennsylvania</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
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<tr>
<td>Rhode Island</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>yes - allowed for property and homeowners (informal) not allowed for automobile. Credit reports are allowed for underwriting property oriented lines if a direct relationship is apparent.</td>
<td></td>
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<tr>
<td>South Carolina</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>South Dakota</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>Tennessee</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>Texas</td>
<td>no</td>
<td>yes, 28 Texas Administrative Code &amp;21.1002</td>
<td>PPA and residential property</td>
<td>Prohibit use underwriting guideline unless it is &quot;actuarially sound&quot;</td>
<td></td>
<td></td>
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<tr>
<td>Utah</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<td>Vermont</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<td>Virgin Islands</td>
<td>no</td>
<td>no</td>
<td>no</td>
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</tr>
<tr>
<td>State</td>
<td>Use</td>
<td>Bulletin 95-7</td>
<td>RCW 48.19.020 and WAC 284-24-065</td>
<td>see bulletin 95-7</td>
<td>Private passenger auto</td>
<td>Any company using factors such as credit reports (and other “lifestyle” factors) must submit sound actuarial supporting analysis for all plans, discounts, surcharges, rating rules, rating tiers, and rating factors by December 1, 1995</td>
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<tr>
<td>Washington</td>
<td>yes</td>
<td>no</td>
<td></td>
<td>no</td>
<td>private passenger auto</td>
<td>any company using factors such as credit reports (and other “lifestyle” factors) must submit sound actuarial supporting analysis for all plans, discounts, surcharges, rating rules, rating tiers, and rating factors by December 1, 1995</td>
<td></td>
</tr>
<tr>
<td>West Virginia</td>
<td>no</td>
<td>no</td>
<td>no, although automobile and property insurance declination statutes do give some guidance as to issues that may be raised in a credit report</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
</tr>
<tr>
<td>Wisconsin</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>Use is not illegal but insurers must apply the criteria fairly and must be able to relate its requirement to risks</td>
<td>no</td>
<td>no</td>
<td></td>
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<tr>
<td>Wyoming</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
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</tbody>
</table>
USE OF CONSUMER CREDIT REPORTS FOR INSURANCE UNDERWRITING PURPOSES:
A Summarization of State Actions from 1993 to Date

August 2, 1996

American Insurance Association
Legislative Reporting Service
1130 Connecticut Avenue, N.W., Suite 1000
Washington, DC 20036
USE OF CONSUMER CREDIT REPORTS
FOR INSURANCE UNDERWRITING PURPOSES:
A Summarization of State Actions from 1993 to Date*

AIA Legislative Reporting Service**
August 2, 1996

Action in the 1993-1994 State Legislative Biennium

LAW

Arkansas H 1686 (Newman) prohibits automobile insurers from refusing to insure risks or refusing to continue insuring risks based solely on knowledge of an insured’s credit history.

Status: Law; effective July 1, 1993; Act 898, Laws 1993.

FAILED TO PASS/VETOED/WITHDRAWN

Illinois H 2962 (Kotlarz) would have created a “credit reporting licensing act” and would have established bonding requirements; included provision(s) related to an insured’s credit history.

Status: Failed to pass (1994 session).

New Jersey A 2058 (Oros) would have required automobile insurers to maintain information in an electronic database; included provision(s) on an insured’s credit history.

Status: Failed to pass (1993 session).

Ohio H 86 (Walsh) would have revised state regulations governing consumer reporting agencies and consumer credit reports. “Consumer report” was defined as “any written, oral, or other communication or any information by a consumer reporting agency bearing on a consumer’s creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living that is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer’s eligibility for credit or insurance to be issued primarily for personal, family, or household purposes; and for employment purposes.”

This proposal would have permitted a consumer report to be furnished to parties who intended to use the information for the purpose of insurance underwriting involving the consumer. Users of the consumer’s credit report, who would deny or alter the extension of credit or insurance based on that report’s contents, would have to notify the consumer of that action in addition to
providing the consumer with the name of the credit reporting agency used. Failure to comply would have been deemed “an unfair or deceptive” [practice]; the state’s attorney general would have been authorized to enforce the act’s provisions.

_Status: Failed to pass (1994 session).

_Washington State S 6458 (Williams)_ would have prohibited the credit history of an applicant for auto insurance from being used as a factor by the insurer in determining the applicant’s eligibility or rates for that policy.

_Status: Failed to pass (1994 session).

**Action in the 1995-1996 State Legislative Biennium**

**LAW**

_Alabama S 587 (Windom)_ amends Title 5, Banks, of the Alabama Code to provide for the insurance that may be required or offered in connection with a consumer credit transaction; and for maximum coverages for insurance, including credit life, disability, involuntary unemployment, collateral protection, property, and nonfiling insurance. The new law amends and clarifies that a creditor has no duty in the absence of a written agreement to obtain insurance; and to provide that a creditor may offer and finance other insurance, which is approved by the superintendent of banks of the state banking department.

_Status: Law; effective May 20, 1996; Act 576, Laws 1996.

_Louisiana S 307 (Lambert)_ amends Title 22, Insurance, of the Louisiana Revised Statutes to prohibit automobile insurers from terminating, modifying coverage, or refusing to issue or renew any policy solely because the insured has filed for bankruptcy by adding this practice to the list of those considered “unfair insurance business practices” as codified in state law. However, these provisions are not applicable when refusal to continue the policy is due to non-payment of premium.


_Maryland H 627 (Harrison)_ allows the Maryland Automobile Insurance Fund (MAIF) to sponsor an agent or broker for the purpose of obtaining accident history reports directly from persons who provide such reports (“accident history report,” as defined, does NOT include a credit history or report, however).

_Status: Law; effective October 1, 1995.
Massachusetts S 79 (Pines) amends the state’s “Trade Laws” regulating consumer [credit] reporting agencies to expand the rights of consumers, as well as to delineate agencies’ and users’ (including insurers) responsibilities with respect to those credit reports. Provisions cover allowing agencies to issue credit reports to users under prescribed situations only, including for the underwriting of insurance; consumer authorization contingencies; prior notification to and consent of a consumer for an “investigative” credit report containing information about that consumer’s character or reputation; accuracy of credit report information; collection of delinquent accounts; consumers’ right-of-access to their credit histories, particularly to dispute inaccuracies in those histories; and written notification to the consumer should insurance, employment, credit, or increased insurance or credit rates be based on an adverse credit report.

Status: Law; effective January 31, 1996; Chapter 125, Laws 1996.

Montana H 488 (Tuss) prohibits automobile and homeowner insurers from denying, cancelling, failing to renew, or limiting coverage on benefits based solely on an individual’s credit history.

Status: Law; effective July 1, 1995.

Virginia H 220 (Cohen) prohibits insurers and agents from refusing to renew an insurance policy for an owner-occupied dwelling based on a number of discriminatory factors, one of which is “credit information contained in a consumer report [sic] as defined in the U.S. Fair Credit Reporting Act.” An insurer is also prohibited from refusing to renew a motor vehicle insurance policy because of information in an insured’s credit report, unless specific requirements are met and covered in the insurer’s notice of non-renewal to the insured.

Status: Law; effective July 1, 1995; Chapter 3, Laws 1995.

Wisconsin A 954 (Freese) amends the Wisconsin Statutes to define a “motor vehicle consumer lease” and “gap amount;” requires disclosure on the part of the lessor to the consumer before entering into a lease; specifies disclosures and conditions required for an inspection of a leased vehicle for excess wear and damage; permits a consumer to purchase a liability insurance policy for bodily injury and property damage with respect to the operation of a leased vehicle; permits the lessor to provide that the consumer is responsible for the “gap amount;” defines “gap protection,” which the consumer may purchase from the lessor; provides that any person who violates the Wisconsin Motor Vehicle Consumer Lease Act is liable to the consumer. This law also governs pre-lease agreements. The bondsman or liability insurer who provides a consumer with a bond or liability insurance policy that must be filed with the state department of transportation in order to rent or lease a motor vehicle is liable for damages caused by the negligent operation of the leased vehicle. Sales finance companies are required to provide and maintain a $25,000 bond or irrevocable letter-of-credit executed in the name of the state.

Status: Law; effective October 1, 1996; Act 329, Laws 1996.
PENDING/PROPOSED

*Florida R 723 (Insurance Department)* is a proposed regulation (Rule 4-125.004) that would require Florida insurers who use credit reports as an underwriting factor to notify an applicant that his or her credit history will be used to determine eligibility. It would also require an insurer to maintain proof-of-mailing and a copy of the credit report in an applicant’s or insured’s file. Insurer compliance with this regulation would be evaluated during regularly scheduled market conduct examinations.

*Status:* Rule 4-125.004 was proposed on July 5, 1996. If requested, a hearing will be scheduled for July 31, 1996, at 9:30 a.m. in Room 116, Larson Building, 200 East Gaines Street, Tallahassee, Florida.

*New Jersey S 885 (Sinagra)* would limit insurance sales activities of financial institutions licensed as insurance producers. Among the bill’s provisions are those that would prohibit an insurance producer from “leasing space or acquiring customer information from a financial institution. Moreover, the use of customer information collected and held by a financial institution on its customers as a result of its lending and other banking activities would be restricted. A financial institution could not disclose customer information collected or received in connection with an insurance transaction unless the disclosure consists of only the customer’s name and address and is authorized by the customer.”

*Status:* Introduced and referred to the Senate Committee on Commerce on March 7, 1996.

*Virginia H 1305 (Deeds)* would prohibit motor vehicle insurance provisions for payment of medical expenses and loss of income from being qualified, limited, or reduced by “exclusion” (which includes use of consumer credit report information).


FAILED TO PASS/VETOED/WITHDRAWN

*Arkansas H 1763 (Newman)* would have allowed property and casualty insurers to use consumer credit reports for denying, non-renewing, or limiting coverage on a policy after verifying that the insured’s credit substantially increases risk and after allowing the insured an opportunity to rebut incorrect information on his or her credit report.

Connecticut H 5006 (Tulisano) would have prohibited automobile insurers from using credit reports to decline coverage, cancel, or non-renew a policy of private passenger automobile insurance.


Delaware S 67 (McBride) would have imposed limits on underwriting standards, including use of credit reports for automobile and property insurance.

Status: Failed to pass (1996 session).

Florida R 687 (Insurance Department), a regulation (Rule 4-233.001) proposed by the state insurance department, would have required Florida insurers who use credit histories as an underwriting factor to notify an applicant that his or her credit history will be used to determine [insurance] eligibility.

Status: Rule 4-233.001 was proposed on June 21, 1996; it was withdrawn from consideration on July 5, 1996.

Florida S 2800 (Jenne) would have required a professional guardian to post a blanket fiduciary bond of not less than $50,000 with the clerk of the circuit court in the county in which the guardian’s primary place of business was located; would have made it mandatory to require a prospective guardian to submit to a credit history analysis AND a criminal background investigatory check.

Status: Failed to pass (1996 session).

Kentucky H 431 (Ackerson) would have prohibited an insurance institution, agent, or insurance-support organization from preparing or requesting an investigative consumer report.

Status: Failed to pass (1996 session).

Louisiana H 830 (Theriot) would have prohibited the Louisiana Auto Insurance Plan from using the financial status of any applicant (e.g., a credit report) to determine if the applicant is entitled to obtain such insurance or to determine a premium rate for such insurance.


Maryland S 387 (Boozer) would have prohibited an insurer from refusing to underwrite any private passenger motor vehicle insurance risk because of the credit history of the applicant or named insured.
**Status:** Failed to pass (1995 session).

*Maryland S 13 (Boozer)* would have prohibited an insurer from refusing to underwrite any private passenger motor vehicle insurance risk because of the credit history of the applicant or named insured.

**Status:** Failed to pass (1996 session).

*Missouri H 62 (Bland)* would have amended the definitions for basic property, commercial, and homeowner’s insurance; would have required the state’s all-industry placement facility to offer premium installment payment plans; and would have defined unacceptable criteria for declining risks, including the applicant’s or insured’s previous credit history.

**Status:** Failed to pass (1995 session).

*Missouri H 784 (Troupe)* would have prohibited insurers from using the credit history or credit rating of any person to establish the premium to be charged for the issuance of an insurance policy or policies.

**Status:** Failed to pass (1996 session).

*New Jersey A 2119 (Russo)* would have prohibited private passenger auto insurers from refusing to renew certain policies, including basing such a decision on an insured’s credit history.

**Status:** Failed to pass (1995 session).

*New Mexico S 1139 (Sanchez)* would have prohibited discrimination based on the economic status of an applicant or insured by an insurer. Motor vehicle insurers would have been prohibited from using credit reports to decide whether or not to deny, non-renew, or limit coverage to an applicant or insured.

**Status:** Vetoed by the Governor on March 27, 1995.

*New York A 8340 (Grannis)* would have allowed multi-tier homeowners’ insurance; mandated five-year personal lines policies in coastal areas; limited personal lines cancellations in underserved areas; established a coastal market assistance plan (MAP); restricted underwriting guidelines in high-risk markets (e.g., the use of credit reports); required insurers to provide home inspections in certain areas; and extended the life of the New York Property Insurance Association until June 15, 1997.

**Status:** Failed to pass (1996 session).
**Oklahoma H 1010 (Stottlemyre)** would have prohibited motor vehicle insurers from using an insured’s financial records as a basis for canceling, non-renewing, refusing to issue, or increasing premium rates.

**Status:** Failed to pass (1995 session).

**South Carolina S 990 (McConnell)** would have created new chapters in the state’s motor vehicle code on liability insurance policies; the titling, registration, and licensure of motor vehicles; regulation of general rates; and regulation of rates for certain types of insurance. Additionally, the proposal would have repealed Articles 1, 3, and 5 of Chapter 77, Title 38 (Automobile Insurance) and Chapters 9 and 10 of Title 56 (the *Motor Vehicle Financial Responsibility Act*). Among other things, the bill’s provisions addressed the use of consumer credit reports for underwriting purposes in the issuance of motor vehicle insurance policies.

**Status:** Failed to pass (1996 session).

**Tennessee S 2718 (Kyle)** would have prohibited the use of a credit reporting agency’s information to determine acceptability by an [insurer] for issuing or renewing an auto insurance policy.

**Status:** Failed to pass (1996 session).

**Wisconsin A 649 (Schneider)** would have required insurance agents to disclose to any person applying for insurance any information that identified the applicant and that the agent has also provided to, or received from, a national or statewide “database.” Insurers would have also been required to disclose to each insured under each policy issued by the insurer, at least annually, any information that identified the insured and that the insurer has provided to, or received from, a national or statewide “database.”

**Status:** Failed to pass (1995 session).

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* The following legislative and regulatory proposals were identified, classified, and monitored for *AIAccess*, the American Insurance Association’s (AIA) on-line Legislative Reporting Service, under the issue entitled “Consumer Credit Reports, Underwriting Purposes, All Lines” (112-07). For more information about the AIA’s on-line database services, please call 1-800-242-2302 or visit the association’s Web Site at http://www.aiadc.org.

** The Legislative Reporting Service (LRS) is part of the American Insurance Association (AIA), a trade organization representing 250 major insurance companies which provide all lines of property-casualty insurance. AIA’s headquarters are located in Washington, D.C., and the association has representatives in every state.
ALLSTATE INSURANCE COMPANY
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SUITE 400
SPRINGFIELD, ILLINOIS 62704
(217) 525-0781
FAX (217) 525-0780

Bonnie J. Williams
Associate Counsel

November 20, 1996

The Honorable Dudley Ewen, Chair
Credit Reports Subgroup
Maryland Insurance Administration
501 St. Paul Place, 7th Floor South
Baltimore, MD 21202-2272

Dear Dudley,

Recently, Kevin Sullivan and I visited with Commissioner George Reider of Connecticut who serves as Chairman of the Market Conduct and Consumer Affairs committee at the NAIC. Among the topics of conversation was the upcoming review of the White Paper composed by members of the credit reports subgroup. I am writing to commend you for your efforts as Chairman of the subgroup in providing a forum for an open exchange on this very complex issue.

As you know, Allstate has worked diligently to share with the members of the subgroup how profoundly we believe that the use of credit reports in underwriting is a valid and powerful tool to help us accurately write insurance. Members of the subgroup visited Allstate’s home office complex and much correspondence occurred following that between Allstate and various members of the subgroup. Our request, at that time, was that you maintain the information as trade secret and that the NAIC not release the information. Instead we asked that interested regulators contact us directly. We want to again thank you for respecting our wishes, even though you felt at that time that the process would be better served by easier access to information.

We wish to reiterate our willingness to provide information to both the subgroup and to the parent committee. A comment was made at the last hearing that although the information had been provided to individual members, it had not been provided to the subgroup as a whole.

As a result of our visit with Commissioner Reider, Allstate wishes to amend its position with respect to the information we have previously provided to members of the subgroup. To wit, I am writing to ask you, as Chairman, to share with the other members of your subgroup, all of the information which Allstate has previously provided to you. We believe that you have copies of...
all the material which has been provided to the NAIC. We ask that you feel free to discuss the
information among yourselves, and that you advise the subgroup that we stand ready and willing
to provide any additional clarification which it is in our power to make.

Our concern, all along, has never been sharing the information with regulators, but rather that our
competitive position would be harmed if the information somehow became public. Although that
risk still exists, we now believe that there has been so much open dialogue on the subject and that
numerous other companies are now engaged in the practice of using credit reports in
underwriting that, on balance, we and the regulatory community would be better served by easier
access to information. For that reason, we will no longer ask you to hold the information
previously shared with the NAIC as proprietary.

I realize that this change in our company’s position comes to you very late in the process of your
deliberations on the issue. Hopefully, the change is not so late as to prevent you from having
meaningful review of the information so as to satisfy those members of the subgroup who still
feel that they have not had an opportunity to have their questions answered. I would ask your
indulgence, nevertheless, in your final considerations for amending the White Paper that
references to Allstate in the draft be changed to reflect this new position.

In closing, I want to personally thank you for your assistance throughout the course of
deliberations on this issue. I greatly respect the effort you have gone through in your role as
chairman, in order to assure that all parties had an opportunity to present their very divergent
views on the issue. It was, indeed, an arduous task, and on behalf of Allstate, I want to commend
you.

Sincerely,

ALLSTATE INSURANCE COMPANY

Bonnie J. Williams
Associate Counsel

CC: Commissioner George Reider, Connecticut
Director Mark Boozell, Illinois
Assistant Director, Madelynne Brown, Illinois
Kevin Sullivan, Allstate
Steve Sheffey, Allstate
Cathy Guissow, NAIC
ALLSTATE INSURANCE COMPANY
LAW AND REGULATION
2775 Sanders Road
Suite A4
Northbrook, Illinois 60062
(847) 402-4568
FAX (847) 326-7523

Steven R. Sheffey

July 30, 1996

***CONFIDENTIAL***

VIA AIRBORNE EXPRESS

Mr. Dudley Ewen
Maryland Insurance Administration
501 St. Paul Place
Baltimore, Maryland 21202

Re: Follow-Up Questions

Dear Mr. Ewen:

This is in response to your letter of June 26, 1996, in which you listed questions arising from our June 6, 1996 meeting with certain members of the Credit Reports Subgroup of the Market Conduct and Consumer Affairs (EX3) Subgroup of the NAIC.

As you know, we are more than happy to provide regulators with the information they need to understand and evaluate our use of credit reports for underwriting purposes. However, we cannot stress strongly enough that the attached answers constitute proprietary and confidential trade secret information of Allstate. Allstate has invested an enormous amount of time, effort and financial resources in developing and formulating the enclosed data and explanations, which, if disclosed, would give advantage to Allstate's competitors and significantly and irreparably injure the Allstate's legitimate business interests. Consequently, Allstate has a strong, legitimate and critical business interest that these materials remain confidential and not subject to public disclosure nor made part of the public record. We believe that pursuant to Sections 11-1201 to 11-1209 of the Maryland Uniform Trade Secrets Act, this data and explanation is protected from disclosure to the public,
Allstate's competitors, or any other third party.

On July 29, 1996, I spoke with Cathy Gussow of the NAIC regarding our need to balance the necessity of maintaining the confidentiality of this data and explanation against our desire to make as much information as possible available to you and other regulators. We are therefore providing this information to you with the understanding that (i) you will not disclose this information to any third parties, including other regulators, other than the NAIC and (ii) you will only disclose this information to the NAIC for the purpose of Mike Barth’s review of these answers and on the condition that Mike Barth and the NAIC agree to maintain the confidentiality of this data and explanation and not disclose it to any third party, including regulators. We would appreciate your informing me when and if this information is conveyed to the NAIC. If other regulators desire this information, Allstate can provide this information directly to them. As Ms. Gussow and I discussed, however, it probably would be best to wait until Mr. Barth has had the opportunity to review this information and formulate additional questions, if any, before disseminating this information further.

Thank you again for inviting us to your meeting on July 18 and July 19 in Baltimore. As we mentioned at the meeting, it is our hope that the report will be worded such that an interested party reading the report would come away with a good understanding of both industry and regulatory concerns (to the extent there is a difference) and would therefore be in a good position to make informed judgments regarding the use of credit reports for underwriting purposes. In our opinion, the report will have failed its purpose if its publication puts either us or regulators in the position of having to point our errors of omission or misstatements of fact or positions. We believe, therefore, that the best approach is to provide readers with all sides of the story and let the merits of the positions speak for themselves.

We are looking forward to continuing to work with you and other members of the subgroup in developing a fair, balanced paper on
the use of credit reports and are looking forward to receiving the next draft.

Sincerely,
ALLSTATE INSURANCE COMPANY

Steven R. Sheffey

Attachment

C: Ms. Cathy Gussow via FAX #816-374-7186
(Without attachment)
Describe the research hypothesis, the assumptions underlying the hypothesis, and explain the techniques that can be employed to confirm or refute the hypotheses.

The 1996 Auto Validation Study is an analysis to test the hypothesis that payment behavior is useful in explaining loss experience. An Analysis of Variance model using Loss Statistics as dependent variables and a categorical variable representing type of payment behavior is used to test the hypothesis.

Describe the modeling technique selected, the reasons that it was chosen over other approaches, the major underlying statistical assumptions of the modeling technique, the effect of violations of those assumptions on either parameter estimates or model estimates (the y-hats).

A One-Way Analysis of Variance model was selected to test the hypothesis. An Analysis of Variance model was selected because a) it's relatively simple to apply and b) it answers the questions put forth in the hypothesis. For hypothesis testing, the model errors are assumed to be normally and independently distributed random variables with mean zero and variance $\sigma^2$. The variance $\sigma^2$ is assumed constant for all levels of the factor. Substantive violations of these assumptions may affect the variance of the parameter estimates and hypothesis test results. Several tests were performed to assess the effect of violations of these assumptions. The results of those tests are given in a following paragraph.

Describe the model inputs (independent and dependent variables), statistical properties of the inputs (means, units of the means, variances, normally distributed or skewed, transformations of variables, continuous or class, etc.), assumptions about the relationships of the independent variables to the dependent variable(s), assumptions about the relationship of the independent variables to one another, statistical properties of the inputs if necessary (e.g., must be multivariate normal), and other potential inputs that could be employed and the reasons that they are not included.

The data set used contains policy level data on Earned Exposures, Earned Premium, Incurred Losses, Number of Claims and a categorical variable indicating the type of Payment Behavior for each New Business Policy. The two types of insurance statistics modeled are Loss Ratio and Frequency. Analysis of Variance is used to model the effect of payment behavior on these two statistics. The relationship between the dependent variable (Loss Ratio or Frequency) and the independent variable (Payment Behavior) is
CONFIDENTIAL AND PROPRIETARY INFORMATION
Subject to July 30, 1996 letter from Steven R. Sheffey to Dudley Ewen

given in equation (1). As was stated previously, the Payment Behavior variable is a categorical variable. The models used are essentially the same, only the response variable and weight given each observation is different. Loss Ratio and Frequency are weighted by Earned Premium and Earned Exposure respectively. The model used for Loss Ratios is:

\[ Y_{ij} - \mu = \tau_i + \varepsilon_{ij} \tag{1} \]

where \( Y_{ij} \) is the loss ratio for policy j with payment behavior i, \( \mu \) is the overall average Loss Ratio, \( \tau_i \) is the effect on the loss ratio of policies with payment behavior i. \( \varepsilon_{ij} \) is the random error associated policy j with payment behavior i. \( \varepsilon_{ij} \)'s are assumed to be independent and identically distributed Normal random variables: \( \varepsilon_{ij} \sim N(0, \sigma^2) \). The four (4) levels of policy behavior are Clean Credit, Acceptable Credit, Unacceptable Credit and Missing Data. For the purposes of our analysis, \( \mu \) was estimated first and subtracted from each of the observed Loss Ratios. Again, the Frequency model is essentially the same as the Loss Ratio model.

The statistical properties of the inputs will be presented in the section describing the results of the modeling. Except in the validation of assumptions, no transformation of the data was done. The rank transformation will be described when discussing the validation tests. There is only one independent variable in our model, hence no assumption about the relationship between it and other independent variables is necessary. No other independent variables were deemed necessary since we were studying the efficacy of using payment behavior as a partition of the new business population.

Describe results of validation tests on the assumptions about the statistical properties of the model inputs.

No assumptions were made about the model inputs other than those assumptions associated with the Analysis of Variance model described in equation (1). As such, they are dealt with in the next section.

Describe results of modeling, along with the validation tests of major statistical assumptions (e.g., orthogonality, normally distributed error terms) and of the parameter estimates. Summarize any violations of the usual statistical assumptions and describe the potential impact, if any, of those
violations (Note: virtually every statistical process that uses “real life” inputs has violations of the assumptions, but in most cases those assumptions are not material to the fundamental results).

There are three assumptions about the error terms as stated in a preceding paragraph, the Normality, independence and homoscedasticity assumptions. Departure from any of these assumptions still results in the parameter estimates of the Analysis of Variance model being unbiased. The effect of a violation of any of these assumptions primarily affects the variance of the parameter estimates and hence the variance of the y-hats. However, even if the distribution is far from Normal, the estimators generally have the property of asymptotic Normality, i.e. their distributions approach Normality under very general conditions as the sample size increases (See Applied Linear Regression Models, Neter, Wasserman and Kutner (1983), p70). The size of the data set used in the analysis, 731,206 observations, was deemed to be sufficiently large to make the Normality assumption. Even so, an additional test was performed. To assess the effect of the three Analysis of Variance assumptions, a rank transformation was performed on the data (the dependent variables, Loss Ratio and Frequency). An Analysis of Variance was performed on both the original and ranked data. Both procedures gave similar results indicating the Analysis of Variance assumptions are reasonably well satisfied, hence it was deemed appropriate to use the original data in further analysis (For a description of this technique see Design and Analysis of Experiments, Douglas C. Montgomery (1984), p116-118). Given the nature of the data, a violation of the independence assumption, of any material effect, seemed unlikely. Nevertheless, a plot of residuals vs. fitted values was created. There was no apparent pattern and it was concluded that the independence assumption held adequately.

The Analysis of Variance for the model given in equation (1) resulted in an F-Value for the model of 37.13 and 63.56 for the Loss Ratio and Frequency data respectively. The parameter estimates for the Loss Ratio analysis are:

- $\hat{\tau}_c = -0.0903, \text{StdError} = 0.0110$
- $\hat{\tau}_s = +0.0613, \text{StdError} = 0.0142$
- $\hat{\tau}_u = +0.1860, \text{StdError} = 0.0350$
- $\hat{\tau}_u = +0.1152, \text{StdError} = 0.0198$

T-statistics for these parameters show significance at the 0.01 level. These parameter estimates correspond to Loss Ratio Relativities of 88, 108, 124 and 115 respectively and are significantly different from the average relativity of 100 (corresponding to a mean Loss Ratio of 0.7699).
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Subject to July 30, 1996 letter from Steven R. Sheffey to Dudley Ewen

Parameter estimates for the Frequency analysis are:
\[
\hat{\tau}_c = -0.0187, \text{StdError} = 0.0018 \\
\hat{\tau}_a = +0.0112, \text{StdError} = 0.0022 \\
\hat{\tau}_u = +0.0456, \text{StdError} = 0.0056 \\
\hat{\tau}_m = +0.0216, \text{StdError} = 0.0030
\]

T-statistics for these parameters again show significance at the 0.01 level. These parameter estimates correspond to Loss Ratio Relativities of 93, 104, 116 and 108 respectively and are significantly different from the average relativity of 100 (corresponding to a mean frequency of 0.2783).

In addition to the analysis of variance, hypothesis tests on the differences in means for each of the effects was performed. The hypotheses took the form \( H_0: \tau_i = \tau_k, H_A: \tau_i \neq \tau_k, i \neq k \), for \( i = c,a,u \) and \( k = c,a,u \). T-tests were used to test these hypotheses. It was found that all pairs of tests were significant at the 0.01 level for the Loss Ratio data. The test statistics for each of the hypothesis test are:

Loss Ratio:
\[
H_0: \tau_c = \tau_a, \ t - \text{stat} = -8.444 \\
H_0: \tau_c = \tau_u, \ t - \text{stat} = -7.537 \\
H_0: \tau_a = \tau_u, \ t - \text{stat} = -3.302
\]

For Frequency, the t-statistics also indicate significance at the 0.01 level.
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Frequency:
\[ H_0: \tau_c = \tau_a, t - \text{stat} = -10.556 \]
\[ H_0: \tau_c = \tau_u, t - \text{stat} = -10.885 \]
\[ H_0: \tau_a = \tau_u, t - \text{stat} = -5.664 \]

Conclusions and support for conclusions, including any hypotheses about unexpected statistical results that do not seem to support the initial assumptions. Sometimes statistical tests fail to conclusively prove something because they are the wrong test or because one or more of the variables aren't adequate proxies for the trait that is being modeled.

Given the results of the Analysis of Variance and the t-tests on the differences in means in the preceding section, we conclude that the use of the current definitions of payment behavior do significantly partition the insured population into less heterogeneous groups than would exist without the use of payment behavior information.

Describe the steps taken to translate this research into a pricing, rating or underwriting program.

This analysis was confirmatory in nature. It validated the current use of payment behavior as an additional piece of information available for use in the underwriting process. As such, this research was not used in the implementation of new pricing, rating or underwriting procedures.
December 10, 1996

Mr. Lamont D. Boyd, CPCU, AIM  
Senior Marketing Representative  
Fair, Isaac  
120 North Redwood Drive  
San Rafael, California 94903-1996

Dear Mr. Boyd:

Attached is our analysis of the data provided to calculate the P-Value of the slope parameter from the regression analysis of Insurance Bureau Scores and loss ratio relativities. We hope this study is useful in your discussions with the insurance industry regulators.

Thank you for the opportunity to work with you and your staff on this project. We will be happy to answer any questions that may arise.

Sincerely,

TILLINGHAST -TOWERS PERRIN

By: Wayne D. Holdredge, ACAS, MAAA

WDH: jfb
Attachment
# Table of Contents

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</thead>
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<td>6</td>
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<td>8</td>
</tr>
</tbody>
</table>

**EXHIBITS**
Purpose

Tillinghast -Towers Perrin (Tillinghast) was retained by Fair, Isaac and Co., Inc. (Fair, Isaac) to analyze certain data to be provided to Tillinghast by numerous property/casualty insurance companies. Specifically, based on each set of data provided, we were asked to calculate and report on the P-Value of the slope parameter from the regression analysis of Insurance Bureau Scores based on consumer credit information, and loss ratio relativities.

The purpose of calculating P-Values is to measure the confidence or statistical significance of the relationship between the Insurance Bureau Scores and loss ratio relativities. P-Values are defined on pages 8 to 9.
Distribution and Use

The results of our analysis are being provided to Fair, Isaac for its use in discussions with the National Association of Insurance Commissioners (NAIC) about the use of Insurance Bureau Scores in underwriting personal insurance. A copy of this report in its entirety may be provided to the NAIC during the course of these discussions. Further, Fair, Isaac may release copies of this report to state insurance regulators and legislators, Fair, Isaac insurance company prospects and clients and to the press provided that:

1. The entire report is provided;

2. Fair, Isaac maintains a list of the names of the parties to whom copies of the report are given and provides that list to Tillinghast; and

3. Fair, Isaac advises each party to whom a copy of such report is given that such party may contact Tillinghast to discuss the report. Tillinghast will notify Fair, Isaac when it is contacted by a recipient of the report.

Any other use or further distribution of the report is not authorized without Tillinghast prior written consent.
Reliances and Limitations

Data, as identified later in this report, was provided by individual insurance companies to Fair, Isaac who in turn sent the data to Tillinghast. We confirmed with the person responsible for providing the data at each insurance company that the data we relied on is correct and is from that company's book of business.

We understand that different groupings of the same data could produce different P-Values. However, the way the data was subtotaled when it was provided to us appears reasonable to us.

We were requested to determine and give a report on a particular statistic from the regression of certain Insurance Bureau Scores and loss ratio relativity information provided by insurance companies. No analysis of or opinion on any other aspects of the use of Insurance Bureau Scores in underwriting personal insurance is offered by Tillinghast or implied from the conclusions of this report.

Throughout this report, the word “relationship” is used interchangeably with the word ."correlation."
Conclusions

Fair, Isaac requested data from a number of insurance companies, several of which, as shown below, have already responded to the request for data. The following P-Values of the slope parameters were calculated from all of the data provided to us up to this point.

<table>
<thead>
<tr>
<th>Company</th>
<th>Line of Business</th>
<th>P-Value</th>
<th>Probability (1 - P-Value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Auto</td>
<td>.0009</td>
<td>.9991</td>
</tr>
<tr>
<td>2</td>
<td>Homeowners</td>
<td>.0833</td>
<td>.9167</td>
</tr>
<tr>
<td>3*</td>
<td>Homeowners</td>
<td>.0002</td>
<td>.9998</td>
</tr>
<tr>
<td>4</td>
<td>Auto</td>
<td>.0038</td>
<td>.9962</td>
</tr>
<tr>
<td>5</td>
<td>Personal Property</td>
<td>.0001</td>
<td>.9999</td>
</tr>
<tr>
<td>6</td>
<td>Homeowners</td>
<td>.0068</td>
<td>.9932</td>
</tr>
<tr>
<td>7</td>
<td>Homeowners</td>
<td>.0061</td>
<td>.9939</td>
</tr>
<tr>
<td>8*</td>
<td>Auto</td>
<td>.0000</td>
<td>1.0000</td>
</tr>
<tr>
<td>9</td>
<td>Homeowners</td>
<td>.0038</td>
<td>.9962</td>
</tr>
</tbody>
</table>

*Companies 3 and 8 are the same company. Its homeowners and auto submissions are designated as separate companies.

From the data and P-Values, we conclude that the indication of a relationship between Insurance Bureau Scores and loss ratio relativities is highly statistically significant. In a more technical sense, the conclusion is that it is very unlikely that Insurance Bureau Scores and loss ratio relativities are not correlated based on this data.

_Tillinghast-
_Towers Perrin_
The data for all companies included in this study except Company 2 indicates at least a 99% probability that a relationship exists. The data for Company 2 indicate a 92% probability that there is a relationship. A layman's interpretation of this result could be that it is very likely there is a correlation between Insurance Bureau Scores and loss ratio relativities.
Data

The data we received for each company is included as we received it in Exhibit I. In each case there are four columns of numbers:

- Score Interval
- Midpoint
- Earned Premium
- Loss Ratio Relativity

We are assured by Fair, Isaac and the individual companies that this data is representative of each company’s entire block of business. The time frames from which the data is taken are not the same for all companies, although our understanding is that it represents relatively recent experience. Also note that the Insurance Bureau Scores were determined prior to the experience underlying the loss ratios.

The score intervals in the first column were selected to produce 10 groups with approximately equal volume. In three instances, Company 6, Company 7 and Company 9, the score intervals were established to create fewer groups with similar volume. The data could have been grouped numerous other ways, and perhaps different groupings would have produced different results. The groupings of the data as presented to us seemed reasonable and appropriate for this analysis.
In the second column is the midpoint of each of the intervals shown in the first column. For the first and last intervals, the midpoint is the mean of the scores in that interval.

The third column shows the percentage of the total premium from the risks with the corresponding Insurance Bureau Scores in the first column. As stated above, the intervals were selected so that approximately 10% of the total premium (except for Company 6, 7 and 9) was included in each interval.

The loss ratio relativities in the last column are not loss ratios. They are the relativities of the loss ratios for each interval to the total loss ratio. For example, a loss ratio relativity of 1.20 for a given. Interval means that the loss ratio for the group of insureds with Insurance Bureau Scores in that interval was 20% greater than the loss ratio for all the company's insureds in this study. From this information we are not able to conclude anything about the absolute level of the loss ratios, only the loss ratio relativities.
Detailed explanations of the P-Value as we have calculated it are contained in most statistical text books. For a rigorous definition of this statistic, the reader is encouraged to reference one of those texts. In the following paragraphs we explain the P-Value in general terms only.

For purposes of this analysis, we tested the hypothesis that there was no correlation between Insurance Bureau Scores and loss ratio relativities. If this hypothesis is true, the loss ratio relativities as shown in Exhibit II will be randomly distributed about the line representing the loss ratio relativity of 1.00. If the hypothesis is false, the loss ratio relativities will be randomly distributed about some other reasonably identifiable line.

The P-Value is a test statistic to test this hypothesis. If the hypothesis is true and the loss ratio relativities are randomly distributed above and below the loss ratio relativity $= 1.00$ line on the graphs in Exhibit II, the P-Value will be high. If the hypothesis is false and the loss ratio relativities do not appear to be randomly above and below the loss ratio relativity line $= 1.00$, the P-Value will be low. A low P-Value means it is unlikely that the differences between the actual results and the initial hypothesis are due to random variation. This means it is unlikely the initial hypothesis is correct.
While no statistical test will allow us to reject the initial hypothesis absolutely, this test indicates that it is very unlikely the initial hypothesis is valid. That is, there is very strong evidence of correlation between Insurance Bureau Scores and loss ratio relativities, (i.e., we should reject the hypothesis that there is no correlation between Insurance Bureau Scores and loss ratio relativities).

This test does not identify what that correlation is or how strong the correlation is but only whether the conclusion of the existence of a correlation is significant or not. From simply viewing the graphs in Exhibit II, it seems clear that higher loss ratio relativities are associated with lower Insurance Bureau Scores.
# COMPANY 1

## Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>813 or More</td>
<td>850.0</td>
<td>10.2%</td>
<td>0.657</td>
</tr>
<tr>
<td>768-812</td>
<td>790.0</td>
<td>9.9%</td>
<td>0.584</td>
</tr>
<tr>
<td>732-767</td>
<td>749.5</td>
<td>11.0%</td>
<td>0.692</td>
</tr>
<tr>
<td>701-731</td>
<td>716.0</td>
<td>10.9%</td>
<td>0.683</td>
</tr>
<tr>
<td>675-700</td>
<td>687.5</td>
<td>10.4%</td>
<td>1.184</td>
</tr>
<tr>
<td>651-674</td>
<td>662.5</td>
<td>9.8%</td>
<td>0.793</td>
</tr>
<tr>
<td>626-650</td>
<td>638.0</td>
<td>9.9%</td>
<td>1.332</td>
</tr>
<tr>
<td>601-625</td>
<td>613.0</td>
<td>10.0%</td>
<td>1.280</td>
</tr>
<tr>
<td>560-600</td>
<td>580.0</td>
<td>9.4%</td>
<td>1.214</td>
</tr>
<tr>
<td>559 or Less</td>
<td>525.0</td>
<td>8.6%</td>
<td>1.752</td>
</tr>
</tbody>
</table>

Total 100.0% 1.000
COMPANY 2

Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>840 or More</td>
<td>854.0</td>
<td>10.0%</td>
<td>0.607</td>
</tr>
<tr>
<td>823-839</td>
<td>831.0</td>
<td>10.0%</td>
<td>0.813</td>
</tr>
<tr>
<td>806-822</td>
<td>814.0</td>
<td>10.0%</td>
<td>0.626</td>
</tr>
<tr>
<td>789-805</td>
<td>797.0</td>
<td>-10.0%</td>
<td>1.342</td>
</tr>
<tr>
<td>771-788</td>
<td>779.5</td>
<td>10.0%</td>
<td>1.059</td>
</tr>
<tr>
<td>748-770</td>
<td>759.0</td>
<td>10.0%</td>
<td>1.019</td>
</tr>
<tr>
<td>721-747</td>
<td>734.0</td>
<td>10.0%</td>
<td>1.322</td>
</tr>
<tr>
<td>686-720</td>
<td>703.0</td>
<td>10.0%</td>
<td>0.810</td>
</tr>
<tr>
<td>635-685</td>
<td>660.0</td>
<td>10.0%</td>
<td>0.986</td>
</tr>
<tr>
<td>635 or Less</td>
<td>592.0</td>
<td>9.9%</td>
<td>1.417</td>
</tr>
</tbody>
</table>

Total          | 100.0%   | 1.000          |
COMPANY 3

Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>826 or More</td>
<td>845.0</td>
<td>10.0%</td>
<td>0.723</td>
</tr>
<tr>
<td>803-826</td>
<td>814.5</td>
<td>10.0%</td>
<td>0.903</td>
</tr>
<tr>
<td>782-803</td>
<td>792.5</td>
<td>10.0%</td>
<td>0.895</td>
</tr>
<tr>
<td>759-782</td>
<td>770.5</td>
<td>10.0%</td>
<td>0.795</td>
</tr>
<tr>
<td>737-759</td>
<td>748.0</td>
<td>10.0%</td>
<td>1.073</td>
</tr>
<tr>
<td>710-737</td>
<td>723.5</td>
<td>10.0%</td>
<td>0.941</td>
</tr>
<tr>
<td>680-710</td>
<td>695.0</td>
<td>10.0%</td>
<td>0.912</td>
</tr>
<tr>
<td>640-680</td>
<td>660.0</td>
<td>10.0%</td>
<td>1.115</td>
</tr>
<tr>
<td>583-640</td>
<td>611.5</td>
<td>10.0%</td>
<td>1.221</td>
</tr>
<tr>
<td>583 or Less</td>
<td>535.0</td>
<td>10.0%</td>
<td>1.421</td>
</tr>
</tbody>
</table>

Total: 100.0% 1.000
## COMPANY 4

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>832 or More</td>
<td>859.0</td>
<td>10.0%</td>
<td>0.672</td>
</tr>
<tr>
<td>803-832</td>
<td>817.5</td>
<td>10.0%</td>
<td>1.027</td>
</tr>
<tr>
<td>767-803</td>
<td>785.0</td>
<td>10.0%</td>
<td>0.823</td>
</tr>
<tr>
<td>739-767</td>
<td>753.0</td>
<td>10.0%</td>
<td>1.036</td>
</tr>
<tr>
<td>720-739</td>
<td>729.5</td>
<td>10.0%</td>
<td>0.775</td>
</tr>
<tr>
<td>691-720</td>
<td>705.5</td>
<td>10.0%</td>
<td>1.000</td>
</tr>
<tr>
<td>668-691</td>
<td>679.5</td>
<td>10.0%</td>
<td>1.041</td>
</tr>
<tr>
<td>637-668</td>
<td>652.5</td>
<td>10.0%</td>
<td>1.023</td>
</tr>
<tr>
<td>602-637</td>
<td>619.5</td>
<td>10.0%</td>
<td>1.251</td>
</tr>
<tr>
<td>602 or Less</td>
<td>571.0</td>
<td>10.0%</td>
<td>1.351</td>
</tr>
</tbody>
</table>

Total: 100.0%  1.000
## COMPANY 5

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>845 or More</td>
<td>857.0</td>
<td>10.0%</td>
<td>0.800</td>
</tr>
<tr>
<td>830-845</td>
<td>837.5</td>
<td>10.0%</td>
<td>0.919</td>
</tr>
<tr>
<td>814-830</td>
<td>822.0</td>
<td>10.0%</td>
<td>0.740</td>
</tr>
<tr>
<td>798-814</td>
<td>806.0</td>
<td>10.0%</td>
<td>0.733</td>
</tr>
<tr>
<td>779-798</td>
<td>788.5</td>
<td>10.0%</td>
<td>0.855</td>
</tr>
<tr>
<td>757-779</td>
<td>768.0</td>
<td>10.0%</td>
<td>0.889</td>
</tr>
<tr>
<td>730-757</td>
<td>743.5</td>
<td>10.0%</td>
<td>0.993</td>
</tr>
<tr>
<td>695-730</td>
<td>712.5</td>
<td>10.0%</td>
<td>1.143</td>
</tr>
<tr>
<td>643-695</td>
<td>669.0</td>
<td>10.0%</td>
<td>1.300</td>
</tr>
<tr>
<td>643 or Less</td>
<td>600.0</td>
<td>10.0%</td>
<td>1.628</td>
</tr>
</tbody>
</table>

Total

100.0%

1.000
## COMPANY 6

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>810 and up</td>
<td>837.5</td>
<td>19.7%</td>
<td>0.656</td>
</tr>
<tr>
<td>765-809</td>
<td>777.0</td>
<td>20.1%</td>
<td>0.795</td>
</tr>
<tr>
<td>715-764</td>
<td>739.5</td>
<td>20.8%</td>
<td>0.911</td>
</tr>
<tr>
<td>645-714</td>
<td>679.5</td>
<td>20.2%</td>
<td>1.066</td>
</tr>
<tr>
<td>Below 645</td>
<td>600.0</td>
<td>19.2%</td>
<td>1.593</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>100.0%</td>
<td>1.000</td>
</tr>
</tbody>
</table>
## COMPANY 7

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>750 and up</td>
<td>795.0</td>
<td>21.3%</td>
<td>0.783</td>
</tr>
<tr>
<td>685-749</td>
<td>717.0</td>
<td>25.8%</td>
<td>0.900</td>
</tr>
<tr>
<td>630-684</td>
<td>657.0</td>
<td>19.6%</td>
<td>1.083</td>
</tr>
<tr>
<td>560-629</td>
<td>594.5</td>
<td>19.3%</td>
<td>1.150</td>
</tr>
<tr>
<td>Below 560</td>
<td>520.0</td>
<td>13.9%</td>
<td>1.200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>100.0%</strong></td>
<td><strong>1.000</strong></td>
</tr>
</tbody>
</table>
## COMPANY 8

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>755 or More</td>
<td>775.0</td>
<td>8.9%</td>
<td>0.767</td>
</tr>
<tr>
<td>732-754</td>
<td>743.0</td>
<td>9.3%</td>
<td>0.798</td>
</tr>
<tr>
<td>714-731</td>
<td>722.5</td>
<td>9.6%</td>
<td>0.859</td>
</tr>
<tr>
<td>698-713</td>
<td>705.5</td>
<td>9.9%</td>
<td>0.969</td>
</tr>
<tr>
<td>682-697</td>
<td>689.5</td>
<td>10.3%</td>
<td>0.922</td>
</tr>
<tr>
<td>666-681</td>
<td>673.5</td>
<td>9.7%</td>
<td>0.978</td>
</tr>
<tr>
<td>647-665</td>
<td>656.0</td>
<td>10.5%</td>
<td>1.070</td>
</tr>
<tr>
<td>625-646</td>
<td>635.5</td>
<td>10.2%</td>
<td>1.107</td>
</tr>
<tr>
<td>592-624</td>
<td>608.0</td>
<td>10.7%</td>
<td>1.122</td>
</tr>
<tr>
<td>591 or Less</td>
<td>562.0</td>
<td>10.8%</td>
<td>1.324</td>
</tr>
</tbody>
</table>

| Total          | 100.0%   | 1.000          |

Tillinghast-

*Towers Perrin*
## COMPANY 9

### Score & Loss Ratio Relativity Summary

<table>
<thead>
<tr>
<th>Score Interval</th>
<th>Midpoint</th>
<th>Earned Premium</th>
<th>Loss Ratio Relativity</th>
</tr>
</thead>
<tbody>
<tr>
<td>780 and up</td>
<td>815.0</td>
<td>16.8%</td>
<td>0.637</td>
</tr>
<tr>
<td>745-779</td>
<td>762.0</td>
<td>13.7%</td>
<td>0.715</td>
</tr>
<tr>
<td>710-744</td>
<td>727.0</td>
<td>13.9%</td>
<td>0.734</td>
</tr>
<tr>
<td>670-709</td>
<td>689.5</td>
<td>15.0%</td>
<td>0.807</td>
</tr>
<tr>
<td>635-669</td>
<td>652.0</td>
<td>12.1%</td>
<td>0.909</td>
</tr>
<tr>
<td>590-634</td>
<td>612.0</td>
<td>11.2%</td>
<td>1.241</td>
</tr>
<tr>
<td>530-589</td>
<td>559.5</td>
<td>9.8%</td>
<td>1.357</td>
</tr>
<tr>
<td>Below 530</td>
<td>495.0</td>
<td>7.5%</td>
<td>2.533</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>100.0%</td>
<td>1.000</td>
</tr>
</tbody>
</table>
Company 1

![Graph showing the relationship between score interval midpoint and a scale ranging from 0.40 to 2.00. The x-axis represents score interval midpoint ranging from 500 to 900.]
Company 5
New Duties on Credit Bureaus

* Must provide a free credit report for 60 days after an adverse action has occurred
* Must provide a free report to persons who are unemployed, who receive public assistance, or who are the victims of fraud
* Must establish toll-free numbers for consumers and make live personnel available to callers
* Must investigate consumer complaints within 30 days and notify the consumer how the dispute is resolved and who they contacted and how the consumer can contact them
* Must establish reasonable procedures to prevent the reappearance of mistakes which have been deleted and must notify consumer before reinserting any such information
* Must notify users and furnishers of their responsibilities under FCRA
* Must disclose all information in a consumer’s file
* Must make consumer reports more comprehensible for consumers

New Duties on Users:

* Must disclose to consumers their rights when ad adverse action is taken based on a consumer report - including the right to a free report and to dispute information in their files
* If a credit card issuer uses a marketing list from a credit bureau, the issuer must notify consumers of their right to have their name removed from any such future lists.
* Employers must notify credit bureaus of their permissible purposes for pulling a consumer report - penalties are increased for impermissible uses.
* Must notify employees and get their written authorization before pulling their credit file

New Duties on furnishers of Information:

* Must investigate disputed information within the 30 days reinvestigation time frame
* Are liable if they fail to correct mistakes once they have been notified by the consumer

* For willful violation of the Act, are subject to civil liability - actual damages, statutory damages, punitive damages and attorney’s fees and court costs

* For negligent violation of the Act, are liable for actual damages, attorney’s fees and court costs

* Must notify credit bureaus when consumers dispute information they are supplying and when consumers voluntarily close an account
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