Public Hearing on the Use of Credit Information in the Underwriting and Rating Process
Public Hearing on the Use Of Credit Information In The Underwriting and Rating Process

Final Report

December 2001

NAIC
National Association Of Insurance Commissioners
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minutes of Public Hearing</td>
<td>1</td>
</tr>
<tr>
<td>Center for Economic Justice (Birny Birnbaum)</td>
<td>7</td>
</tr>
<tr>
<td>Consumer Federation of America (Robert Hunter)</td>
<td>11</td>
</tr>
<tr>
<td>Commissioner Steven B. Larsen (MD)</td>
<td>18</td>
</tr>
<tr>
<td>Commissioner John Morrison (MT)</td>
<td>35</td>
</tr>
<tr>
<td>Commissioner Merwin Stewart (UT)</td>
<td>49</td>
</tr>
<tr>
<td>Alliance of American Insurers (Lynn Knauf)</td>
<td>56</td>
</tr>
<tr>
<td>Allstate Insurance Company (Jim McCabe)</td>
<td>59</td>
</tr>
<tr>
<td>American Insurance Association (David Snyder)</td>
<td>73</td>
</tr>
<tr>
<td>ChoicePoint</td>
<td>85</td>
</tr>
<tr>
<td>Fair, Isaac (Eddy Lo)</td>
<td>87</td>
</tr>
<tr>
<td>National Association of Independent Insurer (Sam Sorich)</td>
<td>99</td>
</tr>
<tr>
<td>National Association of Mutual Insurers (Dave Reddick)</td>
<td>111</td>
</tr>
</tbody>
</table>
Credit Scoring Hearing
Executive Summary

The Market Regulation and Consumer Affairs (D) Committee has a standing charge to hold at least one annual public hearing addressing the availability and affordability of insurance. Because of a reported increase in the interest on the use of credit scores in underwriting and rating and the impact this use has had on the availability and affordability of insurance, the D Committee hearing was designed to address the broad policy question of how the use of credit scores should be regulated. The D Committee received testimony from insurance regulators, consumer groups, credit scoring companies and insurance trade associations. The testimony primarily focused on the use of credit scores in personal lines automobile insurance.

Testimony of consumer groups focused on the regulatory possibility of banning the use of credit scores. In addition, consumer groups emphasized the need for an independent analysis regarding the correlation of credit scores to losses and greater public disclosure regarding the use and calculation of credit scores. Finally, consumer groups suggested state regulators should conduct a study as to whether the use of credit scores have a disparate impact on protected classes of individuals.

The D Committee received testimony from Commissioner Steve Larsen (MD), John Morrison (MT) and Mike Kreidler (WA). The commissioners expressed concern about the possible disparate impact credit scores might have on protected classes of individuals, insurer’s use of credit scores to non-renew auto policies and, consumer disclosure regarding the use and calculation of credit scores. Finally, these commissioners highlighted some of the specific regulatory efforts in their states.

The credit scoring entities stressed the Fair Credit Reporting Act (FCRA) permits the use of credit reports in insurance underwriting. The testimony also clarified credit scores are used to predict the likelihood of delinquency or nonpayment of credit obligations where as insurance bureau scores predict future insurance loss ratio relatively. These entities evaluate five main categories of information: 1) payment history, 2) amounts owed, 3) length of credit history, 4) new applications for credit and 5) types of credit in use. Finally, these entities stressed insurance bureau scores to be a valuable tool for the industry since the scores are legal, proven, fair, consistent, accurate, efficient and cost effective.

Testimony for representatives of the insurance industry reiterated that FCRA permits the use of credit reports in insurance underwriting and that there is a correlation between an individual’s insurance bureau score and risk of loss. In addition, testimony stressed that insurance bureau scores make underwriting and rating more objective, more complete and more equitable. These factors have led to a more competitive market, better pricing of risks and an overall benefit for consumers.
The Market Conduct and Consumer Affairs (D) Committee held a Public Hearing on the Use of Credit Scores in Chicago, IL, on Dec. 8, 2001. A quorum was present and Joel Ario (OR) chaired the hearing. The following committee members were present: Lee Covington, Vice Chair (OH); Maryellen Waggoner and Kirk Yeager representing William J. Kirven III (CO); Susan F. Cogswell (CT); Gene Reed representing Donna Lee Williams (DE); Mike Hessler representing Nathaniel S. Shapo (IL); Ken Grotewiel representing Kathleen Sebelius (KS); Scott B. Lakin (MO); Louis Belo representing Jim Long (NC); Bruce Ramge representing Tim Wagner (NE); Debbie Thurner representing Alice Molasky-Arman (NE); Ron Gallagher representing Diane Koken (PA); Guenther Ruch representing Connie O’Connell (WI).

1. Introductory Comments

Administrator Ario explained the D Committee has a standing charge to hold at least one annual public hearing addressing the availability and affordability of insurance and that this hearing is being held to fulfill this charge. Administrator Ario reported there has been an increased interest on the use of credit scores in underwriting and rating and the impact this use has had on the availability and affordability of insurance. Mr. Ario indicated the hearing testimony should address the broad policy question of whether and how the use of credit scores should be regulated.

2. Testimony of Consumer Representatives

Birny Birnbaum (Center for Economic Justice) said the established correlation between an underwriting or rating factor and a risk does not necessarily mean the factor should be accepted as a valid underwriting or rating factor. Mr. Birnbaum then commented regulators should not permit the use of a person’s credit history as an underwriting or rating factor because there is no potential for loss prevention or premium reduction and the use of such a factor often penalizes consumers for things outside of their control. Mr. Birnbaum said consumers do not understand credit scores and that if consumers did understand credit scores they could manipulate them to their benefit. Mr. Birnbaum stressed there is no independent analysis of the correlation between credit history and risk and the only entities that can prove this correlation are insurance companies and credit scoring companies. Mr. Birnbaum then reviewed a chart indicating that a national increase in the rate of personal bankruptcies did not correlate to an increase in insurer private passenger loss ratios.

In response to Administrator’s Ario question regarding how states should regulate the use of credit scores, Mr. Birnbaum responded that doing nothing is tantamount to the deregulation of automobile and homeowners personal lines insurance. With this, Mr. Birnbaum added states should conduct an independent study of the correlation between credit history and loss ratios and determine if the use credit scores result in any unfairly discriminatory practices. Mr. Birnbaum also commented there needs to be better disclosures about the use of credit scores and how the scores are calculated. Mr. Birnbaum then said the use of credit scores does not improve availability or benefit consumers and indicated his first recommendation to regulators is to ban the use of credit scores.
Robert Hunter (Consumer Federation of America) said his first recommendation to regulators is to ban the use of credit scores. If there is not a ban, Mr. Hunter suggested an independent analysis regarding the correlation between a person’s credit history and risk of loss be conducted. In addition, Mr. Hunter said there is a need for better public disclosure about the use and calculation of credit scores. Mr. Hunter said he would like to see how credit scores might be affected by a change in bankruptcy laws or an economic upheaval. For instance, Mr. Hunter questioned how the terrorist attack of Sept. 11th might have adversely impacted the credit scores of individuals whose spouses were killed in this attack. Mr. Hunter emphasized he wants to obtain an understanding of the logic as to why a person’s credit history has a correlation to person’s risk of loss. Administrator Ario responded that the proponents for the use of credit scores would argue that if a person is not able to manage money properly then the person will be careless with managing other property. Mr. Birnbaum responded that credit scores only address how a persons uses credit and not how a person manages money.

Jay Angoff (Attorney & Counselor at Law) said his testimony would focus on the following four areas: 1) the objections to the use of credit scores, 2) the importance of a private right of action, 3) the ban on using credit scores as the sole underwriting/rating reason and 4) insurer reliance on credit score vendors. Mr. Angoff said he has concerns that the use of credit scores may have a disparate impact on protected classes of individuals and that if there is a disparate impact the use of credit scores should be banned. Mr. Angoff also said that while an insurance commissioner may have the authority to order restitution because of the improper use of credit scores, individuals should also have a private right of action to address the improper use of credit scores. Mr. Angoff then said the prohibition against credit scores being the “sole” basis for underwriting or rating does not provide adequate consumer protection because this standard allows companies to rely very heavily on a credit score as long as there is some other factor also being considered. Finally, Mr. Angoff stressed that insurers rely very heavily on vendors to calculate credit scores and urged the NAIC to conduct a study on the role these vendors play in the underwriting and rating process.

Mr. Ario then questioned why companies would use credit scores if they do not work. Mr. Hunter responded that the system forces companies to use credit scores even if there is a weak correlation between credit history and the risk of loss. Mr. Birnbaum clarified that the use of credit scores address insurer profitability and not risk of loss and that the use of credit scores simply helps eliminate the least desirable risks. Mr. Birnbaum added that, unlike other rating factors that lead to loss reduction, credit scores simply reallocate premium and that when some people receive a lower rate other people receive a higher rate. Finally, Mr. Birnbaum again questioned whether the use of credit scores have a disparate impact on protected classes and why won’t insurers and credit vendors refuse to release data and analysis of credit scores by zip code.

3. Testimony of State Insurance Regulators

Steve Larsen (MD) said the Maryland Insurance Administration is in the process of studying whether there is a correlation between a person’s credit score and a person’s risk of loss. Commissioner Larsen then provided a summary of Maryland’s regulation which 1) requires consistent use of credit scores, 2) prohibits unfairly discriminatory use of credit scores, 3) authorizes the insurer to request a finding by the commissioner that the underlying information relied upon to generate a credit score be considered a trade secret and 4) requires a statement of actual reason if a cancellation or nonrenewal of a policy is based wholly or partly on a credit score. Commissioner Larsen then added Maryland’s regulation is being amended to address 1) insurer’s procedures for rechecking credit scores, 2) the requirement that an insurer place an applicant/insurer in the most favorably-priced tier for which the applicant qualifies and
3) verification of credit history if the initial inquiry indicated an applicant/insurer does not have any credit history. Commissioner Larsen then reviewed the findings of a Maryland Insurance Administration study that suggests the use of credit scores has a disparate impact on minorities and low income individuals.

Commissioner Morrison reported the Montana State Auditor’s Office has received numerous calls from consumers regarding the use of credit scores and the adverse impact this use has had on consumers. Commissioner Morrison said that in the absence of legislation regulating the use of credit scores, he issued an advisory memorandum to insurance companies that sets forth the following key guidelines:

- If you deny, non-renew, limit the scope or amount of coverage, or charge more for homeowners or automobile insurance on the basis of credit, either wholly or in part, you must send written notice to those individuals advising them that this action was taken because of their credit information and that they may request a copy of their credit report.

- In addition, when any adverse underwriting decision occurs, including those based on credit in any part, insurers must advise the consumer of the specific reasons for that adverse underwriting decision; for example: specific items in an individual’s credit report that caused the adverse effect, or if a “score” is used, specific credit factors that resulted in an unfavorable score, and also an explanation of how credit history affects an insured’s risk.

- Insurers must also tell consumers the reasons why they are using credit history, how often credit history or credit scores are reviewed by the company, and also that consumers may request that their credit information be corrected or re-reviewed upon their request.

- The company must disclose that the company has made a voluntary decision to use credit information and may not mislead consumers by telling them that the law in Montana or the Department of Insurance requires them to use credit history.

Commissioner Kreidler said he sees the following general problems with the use of credit scores: 1) the calculation of a credit score for someone who does not have a credit history such as a young adult, 2) the calculation of credit scores for elderly individuals who do not use credit as often as other individuals, 3) varying use of credit by different ethnic groups, 4) the calculation of credit scores for stay-at-home spouses finalizing a divorce and entering the workforce and 5) the calculation of credit scores for individuals with financial difficulties because of a medical crisis. Commissioner Kreidler said he would like to see a ban on the use of credit scores for the initial underwriting of a risk and the denial or cancellation of a policy. Commissioner Kreidler then said credit scores could be used within established limits. For instance, Commissioner Kreidler indicated an insured might have a rate deviation up to 20% because of his/her credit score but that the primary underwriting and rating determination should still be based upon standard underwriting and rating criteria. Commissioner Kreidler then reported the Washington Department of Insurance is conducting a study to determine if credit scores have an adverse impact on a protected class and that the use of credit scores in Washington would be prohibited if this were the case.

Administrator Ario then summarized some written comments from Merwin Stewart (UT). Administrator Ario indicated Commissioner Stewart has taken the position that credit scores, while appropriate for determining credit worthiness, are inappropriate to use in insurance underwriting.
4. Testimony of Credit Scoring Companies and Credit Reporting Agencies

Eddy Lo (Fair, Isaac & Company Inc.) stressed the Fair Credit Reporting Act (FCRA) permits the use of credit reports in insurance underwriting and that credit scores do not take into account a person’s race, color, religion, sex, handicap, familial status or national origin. Mr. Lo also clarified credit scores are used to predict the likelihood of delinquency or nonpayment of credit obligations where as insurance bureau scores predict future insurance loss ratios. Mr. Lo said there are five main categories of information used to calculate a credit score: 1) payment history, 2) amounts owed, 3) length of credit history, 4) new applications for credit and 5) types of credit in use. Finally, Mr. Lo stressed insurance bureau scores are a valuable tool for the insurance industry because the scores are legal, proven, fair, consistent, accurate, efficient and cost effective.

In response to Administrator Ario’s question about how the use of credit scores should be regulated, Mr. Lo responded that credit scores are one tool to be used but should not be the sole tool used for underwriting or rating. Administrator Ario then questioned if Fair, Isaac & Company would be willing to provide data to a third party to explore the issues raised by Mr. Hunter. Mr. Lo responded that Fair Isaac & Company’s contractual obligations with insurers prohibit such disclosure but indicated Fair Isaac & Company would be willing to provide data and assist in a study if released from its contractual obligations.

Eric Ellman (Associated Credit Bureau) said the use of credit scores is lawful, commercially sound and regulated by FCRA. Mr. Ellman explained FCRA imposes duties on credit reporting agencies and that such agencies have spent large sums of money to ensure reliability of data and compliance with FCRA. Mr. Ellman said that FCRA mandates that disputes about credit data be resolved in 30 days and that if a dispute cannot be resolved a consumer is allowed to provide a 100 word statement explaining the dispute on his/her credit report. Mona Carter (KY) said she understands the resolution process but said consumers need to complete insurance transactions in a very limited period of time and questioned if a consumer would be able to correct a credit report in a timely manner. Mr. Ellman responded most disputes are resolved in five days or less. Ms. Carter then responded that this five-day period is the timeframe in which ACB reviews the information submitted to the consumer and that it takes a consumer time to collect the relevant information to send to ACB.

Director Lakin asked if the inclusion of a consumer statement on a credit report impacts a person’s credit score. Mr. Ellman said he would not be able to answer this question since ACB does not actually calculate the credit scores. Mr. Lo said any issue in dispute is not used to calculate a person’s credit score.

5. Testimony of Property & Casualty Insurance Industry

Lynn Knauf (Alliance of American Insurers) said the Alliance supports the use of credit scores and that credit scores benefit consumers. Ms. Knauf said the use of credit scores is an objective tool and that there are already sufficient state and federal laws, such as unfair trade practices acts and FCRA, to protect consumers. In addition, Mr. Knauf said FCRA permits the use of credit reports for insurance underwriting. Administrator Ario then asked Ms. Knauf if she thinks FCRA prohibits states from banning the use of credit scores. Mr. Knauf responded that she believes FCRA does prohibit states from banning the use of credit scores.
Sam Sorich (National Association of Independent Insurers) said FCRA permits the use of credit scores. Mr. Sorich then stressed the use of credit scores makes insurance underwriting and rating more objective, more complete, and more equitable. In addition, Mr. Sorich said a correlation between a person’s credit score and risk of loss has already been established through prior studies. Mr. Sorich then added that the use of credit scores are allowing companies to accept more risks in urban areas and provide lower rates to policyholders.

Administrator Ario then questioned if the NAII would support the release of data for an independent study regarding this correlation. Mr. Sorich responded the NAII would support the release of such data and that a Tillinghast study was already completed in 1997. Mr. Sorich then recommended the D Committee review the NAIC white paper on the use of credit reports in underwriting before pursuing any additional action on this issue.

In response to some of Mr. Birnbaum’s comments, Mr. Sorich said consumers have control of their credit standing. In addition, Mr. Sorich said insurers are allowed to use other underwriting and rating factors not directly related to loss prevention, such as age and marital status. Ms. Carter said a person who loses his/her job or has a medical emergency with large medical bills does not have independent control of his/her credit standing.

Dave Snyder (America Insurance Association) said the use of credit scores has benefited consumers by making the automobile insurance marketplace more competitive and making automobile insurance more available. Mr. Snyder then urged the members of the D Committee to review James E. Monaghan’s 2000 Casualty Actuarial Society Forum study, “The Impact of Personal Credit History on Loss Performance in Personal Lines,” which concluded there is a strong correlation between credit history and loss performance. Based upon this study, Mr. Snyder said a person who has problems meeting financial obligations can be expected to have above-average costs to an auto insurer because of maintenance, moral hazard, claim consciousness, fraud and stress. Mr. Snyder also stressed the use of credit history has been used for commercial risks because the financial condition of motor carrier has direct relationship to risk of loss.

In response to some of the consumer education issues, Mr. Snyder said consumer education regarding the use of credit scores is very important and data quality is also very important. Mr. Snyder also said that extraordinary circumstances should be reviewed and considered when calculating credit scores. Commissioner Larsen said he has not seen the consideration of extraordinary circumstances in any credit scoring models or insurer underwriting guidelines. Mr. Snyder responded that these issues are considered on an individual basis if a consumer brings the situation to a company’s attention.

Ms. Waggoner said the Colorado Department of Insurance has found that companies are not using credit score the same way and that insurance companies use varying factors to calculate credit scores. Because of this, Ms. Waggoner said it is important for states to develop parameters regarding the use of credit scores. Ms. Waggoner commented the Colorado Department of Insurance has seen an increase in complaints regarding credit scores and that the department would not see such an increase if the use of credit scores were benefiting all consumers. Finally, Ms. Waggoner said the general public does not understand the difference between a credit history and a credit score and that consumers with a good credit history may receive a bad credit score. Because of this, Ms. Waggoner said notices to consumers that indicate “credit score too high or too low” do not constitute adequate explanations for consumers.
Dave Reddick (National Association of Mutual Companies) referenced a study conducted by the Virginia Bureau of Insurance which contained the following language: “The Bureau analyzed the relationship between credit scores and income as well as the relationship between credit scores and race...Nothing in this analysis leads the Bureau to the conclusion that income or race alone is a reliable predictor of credit scores thus making the use of credit scoring an ineffective tool for redlining.” Commissioner Larsen cautioned relying on this one conclusory statement and urge people to review the entire study. A representative from VA noted VA would have further comment on the study and its interpretation. Administrator Ario then requested NAIC staff to obtain a copy of the Virginia study and to make it part of the official comments to the hearing.

Wes Bissett (Independent Insurance Agents of America) said the IIAA supports the use of underwriting tools that make the insurance marketplace more competitive and does not support a complete ban on the use of credit scores. Mr. Bissett said the IIAA has seen an increase in the number of complaints regarding the use of credit scores, especially with renewal issues. In addition, Mr. Bissett said the IIAA has concerns about how the use of credit scores might adversely impact individuals with little or no credit. Mr. Bissett then urged the D Committee to review 1) existing laws, 2) the NAIC’s white paper on the use of credit reports in insurance underwriting, 3) current state activity on the issue, 4) restrictions on the use of credit scores for non-renewals, 5) restrictions on the use of certain characteristics used to calculate credit scores and 6) required notices regarding adverse actions based upon a person’s credit scores.

Having no further business, the Market Conduct and Consumer Affairs (D) Committee adjourned the public hearing.
Public Hearing on Credit Scoring

Before the NAIC Market Conduct and Consumer Affairs (D)

December 8, 2001

Comments of Birny Birnbaum
Center for Economic Justice

I could talk for several hours about the problems with insurers’ use of consumer credit reports for underwriting and rating personal lines. Since I have about eight minutes, my comments today will be quite limited.

1. The existence of a correlation between a rating factor and risk of loss does not mean that insurers should be permitted to use that characteristic of the consumer, vehicle or property for underwriting or rating. We don’t permit race as a rating factor, but there is a correlation between race and risk of loss for life insurance. There must be more to a rating factor than simple correlation to justify its use – particularly when it is something as enormous as consumer credit information.

2. Credit history should not be permitted as a matter of public policy because it provides nothing beyond an alleged correlation. There is no loss prevention and no reduction in claim costs – only a redistribution of premium. Further, insurers’ use of credit scoring is unfair in a broad sense because it penalizes consumers for events outside of their control, for business decisions of banks, for being the victims of economic or medical catastrophes or because of economic recessions.

3. Credit history should not be permitted because its use – particularly through credit scores – is not understandable or explainable to consumers. And if it was, it is information that is easily manipulated – through activities like rapid rescoring or credit repair. Thus, if insurers explain how they are using credit, then consumers will be able to manipulate their credit histories and distort its value as a rating factor – hence, insurers’ secrecy about what they are doing in the guise of “trade secret.”

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

5. Let’s look at the claim of correlation. Insurers and credit scoring vendors claim that consumer credit information is strongly predictive of loss – payment history, including bankruptcies and delinquencies and amount of credit owed are identified as counting for 65% of the credit score.
Yet, auto loss ratios declined countrywide dramatically from the 1994 and 1995 levels in 1996, 1997 and 1998 – during a period when non-business bankruptcies almost doubled. And during a period when household debt service payments increased dramatically. And during a period mortgage delinquencies increased slightly.

6. Insurers claim that credit scores are unrelated to race or income. There is significant information contradicting this claim. In a review of mortgage credit scoring sponsored by the Federal Reserve Board of Chicago, Executive Vice President Peter McCorkell of Fair, Isaac admitted that credit scoring has a disparate impact on by race and income:

**Doesn’t scoring result in higher reject rates for certain minorities than for whites?**

Again, the short answer is, “Yes,” but it is the wrong question. The question ought to be: “Does credit scoring produce an accurate assessment of credit risk regardless of race, national origin, etc.?” Studies conducted by Fair, Isaac, and Company, Inc. (discussed in more detail below) strongly suggest that scoring is both fair and effective in assessing the credit risk of lower-income and/or minority applicants. Unfortunately, income, property, education, and employment are not equally distributed by race/national origin in the United States. Since all of these factors influence a borrower’s ability to meet financial obligations, it is unreasonable to expect an objective assessment of credit risk to result in equal acceptance and rejection rates across socioeconomic or race/national origin lines. By definition, low-income borrowers are economically disadvantaged, so one would not expect their score distributions to mirror those of higher-income borrowers.1

It is, therefore, unclear how mortgage credit scoring has a disparate impact by race and income but insurance credit scoring does not.

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

- 30% of these groups have "bad" credit records
- 13% of these groups have "indeterminate" credit records
- 57% of these groups have "good" credit records

Credit problems persist across income groups. We estimate that:

- 36 % of consumers with incomes under $25,000 had "bad" credit records
- 33 % of consumers with incomes of $25,000 to $44,999 had "bad" credit records
- 25 % of consumers with incomes of $45,000 to $64,999 had "bad" credit records
- 22 % of consumers with incomes of $65,000 and $75,000 had "bad" credit records

---

Minority borrowers are more likely than white borrowers to experience credit problems. For African-Americans we estimate that:

48% of African Americans have "bad" credit records
16% of African Americans have "indeterminate" credit records
36% of African Americans have "good" credit records

For Hispanics we estimate that:

34% of Hispanics have "bad" credit records
15% of Hispanics have "indeterminate" credit records
51% of Hispanics have "good" credit records

For Whites, in contrast, we estimate that:

27% of Whites have "bad" credit records
12% of Whites have "indeterminate" credit records
61% of Whites have "good" credit records

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

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

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

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

7. Insurers claim that credit scores have no disproportionate impact by geographic location. Then why do they fight to hide insurer-specific ZIP-Code premium and exposure data? If credit scoring is the most important factor in determining who will be written and at what tier, then zip code distribution of premiums and exposures will reveal nothing about the insurers marketing strategy.

8. Insurers’ use of credit history represents a sea change in how consumers are underwritten and rating – instead of a few rating tiers based on expected claim costs, we now have dozens of
rating tiers based essentially upon credit scores. Fair Isaac’s credit scores have redefined what types of consumers are desirable and undesirable for a consumer and Fair Isaac is revolutionizing how insurers classify risks. Compared to even a heavily regulated advisory organization like ISO, Fair Isaac has a much more direct and powerful role in determining what insurers will charge consumers for homeowners and auto insurance – yet regulators have exerted no regulatory authority over Fair, Isaac’s practices. Your actions – or rather your inaction on insurers’ use of consumer credit information for underwriting or rating – are not making a case for state regulation of insurance.

9. State regulators’ failure to take substantial action on insurers’ use of credit information for underwriting and rating is tantamount to deregulation of personal lines insurance without any change in state law.
Good afternoon.

My name is Bob Hunter. I am the Director of Insurance at CFA. I formerly served as Texas Insurance Commissioner and as Federal Insurance Administrator under Presidents Ford and Carter.

CFA has serious doubts about credit scoring as a reasonable way to determine insurability and price. One of our primary concerns is that no one can tell us why credit scoring works, they can only allege that there are strong statistical relationships between credit scoring and insurance results. One industry executive likened credit scoring to gravity saying that you don’t want to sit under an apple tree in a wind even if you don’t understand how gravity works.

But, of course, no one really believes that credit scoring works every time like gravity does. Surely there are substantial numbers of people treated unfairly by credit scoring.

For instance, according to research done by MGIC Investment Corp., which looked at thousands of home loans MGIC insured during the last recession (from 1989 to 1991), some borrowers with the highest (best) FICO scores face much more serious delinquency and foreclosure than borrowers with low scores.

For another example, consider the current economic slowdown, exacerbated by the events of September 11th. Are laid off airline and hotel employees really worse insurance risks because the terrorists attacked
New York? Surely some of them will have economic problems as a result. Is it fair to charge them more for insurance as a result of these events?

Or, consider two consumers with identical financial characteristics such as income, net worth, etc. If the first, a savvy consumer knows the system and puts $10,000 in loans on 10 credit cards whereas the second, not-so-savvy consumer puts the same amount on one card, should they pay different insurance rates? They will because of the loan to limit rules of these scoring systems. This is patently unfair.

A final example is the proposals to alter the bankruptcy law. Should the ease or difficulty of declaring bankruptcy over time alter insurance rates? A system that does that is patently unfair.

The mere fact that a statistical correlation exists is not sufficient information for establishing class. I believe that hair color would show a statistical correlation with loss ratio. Does that mean it should be used? Of course not. It has nothing to do with driving excellence. Neither does credit score.

When used for pricing, credit score only impacts how the actuaries slice up the overall statewide premium pie. If you were to eliminate the use of credit scoring, it would not increase or decrease overall premiums by one cent. The question is not one of overall premium but how that overall premium is to be allocated.

The use of credit scoring violates sound actuarial principles for classifying risk. The Standards of Practice Concerning Risk Classification of the American Academy of Actuaries states that the first principle of a sound class system is that “The system should reflect cost and experience differences on the basis of relevant risk characteristics.” (Emphasis added)

Given that no one can explain why a credit score difference translates into a risk difference, how can credit score be a “relevant risk characteristic?”

Further, the standards do require that “Risk classification characteristics should be neither obscure nor irrelevant to the protection provided…” Credit scoring is at least obscure, if not irrelevant. If I have a poor credit score because I was laid off as a result of terrorism, what in the world does that have to do with my ability to drive?

The standards also require that a characteristic be objective. There are services that promise that they can improve your credit score. How can a scoring system that can be altered by experts be objective or produce fair results?

Other standards that should be applied to class, such as public acceptability, encouragement of loss prevention and so on are also violated by this credit scoring approach.

Further, we feel that classification must be used as incentive for improved loss prevention. Use of driving record is a very excellent example of a sound class that encourages loss prevention. When the people of California voted on insurance classes in their passage of Proposition 103 in 1988, they told the regulators to give the most weight to driving record and the second most weight to miles driven, both classes with clear loss prevention implications.

---

2 ASP No. 12, October 12, 1989.
Credit scores do nothing to encourage safety.

Comparing credit scoring to “normal” classes is instructive. Let’s compare credit scoring to driving record. Let’s say that an insured has an accident and a speeding ticket that causes the consumer’s rate to go up 25% for a three-year period. When the consumer asks why the rate is higher, the agent can explain it as related to the driving experience. It makes sense to almost every consumer I have spoken to that rates rise as the record worsens. The consumer might ask, “What can I do to lower my premium in the future?” With driving record, the answer is obvious. The consumer can see that the class scheme does produce a positive effect on loss prevention.

But if a consumer is up-rated by 25% because of delinquent bills last year, how do you explain why that is fair. Most consumers don’t understand the connection – probably because no one knows why there is a connection, including the insurers who apply the rating structure. In response to the second question, the answer I have gotten from some insurers is that this rating is permanent (Allstate told me that there studies show that this statistical correlation holds over the long term\(^3\)). The consumer is confused since the consumer can see that the class scheme does not produce a positive effect on loss prevention. Indeed, the consumer may be trapped in a permanent situation with no escape if insurers do not update these scores.

Another problem we have with credit scoring is the “black box” nature of the information. How can consumers trust a system that they cannot examine? We are told that these systems are great but that we can’t see them. They are declared, unilaterally, to be proprietary. They say “Trust us.” We do not trust them.

For one thing, the little we know about the statistical approach is troubling. The analysis uses loss ratios rather than a more appropriate multi-variate analysis approach. The loss ratio approach assumes that the premiums are perfect for the other classes and territories, which we know is not true. If other factors are incorrectly priced, the loss ratio method is flawed. We see rate filings all the time where an insurer says the indication is 33% but we will take 9%. This often is for competitive reasons, the filers claim.

It is inappropriate to use a univariate analysis for a factor that so seriously impacts peoples insurance availability and affordability. Analysis to determine if credit is correlated to other known rating factors (the covariance problem) or, worse, to prohibited factors (e.g., race) is essential.

Progressive recently supplied data to the Florida Task Force reviewing this issue. The data shows that something is wrong in the use of credit scoring. Slide 6 shows that, for each coverage of auto insurance, as the score gets worse, the minimum bias relativity goes up, indicating, according to Progressive, higher risk. The charts are shown for BIPD, COLL, COMP and PIP coverages.

By coverage, the charts are similar with the following relativities at the end points:

\(^3\) It is not fair never to update a record in my view. Surely things change, if for no other reason than recession, boom, certain jobs becoming obsolete, etc.
<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>BEST SCORE</th>
<th>WORST SCORE</th>
<th>% DIFFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIPD</td>
<td>59%</td>
<td>131%</td>
<td>273%</td>
</tr>
<tr>
<td>COLL</td>
<td>56%</td>
<td>128%</td>
<td>229%</td>
</tr>
<tr>
<td>COMP</td>
<td>50%</td>
<td>159%</td>
<td>318%</td>
</tr>
<tr>
<td>PIP</td>
<td>45%</td>
<td>145%</td>
<td>322%</td>
</tr>
</tbody>
</table>

Please consider the comprehensive coverage. If you look at the chart, it shows the clearest pattern of increase in relativity as credit score worsens. The problem is, as actuaries have known for decades, comprehensive insurance can not usually be classified. You see, comprehensive losses are totally beyond the insured’s control. Thus, driving record and other classes used in the other coverages are not used in comprehensive.

The only “class” typically used for comprehensive is territory, because auto theft is correlated with that criteria. Use of this class is often over the objections of people who complain that to visit on the poor the breakdown in police protection in parts of our cities is to victimize the victim.

The fact that Progressive reports a strong correlation for comprehensive losses fully indicates that credit score is linked to territory and undermines the industry claim that credit scoring is not linked to poverty and, unfortunately, by logical extension, race.

CFA is convinced that the use of credit scoring produces unfairly discriminatory results in violation of state anti-discrimination statutes.

We also think that these scores must be adversely impacting the poor and minority communities. No real analysis of this potential has been done. The Virginia study is not definitive. Virginia asked the companies who profit from selling these scores to give them results by zip code. The potential for bias is great and there was no independent investigation by the Virginia Insurance department. They simply took the word of the sellers of these products that there products worked in a way that does not adversely impact minorities. In my conversations with large insurers using these plans they admit that they do not know if poor and minority communities have an adverse impact as a result of their use of credit scoring.

Freddie Mac has said that minorities/low income people are adversely impacted by the use of credit scoring in mortgage lending. How can insurance be different?

The NAIC should get the data to do its own study of this minority/low income impact. If the companies controlling the data refuse, States should disallow the use of such plans as unfair by adverse inference.

CFA firmly believes that the use of credit scoring in insurance should be stopped. We are convinced that it produces unfair results and it may produce results that are illegal.

For some insurers, credit scores have a greater impact on final rates than other more normal classes. So Fair Isaac has a larger role in setting prices than the Insurance Services Office (ISO). We believe that Fair Isaac and other scoring agencies should be regulated as advisory organizations by the states.
Because of our concerns with this system, CFA has sent a letter to all insurance commissioners raising 17 questions of concern to consumers, including some of the items I have already discussed with you. The questions are:

(1) Are there statutory limitations on the use of credit history for underwriting or rating insurance in each state?

(2) What is it about a person’s credit score that makes them a good or bad risk other than simply that a statistical correlation exists? Is there any information that explains what it is about credit history that makes a person a worse auto or home insurance risk?

(3) Are there any regulations that limit the use of credit history for underwriting or rating insurance in each state?

(4) What percentage of insurers (percentage of insurance groups) use credit history or credit scoring for (a) underwriting residential property insurance, (b) underwriting private passenger automobile insurance, (c) rating residential property insurance, and (d) rating private passenger automobile insurance? What share of homeowner or private passenger automobile insurance premium volume do these insurers represent?

(5) Has there been any independent analysis undertaken by Insurance Departments to review the relationship of credit history/credit scoring to risk of loss?

(6) Are there studies or documents the states have relied upon in determining that the use of credit history for underwriting or rating personal lines insurance is or is not unfairly discriminatory vis-à-vis (a) minorities, (b) the poor, (c) the disabled and (d) other groups.

(7) Have Insurance Departments done any investigation to determine how insurers are using credit history and credit scoring in underwriting or rating personal lines insurance, including disclosure to consumers, consistent application of credit information, consumer ability to correct errors?

(8) Have steps been taken to inform and educate consumers about insurers’ use of credit information in underwriting or rating, or caused insurers to provide such information and education to consumers?

(9) What explanation do Insurance Departments give consumers who ask how they can lower their insurance rates after they have been up-rated because of their credit history?

(10) Are there specific practices regarding credit history and credit scoring that cause Insurance Commissioners concern?

(11) Do Insurance departments require firms that provide credit-scoring services to insurers, such as Fair Isaac, to be licensed as advisory organizations? If not, why not?

(12) Are insurers permitted to up-rate an insured for a bad credit history based solely upon overdue medical bills?
(13) Can persons be placed in a tier on denied coverage solely because of credit scores?

(14) Do insurers charge more based on the type of credit card you hold (e.g., we have heard that some insurers charge more for two risks with the same credit history but one has a department store card rather than a bank card)?

(15) Do insurers charge more based on the number of inquiries that a credit record has as opposed to credit deficiencies?

(16) How much can just credit impact rates in auto and home insurance?

(17) How are people who chose to pay cash and not take on debt treated?

I have brought a copy of the responses received to date and will be happy to share other responses as they come in with the Committee.

The industry continues to say, in essence, “Our approach is good because we say it is good.” They refuse to supply the data for independent analysis, even under confidentiality agreements. I worked with one state where we asked Allstate if it would agree to supply the data to any independent expert for analysis that both Allstate and the state would agree was independent and they refused. Allstate did confirm, however, that no independent analysis had ever been done on their system of credit scoring.

Given the importance of credit scoring on the final price, it is vital that there be independent verification of the industry claims.

The industry has asked why do consumer groups want to treat credit scoring differently than other classes? The answers are:

- For other classes we have the raw data and we do our own analysis.
- Other classes do have a logical relationship to loss, whereas credit scoring does not.
- Other classes are not related to prohibited factors such as race and credit scoring is.

I will be happy to respond to any questions you might have.

J. Robert Hunter is CFA’s Director of Insurance. He formerly served as Insurance commissioner of the State of Texas and as Federal Insurance Administrator under Presidents Ford and Carter. He is a Member of the American Academy of Actuaries and a Fellow of the Casualty Actuarial Society. He can be reached at (703) 528-0062.

CFA is a federation of 280 pro-consumer groups, ranging in size from small, county-based help line operations up to very large groups such as AARP and Consumer’s Union (publisher of Consumer Reports Magazine). CFA and its member organizations have over 50 million Americans as members, of which more than 3.5 million live in Florida.
Correlation across line coverages

BIPD coverage

COLL coverage

COMP coverage

PIP coverage

© 2002 National Association of Insurance Commissioners
NAIC
Winter Meeting
Chicago, Illinois
Saturday, December 8, 2001

Market Conduct & Consumer Affairs (D) Committee

A Public Hearing On
The Use of Credit Scores in Underwriting and Rating

Steven B. Larsen
Insurance Commissioner
Maryland
## INDEX

<table>
<thead>
<tr>
<th>Topic</th>
<th>Exhibit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key elements of Maryland’s current credit regulation</td>
<td>1</td>
</tr>
<tr>
<td>Effective May 15, 2000</td>
<td></td>
</tr>
<tr>
<td>Key elements of Maryland’s proposed revisions to the current credit regulation</td>
<td>2</td>
</tr>
<tr>
<td>Issues identified as a result of market conduct examinations, consumer complaints and reviewing filings</td>
<td>3</td>
</tr>
<tr>
<td>Graphs comparing data in two different zip codes</td>
<td></td>
</tr>
<tr>
<td>a. Policy Premiums vs Income</td>
<td>4</td>
</tr>
<tr>
<td>b. Policy Premiums vs Population Composition</td>
<td>5</td>
</tr>
<tr>
<td>c. Percentage of Households vs Credit Score Ranges</td>
<td>6</td>
</tr>
<tr>
<td>Maryland’s Current Credit Regulation – COMAR 31.15.11</td>
<td></td>
</tr>
<tr>
<td>Use of Credit Information in Underwriting and Rate Making</td>
<td>7</td>
</tr>
</tbody>
</table>

4 Contact Geoff Cabin, Regulations Coordinator, at `gcabin@mdinsurance.md.state.us` if you would like to receive a copy of the revised credit regulation when it is published.

5 Demographic data contained in graphs a and b is based on 1990 census data.

6 Premium data in graphs a and b represents the average premium expenditure per vehicle for the annual year 2000 in selected zip codes.

7 Data in graph c was provided to the MIA by a third party modeler and a regulated insurer.
MARYLAND REGULATION COMAR 31.15.11 USE OF CREDIT INFORMATION IN UNDERWRITING AND RATE MAKING

SUMMARY OF REGULATIONS

I. Obtaining Credit Information.
   A. The Regulations prohibit an insurer from obtaining a credit report or credit score for an applicant or insured, unless the insurer obtains a credit report or credit score:
      (1) for each applicant or insured of the insurer; or
      (2) in accordance with a written standard that prohibits obtaining a credit report or credit score in an unfairly discriminatory manner.
   B. The Commissioner may require an insurer that uses a written standard for determining when to obtain a credit report or credit score to file the written standard with the Commissioner.

II. Use of Credit Information in Underwriting.
   A. If an insurer uses credit criteria or a credit score as part of the insurer's underwriting standards, the regulations require the credit criteria or credit score to be established and used in a manner that is not unfairly discriminatory.
   B. The Commissioner may require an insurer that uses credit criteria or a credit score as part of the insurer's underwriting standards to file the insurer's underwriting standards and certain underlying information (including any algorithm, computer program or model used to compute credit scores) with the Commissioner.

III. Use of Credit Information in Rate Making.
   A. If an insurer uses credit criteria or a credit score as part of the insurer's rate-making standards, the regulations require the credit criteria or credit score to be established and used in a manner that is not unfairly discriminatory.
   B. The regulations require an insurer that uses credit criteria or a credit score as part of the insurer's rate-making standards to file with the Commissioner, as part of the insurer's rate filing, the rate-making standards and certain underlying information (including any algorithm, computer program or model used to compute credit scores).

IV. Confidentiality.
   When an insurer files information with respect to the use of credit criteria or a credit score as part of the insurer's underwriting or rate making standards, the regulations authorize the insurer to request a finding by the Commissioner that the underlying information be considered a trade secret or confidential commercial information.

V. Notice of Cancellation or Nonrenewal.
   When an insurer cancels or refuses to renew a policy based wholly or partly on credit criteria or a credit score, the regulations require the insurer to provide the applicant or insured with:
      (1) a statement of actual reason for the cancellation or nonrenewal; and
      (2) the information needed to obtain a copy of the insured's credit report as required by the federal Fair Credit Reporting Act.

Exhibit I
SUMMARY OF CHANGES MADE BY PROPOSED AMENDMENTS

I. §27-605 Notice Requirements
   The amendments clarify that the notice requirements of §27-605 of the Insurance Article, which require that the insurer advise the insured in clear and specific terms of the real reason for adverse underwriting action, apply to all increases in premium including those that result from a change in credit history or credit score.

II. Rechecking Credit Reports or Credit Scores
    If an insurer uses credit criteria or a credit score for underwriting or rating, the insurer is required to recheck credit on the earlier of:
    (1) the occurrence of an event that causes the insurer to evaluate the insured with respect to imposition of a surcharge, change in tier placement or other classification, or eligibility for continued coverage; or
    (2) the second anniversary of the start of the policy term following the last time that the insurer obtained a current credit report or credit score for the insured.

III. Best Price Rule
    The amendments codify the "best price" rule, which requires an insurer or group of affiliated insurers to place an applicant or insured in the most favorably-priced (i.e. least expensive) tier or affiliated insurer for which the applicant or insured qualifies.

IV. "No Hits"
    A. If an initial inquiry by an insurer indicates that an applicant or insured does not have any credit history, the amendments require the insurer to take certain steps to try to obtain a credit report or credit score, including verifying the accuracy of information used to obtain a credit report or credit score.
    B. If the applicant or insured does not have any credit history or has insufficient credit history to generate a credit score, the amendments require the insurer to treat the applicant or insured as if the applicant or insured had a neutral credit history or median credit score.
INSURERS USING CREDIT REPORTS / CREDIT SCORES
ISSUES IDENTIFIED IN MARYLAND

1. Insurers failing to file rate related underwriting rules
   a) Ability to increase or decrease policyholder premiums by merely redefining the ranges of credit scores eligible for certain rating tiers.
      - A score of 500 may qualify for a preferred premium during one policy period.
      - Without filing anything, an insurer redefines their credit score eligibility criteria.
      - After redefinition, the 500 credit score is in another rating tier paying a different premium.

2. Rating methodologies are extremely complicated and difficult to explain
   a) Complicated rating methodologies may require regulators to employ outside vendors with advanced expertise to adequately review computer algorithms, models and sophisticated tiering methodologies.
   b) Insurance agents are unable to specifically explain to their customers why the customer has been retiered.
   c) Insurance company staff are unable to specifically explain when questioned by policyholders, agents, and DOI staff.
   d) Credit scoring modelers have difficulty explaining in simple terms.

3. Credit scoring modelers are reluctant to open their “black box” for review and analysis
   a) Modelers unwilling to allow DOI’s outside experts to review models.
   b) Modelers cite confidentiality concerns.
   c) Modelers state “DOI’s do not regulate third party modelers.”

4. Refusal to insure Private Passenger Automobiles solely because of credit score
   a) Refusing to insure below a certain credit score solely because of the score – without reviewing driving record or past claims history.

5. Failure to reorder credit reports in order to rescore policyholders
   a) Failing to order current credit reports and recalculate credit scores to verify that policyholders continue to be properly tiered.
   b) Failing to reorder credit reports when policyholders “Know” their credit report has improved.
6. **Failure to explain, in an understandable manner, why an insurer is taking adverse underwriting action**
   a) Understandable (Real Reason) explanations not provided for retiering, non-renewing, canceling, etc.
   b) Maryland has worked with Fair Isaac and is currently working with ChoicePoint to transform short cryptic reasons into two or three sentence explanations that are understandable to consumers.

7. **Violations of the Fair Credit Reporting Act (“FCRA”)**
   a) Termination notices fail to correctly provide all required Consumer Reporting Agency (“CRA”) information (Name, address telephone number, etc. of CRA).
   b) Notices fail to inform consumer of rights under FCRA (Right to dispute information contained in credit report, right to obtain a free copy of their credit report, etc.).

8. **Failure to order credit reports in a consistent manner**
   a) Failing to order credit reports as required.
   b) Failing to order/reorder credit reports in accordance with rating/underwriting rules.

9. **Unfair discrimination on policy premium for same household**
   a) Unlike driving records, credit reports are not ordered on every member of the household.
   b) Therefore, policy premium (credit score) depends upon whose credit score is used.
   c) Some insurers order the credit score of the first named insured, others order the credit score of the husband and wife and select the highest score while others average the credit scores of husband and wife.
   d) Some agents will order credit scores for husband and wife and then select the one with highest score to generate the premium.
Comparison of Premium by Household Income

INCOME $45,998
Premium = 1.8% of Income
Premium $972
Zip Code 21210

INCOME $14,813
Premium = 9.2% of Income
Premium $1,357
Zip Code 21217
Comparison of Premium by Population Composition

Exhibit 5

MINORITY

48,072

WHITE

12,002

MINORITY

265

Premium

$972

Zip Code

21210

WHITE

3,665

Premium

$1,357

Zip Code

21217

© 2002 National Association of Insurance Commissioners
## Comparison of Credit Score by Percentage

<table>
<thead>
<tr>
<th>Credit Ranges</th>
<th>Zip Code 21217</th>
<th>Combined Totals</th>
<th>Zip Code 21210</th>
<th>Combined Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>297-325</td>
<td>0.2</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>326-350</td>
<td>0</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>351-375</td>
<td>0</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>376-400</td>
<td>0</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>401-425</td>
<td>0</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>426-450</td>
<td>0</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>451-475</td>
<td>0.2</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>476-500</td>
<td>1.2</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>501-525</td>
<td>2.8</td>
<td></td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>526-550</td>
<td>5.8</td>
<td></td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>551-575</td>
<td>11.4</td>
<td></td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td>576-600</td>
<td>10.6</td>
<td><strong>31.4%</strong></td>
<td>1.6</td>
<td><strong>7.6%</strong></td>
</tr>
<tr>
<td>601-625</td>
<td>12.8</td>
<td></td>
<td>8.7</td>
<td></td>
</tr>
<tr>
<td>626-650</td>
<td>10.8</td>
<td></td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>651-675</td>
<td>10</td>
<td></td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td>676-700</td>
<td>10</td>
<td><strong>43.6%</strong></td>
<td>9.8</td>
<td><strong>35.4%</strong></td>
</tr>
<tr>
<td>701-725</td>
<td>5.4</td>
<td></td>
<td>14.7</td>
<td></td>
</tr>
<tr>
<td>726-750</td>
<td>5.6</td>
<td></td>
<td>7.6</td>
<td></td>
</tr>
<tr>
<td>751-775</td>
<td>2.4</td>
<td></td>
<td>9.8</td>
<td></td>
</tr>
<tr>
<td>776-800</td>
<td>2.8</td>
<td></td>
<td>5.4</td>
<td></td>
</tr>
<tr>
<td>801-825</td>
<td>2</td>
<td><strong>18.2%</strong></td>
<td>8.2</td>
<td><strong>45.7%</strong></td>
</tr>
<tr>
<td>826-850</td>
<td>2.8</td>
<td></td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>851-875</td>
<td>0.6</td>
<td></td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>876-900</td>
<td>0.4</td>
<td></td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>901-925</td>
<td>0.6</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>926-950</td>
<td>0.6</td>
<td></td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>951-975</td>
<td>0.6</td>
<td></td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>976-997</td>
<td>0.2</td>
<td><strong>5.6%</strong></td>
<td>1.1</td>
<td><strong>11.5%</strong></td>
</tr>
</tbody>
</table>

The median credit range for 21217 is 626-650 and 701-725 for 21210. The mode credit range for 21217 is 601-625 and 701-725 for 21210.

© 2002 National Association of Insurance Commissioners 26
COMAR 31.15.11 Use of Credit Information in Underwriting and Rate Making

.01. Purpose.

A. The Insurance Commissioner finds that insurers are increasingly using credit reports and credit scores, in some cases obtained from third parties, for the purpose of underwriting and rate making.

B. The purpose of this chapter is to require insurers that use credit reports or credit scores for underwriting or rate-making purposes, with respect to personal lines of property and casualty insurance, to provide the Insurance Commissioner with the underlying information that the Insurance Commissioner needs to ensure that the insurers use the credit reports or credit scores in accordance with the standards for underwriting and rate making that currently exist in Maryland law.

C. This chapter also requires insurers that use credit reports or credit scores for certain adverse actions, with respect to personal lines of property and casualty insurance, to notify consumers of the actual reason for the adverse action in accordance with current Maryland law.
.02 Scope.
A. Insurance.
This chapter applies to personal lines of property and casualty insurance.
B. Insurers.
This chapter applies to each property and casualty insurer that uses credit reports or credit scores for:
   (1) Underwriting purposes, including declinations and placement with a particular insurer within a group of affiliated insurers; or
   (2) Rate-making purposes, including determinations that result in surcharges or tier placement within an insurer.
C. Insurance Transaction Not Initiated by a Consumer.
   (1) This chapter does not apply to the use of a credit report or credit score by an insurer in an insurance transaction that:
      (a) Is not initiated by a consumer; and
      (b) Consists of a firm offer of insurance.
   (2) If an insurer refuses to underwrite after a consumer submits an application in response to a firm offer of insurance made in accordance with §C(1) of this section, the refusal to underwrite:
      (a) Is not part of a transaction that is not initiated by a consumer;
      and
      (b) Is subject to this chapter and any provisions of the Annotated Code of Maryland that are applicable to underwriting, including Insurance Article, §27-501, Annotated Code of Maryland.
D. Accuracy or Completeness of Information in Credit Report.
   This chapter does not apply to a dispute regarding the accuracy or completeness of information in a credit report.

.03 Definitions.
A. In this chapter, the following terms have the meanings indicated.
B. Terms Defined.
   (1) “Affiliated insurer” means an insurer that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another insurer.
   (2) “Control” means the direct or indirect possession of the power to direct, or cause the direction of, the management and policies of an insurer, regardless of whether the power is exercised, by:
      (a) Ownership of voting securities or of securities convertible into voting securities;
      (b) Contract, other than a commercial contract for goods or nonmanagement services; or
      (c) Any other means.
   (3) “Credit criterion” means information bearing on a particular aspect of an individual’s credit history.
   (4) Credit Report
      (a) “Credit report” means any written, oral, or other communication of any information by a consumer reporting agency that:
         (i) Bears on a consumer’s credit worthiness, credit standing, or credit capacity; and
(ii) Is used or collected or expected to be used or collected wholly or partly to serve as a factor in establishing the consumer’s eligibility or pricing for personal lines of property and casualty insurance to be used primarily for personal, family, or household purposes.

(b) “Credit report” does not include:

(i) An accident history report as defined in Insurance Article, § 27-216(e), Annotated Code of Maryland;

(ii) An accident history report or record of motor vehicle violations kept by the Motor Vehicle Administration pursuant to Transportation Article, § 16-117, Annotated Code of Maryland;

(iii) A property loss report or claims history that does not include information that bears on a consumer’s credit worthiness, credit standing, or credit capacity; or

(iv) Any report containing information solely as to transactions or experiences between the consumer and the person making the report.

(5) “Credit Score” means a score that is derived by utilizing data from an individual’s credit report in an algorithm, computer program, model, or other process that reduces the data to a number or rating.

(6) “Firm offer of insurance” has the meaning stated in §C of this regulation.

(7) “Tier” means a category within a single insurer into which insureds with similar risk characteristics are placed for purposes of determining a premium rate.

C. “Firm offer of insurance” means an offer of insurance to a consumer that:

(1) Will be honored if the consumer is determined, based on information in a credit report on the consumer, to meet the specific criteria used to select the consumer for the offer; and

(2) May be further conditioned on one or more of the following:

(a) A determination, based on information in the consumer’s application for insurance, that the consumer meets specific criteria that:

(i) Bear on insurability; and

(ii) Were established before selection of the consumer for the offer and for the purpose of determining whether to extend insurance pursuant to the offer;

(b) Verification:

(i) That the consumer continues to meet the specific criteria used to select the consumer for the offer, by using information in a credit report on the consumer, information in the consumer’s application for the insurance, or other information bearing on the insurability of the consumer; or

(ii) Of the information in the consumer’s application for insurance, to determine that the consumer meets the specific criteria bearing on credit worthiness or insurability; or

(c) Provision by the consumer of any collateral that is a requirement for the extension of the insurance that was:

(i) Established before selection of the consumer for the offer of credit or insurer; and

(ii) Disclosed to the consumer in the offer of insurance.

.04 Obtaining Credit Information.

A. In General.

An insurer or an agent of an insurer may not obtain a credit report or credit score for an applicant or insured unless the insurer or agent obtains a credit report or credit score:

(1) For each applicant or insured of the insurer; or
(2) In accordance with a written standard for determining when to obtain a credit report or credit score that meets the requirements of § B of this regulation.

B. Written Standard.
A written standard for determining when to obtain a credit report or credit score shall:

1. Prohibit obtaining a credit report or credit score based wholly or partly on race, color, creed, sex, religion, national origin, place of residency, blindness, or any other physical handicap or disability of an applicant or insured;
2. Prohibit obtaining a credit report or credit score for any arbitrary, capricious, or unfairly discriminatory reason;
3. Require the decision to obtain a credit report or credit score to be reasonably related to the insurer’s economic and business purposes; and

C. Renewal Underwriting Program.
If an insurer uses credit criteria or a credit score for initial underwriting and has a renewal underwriting program to evaluate an insured’s eligibility for continued coverage or continued placement in a tier, the insurer shall, at the time of renewal underwriting, obtain a current credit report or credit score:

1. For each insured that is subject to the renewal underwriting program; or
2. In accordance with a rating rule approved by the Commissioner.

D. Filing Information With the Commissioner.
At the request of the Commissioner, an insurer shall file with the Commissioner a copy of its written standard pursuant to Insurance Article, §27-501(h)(2), Annotated Code of Maryland.

E. Confidentiality of Information.
(1) An insurer that submits a written standard to the Commissioner under §D of this regulation may, under Insurance Article, §27-501(h)(4), Annotated Code of Maryland, request a finding by the Commissioner that its written standard be considered a trade secret or confidential commercial information under State Government Article, §10-617(d), Annotated Code of Maryland.

(2) A written standard that is the subject of a confidentiality request shall be considered confidential pending review by the Commissioner.

(3) A finding that information submitted to the Commissioner pursuant to this chapter is a trade secret or confidential commercial information under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland:
   a. Applies only to an application for inspection of a public record under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland;
   b. Does not apply to a hearing to determine whether an insurer has violated Insurance Article, §27-501, Annotated Code of Maryland; and
   c. Does not excuse an insurer from providing any information necessary to meet its burden of persuasion at the hearing in accordance with Insurance Article, §27-501(g), Annotated Code of Maryland.

(4) If the Commissioner finds that a written standard is not a trade secret or confidential commercial information, the insurer that submitted the written standard may:
   a. Withdraw the written standard; or
   b. Request a hearing on the Commissioner’s finding pursuant to Insurance Article, §2-201(a)(2)(ii), Annotated Code of Maryland.

(5) An insurer may not use a written standard that has been withdrawn.
.05 Use of Credit Information in Underwriting.

A. In General.

(1) If an insurer, or an agent on behalf of an insurer, uses credit criteria or a credit score wholly or partly as a reason to cancel or refuse to renew coverage or to refuse to underwrite a particular insurance risk or class of risk, the credit criteria or credit score shall be established and used in a manner that:

(a) Is not based wholly or partly on race, color, creed, sex, religion, national origin, place of residency, blindness, or any other physical handicap or disability of an applicant or insured;

(b) Is not arbitrary, capricious, or unfairly discriminatory;

(c) Is reasonably related to the insurer’s economic and business purposes; and

(d) Otherwise complies with Insurance Article, § 27-501, Annotated Code of Maryland.

(2) If an insurer or agent cancels or refuses to renew a policy or refuses to underwrite a risk based wholly or partly on information contained in a credit report or credit score that the insurer or qualified agent knows is inaccurate or incomplete, the action of the insurer or agent is deemed to be:

(a) Arbitrary, capricious, and unfairly discriminatory;

(b) Not reasonably related to the insurer’s economic and business purposes; and

(c) In violation of this regulation.

B. Filing Information With the Commissioner.

On request of the Commissioner, an insurer that uses credit criteria or a credit score wholly or partly as a reason to cancel or refuse to renew coverage or to refuse to underwrite a particular insurance risk or class of risk, or another person authorized by the Commissioner to act on behalf of the insurer, shall file with the Commissioner under Insurance Article, §27-501(h)(2), Annotated Code of Maryland:

(1) The characteristics or factors from a credit report that are used as credit criteria or used in determining a credit score;

(2) In the case of credit scoring, the algorithm, computer program, model, or other process that is used in determining a credit score, along with the underlying support, including statistical validation, for the development of the algorithm, computer program, model, or other process that is used in determining a credit score; and

(3) Any underwriting guidelines relating to the use of the credit criteria or credit scores, along with all appropriate supporting material for the use of the guidelines in accordance with Insurance Article, §27-501, Annotated Code of Maryland and Crumlish v. Insurance Commissioner, 70 Md. App. 182, 520 A. 2d 738 (1987).

C. Confidentiality of Information.

(1) An insurer or other person that submits information to the Commissioner under §B of this regulation may, under Insurance Article, § 27-501(h)(4), Annotated Code of Maryland, request a finding by the Commissioner under State Government Article, § 10-617(d), Annotated Code of Maryland that an underwriting guideline or an algorithm, computer program, model, or other process that is used in determining a credit score is a trade secret or confidential commercial information.

(2) An underwriting guideline or an algorithm, computer program, model, or other process that is the subject of a confidentiality request shall be considered confidential pending review by the Commissioner.

(3) A finding that information submitted to the Commissioner pursuant to this chapter is a trade secret or confidential commercial information under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland:
(a) Applies only to an application for inspection of a public record under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland;
(b) Does not apply to a hearing to determine whether an insurer has violated Insurance Article, §27-501, Annotated Code of Maryland; and
(c) Does not excuse an insurer from providing any information necessary to meet its burden of persuasion at the hearing in accordance with Insurance Article, §27-501(g), Annotated Code of Maryland.

(4) If the Commissioner finds that any information submitted under §B of this regulation is not a trade secret or confidential commercial information, the insurer or other person that submitted the information may:
   (a) Withdraw the information; or
   (b) Request a hearing on the Commissioner’s finding pursuant to Insurance Article, §2-201(a)(2)(ii), Annotated Code of Maryland.

(5) An insurer may not use an underwriting guideline or an algorithm, computer program, model, or other process that has been withdrawn.

.06 Use of Credit Information in Rate Making.
A. Scope.
   This regulation applies to an insurer with more than one tier.
B. In General.
   (1) If an insurer uses credit criteria or a credit score as part of the insurer’s rate-making standards, the credit criteria or credit score shall be established and used in a manner that:
      (a) Does not result in rates that are excessive, inadequate, or unfairly discriminatory; and
      (b) Otherwise complies with Insurance Article, § 11-306, Annotated Code of Maryland.
   (2) If an insurer increases a premium based wholly or partly on information contained in a credit report or credit score that the insurer knows is inaccurate or incomplete, the resulting rate is deemed to be:
      (a) Excessive and unfairly discriminatory; and
      (b) In violation of this regulation.
C. Inclusion of Information in Rate Filing.
   An insurer that uses as part of its rating methodology credit criteria or a credit score for determining placement in a tier or as a rating factor, or another person authorized by the Commissioner to act on behalf of the insurer, shall file with the Commissioner as part of the insurer’s rate filing under Insurance Article, § 11-307, Annotated Code of Maryland:
   (1) The rate-related underwriting rule included in the definition of supplementary rate information in Insurance Article, § 11-101(e), Annotated Code of Maryland;
   (2) The credit criterion or factor associated with the tier rating factor;
   (3) The tier rating factor;
   (4) In the use of credit scoring, the algorithm, computer program, model, or other process that is used in determining a credit score; and
   (5) The underlying support, including statistical validation, for the development of the standards listed in §C(1) - (4) of this regulation.
D. Confidentiality of Information.
(1) An insurer or other person that submits an algorithm, computer program, model, or other process that is used in determining a credit score to the Commissioner under §C of this regulation may, under Insurance Article, §11-307(c)(3), Annotated Code of Maryland, request a finding by the Commissioner under State Government Article, § 10-617(d), Annotated Code of Maryland that the algorithm, computer program, model, or other process is a trade secret or confidential commercial information.

(2) An algorithm, computer program, model, or other process that is the subject of a confidentiality request shall be considered confidential pending review by the Commissioner.

(3) A finding that information submitted to the Commissioner under this chapter is a trade secret or confidential commercial information under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland:

(a) Applies only with respect to an application for inspection of a public record under State Government Article, Title 10, Subtitle 6, Annotated Code of Maryland; and

(b) Does not apply to a hearing to determine whether an insurer has violated Insurance Article, §11-306, Annotated Code of Maryland.

(4) If the Commissioner finds that any information filed under §C of this regulation is not a trade secret or confidential commercial information, the insurer or other person that submitted the information may:

(a) Withdraw the information; or

(b) Request a hearing on the Commissioner’s finding pursuant to Insurance Article, §2-210(a)(2)(ii), Annotated Code of Maryland.

(5) An insurer may not use an algorithm, computer program, model, or other process that has been withdrawn.

A. Information Required.

When an insurer cancels or refuses to renew a policy or binder subject to Insurance Article, §§ 27-601 and 27-602, Annotated Code of Maryland or cancels, refuses to renew, or reduces coverage under a policy or binder subject to Insurance Article, § 27-605, Annotated Code of Maryland based wholly or partly on a credit criterion or credit score, the insurer shall provide the insured with:

(1) A reason in the statement of actual reason that is sufficiently clear and specific so that an insured of reasonable intelligence can identify the basis for the insurer’s decision without making further inquiry in accordance with Insurance Article, §§ 27-602 and 27-605, Annotated Code of Maryland; and

(2) The information needed to obtain a copy of the insured’s credit report as required by the federal Fair Credit Reporting Act.

B. Generalized Terms Not Sufficient.

(1) The use of generalized terms such as “poor credit history,” “poor credit rating,” or “poor credit score” does not meet the requirements of Insurance Article, § 27-602 or § 27-605, Annotated Code of Maryland.

(2) A reason provided in the statement of actual reason is sufficiently clear and specific if it identifies the primary attributes or characteristics of the insured’s credit history that led to the insurer’s decision.

C. Review of Action.
(1) If an insured believes that a cancellation of, refusal to renew, increase in premium for, or reduction in coverage under a policy or binder subject to Insurance Article, §§27-601 and 27-602, Annotated Code of Maryland violates Regulation .04, .05, or .06 of this chapter, the insured may request the Commissioner to review the action of the insurer.

(2) In the case of a cancellation of or refusal to renew a policy, the policy remains in effect under Insurance Article, § 27-501, Annotated Code of Maryland until a finding is issued under Insurance Article, § 27-505, Annotated Code of Maryland if the:

(a) Insured asks the Commissioner to review the cancellation or refusal to renew before the effective date of the termination of the policy; and

(b) Commissioner begins action to issue a finding under Insurance Article, § 27-505, Annotated Code of Maryland.

D. Right of Protest - Private Passenger Motor Vehicle Insurance.

(1) If an insured believes that a cancellation of, refusal to renew, increase in premium for, or reduction of coverage under a policy or binder subject to Insurance Article, § 27-605, Annotated Code of Maryland violates Regulation .04, .05, or .06 of this chapter, the insured may protest the action of the insurer under Insurance Article, § 27-605, Annotated Code of Maryland.

(2) A timely filed protest under Insurance Article, § 27-605, Annotated Code of Maryland stays the proposed action of the insurer pending a final determination by the Commissioner.

E. Other Information.

The information that an insurer or agent is required to provide by this regulation is in addition to any other information required to be provided by any other provision of law.

.08 Denial of Insurance.

A. Information Required.

When an insurer, or an agent on behalf of an insurer, denies insurance to an applicant based wholly or partly on information in a credit report or on a credit score, the insurer or agent shall comply with:

(1) Any notice requirements of Commercial Law Article, §14-1212, Annotated Code of Maryland; and

(2) The federal Fair Credit Reporting Act.

B. Review of Action.

If an applicant believes that a denial of insurance violates Regulation .04, .05, or .06 of chapter, the insured may request the Commissioner to review the denial of insurance.

STEVEN B. LARSEN
Insurance Commissioner
To: Property and Casualty Insurers  
From: John Morrison, Montana State Insurance Commissioner  
Date: September 7, 2001  
Re: ADVISORY MEMORANDUM  
Reasons for Adverse Underwriting Decisions related to Credit  
Attn: Personal Lines Underwriting Department

The Montana Department of Insurance advises all property and casualty insurers who are using credit history for underwriting and/or rating purposes that Montana Law requires that consumers be notified when their credit history adversely affects their ability to obtain or renew insurance or causes them to pay more for their insurance for any reason, including failure to receive discounts.

The Department seeks your proactive cooperation in this matter. Consumers must understand how the use of credit can affect their ability to obtain certain types of insurance and also affect the cost of that insurance. If they are provided with sufficient information, consumers can take steps to avoid credit problems in the future. Many consumers are aware of how a bank or credit card company may view their credit. However, insurance companies often evaluate credit information differently than a bank does. Also, different insurance companies evaluate the same credit information differently. Even more importantly, credit reports sometimes contain errors that can cost consumers money in increased premium. Consumers have a legal right to correct those errors and to understand how the use of credit affects their insurance.

There are several statutes that govern this notification process, and as insurers, you have the obligation to comply with all of these statutes. If you deny, non-renew, limit the scope or amount of coverage, or charge higher rates for homeowners or automobile insurance solely on the basis of credit, you must send written notice to those individuals, advising them that this action was taken because of their credit history and telling them that they may request a copy of their credit report. [Section 33-18-210(11)(b), Montana Code Annotated, 2001] Also, Section 31-3-131, MCA requires that insurers, who deny or charge more for personal, family or household insurance wholly or in part because of information contained in a consumer report, shall advise the consumer that the adverse action was taken because of their credit history and must supply the name and address of the agency making the report. These two statutes make it clear that when an adverse underwriting decision is made or a consumer is charged more for their insurance for reasons based in any part on credit history, the consumer must be so notified and must also be advised of their right to obtain a copy of their credit report.

In addition, the Montana Insurance Information Privacy Protection Act provides that individuals have the right to request specific reasons for ALL adverse underwriting decisions. The provisions of 33-19-303, MCA must be followed even when 33-18-210(11)(b) and 31-3-131 apply.

When an adverse underwriting or rating decision is made, the insurance institution must inform the applicant or insured in writing of the specific reasons for the adverse underwriting decision and inform that person of his or her rights under 33-19-301 [Access to recorded personal information] and 33-19-302 [Correction, amendment, or deletion of recorded personal information.] The law also allows the insurer the option of instead notifying that consumer of his or her right to request, within 90 days, those specific reasons.
Companies then have 21 business days to respond. However, to avoid increased harm to consumers caused by this delay, the insurance department maintains that the better practice is to specify the reasons immediately without waiting for a consumer’s request. Consumers must also be told how often their credit score or credit history is reviewed by the company, and also that the consumer may request that the underwriting or rating decision be reconsidered after a correction to their credit report has been made or after they believe that their credit information has otherwise improved. [See 33-19-301 and 33-19-302, MCA.]

When credit history contributes to an adverse underwriting decision, a copy of a credit report alone is NOT sufficient to meet the requirement of “specific reasons.” The insurer must point out what specific items in that individual’s credit report resulted in the adverse decision, and/or what specific credit factors resulted in an unfavorable credit score, as well as give an explanation of how credit history affects that person’s risk as an insured driver or homeowner and what makes credit history a reason for an adverse underwriting decision. The two major organizations that sell credit scores to insurers have assured the Department that any insurance company using their services may access the specific reasons for a particular credit score. Those organizations are then able to specify the main credit factors that resulted in a particular credit score, and that information can be communicated to the consumer. Companies must inform consumers that the law in Montana allows insurance companies to use credit history under certain circumstances and that the company has made a voluntary decision to use credit history and the reasons why. Companies may not mislead consumers by telling them that the law in Montana or the Department of Insurance requires them to use credit history.

“Adverse underwriting decision” is defined in part, as a declination; a termination; failure to place insurance with a specific insurance institution; placement with a residual market mechanism, unauthorized insurer, or company that specializes in substandard risks; OR charging a higher rate on the basis of information that differs from that which the applicant or policyholder furnished. [33-19-104(1), MCA, 2001] Credit information or credit scores are never furnished by the applicant or the insured and must always be obtained from an outside source. Therefore, charging a higher rate wholly or in part because of reasons related to credit, will always be an adverse underwriting decision. “Charging a higher rate” means any practice that causes an individual to pay more for their insurance, either for initial premium or on renewal, including but not limited to, refusal to apply discounts based on credit that would result in a lower rate, or placement of a risk into a higher premium/rate tier within a company or placement into a higher premium/rate company within a group of companies.

Because of the need to educate consumers and to protect them against possible errors in their credit reports, the Commissioner is taking this opportunity to remind all property and casualty insurers of their obligation to tell consumers of their right to obtain a copy of their credit report and to fully inform consumers of the specific reasons for adverse underwriting decisions, particularly those based on credit, as required by Montana law. Failure to do so is a possible violation of Section 33-19-303, MCA and/or 33-18-210(11)(b) and 31-3-151, MCA. Consumers must also be notified of their rights to access recorded personal information [33-19-301] and to correct or dispute information contained in their credit reports and in insurance company records. [33-19-302 and 31-3-124, MCA] The Department will enforce these statutes in the manner outlined in this memo for any adverse underwriting decisions made since June 1, 2001. The penalty for violation of the insurance code provisions addressed above is up to $25,000 per violation. Each adverse underwriting decision for each policyholder will be considered a separate violation. In addition, Montana statute provides for remedies that are available to individual consumers. [33-19-407 and 31-3-141, MCA]

If you have any questions concerning this advisory memorandum, you may contact the Montana Department of Insurance at 406-444-2040.
SUMMARY OF REQUIRED ACTION

If you deny, non-renew, limit the scope or amount of coverage, or charge more for homeowners or automobile insurance on the basis of credit, either wholly or in part, you must send written notice to those individuals advising them that this action was taken because of their credit information and that they may request a copy of their credit report.

In addition, when any adverse underwriting decision occurs, including those based on credit in any part, insurers must advise the consumer of the specific reasons for that adverse underwriting decision; for example: specific items in an individual’s credit report that caused the adverse effect, or if a “score” is used, specific credit factors that resulted in an unfavorable score, and also an explanation of how credit history affects an insured’s risk.

Insurers must also tell consumers the reasons why they are using credit history, how often credit history or credit scores are reviewed by the company, and also that consumers may request that their credit information be corrected or re-reviewed upon their request.

The company must disclose that the company has made a voluntary decision to use credit information and may not mislead consumers by telling them that the law in Montana or the Department of Insurance requires them to use credit history.
The Policyholder Services Division of the Montana Insurance Department has received hundreds of calls from individuals who are complaining about the adverse impact of credit scoring. Some of these complaints reflect the extreme inequity that is occurring in the current auto and homeowner insurance market because of the use of credit scoring:

For example, a consumer reported to us that she had been insured with a particular company for 25 years and she had a clean driving record and no losses. In addition, she was a licensed insurance producer working as a captive agent for that same insurance company. She recently went through a divorce, and in the process, her ex-husband “ruined” her credit. Based solely on her credit history, her company of 25 years non-renewed her auto insurance policy.

Other examples include consumers who have been approved by a bank for a mortgage, but then are unable to obtain homeowners insurance because of their credit, and consumers who are unable to obtain affordable homeowners or auto insurance because of credit problems caused by medical bills.

My office proposed a bill to the 2001 Montana Legislature that would have limited the use of credit scoring in the underwriting process. Another piece of legislation called for a total ban. The insurance industry opposed both bills, which died in committee.

A lack of public awareness about the use of credit scoring made it difficult for us to find witnesses to testify before the legislative committee. Since that time, public awareness has increased. As insurance rates have increased across the board, people are starting to ask why. In recent months my office has received calls and input from consumers and legislators who are outraged by the use of credit scoring.

A year ago I spoke with the PIA in Montana and found agents evenly divided on whether to ban credit scoring. Today, nine out of ten agents want it banned – and it is at the top of their priority list.

In the absence of new legislation, we want companies at a very minimum to comply with Montana’s existing notification requirements. We want consumers to know when their credit is used and how it impacts their insurance premiums. In September, my office issued an advisory to property and casualty insurers advising them that Montana law requires them to notify consumers when credit history adversely affects their ability to obtain or renew insurance or causes them to pay more for their insurance.

The advisory relies on existing Montana statutes and states:
If you deny, non-renew, limit the scope or amount of coverage, or charge more for homeowners or automobile insurance on the basis of credit, either wholly or in part, you must send written notice to those individuals advising them that this action was taken because of their credit information and that they may request a copy of their credit report.

In addition, when any adverse underwriting decision occurs, including those based on credit in any part, insurers must advise the consumer that they may request, in writing, the specific reasons for that adverse underwriting decision; for example: specific items in an individual’s credit report that caused the adverse effect, or if a “score” is used, specific credit factors that resulted in an unfavorable score.

Insurers must also tell consumers the reasons why they are using credit history, how credit history affects an insured’s risk, how often credit history or credit scores are reviewed by the company, and also that consumers may request that their credit information be corrected or re-reviewed upon their request.

The company must disclose that the company has made a voluntary decision to use credit information and may not mislead consumers by telling them that the law in Montana or the Department of Insurance requires them to use credit history.

In addition to the advisory, as part of the rate approval process, the Department requires companies that rely on credit scores when setting rates to provide their scoring model to us. Reviewing these models provides us with knowledge of the factors being used and how those factors are weighted, and the statistics that allegedly support the factors chosen and their weight. Since many insurers “buy” their scores from Choicepoint and Fair Isaac, Department staff met with representatives from both of those companies and reviewed their models. It is interesting to note that companies who buy scores from Fair Isaac and Choicepoint are never allowed to see the scoring models and have no actual knowledge of how scores are determined. They do not know what factors are used or how those factors are weighted.

My office is gathering information and tracking complaints, and is considering legislation for the 2003 Legislature. We aren’t sure if we would support a total or partial ban, but I do believe credit scoring should be, at least, carefully regulated to ensure consumers understand the practice.
WHAT YOU SHOULD KNOW ABOUT
THE USE OF YOUR CREDIT HISTORY

TIPS FOR THE INSURANCE CONSUMER

1. Most insurance companies that sell homeowners and auto insurance use your credit history to determine if you are eligible for insurance coverage and the amount of premium you will pay.

2. Just because you think you have good credit, doesn't mean the insurance company agrees. Insurance companies may use credit differently from banks. Insurance companies typically create a "credit score" based on information obtained from your credit report. These credit scores may be based on factors that normally wouldn't adversely affect your credit, such as the number of times your credit has been checked or the type of credit cards you use.

3. You have the right to know how insurance companies use credit. If you aren't notified that your credit history is being used to determine your eligibility or the amount of premium you pay, call your company and ask if credit is being used. If it is being used, call the Insurance Department at 1-800-332-6148 and let us know that the company is not complying with the notification laws.

4. Insurance companies are required by law to notify consumers in writing when an adverse action has been taken against the consumer that is wholly or partially based upon the consumer's credit. For example, if your auto insurer determines upon renewal that you have an unfavorable credit score and decides to raise your rates by 15 percent, the notification of the rate increase must indicate that the reason for the increase was based partially or completely on your credit.

5. If you have been adversely treated by an insurance company, by paying higher rates, being non-renewed, denied coverage or placed into a sub-standard company, there are two things you should do. First, request a free copy of your credit report. Second, ask in writing for the specific reasons for the action. By doing this you can see the kinds of factors that may be causing you to pay more for your insurance and note any mistakes on the credit report.

6. If there are mistakes on your credit report, ask the insurance company to re-calculate your "credit score" based on accurate information. Having the credit score re-calculated might result in a significant change in your rate.

7. Shop around. Some insurance companies use credit to a greater extent than others, and credit scores can vary greatly from one company to the next. You might want to choose a company that bases its rates more heavily on factors such as driving record and claims history. You should find out how a company uses your credit and how often the company checks your credit report.

8. Call the insurance company to complain if you aren't satisfied with the company's practices. Agents aren't always given the information about your credit history and are often sympathetic with the
consumer, but unable to change the company's policies. Agents can give you contact information for the companies they represent, but are not responsible for the insurance company's rating decisions.
CREDIT SCORING ISSUES IDENTIFIED

- Insurance producers and other insurance company staff are unable to specifically explain to consumers why their insurance score is adversely affecting their premiums or preventing them from getting coverage. Few if any, insurance company staff understand the scoring models or even know the factors that make up the score.

- Many insurance companies are reluctant to share any credit scoring information with consumers. Some companies have been reluctant to disclose to their customers the extent to which they are relying on credit history.

- The Department of Insurance would have to hire additional experts in order to properly investigate credit scoring models and analyze statistics and data. The Department does not have sufficient resources to do so.

- Some companies are refusing to issue new insurance and refusing to renew insurance solely on the basis of credit score. They do not consider driving record or claims history. Some individuals are being nonrenewed or refused coverage, even though they have clean driving records and no claims.

- Certain insurers penalize individuals who have no credit. This adversely impacts certain segments of the population, such as senior citizens, who sometimes choose not to use credit.

- Many consumers are adversely impacted by mistakes in their credit reports. If the insurance company has not fully disclosed how premium is affected by credit history, those individuals may never discover the mistakes in their credit reports. Even if they do discover the mistakes, and take steps to correct them, some companies are slow to correct or may refuse to retroactively remedy the adverse impact caused by the credit report mistake.

- The Department has received reports stating that certain companies experience large numbers of computer errors when generating credit scores, and they apparently are not correcting these errors.

- Credit scores are usually run for only one member of the household, and therefore, policy premium can depend on whose credit score is used. Credit scores run separately on a husband and wife often vary widely.

- A credit score for the same individual, run at the same point in time, can vary widely from one company to another. A person could go to four different insurers on the same day and receive
widely varying credit scores. There is no consistency in credit scoring and therefore inequities are inevitable.

- The credit history of some individuals is adversely impacted by circumstances that they have no control over, such as serious illness or divorce. These consumers sometimes find it difficult or impossible to find affordable insurance. Due to the fact that Montana has no residual market mechanism for homeowners, some individuals are unable to obtain homeowners insurance at any price. They are being penalized for credit problems that do not reflect character traits or spending habits.
## Current Montana Statutes Relevant to Credit Scoring

<table>
<thead>
<tr>
<th>Statute</th>
<th>Language</th>
</tr>
</thead>
</table>
| 33-18-210. Unfair discrimination and rebates prohibited -- property, casualty, and surety insurances. | (11) (a) For the purposes of this subsection (11), "credit history" means that portion of a credit report or background report that addresses the applicant's or insured's debt payment history or lack of history but does not include public information including convictions, lawsuits, bankruptcies, or similar public information. 
(b) An insurer writing automobile or homeowner insurance may not refuse to insure, refuse to continue to insure, charge higher rates, or limit the scope or amount of coverage or benefits available to an individual based solely on the insurer's knowledge of the individual's credit history unless: 
(i) the insurer possesses substantial documentation that credit history is significantly correlated with the types of risks insured or to be insured; 
(ii) the insurer sends written communication to the individual disclosing that the insurance coverage was declined, not renewed, or limited in scope or amount of coverage or benefits because of credit information relating to the applicant or the insured; and 
(iii) upon subsequent request of the individual, mailed within 10 days of receipt of the denial, nonrenewal, or limitation, the insurer provides the individual with a copy of the credit report at issue or the name and address of a third party from whom the individual may obtain a copy of the credit report, within 10 days of receipt of the request. 
(c) The provisions of this subsection (11) are not intended to conflict with any disclosure provisions of state law or the federal Truth in Lending Act applicable to lending institutions, credit bureaus, or other credit service organizations that maintain or distribute credit histories on insurance applicants or policyholders. 
| 33-19-104. Definitions | As used in this chapter, the following definitions apply: 
(1) (a) "Adverse underwriting decision" means any of the following actions with respect to insurance transactions involving insurance coverage that are individually underwritten: 
(i) a declination of insurance coverage; 
(ii) a termination of insurance coverage; 
(iii) failure of an insurance producer to apply for insurance coverage with a specific insurance institution that the insurance producer represents and that is requested by an applicant; 
(iv) in the case of a property or casualty insurance coverage: 
(A) placement by an insurance institution or insurance producer of a risk with a residual market mechanism, an unauthorized insurer, or an insurance institution that specializes in substandard risks; or 
(B) the charging of a higher rate on the basis of information that differs from that which the applicant or policyholder furnished; 
(v) in the case of a life, health, or disability insurance coverage, an offer to insure at higher than standard rates. 
(b) The following actions are not adverse underwriting decisions, but the insurance institution or insurance producer responsible for their occurrence shall nevertheless provide the applicant or policyholder with the specific reason or reasons for their occurrence: 
(i) the termination of an individual policy form on a class or statewide basis; 
(ii) a declination of insurance coverage solely because the coverage is not available on a class or statewide basis; or 
(iii) the rescission of a policy. 
(2) "Personal information" 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. Personal information includes an individual's name and address and medical record information but does not include privileged information. |
### 33-19-301. Access to recorded personal information

(1) If an individual, after proper identification, submits a written request to an insurance institution, insurance producer, or insurance-support organization for access to recorded personal information about the individual that is reasonably described by the individual and reasonably locatable and retrievable by the insurance institution, insurance producer, or insurance-support organization, the insurance institution, insurance producer, or insurance-support organization shall, within 30 business days from the date such request is received:

(a) inform the individual of the nature and substance of the recorded personal information in writing, by telephone, or by other oral communication, whichever the insurance institution, insurance producer, or insurance-support organization prefers;

(b) permit the individual to see and copy, in person, the recorded personal information pertaining to him or to obtain a copy of the recorded personal information by mail, whichever the individual prefers. If the recorded personal information is in coded form, an accurate translation in plain language must be provided in writing.

(c) disclose to the individual the identity, if recorded, of those persons to whom the insurance institution, insurance producer, or insurance-support organization has disclosed the personal information within 2 years prior to the request and, if the identity is not recorded, the names of those insurance institutions, insurance producers, insurance-support organizations, or other persons to whom such information is normally disclosed; and

(d) provide the individual with a summary of the procedures he may use to request correction, amendment, or deletion of recorded personal information.

(2) Personal information provided pursuant to subsection (1) must identify the source of the information if such source is an institutional source.

(3) Medical record information supplied by a medical care institution or medical professional and requested under subsection (1), together with the identity of the medical professional or medical care institution that provided the information, shall be supplied either directly to the individual or to a medical professional designated by the individual and licensed to provide medical care with respect to the condition to which the information relates, whichever the insurance institution, insurance producer, or insurance-support organization prefers. If it elects to disclose the information to a medical professional designated by the individual, the insurance institution, insurance producer, or insurance-support organization shall notify the individual, at the time of the disclosure, that it has provided the information to the medical professional. The medical professional may review and interpret the information and at the request of the affected individual shall consult with the affected individual.

(4) Except for personal information provided under 33-19-303, an insurance institution, insurance producer, or insurance-support organization may charge a reasonable fee to cover the costs incurred in providing a copy of recorded personal information to individuals.

(5) The obligations imposed by this section upon an insurance institution or insurance producer may be satisfied by another insurance institution or insurance producer authorized to act on its behalf. With respect to the copying and disclosure of recorded personal information pursuant to a request under subsection (1), an insurance institution, insurance producer, or insurance-support organization may make arrangements with an insurance-support organization or a consumer reporting agency to copy and disclose recorded personal information on its behalf.

(6) The rights granted to individuals in this section extend to all natural persons to the extent information about them is collected and maintained by an insurance institution, insurance producer, or insurance-support organization in connection with an insurance transaction. The rights granted to all natural persons by this subsection do not extend to information that relates to and is collected in connection with or in reasonable anticipation of a claim or civil or criminal proceeding involving them.

(7) For the purposes of this section, the term "insurance-support organization" does not include "consumer reporting agency".

History: En. Sec. 10, Ch. 580, L. 1981; amd. Sec. 1, Ch. 713, L. 1989.

### 33-19-302. Correction, amendment

(1) Within 30 business days from the date of receipt of a written request from an individual to correct, amend, or delete any recorded personal information in its possession about the individual, an insurance institution, insurance producer, or insurance-support organization shall either:
or deletion of recorded personal information.

(a) correct, amend, or delete the portion of the recorded personal information in dispute; or
(b) notify the individual of:
(i) its refusal to make the correction, amendment, or deletion;
(ii) the reasons for the refusal; and
(iii) the individual's right to file a statement as provided in subsection (3).
(2) If the insurance institution, insurance producer, or insurance-support organization corrects, amends, or deletes recorded personal information in accordance with subsection (1)(a), the insurance institution, insurance producer, or insurance-support organization shall notify the individual in writing about the action that it has taken and furnish the correction, amendment, or fact of deletion to:
(a) any person specifically designated by the individual who may have, within the preceding 2 years, received recorded personal information about the individual;
(b) any insurance-support organization whose primary source of personal information is insurance institutions if the insurance-support organization has systematically received recorded personal information from the insurance institution within the preceding 7 years, but the correction, amendment, or fact of deletion need not be furnished if the insurance-support organization no longer maintains recorded personal information about the individual; and
(c) any insurance-support organization that furnished the personal information that has been corrected, amended, or deleted.
(3) Whenever an individual disagrees with an insurance institution's, insurance producer's, or insurance-support organization's refusal to correct, amend, or delete recorded personal information, the individual may file with the insurance institution, insurance producer, or insurance-support organization:
(a) a concise statement setting forth what the individual thinks is the correct, relevant, or fair information; and
(b) a concise statement of the reasons why the individual disagrees with the insurance institution's, insurance producer's, or insurance-support organization's refusal to correct, amend, or delete recorded personal information.
(4) If an individual files either statement described in subsection (3), the insurance institution, insurance producer, or insurance-support organization shall:
(a) file the statement with the disputed personal information and provide a means by which anyone reviewing the disputed personal information will be made aware of the individual's statement and have access to it;
(b) in any subsequent disclosure by the insurance institution, insurance producer, or insurance-support organization of the recorded personal information that is the subject of disagreement, clearly identify the matter in dispute and provide the individual's statement along with the recorded personal information being disclosed; and
(c) furnish the statement to the persons in the manner specified in subsection (2).
(5) The commissioner may review a refusal by an insurance institution, insurance producer, or insurance-support organization to correct, amend, or delete recorded personal information in order to determine if the information is correct. The commissioner may order the insurance institution, insurance producer, or insurance-support organization to correct, amend, or delete information that the commissioner determines is erroneous in an individual's recorded information file.
(6) The rights granted individuals by this section extend to all natural persons to the extent information about them is collected and maintained by an insurance institution, insurance producer, or insurance-support organization in connection with an insurance transaction. The rights granted to natural persons by this subsection do not extend to information about them that relates to and is collected in connection with or in reasonable anticipation of a claim or civil or criminal proceeding involving them.
(7) For the purposes of this section, the term "insurance-support organization" does not include a consumer reporting agency.

Reasons for

(1) If an adverse underwriting decision is made, the insurance institution or insurance producer responsible for the decision shall:
adverse underwriting decisions.

(a) 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 the person that upon written request, the person may receive the specific reason or reasons in writing; and

(b) provide the applicant, policyholder, or individual proposed for coverage with a summary of the rights established under subsection (2) and 33-19-301 and 33-19-302.

(2) If a written request is received within 90 business days from the date of the mailing of notice or other communication of an adverse underwriting decision to an applicant, policyholder, or individual proposed for coverage, the insurance institution or insurance producer shall within 21 business days from the date of receipt of the written request furnish the person:

(a) the specific reason or reasons for the adverse underwriting decision, in writing, if the information was not initially furnished in writing pursuant to subsection (1)(a);

(b) the specific items of personal and privileged information that support those reasons; however:

(i) the insurance institution or insurance producer is not required to furnish specific items of privileged information if it has a reasonable suspicion, based upon specific information available for review by the commissioner, that the applicant, policyholder, or individual proposed for coverage has engaged in criminal activity, fraud, material misrepresentation, or material nondisclosure; and

(ii) specific items of medical record information supplied by a medical care institution or medical professional must be disclosed either directly to the individual about whom the information relates or to a medical professional designated by the individual and licensed to provide medical care with respect to the condition to which the information relates, whichever the insurance institution or insurance producer prefers; and

(c) the names and addresses of the institutional sources that supplied the specific items of information pursuant to subsection (2)(b), except that the identity of any medical professional or medical care institution must be disclosed either directly to the individual or to the designated medical professional, whichever the insurance institution or insurance producer prefers.

(3) The obligations imposed by this section upon an insurance institution or insurance producer may be satisfied by another insurance institution or insurance producer that is authorized to act on its behalf.

(4) When an adverse underwriting decision results solely from an oral request or inquiry, the explanation of reasons and summary of rights required by subsection (1) may be given orally but must be made in writing at the request of the applicant, policyholder, or individual.

History: En. Sec. 12, Ch. 580, L. 1981; amd. Sec. 1, Ch. 713, L. 1989; amd. Sec. 3, Ch. 258, L. 1997.

© 2002 National Association of Insurance Commissioners  47
(3) No person may be held liable for any violation of this section if he shows by a
preponderance of the evidence that at the time of the alleged violation he maintained
reasonable procedures to assure compliance with the provisions of subsections (1) and
(2).
History: En. 18-515 by Sec. 15, Ch. 547, L. 1975; amd. Sec. 4, Ch. 185, L. 1977; R.C.M. 1947, 18-515.
CREDIT SCORING

For the past year the Insurance Department has been studying the insurance industry’s use of credit scoring to underwrite, rate and terminate insurance policies. Credit scoring has been an ongoing practice, primarily used in connection with Homeowner and Automobile Insurance for at least the past five years. Insurance companies favor the use of credit scoring, while consumers and agents generally oppose its use. (For an analysis of “Desirable Characteristics of a Rating Structure” see Attachment “A.”)

We have listened to both sides and have reviewed with proponents the principles on which credit scoring is based. We agree that credit scoring can correlate with property/casualty risk. However, the correlation is just association. It is not a correlation based on cause and effect. Accordingly, credit scoring frequently associates poor insurance risks with high credit scores. This results in some individuals receiving high credit scores and favorable premiums that are not justified by their claims experience. Also, some persons get high premiums or lose coverage altogether because they have a low credit score even though their claims experience is very good. (See Attachment “B”)

Credit scoring is an automated process and generally less expensive. It allows companies to reduce or eliminate a liability based on an erroneous credit score. Companies do not share the cause of a low credit score with an insured or agent. The formula is a “trade secret.”

Several points to consider regarding credit scoring for auto and homeowners coverage are as follows:

- Credit scoring is based on factors that do not directly relate to a person’s driving or premium payment records.
- Credit reports can be inaccurate, both in the information collected on an individual and the information distributed by the reporting bureaus.
- Reporting bureaus are slow in remedying errors contained in consumer reports.
- Information that clearly explains the reasons why the consumer is negatively impacted is not available.
- Traditional insurance underwriting practices that relate directly to the risk assessed by the insurance company are ignored.
- Credit scoring, without appropriate regulation, will increase the number of uninsured motorists as a result of premium increases.
- Automobile coverage is required by law.

In January 2001, an interview on KUTV Channel 2 News concerning use of credit scoring generated over 100 consumer telephone calls relating to this practice. In addition, the Utah Insurance Department received numerous written complaints illustrating abusive use of credit scoring in the...
rating, underwriting and canceling of insurance policies. Examples of the ways consumers have been affected by this practice are outlined in Attachment “C.”

A recent news article in the Deseret News entitled “FICO Scores Determine Credit Winners” stated, “Fair Isaac closely guards the equations used to determine the score, but some factors include payment history, outstanding loan balances and the number of credit cards already issued to a consumer.” Because of “political pressures” Fair Isaac has begun to offer consumers a chance to review their personal FICO scores, but not the formula on which they are based. Fair Isaac is beginning to allow people the opportunity to see their credit scores; however, “Each FICO score, and the Equifax report it’s drawn from, costs $12.95…. for a service some consumer groups think should be available for free. (See Attachment “D”)

The Insurance Department takes the position that credit scoring, while appropriate for determining credit worthiness, is inappropriate to use in insurance underwriting.

If we can be of assistance further in this matter, please feel free to contact me at (801) 538-3804.

Merwin U. Stewart
Insurance Commissioner
To: Merwin U. Stewart, Commissioner

From: Tomasz Serbinowski, Actuary

Date: October 2, 2001

Re: Desirable Characteristics of a Rating Structure.

Section 31A-19a-201 of the Utah Insurance Code states that "rates may not be excessive, inadequate, or unfairly discriminatory.
Excessiveness and adequacy of the rates relates to the economic and actuarial principles underlying ratemaking. Unfair discrimination relates to a policyholder protection function of the Code.

Generally, the statute allows any risk classification scheme as long as "price differentials [...] equitably reflect the differences in expected losses and expenses after allowing for practical limitations".

However, from the public policy point of view, there are several additional desirable characteristics of the rate structure. These are

1. Fairness
2. Prevention
3. Transparency
4. Affordability

Fairness. The risk classification should reflect the expected losses. The resulting risk classes should be homogenous to the extent it is practical.

The following example will illustrate the application of the fairness principle. Suppose that, on average, medical costs associated with an automobile accident are lower for the drivers of expensive cars. A risk classification could be then established based on the value of the car. At first it may appear fair, because drivers of expensive cars have lower expected medical claim costs per accident. Suppose however, that research reveals that the lower cost is associated with airbags which are installed more often, in expensive cars. Now the risk classification appears to hinge on a "mere" correlation: expensive cars are more likely to have airbags installed. It seems clear that the risk classification based on vehicle price is unfair, and should be replaced with the one that reflects safety equipment (airbags). The fairness principle is violated, because the classes are not homogenous. Among the drivers of expensive cars there are some good risks (have airbags installed) and some bad risks (no airbags). The same is true for the drivers of cheaper cars.

In the above example, once the correlation between the car’s price and the medical costs is observed, the insurers may find it efficient and convenient enough to use. Further research into the underlying cause may be costly and of uncertain value. In the absence of the airbag study, it is difficult to critique the proposed risk classification.

The same is true of credit scoring. The industry is able to show a correlation between the credit score and losses. The reasons for the correlation are uncertain. Consumer advocates claim that
the risk classes created by credit scores are not homogenous: there are good drivers among people with low credit scores and vice versa. However, there is no research to demonstrate that

Prevention. Here is a quote from the Introduction to Ratemaking and Loss Reserving for Property and Casualty Insurance by Robert L. Brown, FSA, FCIA, ACAS.

"A well-designed risk classification process will provide strong economic incentives for the policyholder to reduce loss costs by reducing claim frequency, or loss severity, or both. Examples of methods used to encourage loss control are good driver discounts in auto insurance, discounts for sprinkler systems and burglar alarms in homeowners and commercial property insurance, discounts for accident prevention and rehabilitation programs in the workers compensation, and so on. Encouraging loss control not only allows the insurer to offer lower rates, it also provides an important service to society by reducing accidents, and the injuries and property damage that ensue."

Risk classification based on credit scoring does not appear to have any loss prevention value.

Transparency. Rating structure should be easy to understand both for the consumers and the agents. Here is another quote from the Browns book.

"It will be difficult to promote loss control if the policyholder does not understand the connection between loss control and lower rates."

The lack of understanding on the part of the policyholder and/or the agents is also a source of complaints due to the actual or perceived injustice. It is particularly important that an agent be able to explain the reason for the decision, as well as the future steps that will help the insured to qualify for a better rate able to explain the reason for the decision, as well as qualify for a better rate.

When the accident record is used in the underwriting, the reason for the higher rate is clear and acceptable to the policyholder. In addition the agent is able to provide the timeframe for the eligibility for a better rate (e.g., no accidents in the next two and a half years). This is not the case with credit scoring. In some cases the agent cannot provide any explanation beyond that the denial is due to a low credit score. Neither the agent nor the policyholder feels comfortable with that explanation.

Affordability. Affordability of certain lines of insurance (auto, homeowner, health0 and widespread coverage is vital for the overall wellness of society. In Utah, automobile liability insurance is mandated by the Legislature. In such cases spreading the risk over a large group of regardless of individual risks may be acceptable or even necessary.

Risk classification based on the credit scoring has two undesirable characteristics. Using it for eligibility may prevent certain individuals from getting coverage altogether if all insurers deny coverage to those with bad credit history. If people with low credit scores are more likely to experience financial difficulties then higher premium rates can make the insurance coverage prohibitively expensive to that group.

Cc: R. Peter Stevens
    Brad Tibbitts
(1) Reward for high credit score – Conventional underwriting criteria not considered that would identify negative experience with insurer or potential insurers.

(2) Inappropriately penalized for low credit score – Conventional underwriting criteria and the insured’s actual experience is not considered.
Examples Of Complaints Received By The Utah Insurance Department

• A gentleman lived in a home he owned that was unencumbered by any mortgage or liens. He owned an automobile that was paid for. He did not have any credit cards as he believed in paying cash for his purchases. His auto insurance company increased his premium by over $200 per six months because he didn't have enough established credit.

• A husband had suffered a massive, debilitating heart attack. He was totally disabled, requiring constant care and the total medical costs from this problem were over $1.5 Million. Their insurance paid $1 Million and with very little income they had to declare bankruptcy. The couple had been with this company in excess of 15 years and never turned in a claim all neither had any moving violations on their driving records. The insurance company cancelled the policy and when she inquired of them as to the reason, she was told it was the bankruptcy.

• A woman telephoned to let us know of a 30 day notice of non-renewal of her auto policy received from her insurance company of 15 years. She indicated there had never been a claim turned in to them. When she phoned to inquire as to their reasons for this action, she was told only that her credit score was too low and she no longer met the eligibility requirements.

• A consumer telephoned and explained that a year and a half ago her son, while riding his bicycle home from school, was hit by an uninsured driver. Their insurer determined her son was equally at fault in the accident so denied uninsured motorist coverage. Because of this her medical insurance has paid in excess of $75,000, according to its limited coverage, leaving them with many unpaid bills causing them credit problems. They are moving to another state now and cannot obtain auto insurance because of the poor credit score due to excessive medical expenses.

A woman, whose two teenage sons had been in accidents, had her auto insurance premiums increase considerably. Because she felt them to be excessive, she applied with another insurer who quoted a lower premium. After the policy was issued she received an additional premium billing which added another surcharge for a low credit score, in addition to the one for her sons accidents. This put the premium payment higher than that offered by her previous insurer.
Alliance of American Insurers

Position on

The Use of Credit Reports and Insurance Credit Scores
In Insurance Underwriting and Rating

The Alliance of American Insurers opposes legislation or regulation that would restrict the right of insurers to consider credit information in their underwriting or rating decisions. We believe that the use of credit reports or insurance credit scores allows insurers to underwrite or rate risks with greater certainty, and that consumers directly benefit from more sophisticated underwriting practices.

The terms “credit reports,” “credit scores” and “insurance scores” are used interchangeably when referring to the concept of considering an applicant or policyholder’s credit history as an indication of the likelihood of future loss. But actually, the terms are distinct and warrant clarification.

Credit reports are detailed histories of an individual or firm’s current and past credit-related transactions. Credit reports include detailed information on revolving credit, mortgages, collections and bankruptcies. There are three major credit bureaus in the United States, Equifax, Experian and Trans Union, which collect this credit information on individuals and businesses.

Credit scores are numerical indicators of risk. Credit scores are derived by selecting specific information from an individual’s credit history, provided by the credit bureaus, and entering that information into a computer model designed to produce a score. The score represents an objective “snapshot” of the credit habits of an individual. Banks and lending institutions use credit scores to determine an applicant’s ability to repay a loan.

Although we often use the term “credit scoring” when referring to insurer use of credit, insurance companies actually use scores differently than lending institutions. Rather than using a score to determine the likelihood of repaying a loan, insurers use “insurance scores” to predict the likelihood of future losses. Insurers may rely on their own proprietary computer models to determine one’s score, or may rely on the models of an independent data vendor such as Choicepoint or Fair Isaac. The models will then produce a numerical score for use in underwriting and/or rating. The score does not include specific details from one’s credit report, but represents a composite “picture” of an insurance risk. Although many insurers may use scoring information from the same vendor, each company has its own underwriting rules and may consider those scores differently.

Some opponents of insurer use of credit information have charged that insurers use credit information for the purpose of refusing business or to charge “higher” rates. We firmly disagree with this charge. Insurers are in the business to write policies. Any insurer who would attempt to disqualify as much business as possible, or to unfairly rate their policies, would not remain in business very long. On the contrary, credit information has proven to be an effective tool for insurers, allowing them to underwrite or rate business with a greater degree of certainty and accuracy. In short, use of credit information allows an insurer to write more business – not less, leading to a more competitive marketplace with more choices for the consumer.

© 2002 National Association of Insurance Commissioners 56
Studies have shown that there is a clear correlation between credit history and loss potential. An independent study by Tillinghast affirms that there is a direct correlation between future claims history and insurance credit scoring. Many opponents have argued that there is no correlation between a person’s credit habits and their driving record, or no correlation between their credit and their risk of loss under a homeowners policy. The relationship does appear strange until one looks at the broader picture – that a person with a proven track record of responsibility, as reflected in their ability to manage credit, will also likely manage insurance risk in the same responsible manner.

And most consumers are aware of the importance of their credit histories in financial and insurance transactions. A Lou Harris consumer survey of a few years ago showed that 69% of those surveyed agreed with the use of credit reports to assure fairer insurance pricing decisions. Half of the remaining 31% said that they also agreed with the use of credit information in underwriting. Since that time, insurers and independent scoring “modelers” have gone to great lengths to “de-mystify” the process by better explaining to consumers how credit information is used in insurance, how credit scores are comprised, and how consumers can take control of, and improve, their credit scores. Consumers may now easily obtain their scores from various vendors, along with complete explanations of the factors considered in the score.

Some people have objected to the use of credit information in underwriting, claiming that it is discriminatory towards lower income individuals. In actuality, people of all economic levels have good and bad credit records, and insurers may use insurance scores as a tool that increases fairness through the use of another objective standard. Insurance underwriting is not about the business of disqualifying people, but qualifying them. Credit reports or insurance scores are underwriting tools that allow insurance companies to refine their judgments, and qualify more people.

Some critics have also alleged that using credit history can result in more risks being placed in state residual markets. This has not been the case. Driving record, driving experience, losses, and property condition are the major causes for residual market growth. There is no evidence that insurer use of credit information in underwriting adversely affects insurance availability. As we previously pointed out, the opposite is true – use of credit information often allows insurers to accept risks that they might not have otherwise accepted.

Privacy is another issue that has been raised in opposition to the use of credit information and insurance scoring. Today, more than ever, consumers are concerned with privacy and confidentiality of personal records. We do not believe that the use of credit reports, either directly, or indirectly through scoring mechanisms, is intrusive. Insurers must employ strict confidentiality procedures in their use of credit histories. And the use of “scoring” allows the underwriter to objectively consider credit information and credit management habits without having to scrutinize all the details of one’s credit history. Likewise, an applicant or policyholder will not have to fear that every detail of his private credit information will become known to his agent – who may be a family friend or neighbor. Consumers need not feel that their insurer’s use of a credit history will jeopardize their privacy.

Some people have also voiced concern over possible inaccuracies or errors in their credit records. While errors obviously occur, their impact on insurance underwriting has been negligible. Often errors found on credit reports are not relevant to the information included in an insurance score and considered by insurers. One large insurer recently confirmed that out of over one million records processed, only four
records were found to have errors that resulted in an incorrect rating decision – far less than the number of relevant errors revealed on motor vehicle records! For those records found to be in error, the Federal Fair Credit Reporting Act already clearly protects consumers by prohibiting insurers from considering information known to be in error.

Finally, if an applicant or policyholder objects to an insurer’s practice of reviewing a credit report or insurance score, that person is free to shop for another insurance company that does not use credit information. Not all insurers will choose to use credit reports in their decision-making and rating process, and those that do will not all use them in the same manner.

The Alliance believes that the use of credit reports and insurance scores is appropriate for the purpose of underwriting and rating business, and has positive overall effects on consumers. It is true that a very small number of risks may be rejected by the insurer of their choice based on information contained in a credit report and reflected in an insurance score. However, the use of credit information as an underwriting tool provides insurance companies greater opportunity to write business in all markets. Our trade organization and others have pointed out many times that insurers are looking to write more business, not less. The use of credit reports adds another level of sophistication to the underwriting process that allows insurers to accept business with a higher degree of certainty than existed before. Increased certainty in risk selection and rating will translate to fairness and accuracy in rates -- a direct benefit to policyholders.
From: Jim McCabe       December 4, 2001
Government Relations Manager

To: NAIC Market Conduct & Consumer Affairs (D) Committee

PUBLIC HEARING COMMENTS
THE USE CREDIT SCORES IN UNDERWRITING AND RATING

Mr. Chairman and members of the Market Conduct & Consumer Affairs Committee, I have attached the comments of Allstate Insurance Company for your consideration in this hearing and thank you for the opportunity to share our views. We encourage this Committee to examine this tool not in terms of consumers as victims but rather consumers as beneficiaries.

While over the past couple of years many of you have accepted Allstate’s invitation to be available to this Committee and to the individual states, we reiterate our offer to talk through concerns on this issue and to participate in a discussion of solutions.

In addition to our comments, I have taken the liberty of also attaching a copy of the Allstate brochure entitled Allstate's Use of Credit Information to Price and Underwrite Insurance Policies available to customers and consumers on the Allstate web site at www.allstate.com.

In a competitive market the competitors understand that the customer is our only reason for being there. Recognizing that further emphasizes how critical we see it to keep every customer we reasonably can and that every consumer represents future business. The 21st Century economy requires an understanding that if you do not provide services benefiting and satisfying to your customers you won’t stay in business long. Creating products that benefit and satisfy customers assures that you will be positioned to survive and thrive in difficult or prosperous times. Allstate Insurance Co. is committed to consumers by not merely surviving but thriving as a leading edge competitor.

Regards

Jim McCabe
Government Relations Manager
Allstate Insurance Co.
STATEMENT OF ALLSTATE INSURANCE COMPANY
before the
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS
DECEMBER 8, 2001

We appreciate this opportunity to offer our views. The use of credit history by the insurance industry has been the subject of discussion for many years and it appears that some important considerations may have been forgotten:

I. The use of credit reports by insurers is pro-consumer. Too often, these discussions start based on the mistaken assumption that the consumer is somehow being victimized, when the reality is that by using credit history, insurers are able to make insurance more available, control the cost of insurance, and improve accuracy and fairness.

II. The use of credit reports by insurers is already extensively regulated. The question is not whether we need regulation, but whether we need even more regulation than already exists.

III. We support reasonable efforts to address concerns. We recognize that reasonable minds may differ on the particulars of certain issues. Even where we believe that additional regulation is not necessary, we are committed to working with regulators and legislators to fashion solutions in the public interest.

These key points are discussed in further detail below.

I. The use of credit reports by insurers is pro-consumer.

A. Why consideration of credit history is pro-consumer.

The use of credit reports is not something consumers need to be protected from. Rather, the use of credit reports benefits consumers. Restrictions on the use of credit reports will result in less availability, higher prices, and unfairness, results that are hardly pro-consumer.

Allstate’s insurance scores are based on information contained in credit reports, a practice that we believe benefits the majority of the insurance-buying public because it allows us to write more insurance, because it is fair, and because it helps control the cost of insurance. Our use of insurance scoring is a positive step in addressing issues of insurance affordability and availability.

The history of insurance underwriting is the history of developing better methods of distinguishing risks. Fundamental fairness challenges not just Allstate, but the entire industry and its regulators, to recognize that consumers less likely to incur losses in the future should pay less for insurance, and that conversely, those who are more likely to incur losses should be evaluated accordingly. We have found that insurance scores are an extremely powerful predictor of future loss. Although we still are not at the point where we can underwrite each individual as a group of one, our use of insurance scoring allows us to create fairer pooling of risks by creating groups within those pools distinguished more fairly by loss potential.
Our customers—your constituents—want insurance at the lowest possible price. They want to pay their fair share: no more, no less.

Allstate wants to write as much profitable business as it can. We are a company that is committed to growth and customer service. Through our use of insurance scoring, we can write more business than we could before, and reduce subsidies among the business we do write; if we lose this pricing and underwriting tool, we will be forced to write less business in our preferred company and reintroduce pricing subsidies. The net effect of our use of insurance scoring is that more people are written and get the benefit of the rates in our preferred company because our ability to consider insurance scores allows us to relax other underwriting standards for customers less likely to incur losses. In addition, within our preferred company, we are able to offer even lower rates to those with better insurance scores.

Our use of insurance scoring controls the cost of insurance in the long-run because it allows us to identify groups of people who are much more likely to incur losses, and to price them adequately. Allstate found that preferred auto customers in the top 20% of scores (the quintile with the poorest scores) produce a loss ratio 23% above average, while those in the bottom 20% of scores (the quintile with the best scores), have a loss ratio 16% below average. Those in the highest-scoring quintile are thus nearly 40% more likely to incur losses as those in the lowest-scoring quintile. In our nonstandard company, we have found very similar results -- the highest-scoring quintile has a loss ratio 25% above average, and the lowest-scoring quintile has a loss ratio 20% below average. On the property side, Allstate has found even stronger results. Homeowner customers in the lowest-scoring quintile have a loss ratio 34% below average, and those in the highest-scoring quintile, 50% above average. Homeowner policyholders in the highest-scoring quintile therefore are more than twice as likely to incur losses as those in the lowest-scoring quintile.

We do not use insurance scoring to assess anyone's "credit worthiness" or whether they will pay their premiums on time. We do not look at income, we do not ask for income information, and we do not obtain income information from outside sources as part of our underwriting process. Under our criteria, someone earning $10,000 per year could have a better insurance score than someone earning $100,000 per year, whereas someone turned down for a credit card or a bank loan would not necessarily score poorly for insurance purposes. Our insurance scoring is based on objective measurements that do not include income level.

B. Consideration of credit history is not unfair.

We believe that fairness means ensuring, to the best of our ability, that risks less likely to incur losses do not subsidize risks more likely to incur loss. However, some have suggested that the use of credit history may be “unfair” to the extent that it disproportionately disadvantages members of certain ethnic or income groups. Although we do not believe that “disparate impact” is the legal standard, we believe that it is important to address these concerns and clarify these misconceptions.

Our insurance scoring model does not consider race, ethnicity, or income. We do not consider these factors at all in our underwriting and pricing, and our presence in the urban markets remains as strong, if not stronger, since we started using credit history. Allstate is proud of its presence in these communities, and our goal is to continue to grow there. When we began using credit reports, we had no
reason to believe that our use of credit history would do anything but help us in the urban markets. The suggestion that members of certain ethnic groups are intrinsically more responsible or deserving of insurance than others is socially offensive and un-American, which is part of the reason we are not surprised that we continue to remain strong in these markets, even as we expand our use of insurance scoring.

The predictive power of insurance scoring is not a matter of theory or conjecture, but of fact. No matter how the data is sliced and diced, the results come out the same: Insurance scoring provides a level of risk assessment beyond that of other tools. To ignore its predictive value would be unfair to everyone who we know is less likely to incur loss.

Society has identified very few factors as inherently unfair for insurance purposes. Credit reports hardly fall into the same category as race, religion, and national origin. If they did, then the use of credit reports would not be so widespread and commonly accepted throughout society for purposes as diverse as financial services, employment, and housing. At first glance, the use of credit reports to predict likelihood of future loss may seem less intuitively obvious to some than, for example, the use of driving history. But that is not because credit history is unfair, but because those people still have not gotten used to the concept of using consumer credit information for auto or homeowners insurance underwriting.

Through our research, we have identified people who have higher insurance costs. Should society require subsidization of everyone with higher costs? Surely that would not be fair. Indeed, to the extent that anyone recommends or implies that the use of credit reports be restricted, we must remember that the trade-off will not only be subsidization of higher cost insureds by lower cost insureds, but eventually higher overall rates for the majority of our customers. Low income people will be hit the hardest, because they can least afford to pay more, whereas those higher income people who are more likely to incur loss will benefit from restrictions on the use of credit reports by insurers.

The Report of the Virginia State Corporation Commission’s Bureau of Insurance on the Use of Credit Reports in Underwriting, released on December 22, 1999, concluded that insurance scoring is NOT a redlining tool. Allstate is proud that it is a leading writer in urban markets. We use credit history extensively. If it were a tool for redlining, we would not be a leading writer in urban markets. We use insurance scoring the same way in all geographic areas, without regard to ethnicity or income.

Using credit reports for insurance underwriting does not discriminate against those with lower incomes. According to an American Bankers Association survey conducted November 14-16, 1997, 14% of consumers were late with their credit card payments in the last 12 months. Of those who were late, 44% earned more than $50,000 a year compared to only 4% who earned under $15,000. James Chessen, chief economist for the American Bankers Association, stated, “the person filing for bankruptcy really mirrors America. They’re black, white and brown. They’re rich and poor. And they’re male and female.” (January 7, 1998 Chicago Tribune).

If anything, Allstate’s use of insurance scoring helps those with lower incomes because it helps us control the cost of insurance. If we were not allowed to use credit reports in underwriting, the majority of our customers - at all income levels-would pay more for insurance. The poor would be hit the hardest because they can least afford to pay more.
II. The use of credit reports by insurers is already extensively regulated.

The use of credit reports is already the subject of Federal law. Enacted in 1970 and amended in 1996 to explicitly allow insurers to pre-screen using credit history, the Fair Credit Reporting Act has specifically stated since its original enactment that the use of information from credit reports in connection with the underwriting of insurance is a permissible purpose. The 1996 amendments to the FCRA, passed by a Republican Congress and signed by a Democratic President, enacted many important additional consumer protections, and the FCRA contains significant penalties for non-compliance.

The United States Court of Appeals stated in *Guimond v. Trans Union*, 45 F.3d 1329 (9th Cir. 1995) that the “legislative history of the FCRA reveals that it was crafted to protect consumers from the transmission of inaccurate information about them. . . These consumer oriented objectives support a liberal construction of the FCRA.” *Id.* at 1333 (emphasis added). The Sixth Circuit stated in 1998 that “[w]e are additionally guided by the fact that the FCRA is to be liberally construed in favor of the consumer.” *Jones v. Federated Financial Reserve Corp.*, 144 F.3d 961, 964 (6th Cir. 1998).

The FCRA is enforceable at the federal and state level, as well as through private causes of action. Section 1681n(a) states that any person who willfully fails to comply is liable to the consumer for actual damages, or damages not less than $100 or more than $1,000, as well as attorney’s fees and punitive damages. Section 1681o(a) states that the civil liability for negligent noncompliance is actual damages and attorney’s fees. Section 1681s allows the FTC to commence a civil action in the event of knowing violations, and sets the civil penalty at not more than $2,500 per violation. This section also allows individual states to bring actions on behalf of their residents to recover damages for which a person is liable to the residents, or damages of no more than $1,000 for each willful or negligent violation.

Additional state regulation on top of this federal legislation is not necessary. If there were ever a textbook example of something the marketplace could best handle, this is it. Literally hundreds of insurance companies operate in every state. Some use credit reports to varying degrees. Others do not use credit reports at all (though its use is becoming more prevalent precisely because it is an accurate risk segmentation tool and companies that do not give their customers the benefit of this tool will be at a competitive disadvantage). There once was a controversy about whether there was a correlation between insurance scores and losses, but the fact of that correlation is now commonly accepted and has been borne out by study after study. The real question is which companies will effectively use insurance scores. That question can be answered by dozens of regulators or tens of millions of consumers. We prefer the latter approach. Those companies that use insurance scoring effectively will be chosen by consumers. Those that do not will lose business or profits until they figure out how to get it right. Consumers will decide who wins through the free market. New uses of insurance scoring are exactly the kinds of innovation demonstrated by American business across a broad spectrum of products.

The marketplace will force an answer to the question of whether insurers are using insurance scoring rationally and with justification. The only sure winner in all of this is the consumer. Given these considerations, we believe that the marketplace, not regulation, is the most responsible and efficient arbiter of this question because the beneficiary of such competition will be some insurers and all consumers. It is precisely because credit reports are used in so many ways by so many different companies that consumers benefit from free market economics.
III. We support reasonable efforts to address concerns.

That this hearing is even taking place shows that there are still concerns. We support reasonable efforts to address these concerns. At the same time, we would caution against over-regulation or over-reaction. Insurance companies are grappling with many of these same issues every day. We should be careful not to adopt any measures that might inhibit the learning process and shut down potentially useful avenues of exploration, which would only hurt consumers.

Our experience has taught us that certain key issues merit further discussion, such as notice of practices and explanations of reasons, education, accuracy of reports, medical or extraordinary circumstances, inquires in credit reports, the role of scoring modelers, filing of models, pre-screening, and payment plans.

We would be more than happy to explore these and any other issues further, in the spirit of developing solutions that will address public policy concerns and also allow both the industry and its regulators to focus on their customers and constituents. Throughout these discussions, we would urge all parties to remember that consumers are not the victims, but the beneficiaries, of insurer use of credit reports because insurance scoring enables insurers to serve their customers by controlling the cost of insurance, making insurance more available, and creating a fairer underwriting structure. We must be careful that in fashioning solutions, we do not instead exacerbate problems of affordability and availability.
Why Does Allstate Use Credit Information to Price and Underwrite Insurance Policies?

A Strong Connection

Over the past several years, insurance companies have increasingly included certain information from credit reports among the factors used both to underwrite and to price insurance policies. As consumers hear more about this practice, they may have questions and concerns, most of them related to the following:

- What makes credit information relevant to the likelihood of future insurance losses?
- What kind of information from a policyholder’s credit history determines the insurance rate that he or she receives?

In this document we’d like to explain how Allstate uses credit information, and why. Below are some frequently asked questions about the use of credit information in insurance rating and underwriting.

Why is Allstate using credit information?

Certain information from credit reports is one factor among many others that we consider in order to determine as precisely as possible the risk presented by a given customer. We consider this information due to our ongoing concern for the fairness of our underwriting and pricing, because it helps us control the cost of insurance, and because it helps us make insurance more widely available.

The information we use has proved an effective predictor of future insurance losses. In fact, independent studies confirm the connection between credit report information and the likelihood of experiencing a loss.

At Allstate, we’re finding that our use of credit information enables us not only to offer lower rates to many customers who otherwise would pay more for their insurance; it also allows us to provide insurance coverage to more drivers and homeowners than we previously could.

Other insurance companies that consider credit information report similar experiences. A survey
conducted recently by the National Association of Independent Insurers found insurance companies providing insurance to more people than they had been prior to using credit information. In many cases, a customer’s credit information offsets other information that previously would have prevented that customer from obtaining coverage.

**I qualified for the best rate with my mortgage company. Why don’t I qualify for the best rate on my insurance? What’s the difference between the two?**

The difference is that an insurance company considers only those items from credit reports that are relevant to insurance loss potential. Unlike a mortgage company, an insurance company is not assessing a customer’s credit-worthiness. The determinations made on the basis of credit report information by a mortgage company can differ from those made by an insurance company because the two companies are looking for different things when they review credit information. Information that’s important to one may not be as important to the other, or the two may consider the same piece of information in different ways.

The most important thing to keep in mind, however, is that many people who get the best rate with a mortgage company also do well on Allstate’s insurance model; they would qualify for better rates with Allstate than they would have if Allstate did not consider credit information at all. That’s true even if the policyholder doesn’t qualify for the very best rate based on credit information.

**What kind of credit information is Allstate using?**

As mentioned above, we consider only those items from credit reports that are relevant to insurance loss potential. We do not consider information such as how much money you make or whom you owe because we are not assessing our customers’ credit-worthiness.

The kind of information in credit reports that has proved relevant to calculating insurance risk includes bankruptcies (in most states), judgments, collections, and delinquencies. The number and the types of credit accounts a customer has, length of account history, and account balances relative to limits are other factors we consider.

Also, the presence in your credit report of some types of inquiries* can affect your insurance rate, but it’s important to understand which types of inquiries can have an effect. Your insurance rate will not be affected by promotional inquiries, account review inquiries, the inquiry you make yourself in order to get a copy of your credit report, or the inquiry Allstate or any other insurer makes to review your credit history for insurance purposes.

**How is Allstate using information from credit reports?**

In rating and underwriting insurance policies, each of the several factors we consider from credit reports is assigned a “score”—some have positive scores, some negative. We then calculate an overall total, in which positive factors are allowed to offset negative ones, and make the appropriate rating and underwriting determinations. Our method of considering all of these factors together, as a whole, ensures that no single negative item will necessarily prevent a customer from receiving our best rates. And many customers, while not qualifying for the very best rate, will still qualify for a rate that is significantly better than average due to the information we consider from credit reports.

**What type of credit information is generally associated with the best scores?**
Customers who have the best scores include those with a long-established credit history that is free of major events such as judgments and collections, and reflect either no delinquencies or only delinquencies involving smaller amounts that occurred well in the past. These customers will typically have some credit account activity, but relatively low balances compared to the available credit limits. In addition, they will have few recently opened accounts or inquiries* prompted by the seeking of additional credit. While it’s difficult to identify specific actions that any customer could take to improve his or her insurance score, customers who manage their finances in a way that is consistent with these characteristics are more likely to have better scores.

**What does credit have to do with my likelihood of having an insurance loss?**
The link between credit history and loss potential has been studied extensively by many scholars outside the insurance industry, in fields such as psychology, safety engineering, occupational medicine, consumer research, and risk perception.

Nearly 30 articles and studies that we analyzed point to various possibilities. The two theories that emerge from these studies point to the added stress that financial pressures can bring and the possibility that financial difficulties may indicate a tendency toward risk-taking behavior—either of which can mean a higher likelihood of accidents.

Whatever the reasons behind the relevance of credit information to insurance loss potential, the predictive power of this information is a matter of fact, not of theory or conjecture. Auto insurance policyholders with the least favorable scores are nearly 40% more likely to experience losses that are greater in number and severity than those with the most favorable scores. The difference is even more dramatic among property insurance policyholders. The dollar amount of losses experienced by homeowners policyholders with the least favorable scores is almost twice as much as for those with the most favorable scores.

**How can I correct my credit report information if it’s wrong? Will my rate change?**
If you discover a mistake in your credit report, all you have to do is contact the reporting agency and correct the report. Then let us know, and we will be happy to re-evaluate any decision we’ve made based on your credit information.

But credit reports are generally very accurate. In the first quarter of 2001, Allstate ordered over four million credit reports from our vendor, Trans Union. The number of written requests from the consumer disputing information on their credit report totaled 377 or .009% of the total number of reports ordered.

However, mistakes do happen. If you discover a mistake, all you have to do is contact the reporting agency and correct the report.

**Is Allstate’s use of credit information legal?**
Yes. In all states in which we consider credit history, we are doing so in a legally permissible manner.

**Do other insurance companies use credit report information?**
Yes. Many personal lines insurance companies use some type of evaluation of one’s credit report for assessing risk or pricing insurance policies.
Doesn’t the use of credit report information discriminate against minorities, women, and low-income people?
No. None of the insurance scoring models we use today considers ethnic group, religion, gender, marital status, nationality, age, income, or address. These are simply not factors in credit scoring models.

The use of credit information benefits consumers
For all of the reasons outlined above, the use of credit information by insurers is becoming more common. The relevance of credit information to insurance loss potential is proven by the actual loss experience of the insurance companies using it and by independent studies. These same sources also demonstrate that consideration of credit information increases the fairness of insurance underwriting, allows many consumers to pay less for insurance than they otherwise would, and enables insurance companies to offer coverage to more consumers than they had in the past.

*The scoring model used in Illinois and Connecticut does not consider any types of inquiries.*
¿Por qué es que la Compañía Allstate utiliza la información crediticia para fijar precios y asegurar las pólizas de seguro?

Una conexión fuerte

Durante los últimos años, las compañías de seguros han incluido cierta información de los reportes de crédito entre los factores que se utilizan para ambos, para asegurar y para fijar los precios de las pólizas de seguros. Según los consumidores se enteran sobre esta práctica, es posible que ellos tengan preguntas y preocupaciones, y la mayoría de estas preocupaciones están relacionadas con lo siguiente:

- ¿Qué es lo que hace que la información crediticia sea relevante a la posibilidad de las pérdidas de los seguros en el futuro?
- ¿Qué tipo de información del historial crediticio de un dueño de póliza determina la tarifa de seguro que él o ella reciba?

Nos gustaría explicar en este documento cómo es que Allstate utiliza la información de crédito, y por qué. Abajo aparecen algunas de las preguntas que se hacen con más frecuencia sobre el uso de la información crediticia en cuanto a la subscripción de los seguros y la manera de fijar las tarifas.

¿Por qué es que Allstate utiliza información crediticia?

El uso de cierta información proveniente de los reportes de crédito es uno entre muchos otros factores que nosotros consideramos para poder determinar con la mayor precisión posible los riesgos que un determinado cliente pudiese presentar. Nosotros consideramos esta información debido a nuestra preocupación constante de que nuestra práctica de asegurar y de fijar precios sea justa, porque nos ayuda a controlar los costos de seguro, y porque nos ayuda a poner los seguros a mayor disponibilidad. La información que nosotros utilizamos ha probado ser un instrumento efectivo para predecir las pérdidas futuras de los seguros. De hecho, estudios independientes confirman la conexión entre la información de reportes de crédito y la posibilidad de tener una pérdida.

En Allstate, nosotros encontramos que nuestro uso de información crediticia nos permite no sólo ofrecer tarifas más bajas a muchos clientes que de otra manera pagarían más por sus seguros, sino que también nos permite proveerle cobertura de seguro a más automovilistas y a dueños de casas que de otra manera nosotros pudiéramos ofrecer.

Otras compañías de seguros que toman en consideración la información crediticia también reportan experiencias similares. En una encuesta que recientemente llevó a cabo la Asociación Nacional de Aseguradores Independientes (National Association of Independent Insurers) se encontró que las compañías de seguros están proveyendo seguros a más personas que antes de que comenzaran a utilizar la información crediticia. En muchos casos, la información crediticia balancea otra información que anteriormente le hubiese prevenido a ese cliente obtener cobertura.

Yo califiqué para la mejor tarifa con mi compañía de hipotecas. ¿Por qué es que yo no califico para la mejor tarifa para mi seguro? ¿Cuál es la diferencia entre las dos compañías?
La diferencia es que una compañía de seguros solamente considera esos componentes de los reportes de crédito que son relevantes al potencial de una pérdida de seguros. Diferente a una compañía de hipotecas, una compañía de seguros no está evaluando si un cliente merece crédito. Las determinaciones que se hagan en base a la información que aparece en un reporte de crédito por parte de una compañía de hipotecas pueden ser diferentes de las determinaciones hechas por una compañía de seguros porque las dos compañías están evaluando cosas diferentes cuando revisan la información crediticia. La información que pudiese ser importante para una pudiese no ser de tanta importancia para la otra, o las dos compañías pudiesen tomar en consideración la misma información de diferentes maneras.

Sin embargo, lo más importante que se debe tener en mente es que muchas personas que consiguen la mejor tarifa con una compañía de hipotecas también obtienen una buena evaluación con el modelo de seguros de Allstate; ellos calificarán para mejores tarifas con Allstate que si de otra manera Allstate no hubiese tomado en consideración la información crediticia. Esto es cierto aún si el dueño de la póliza no califica para la mejor tarifa basada en la información crediticia.

¿Qué tipo de información crediticia está utilizando Allstate?
Como mencionamos anteriormente, nosotros solamente tomamos en consideración aquellos detalles de losreportes de crédito que tienen relevancia para el potencial de pérdidas para un seguro. Nosotros no tomamos en consideración información tal como cuánto dinero usted gana o a quién le debe, porque nosotros no estamos evaluando si nuestros clientes merecen crédito.

El tipo de información en los reportes de crédito que ha probado ser relevante en calcular los riesgos de seguros incluye bancarrotas (en la mayoría de los estados), dictámenes, colecciones y delincuencias. Otros de los factores que nosotros consideramos son el número y los tipos de cuentas de crédito que un cliente tiene, el tiempo del historial de las cuentas y los balances pendientes relativo a los límites.

También si su reporte de crédito muestra algunos tipos de investigaciones*, esto pudiese afectar su tarifa de seguro, pero es importante que usted entienda qué tipos de investigaciones pudiesen tener un efecto. Su tarifa de seguros no será afectada si las investigaciones son de promociones, investigaciones para revisión de cuentas, la investigación que usted mismo hace para recibir una copia de su reporte de crédito, o la investigación que Allstate o cualquier otro asegurador haga para revisar su historial de crédito para propósitos de seguros.

¿Cómo es que Allstate utiliza la información de los reportes de créditos?
Al fijar tarifas y subscribir las pólizas de seguros, a cada uno de los varios factores que nosotros consideramos de los reportes de créditos se le asigna una "puntuación"- algunos tienen puntuación positiva, otros negativa. Entonces, nosotros calculamos el total en general, en el cual a los factores positivos se les permite balancear a los negativos haciendo las determinaciones sobre tarifas y subscripción apropiadas. Nuestro método de considerar todos estos factores juntos, como una totalidad, asegura que ningún factor negativo por sí solo necesariamente prevenga que un cliente reciba nuestras mejores tarifas. Y muchos clientes, aunque no califiquen para la mejor tarifa, aún calificarán para una tarifa que es significativamente mejor que la promedio debido a la información que nosotros consideramos de los reportes de crédito.

Generalmente, ¿qué tipo de información crediticia está asociada con las mejores puntuaciones?
Los clientes que tienen las mejores puntuaciones incluyen aquellos que tienen un historial crediticio por

---

*El modelo de puntuación utilizado en Illinois y Connecticut no toma en consideración ningunos de los tipos de investigaciones antes mencionadas

© 2002 National Association of Insurance Commissioners 70
largo tiempo que está libre de eventos mayores como los dictámenes judiciales y las colecciones, y que no reflejan delincuencia solamente delincuencia que se traten de cantidades pequeñas que hayan ocurrido hace mucho tiempo en el pasado. Por lo general, estos clientes tienen alguna actividad en sus cuentas de crédito, pero con balances relativamente bajos comparados con los límites de crédito disponibles. Además, estos clientes tendrán pocas cuentas abiertas recientemente o investigaciones* por razones de la búsqueda de crédito adicional. Aunque es difícil identificar las acciones específicas que cualquier cliente pudiese tomar para mejorar su “puntuación”, los clientes que administran sus finanzas de una manera que es consistente con estas características tienen mayor posibilidad de tener mejores puntuaciones.

¿Qué tiene que ver el crédito con mi posibilidad de tener una pérdida de seguro?
La relación entre el historial crediticio y el potencial de una pérdida han sido estudiados extensamente por muchos eruditos fuera de la industria de los seguros, en campos como la psicología, ingeniería para la seguridad, medicina ocupacional, estudios de consumidores y de la percepción de riesgo.

Casi unos 30 artículos y estudios que nosotros hemos analizado apuntan a varias posibilidades. Las dos teorías que surgen de estos estudios señalan al estrés que se suma que pudiese ocurrir por presiones financieras y la posibilidad que las dificultades financieras puedan indicar una tendencia hacia un comportamiento de tomar riesgos, cualquiera de los cuales puede significar una posibilidad más alta para los accidentes.

Cualquiera que sean las razones detrás de la relevancia de la información crediticia al potencial de pérdidas de seguros, el poder de predecir de esta información es un hecho, no una teoría o conjetura. Los dueños de pólizas de automóviles con las puntuaciones menos favorables tienen casi un 40% de mayor posibilidad de tener pérdidas mayores en número y severidad que aquellos que tienen las puntuaciones más favorables. La diferencia es aún más dramática entre los dueños de pólizas de seguros sobre la propiedad. La cantidad de dólares de las pérdidas de los dueños de pólizas de casas con las puntuaciones menos favorables es casi el doble de aquellos con las puntuaciones más favorables.

*El modelo de puntuación utilizado en Illinois y Connecticut no toma en consideración ningunos de los tipos de investigaciones antes mencionadas.

¿Cómo puedo yo rectificar mi información crediticia si está incorrecta? ¿Cambiará mi tarifa?
Si usted descubre un error en su reporte de crédito, todo lo que tiene que hacer es comunicarse con la agencia que prepara el reporte y corregir el reporte. Entonces notifiquemos a nosotros, y con mucho gusto, nosotros volveremos a evaluar cualquier decisión que nosotros hayamos tomado basado en su información crediticia.

Pero por lo general, los reportes de crédito son muy exactos. Durante el primer trimestre del año 2001, Allstate ordenó más de cuatro millones de reportes de crédito del suplidor, Trans Union. El número de peticiones por escrito de parte de consumidores disputando la información de su reporte de crédito fue un total de 377 o el .009% del número total de reportes que se ordenaron.

Sin embargo, los errores sí ocurren. Si usted descubre un error, todo lo que tiene que hacer es comunicarse con la agencia que prepara los reportes y rectificar el reporte.
¿Es legal que Allstate utilice la información crediticia?
Sí. En todos los estados en los que nosotros consideramos el historial crediticio, lo hacemos de manera legal según es permitido.

¿Utilizan las otras compañías de seguros la información de los reportes crediticios?
Sí. Muchas de las compañías de seguros de líneas personales utilizan algún tipo de evaluación del reporte de crédito de uno para evaluar riesgos o para fijar los precios de las pólizas de seguros.

¿Es cierto que el uso de la información de los reportes de crédito discrimina contra las minorías, las mujeres y las personas de bajos ingresos?
No. Ninguno de los modelos de puntuación de seguros que nosotros utilizamos hoy día toma en consideración el grupo étnico, religión, género, estado civil, nacionalidad, edad, ingresos o dirección. Sencillamente estos no son factores en los modelos de puntuación de crédito.

El uso de información crediticia beneficia a los consumidores
Por todas las razones que se han explicado anteriormente, el uso de información crediticia de parte de aseguradores es más común. La relevancia que tiene la información crediticia al potencial de las pérdidas en los seguros es probada por la experiencia de las pérdidas actuales de las compañías de seguros que la utilizan y por los estudios independientes. Estas mismas fuentes también muestran que considerar la información crediticia aumenta la imparcialidad en la subscripción de seguros, permitiéndole a muchos clientes pagar menos por seguros que de otra manera, y le permite a las compañías de seguros a ofrecer cobertura a más consumidores que a los que les ofrecían en el pasado.
American Insurance Association Statement to
The National Association of Insurance Commissioners

Market Conduct & Consumer Affairs (D) Committee
Hearing on Credit-Based Insurance Scores
December 8, 2001

Prepared by: David F. Snyder Catherine I. Paolino
Assistant General Counsel Associate Counsel

The American Insurance Association (AIA) welcomes the opportunity to provide this statement to the National Association of Insurance Commissioners (NAIC). The AIA is a national trade association representing more than 413 property and casualty insurers that write insurance in every jurisdiction in the United States. Their U.S. premiums exceeded $87 billion last year. AIA member companies offer all types of property and casualty insurance including personal and commercial automobile insurance, commercial property and liability coverage, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance.

This statement gives general information about the benefits of using credit-based insurance scores, discusses government involvement in the issue of insurer use of credit as well as the resulting consumer protections, and provides background material on the issue (in Exhibit A). Common consumer concerns are also addressed. AIA hopes to remain involved as the NAIC’s review of this issue moves forward.

Some Benefits of Credit-Based Insurance Scores

One reason personal lines of insurance have become more competitive in recent times is because of advancing low cost underwriting and rating tools, including the responsible use of credit history and credit-based insurance scores. Insurance companies learned that credit-based insurance scores predict future loss likelihood. Since the use of insurance scores has become more prevalent over the last decade, competition in the U.S. personal lines automobile insurance market has increased by 15 percent, according to a commonly used measure of competitiveness. (See Exhibit B.)

Credit history is a source of affordable, objective information readily available in the market that is useful to insurers. Using credit information supplements the underwriting picture so more accurate and consistent underwriting decisions are made. With the use of credit-based insurance scores, subjectivity is minimized, as a strict formula is applied that evaluates empirically derived data, allowing for an impartial underwriting and pricing decision.

The use of credit-based insurance scores allows insurance companies to give more favorable rates to consumers who are less likely to have losses. Better experience means more choice for many consumers.


**High Correlation to Risk**

Numerous studies, several referenced below, show a correlation between credit history and the costs of future insurance losses.\(^8\)

First, James E. Monaghan in his 2000 Casualty Actuarial Society (CAS) Forum study, “The Impact of Personal Credit History on Loss Performance in Personal Lines”, concluded as follows:

\[
\text{The data reviewed in this study produced clear evidence of a strong correlation between credit history and future loss performance.}
\]

Second, Fair Isaac produced a paper in 1999, “Predictiveness of Credit History for Insurance Loss Ratio Relativities”, that assessed isolated credit characteristics and loss ratio relativities. The credit characteristics reviewed (for both homeowners and automobile business) were as follows: adverse public records, time passed since most recent adverse public record, trade lines in delinquency, number of collections, and number of trade lines. In summary, it stated:

\[
\text{Given that loss ratio relativity includes the original premium surcharges and discounts, the above 10 charts show that credit information can further separate insurance policies in terms of loss ratio relativity.}
\]

Third, The Tillinghast-Towers Perrin study of 1996, “Insurance Bureau Scores vs. Loss Ratio Relativities”, analyzed data from a number of property and casualty insurers using credit-based insurance scores. That study found a strong relationship between credit and loss ratio relativity. It stated:

\[
\text{We conclude that the indication of a relationship between Insurance Bureau Scores and loss ratio relativities is highly statistically significant. In a more technical sense, the conclusion is that it is very unlikely that Insurance Bureau Scores and loss ratio relativities are not correlated based on this data.}
\]

**Questions of Causation**

The existence of a correlation between credit score and risk appears to prompt at least some consumers to ask for the causation. Determining causation is not easy, nor is it necessary. Consider a situation of a prior drunk driving conviction; simply because someone has driven under the influence in the past does not make him repeat this behavior. For that matter, having an accident does not make a person have another.

Monaghan’s study, discussed above, worked through this issue. He started with looking at section 5.2 of the Actuarial Standards of Practice #12 on risk classification (emphasis added):

\[
5.2 \text{ Causality – Risk classification systems provide a framework of information which can be used to understand and project future costs. If a cause-and-effect relationship can be}
\]

\(^8\) AIA is unaware of any study showing that such correlation does not exist.

© 2002 National Association of Insurance Commissioners 74
established, this tends to boost confidence that such information is useful in projecting future costs, and may produce some stability of results.

However, in financial security systems, it is often impossible or impractical to prove statistically any postulated cause-and-effect relationship. Causality cannot, therefore, be made a requirement for risk classification systems.

Often, the term ‘causality’ is not used in a rigorous sense of cause and effect, but in a general sense, implying the existence of a plausible relationship between the characteristics of a class and the hazard for which financial security is proved. For example, living in a river valley would not by itself cause a flood insurance claim, but it does bear a reasonable relationship to the hazard insured against, and thus would be a reasonable basis for classification.

Risk classification characteristics should be neither obscure nor irrelevant to protection provided, but they need not exhibit a cause-and-effect relationship.

Monahan then sought to answer the question, “Why would an individual who has current past difficulties with meeting financial obligations be expected to have above-average costs to an auto insurer?” He listed the following possibilities (perhaps with some working together rather than in isolation to result in an increased likelihood of higher claim costs):

- Maintenance;
- Moral Hazard;
- Claim Consciousness;
- Fraud: Increased Severities;
- Fraud: Increased Frequencies; and
- Stress.

Credit appears to measure personal responsibility, which extends from the financial realm into other areas of an individual’s life such as his risk under a personal automobile insurance policy. Credit may also be an indicator of whether an insurance claim will be filed, whether an insurance claim will be inflated, and whether fraud will be committed. For these and other reasons, the relevance of credit as a factor in underwriting and rating personal lines of insurance seems to be established. Furthermore, credit is used heavily in our society, which is one of the reasons why it can hardly be considered obscure.

Fair Isaac, in their 1999 “Predictiveness of Credit History for Insurance Loss Ratio Relativities” paper, made a similar point:

It is important to note that statistical techniques in general do not determine a causal relationship between predictive characteristics and outcomes. Instead, these techniques numerically describe the statistical relationship between these variables. Other fields than insurance or financial services have used these same statistical techniques to discover relationships, without identifying causal relationships between particular genes and symptoms of diseases such as Alzheimer’s Parkinson’s and Huntington’s was hailed as a medical breakthrough, even though the causal relationship remained unknown.
The point is that while the exact causal relationship between credit characteristics and loss ratio relativities is not known, there is a demonstrated statistical relationship between the two.

Resources on Link Between Insurance Risk and Credit-Based Insurance Score

Some existing resources discussing the link between insurance risks and credit-based insurance scores are as follows:

- Statement of the American Insurance Association (March 1999): On the Lack of Correlation Between Income and Credit Score Whether Tested Against the Average or Median Score.
- Arkansas Insurance Department Study (1996): The Use of Credit Related Information in the Underwriting of Homeowners and Automobile Insurance in the State of Arkansas.
- The David Cox Company (October 1995): Actuarial Review for the Arizona Department of Insurance Study.

Laws, Regulations and Market Imperatives – Consumer Protections in Place

Numerous consumer protections are currently are in place, including the federal Fair Credit Reporting Act (FCRA) as well as state laws and regulations. Legislators and regulators continue to look at
requirements even after they are put into place. To date, this year there have been over 60 bills and regulations proposed relating to the use of credit. In addition to credit-specific regulations, there are additional mechanisms to ensure consumer protection. The market conduct process allows state Insurance Departments to assess whether insurers are acting in accordance with laws and regulations. As part of this process Departments will often review an insurer’s complaint log, which indicates complaints the company has received. The consumer complaint process (where a consumer calls or writes to an Insurance Department about their concerns) serves as a flag to regulators, indicating that there may be a non-compliance or discrimination problem.

It is in the industry’s self-interest to maintain fair underwriting and rating practices. There is a clear market incentive for insurers to accurately price and underwrite. Otherwise, they fail to attract good drivers and/or fail to charge bad drivers to cover their losses.

State prohibitions on unfair discrimination and federal requirements relating to the use of credit are discussed in further detail in the sections that follow.

**State Law Prohibiting Unfair Discrimination**

Policyholders benefit by having an underwriting and rating process that is free from unfair discrimination. AIA supports the limitation against using credit-based insurance scores for discriminatory purposes. Indeed, the use of credit-based insurance scores allows for objective, consistent and accurate underwriting. With the use of credit-based insurance scores, subjectivity is minimized, as a strict formula is applied that evaluates empirically derived data, allowing for an impartial underwriting and pricing decision.

Perhaps one reason people may be uneasy with insurers using credit-based insurance scores is a concern that it differentiates between people based on income (and that differentiating based on income is a method to indirectly discriminate based on gender, race, nationality or religion). It is AIA’s understanding that while lenders look at income when making decisions, property and casualty insurers do not. Interestingly, the concept of financial responsibility is not related to the amount of money a consumer makes. In the 1999 “Statement of the American Insurance Association On the Lack of Correlation Between Income and Credit Score Whether Tested Against the Average or Median Score”, we learned the following:

*The analysis concluded that credit score is not significantly correlated with income for the AIA company’s policyholders.*

The Virginia Bureau of Insurance arrived at a similar conclusion in its 1999 report on “Use of Credit Reports in Underwriting”:

*The Bureau analyzed the relationship between credit scores and income as well as the relationship between credit scores and race. Nothing in this analysis leads the Bureau to the conclusion that income or race alone is a reliable predictor of credit scores thus making the use of credit scoring an ineffective tool for redlining.*
As discussed above, unfair discrimination is prohibited under state law. Turning once again to Fair Isaac in “Predictiveness of Credit History for Insurance Loss Ratio Relativities”, voluntary compliance with federal statutes is as follows:

While the 1974 federal statute Equal Credit Opportunity Act (ECOA) has no application to the insurance industry, Fair, Isaac insurance scoring models follow the ECOA guidelines. In its scoring model development, Fair, Isaac does not include any discriminatory practices as defined by the ECOA; these include data elements of age, gender, income, location, marital status, nationality, net worth, race and religion.

The Fair Housing Act applies to residential real estate-related transactions, including homeowner’s insurance. Fair, Isaac’s insurance scoring models comply with the guidelines of this federal statute and do not take into account a person’s race, color, religion, sex, handicap, familial status or national origin.

Legislation and/or regulations relating to the use of credit in underwriting and rating often include a prohibition against unfair discrimination. It is useful to recognize, however, that additional limitations in the context of credit may be duplicative; protections are often already afforded under the insurance code (serving as a foundation governing all insurance activity). Regardless of the seemingly duplicative nature of the prohibition against unfair discrimination, it may serve to highlight the prohibition and to ease the concerns of consumers who are less familiar with the overall framework of insurance law.

**FCRA - Ensuring Proper Communication with Consumers**

To ensure that credit data is not reviewed by anyone with no business to look at such information, the federal Fair Credit Reporting Act (FCRA) requires that users of consumer credit reports must have a permissible purpose, such as underwriting insurance. In addition, the FCRA requires that if credit information is used and if an insurer takes an adverse action resulting from information contained in a consumer’s credit history, specific actions with regard to notice are required. First, the insurer must notify the insured that an adverse action was based upon information contained in a credit report. Second, the insurer must provide the insured with information on how the insured may obtain a free copy of the report (including the name, address and toll free telephone number of the consumer reporting agency which furnished the report).

The FCRA notice requirements, imposed after an adverse action has been taken, make sense. The consumer should be informed of the manner in which he/she may obtain his/her credit report. The most direct source for an individual to obtain information about his/her credit report is through a credit bureau. Indeed, it is these organizations that will be responsible for correcting any errors contained on a credit report. Furthermore, the insurer is generally unable to provide credit history information directly. Consider in many instances the score is vendor-generated; it is not in the control of the insurer. Most insurers that use credit scoring do not review the actual credit history of an insured when making a

---

10 See, 15 U.S.C.A. 1681m(a) on duties of users of consumer reports taking an adverse action.
11 See, 15 U.S.C.A. 1681m(a)(1) on duties of users of consumer reports taking an adverse action to provide notice.
12 See, 15 U.S.C.A. 1681m(a)(2) and (3) on the content of notices provided by those taking adverse actions on the basis of information contained in consumer reports.
© 2002 National Association of Insurance Commissioners
decision. This is a useful arrangement. Reasons for not reviewing the report include consumer privacy concerns and potential misinterpretation of the relevance of a particular item contained on the report. The information given to the insurer by a third-party vendor may be in a summary or code format, therefore the carrier may not be in the best position to provide the consumer of the credit status and of particular transactions contained in a credit report.

Federal law requires that the insurer notify a consumer if an adverse decision is made based on credit information. That consumer may contact the credit bureau and if the information is incorrect, the bureau is required to review and correct any errors in the report promptly (within 30 days). If an adverse underwriting decision is made based on previous, erroneous information, the consumer may resubmit the application and the insurer may then reinitiate the request for a credit-based insurance score in order to take the corrected information into account. In addition, consumers may request a free copy of their credit bureau report if they are denied a policy.

Quality of Credit Bureau Information

Insurer interests are aligned with those of the consumers on the matter of the importance of the accuracy of credit report data. To the extent that a consumer disputes information contained in his/her credit history, such information should not be included when the credit-based insurance score is developed. As a practical matter, information may only be withheld from the score when the dispute is known and included in the information maintained by the consumer reporting agency. Following the procedures found in the FCRA is the only way in which all parties are on notice that there is a dispute; there are processes in place for fixing errors (information that is inaccurate or incomplete). As previously stated, the FCRA requires a consumer reporting agency, which has received notice from a consumer disputing the completeness or accuracy of an item in the consumer’s file, to reinvestigate or to delete the item within 30 days.

Furthermore, no system is perfect; there are sometimes even errors in traditional underwriting tools, such as motor vehicle reports (MVRs). Studies have found that many convictions and reportable accidents do not find their way into motor vehicle records. We believe that this is a significant issue that should be urgently addressed, especially considering the abuse of these systems by potential terrorists.

Lastly, it is in everyone’s best interest to work for improvements in this area. For example, this could be accomplished by: consumers periodically reviewing their credit files for accuracy; financial services companies, including insurers, educating consumers on the benefit of periodically reviewing their credit history (as discussed in further detail below); and credit bureaus continually-improving responsiveness and accuracy. (Moreover, if errors are the biggest concern, perhaps it is an issue best addressed directly with the credit bureaus.)

---

14 See, 15 U.S.C.A. 1681m on duties of users taking adverse actions on the basis or information contained in consumer reports.
16 See, 15 U.S.C.A. 1681m(a) and 1681j(b) on free disclosure after adverse notice to consumer.
18 See, Insurance Research Counsel’s April 1991 paper, “Adequacy of Motor Vehicle Records in Evaluating Driver Performance”, which states, “A 1990 survey of 39 states and the District of Columbia found that publicly available records contained information on only 40% of a sample of 27,629 known accidents serious enough to meet each state’s accident reporting requirements.” It further provides, “On average, only 19% of the drivers in the study had a conviction recorded in connection with the accident surveyed, even though over 60% of the drivers were considered legally at fault.”

© 2002 National Association of Insurance Commissioners
Extraordinary Circumstances

Questions from regulators and consumers seem to reflect a concern about how insurers address extraordinary circumstances in the context of using credit information. AIA member companies have indicated receptivity to reviewing action they have previously taken on a credit-based insurance score, if a consumer brings an extenuating circumstance to their attention and if he/she provides documented and verifiable information. Such an extenuating circumstance might include a situation like medical bankruptcy, identity theft, or economic hardship as a direct result of the terrorism events of September 11, 2001. (However, repeated events would not likely be considered extenuating circumstances.)

Individual Rating and Risk Classification Issues

Ironically, for years the insurance industry has heard objections to large groupings of risks (or to pooling) from the same groups who are now criticizing the use of credit scores. The concept of “fairness” is a matter of perspective. The recent Conning & Co. study, “Insurance Scoring in Personal Automobile Insurance” discusses the role of risk classification systems as follows:

Failure by insurers to redefine or enhance their risk classifications system by considering characteristics that are predictors of loss can result in a subsidy of consumers with a higher loss expectancy.

In today’s society, and for the foreseeable future, there are consumer groups with high and low loss expectancy. The insurance system does not create them; rather, it seeks to identify them in the risk classification process. They are identified based on a combination of many factors, including driving record, driving experience and, with the use of credit data, financial stability. Risk classification is used to identify these differences in risk factors to minimize subsidy.

Pricing and Underwriting Proficiency

Pricing proficiency and precision can be achieved via custom modeling and analysis of automated underwriting and pricing systems. The best automated underwriting and pricing systems are based on data derived from actual loss ratio performance. These systems can sort through data, analyze many risk characteristics, apply positive and negative financial risk characteristics and seek out more information. In addition, these systems can better estimate loss costs for pricing and find the best path to underwriting approval, going right up to the edge of risk acceptability.

By its very nature, the use of fewer tiers or pools of risks only benefits some while being less favorable to others. For example, the better risks in each of those categories would subsidize the poorer risks. When there are more risk levels, insureds are placed with others with a more similar risk profile which results in a fairer price and insurers can offer coverage to people they might have had to decline if more rating alternatives were not available.
**Consumer Education**

Insurers are doing a number of things to improve consumer understanding of the credit-based scoring process. This year AIA began an education campaign, working with industry leaders to develop materials for distribution to agents and consumers. AIA has received direction from member companies that this should be a top priority for guiding our efforts on the credit issue. To start, a targeted brochure has been developed for agents in one state. Next, our efforts are turning to a countrywide consumer education piece and then to a countrywide agent education brochure. These education efforts are not in response to legislative or regulatory mandates; rather they are industry actions taken to improve communication surrounding the issue of the use of credit in assessing an insurance risk. A draft of the AIA consumer brochure was shared with attendees of the National Insurance Task Force symposium in October.

**Conclusion**

In conclusion, there are several benefits of credit-based insurance scores. They are an objective and cost-effective tool for insurers in accurately underwriting and/or rating risks. They improve competition, which ultimately benefits consumers. Lastly, there are ample tools already in place to address specific problems with an insurer’s use of credit, should any concerns arise. If you have questions, contact David F. Snyder, Assistant General Counsel, at 202-828-7161 or Catherine I. Paolino, Associate Counsel, at 202-828-7159.
Developing Credit-Based Insurance Scores

Computer model analysis permits review of credit history, helping to ensure an objective look at credit information. Several vendors and insurers developed mathematical models to identify predictive characteristics of loss and then assign weights to these characteristics. Overall, credit-based insurance scores consider patterns of credit management practices.

Single incidents generally have minimal impact. A credit-based insurance score is a snapshot of a consumer’s insurance risk based on information contained in his/her credit report that reflect his/her credit payment patterns over time, generally with more emphasis on recent information. Consumers can often increase their scores over time by using credit responsibly. Consumer credit report information used in scoring includes the following: late payments, collections, bankruptcies, outstanding debt, length of credit history, new applications for credit, and types of credit in use.

Insurers and lenders use credit information differently. People are generally most familiar with a credit score used by a lender; it is a number that predicts the likelihood of future delinquency on credit accounts of a credit prospect or consumer (in essence, it assesses how likely a consumer is to repay a loan). A credit-based insurance score is a number that predicts future claim costs. Just as companies’ underwriting guidelines and rating tools are different, insurers use credit-based insurance scores in a variety of ways.

Perhaps it will be useful to review the process of using credit for assessing insurance risk as well as the parties involved. The process may begin when an applicant requests a new policy. The agent or insurer may then request a credit-based insurance score in the course of reviewing the risk. An insurer does not generally review the credit report directly. Rather, a third party vendor is used to extract the information found in the credit report by using computer model analysis to develop a score used to assess the insurance risk.

Credit-based insurance scores are based on information from consumer credit reports that insurers or modelers usually get from one or more of three major national credit bureaus: Equifax, Experian (formerly known as TRW) and TransUnion. Generally, an insurer sends an inquiry to one of the major credit bureaus. The credit bureau then conducts a process in which specific credit report attributes are input into the model that then produces a score. In addition to credit bureaus, there are a variety of other third party vendors involved in the process of reviewing credit-based insurance scores for assessing insurance risk. As the use of such scores becomes more prevalent, more and more companies are introducing products into the marketplace. At the same time, many insurers are developing their own models for credit-based insurance scores.
Credit is Not a Commercial Lines Issue

The scope of restrictions on the use of credit in rating and underwriting should not extend to commercial lines for a number of reasons.

First, the financial status of a commercial entity is fundamental to its insurability. For example, when a commercial auto policyholder begins to get in trouble financially, its safety performance deteriorates. There is no need to protect financial information of commercial policyholders, while this concern drives the efforts with regard to personal lines. Insurers of commercial lines have long been able to use tools such as financial reports to underwrite and to rate commercial insureds.

Second, commercial policyholders are sophisticated buyers of insurance products. Some employ professional risk managers to procure insurance and to engage in arms-length negotiations with insurers. Due to the sophistication and bargaining power of these consumers, they have no need for a regulator to serve as a third party representative in negotiations with their insurers. In fact, they are not well-served by regulation that fails to distinguish between their needs and those of other policyholders, instead lumping all needs together into a “one size fits all” category.

Third, underwriters’ use of credit reports in commercial lines has been free from regulation as a matter of custom and practice for decades. The credit risk typical to commercial insurance transactions and the relative sophistication of the buyer of insurance, among other factors, justify unfettered use of credit reports (often called “D&Bs” after Dun & Bradstreet, which for decades has produced commercial credit reports) by insurers in commercial lines insurance.19

---

19 The NAIC’s 1997 paper, “Credit Reports and Insurance Underwriting”, acknowledges the important differences between personal and commercial lines with respect to the use of credit in underwriting.
EXHIBIT B - HHI

Herfindahl-Hirschman Competitiveness Index
Top 50 Private Passenger Automobile Groups
Office of Government Relations

The Use of Credit Reports and Insurance Score by Insurers

ChoicePoint serves the information needs of the property and casualty insurance industry; Fortune 1000 corporations; law enforcement; and, federal, state, and local government agencies. ChoicePoint is the leading provider of public records and risk assessment information, which helps our customers make informed, timely, and accurate decisions for society’s greater good.

We support the use of a consumer’s credit history to evaluate their eligibility for automobile and homeowners insurance when used in conjunction with that consumer’s claims history. We support the combined use of credit and claims history because we believe that a consumer is best served when insurance companies make informed decisions based on that consumer’s complete characteristics and not solely on a consumer’s credit history.

In an attempt to bring a more comprehensive set of predictive behaviors into the underwriting and pricing process, ChoicePoint has developed several insurance models that consider both a consumer’s credit and claims history. These models give insurers a more balanced view of the consumer, rather than one based solely on credit, which benefits consumers and insurers alike. Our models are strong predictors of the consumer’s future behavior and are fair to consumers.

Furthermore, the use of consumer credit and claims history information by insurance companies benefits consumers by basing insurance rates more on the specific behavior of the individual, and less as part of a group. An insurance company’s ability to properly assess risk and avoid possible loss provides lower rates for most consumers.

Many studies confirm the better a person is at handling his or her financial responsibilities, the better that person is at handling his or her insurance responsibilities. The following studies show a strong correlation between credit histories and insurance risks:

- In 1999, the Virginia Bureau of Insurance issued a report stating that “in every case where insurers have proposed to use insurance scoring as a rating factor and have been able to provide sufficient data to the Bureau’s actuaries, the use of the scoring has been found to be statistically correlated to losses.”

- A National Association of Independent Insurers (NAII) study in 1997 found that companies that use credit reports for underwriting assessments reported that automobile insurance claims are 60% higher for drivers with a poor insurance rating. Also, homeowners or renters with poor insurance scores file twice as many claims as individuals with the best credit ratings. These insurance companies also end up paying out more than three times as many claim dollars on those with poor credit ratings than those with good credit ratings.
In 1996, Tillinghast-Towers Perrin studied data from nine home and auto insurance companies to determine if there is any relationship between insurance scores and loss ratios. In eight of the companies, Tillinghast determined that there was a 99% chance of a relationship, and in the ninth company, it established a 92% probability of a link between credit behavior and future insurance behavior.

An insurance score itself is purely an analytical, non-biased assessment that is generated without regard to race, income, or gender. The models that ChoicePoint has created consider only those factors that establish how a consumer handles his or her financial and insurance responsibilities, factors like prior claims history, bankruptcies, number of credit accounts, and how much debt the consumer has. ChoicePoint believes that consumers should be able to trust the underwriting process and has created models open to any legislator or regulator to discuss.

Finally, the use of credit and insurance scores in the insurance process provides consumers with important privacy protections. The use of consumer credit reports to underwrite insurance is governed and expressly allowed by the federal Fair Credit Reporting Act (FCRA), 15 U.S.C.§ 1681 et seq. Under the federal FCRA, consumer safeguards require insurers to notify their customers, if they take an adverse action based, in whole or in part, on a credit report. Consumer reporting agencies must provide consumers with access to a free credit report if they have been denied insurance and they must investigate consumer complaints about disputed information and remove any inaccurate information. If the dispute is not resolved, the consumer has the right to file a brief statement explaining the dispute and either that statement or an accurate summary of the statement must accompany subsequent consumer reports.

The use of credit, in conjunction with claims history information, in insurance decision making is an important benefit. It benefits insurance companies by giving them a tool to lower their risk and lower their costs of doing business. It benefits consumers by helping the consumer get insurance at a cost that better reflects their individual experiences, rather than being lumped into a risk pool, and by providing an objective means by which they can be judged, without regard to income, gender, or race. ChoicePoint hopes that these important benefits are not taken away from consumers.
Statement of the  
Fair, Isaac and Company Inc.  
To the NAIC  
Market Conduct & Consumer Affairs (D) Committee  
Regarding  
The use of Credit Scores in Underwriting and Rating  

Chicago, IL  
December 8, 2001

Fair, Isaac is a global provider of custom analytics and decision technology. Widely recognized for our pioneering work in credit scoring, Fair, Isaac revolutionized the way lending decisions are made. Today the company helps clients in multiple industries, including the insurance industry, make more objective, consistent, and efficient decisions that increase the value of customer relationships.

For purposes of this statement, Fair, Isaac will be discussing Fair, Isaac-developed insurance bureau scores.

**Definition of Insurance Bureau Scores**

A Fair, Isaac insurance bureau score is a predictor of a consumer’s insurance loss potential based on information contained in the consumer’s credit file at a particular point in time. More specifically, Fair, Isaac’s scores are developed to rank order the applicant’s or policyholder’s likely loss ratio performance relative to other consumers. Fair, Isaac insurance bureau scores are available at the three major credit-reporting agencies and through ChoicePoint. (The credit reporting agencies have different product names for the Fair, Isaac insurance bureau scores they sell.)

**Distinction Between Insurance Bureau Scores and Credit Bureau Scores**

Fair, Isaac is frequently asked if there is a difference between the Fair, Isaac insurance bureau scores and the Fair, Isaac credit bureau risk scores (commonly referred to as FICO® Scores). While both types of scores use information from consumer credit files, they are designed to predict very different outcomes. The credit bureau risk models are built to predict the likelihood of delinquency or non-payment of credit obligations. Insurance bureau scores, by contrast, are built to predict future insurance loss ratio relativity and are discussed below, but not credit bureau risk scores.

**Fair Credit Reporting Act**

The Fair Credit Reporting Act (FCRA) allows insurers to use credit reports under the permissible purpose of "underwriting insurance." The FCRA also allows consumer credit information to be used for insurance prescreening in a transaction not initiated by the consumer, provided that the consumer receives a firm offer of insurance. However, the FCRA also permits making such an offer conditional, subject to the verification of the information in the credit report or application at the time of acceptance, in order to ensure the consumer still meets the prescreen criteria.
In addition, the FCRA stipulates that users of consumer reports must give notice to applicants or policyholders when adverse actions (such as denial of insurance or an unfavorable change in policy terms) are taken based on information in the report – the user must inform the consumer of the credit bureau used and of his right to get a free copy of his report in order to verify the information in it.

Also, the FCRA mandates a quick resolution for any errors found and reported to the consumer reporting agencies so that accuracy can be maintained.

**Information Not Used in Fair, Isaac Insurance Bureau Scores**

The Fair Housing Act (FHA) applies to residential real estate-related transactions, including homeowner’s insurance. Fair, Isaac’s insurance bureau score models comply with the FHA guidelines and do not take into account a person’s race, color, religion, sex, handicap, familial status or national origin.

While the Equal Credit Opportunity Act (ECOA) does not cover the insurance industry, Fair, Isaac insurance bureau scoring models follow ECOA guidelines. Therefore, Fair, Isaac insurance bureau score models do not take into account any characteristic which is a prohibited basis as defined by the ECOA, including race, religion, sex, age, marital status, and public assistance source of income.

Moreover, the Fair, Isaac insurance bureau score models do not take into account the income or the address of the consumer.

**Information Used in Fair, Isaac Insurance Bureau Scores**

Fair, Isaac insurance bureau scores are based entirely on information from consumer credit reports. They evaluate five main categories of information:

1. Payment History
2. Amounts Owed
3. Length of Credit History
4. New Applications for Credit
5. Types of Credit in Use

The score takes into consideration numerous pieces of information from all five categories – no one piece of information or factor alone will determine the score. The score considers both positive and negative information in the credit report. For example, late payments will lower a score, but establishing or re-establishing a good track record of making payments on time will raise the score.

**Development of Fair, Isaac Insurance Bureau Scores**

Fair, Isaac pioneered the development of insurance risk scores based on consumer credit information in the early 1990’s. The scores were developed by analyzing large samples of auto and home insurance policies to determine the statistical correlation between information on consumer credit bureau reports and subsequent insurance loss ratio. The development process included the following steps:
• **Fair, Isaac accumulated a historical development sample** of hundreds of thousands of automobile and property insurance policies from several national and regional insurers, which included specific information regarding premium and loss information. This information was used to calculate the loss ratio for each policy in the sample and for the overall population.

• **Fair, Isaac then had a consumer reporting agency append archived credit file information** for each match that could be found. Thus, this data reflected each consumer’s credit file as it appeared at the time the policy was written.

• **Fair, Isaac developed separate models (or scorecards) for the major types of both auto and homeowner insurance.**

• **Fair, Isaac used advanced statistical modeling to empirically determine the correlation of hundreds of credit variables** (for example, the number of 60-day delinquencies in a credit file) **with insurance loss performance.** The credit variables that were determined to be most predictive of later loss performance were used to build the models. **Attachment A contains examples of several credit bureau characteristics and their relationship to loss ratio relativities.**

The final models rank-order the likely loss ratio relativity of individual new applicants at the time of application or, in the case of a policyholder, at the time of renewal. The scores are represented by a three-digit number, ranging from the 100’s to the 900’s. The higher the score, the lower the likely loss ratio relativity and the better the risk. The rank-ordering is illustrated in Attachment B.

Score Delivery: Although Fair, Isaac developed the algorithms and software used to generate insurance bureau scores, the score is calculated by the consumer reporting agencies based on the information in their credit databases, and the score is delivered by the credit reporting agencies to the insurer, along with the underlying credit report upon which the score is based.

**Scoring Reason Codes**

When an insurance company requests a Fair, Isaac insurance bureau score from the credit reporting agency, they receive not only the three-digit numeric score, but also a set of up to four score reasons which represent the factors in the credit file that had the greatest influence on the score. The score reasons are listed in order of importance, starting with the reason that had the greatest impact on the score. Score reasons may include both positive characteristics (factors that have a favorable impact on the score) and negative characteristics (factors that have a negative impact on the score).

If adverse action is taken based on the consumer’s insurance bureau score, Fair, Isaac recommends that insurers use the score reasons to provide consumers with more specific information on the reasons for the action. Since the score is based on consumer credit characteristics, communication with the consumer should include the score reasons.
Validation of Fair, Isaac Insurance Bureau Scores

The predictive power of Fair, Isaac insurance bureau scores has been validated many times, both by Fair, Isaac and by independent entities including the following:

- Tillinghast-Towers Perrin Study. This 1996 study, commissioned by Fair, Isaac, supported the relationship between credit data and loss ratio.

- Virginia Bureau of Insurance Study. This 1999 independent study, which used data provided by Fair, Isaac, concluded that there is a concrete statistical correlation between insurance scores based on credit bureau data and the likelihood of an individual filing an insurance claim. It also found that credit scoring would be an ineffective tool for discriminatory redlining, since neither race nor income alone were reliable predictors of scores. This conclusion supports the insurance industry position that use of credit information does not discriminate against women, minorities or any income group.

- American Insurance Association Study. This 1999 study by a member of the Association, which used Fair, Isaac insurance scores, concluded that the insurance score is not significantly correlated with income, and that, based on information available for AIA company’s policyholders, there is no evidence that insurance scores based on credit bureau data unfairly discriminate against lower income groups.

Fair, Isaac Suggestions Regarding the Use of Insurance Bureau Scores

Fair, Isaac’s insurance bureau scores are used by hundreds of leading insurers in the US and Canada to improve the speed, consistency, and objectivity of the underwriting process. By using scoring, insurers save resources, make faster approvals, and better manage their books of business.

Regarding the use of Insurance Bureau Scores, Fair, Isaac suggests that:

1) Insurers to use insurance bureau scores in conjunction with other important sources of underwriting information such as applications, motor vehicle reports and claims history reports. We do not suggest that insurers make underwriting or pricing decisions based solely on insurance bureau scores.

2) Insurers to use insurance bureau scores to identify expected good performing risks in traditionally poor risk segments, and to identify expected poor performance risks in traditionally better risk segments. This allows insurers to better understand the risk associated with these populations, and thus extend offers to segments traditionally overlooked.

3) Insurers that are evaluating insurance bureau scores to conduct a retrospective analysis to validate the strength of the models on their book of business and to determine underwriting policies based on the insurance bureau score and other information.

4) Insurers to track and analyze the results associated with the use of the Fair, Isaac insurance bureau scores to monitor score distribution trends, measure the performance of the scores on their book of business, and refine their strategies.
Fair, Isaac does NOT:

1) Suggest penalizing applicants who do not have a credit history or for whom an insurance bureau score cannot be calculated.
2) Provide guidance regarding the specific business decisions and processes of insurance companies. Each insurance company determines how they will use insurance bureau scores and the specific score cutoffs to be used in their underwriting processes, based on their particular appetite for risk and the regulations of the states in which they do business.

Summary

In closing, the primary reasons for the use Fair, Isaac insurance bureau scores to be a valuable tool for the insurance industry are as follows:

- **Legal.** Fair, Isaac insurance bureau scores are built based on credit information, the use of which is a permissible purpose as defined in the Fair Credit Report Act.
- **Proven.** Fair, Isaac insurance bureau scores are empirically derived, statistically sound scoring systems that demonstrate a strong relationship between credit data and insurance loss relativity.
- **Fair.** Only credit-related information is used to calculate insurance bureau scores. Fair, Isaac insurance bureau scores do not use as a characteristic any prohibited basis of comparison such as age, gender, familial status, religion, nationality, race, or handicap. The scores are carefully developed to balance all of the predictive characteristics, both positive and negative, from the credit report.
- **Consistent.** Because Fair, Isaac insurance bureau scores are usually applied in an automated environment and in combination with the insurer’s rules and other criteria, all applicants are treated according to a consistently applied standard.
- **Accurate.** By using insurance bureau scores, underwriters have the opportunity to identify and write risks that in the past they may have declined because of incomplete knowledge or information. For example, a good credit history can offset negative underwriting factors, such as a poor driving record, and thereby enable someone to get insurance who might otherwise be denied or charged more.
- **Efficient.** Fair, Isaac insurance bureau scores allow insurers to use their underwriting resources more effectively and thus lower operational costs. The scores help insurers more quickly evaluate the lowest and highest risk applicants. More time and resources can then be used for evaluating applicants scoring in the “gray area.”
- **Cost effective.** The use of insurance scores keeps the insurance marketplace competitive, resulting in lower prices, better service, and more choice for consumers.

Fair, Isaac stands by to answer any questions on the above on the use of credit information and scoring for auto and homeowner insurance underwriting.

Eddy Lo
Insurance Manager
Attachments
The following illustrations are based on correlations of single credit characteristics with losses that have already been experienced.

**Personal Property Insurance**

For personal property insurance—using a dataset of approximately 230,000 policies with claims, 1 million policies without claims and corresponding credit information on those policyholders taken from 11 archives of credit history from consumer credit bureaus—the relationship of five credit characteristics and loss ratio relativities are summarized as follows:

Of this population, 96% did not have any adverse public records. For the remaining 4% having one or more adverse public records, loss ratio was 54% higher than for those without any adverse public records.
Figure 2. Months since most recent adverse public record vs. loss ratio relativities

![Univariate Analysis](image)

Furthermore, of the 4% having one or more adverse public records, those having the most recent adverse public records (less than 48 months) were found to have 68% higher loss ratio than those without any adverse public records. Those having less recent adverse public records (more than 48 months) were found to have a 23% higher loss ratio than for those without any adverse public records.

Figure 3. Number of trade lines 60+ days delinquent in last 24 months vs. loss ratio relativities

![Univariate Analysis](image)

Of this population, 89% did not have any trade lines that were more than 60 days delinquent in the last two years. For people with one such delinquency, loss ratio was 29% higher than those without. For those with two or more such delinquencies, loss ratio was 80% higher than for those without.
Of this population, 97% did not have collection accounts established. Among the remaining 3% who did have such accounts, loss ratio was 69% higher.

Of this population, 60% did not open any trade lines in the last year. People who opened one trade line in the last year had a loss ratio 15% higher on average than people who did not; two trade lines in the last two years, 22% higher; three trade lines, 50% higher; four or more trade lines, 66% higher.
**Personal Auto Insurance**

For personal auto—using a dataset of 350,000 policies with claims, 1 million policies without claims and corresponding credit information on those policyholders taken from six archives of credit history from consumer credit bureaus—the relationship of five credit characteristics to loss ratio relativities are summarized as follows:

- Figure 6. Number of adverse public records vs. loss ratio relativities

![Univariate Analysis](image)

Of this population, 97% did not have any adverse public records. For the remaining 3% that had one or more adverse public records, loss ratio was found to be 23% higher than for those without any adverse public records.
Again, 97% of the population did not have any adverse public records. Of the remaining 3%, those having the most recent adverse public records (less than 18 months) were found to have 34% higher loss ratio than those without any adverse public records. Those having less recent adverse public records (more than 18 months) were found to have 18% higher loss ratio than for those without any adverse public records.

Of this population, 86% did not have any trade lines in delinquency for more than 60 days in the last two years. For people with one such delinquency, loss ratio was 24% higher than those without such delinquency. For those with two or more such delinquencies, loss ratio was 44% higher than for those without.
Of this population, 96% did not have collection accounts established. For the remaining 4% that had collections accounts set up, loss ratio was 49% higher.

Of this population, 82% opened just one or zero trade lines in the last year. People who opened two or three trade lines in the last year had a loss ratio 8% higher than people in the first group; four or more trade lines opened in the last year, 27% higher.
Attachment B
Scorecard Examples
Rank Ordering

© Fair, Isaac and Co., Inc.
The National Association of Independent Insurers (NAII) is a property/casualty insurance trade association with more than 690 member insurance companies. NAII member companies are responsible for 34% of all property/casualty premiums, and 44% of the personal lines premium volume written in the United States.

This statement addresses the following issues:

- The legal authority for personal lines insurers’ use of credit information
- The development and nature of credit-based insurance scores
- How the use of insurance scores achieves the fundamental goals of insurance underwriting and rating.
- Answers to concerns about insurers’ use of credit information
Legal Authority for Personal Lines Insurers’ Use of Credit Information

The use of credit information by personal lines insurers is nothing new. For more than thirty years, federal law has authorized personal lines insurers to use credit information for underwriting and rating.

Fair Credit Reporting Act

The federal Fair Credit Reporting Act (FCRA) was enacted in 1970. The Act regulates the use of credit information about consumers. The FCRA specifies that consumer reporting agencies (also called “credit bureaus”) may only provide consumer credit reports without written authorization for certain permissible purposes. One of the FCRA’s express permissible purposes for providing a credit report is “in connection with the underwriting of insurance involving the consumer.” The FCRA defines “consumer report” to include a report to establish a consumer’s eligibility for “insurance to be used primarily for personal, family, or household purposes.”

The use of credit information for personal lines insurance underwriting takes in a range of activities. For the purposes of the FCRA, “underwriting” includes the decision whether or not to issue a policy, the decision whether or not to renew or cancel a policy, the amount and terms of coverage, the duration of the policy, and the rates to be charged. A personal lines insurer may use credit information for all of these activities.

The FCRA imposes responsibilities on an insurer that receives credit information from a consumer reporting agency. The insurer must certify that it is obtaining the credit information for a permissible purpose. In addition, whenever insurance is denied or the charge for insurance is increased because of information contained in a credit report, the insurer must notify the consumer and must supply the consumer with the name, address and toll-free telephone number of the consumer reporting agency that provided the credit report. The consumer must also be advised by the insurer that the consumer has a right to a free copy of the credit report and may dispute the accuracy or completeness of any information in the report.

State Laws

To some extent, the FCRA preempts state laws relating to the collection, distribution and use of credit information about consumers. The Act’s preemption of state laws has two aspects. First, a state law is preempted if it is inconsistent with the FCRA. Second, the FCRA lists a number of subjects on which states are preempted from imposing any requirement or prohibition. The list includes prescreening activities. “Prescreening” is the process whereby a consumer reporting agency compiles a list of consumers who meet specific criteria and provides the list to an insurer for the insurer’s use in making firm offers of insurance to consumers on the list. The preemption of state laws relating to prescreening remains in place until January 1, 2004.

© 2002 National Association of Insurance Commissioners 100
Credit-Based Insurance Scores

Development of Insurance Scores

Although credit information was authorized for underwriting and rating personal lines insurance, credit reports were not widely used by personal lines insurers until the past few years. The major reason for the limited use of credit information was that many individual underwriters do not have the expertise to subjectively evaluate credit history as it relates to loss potential. The evaluation of the relationship between credit information and the likelihood of insured losses requires a high degree of analytical skill. Insurance underwriters often do not have this skill level.

During the past decade, Fair, Isaac and some insurance companies have developed systems which analyze how certain credit characteristics relate to loss ratios for automobile and homeowners insurance. Credit-based insurance scores are products of these systems.

The insurance scoring systems are based on analyses of the credit reports and loss ratios of millions of automobile and homeowners insurance policyholders. The analyses have produced mathematical models that weigh various credit characteristics based on how each characteristic relates to loss ratios. The models are used to generate credit-based insurance scores. Insurance companies use the insurance scores to help them make decisions, including whether to write a policy, whether to renew a policy, and what premium to charge for a policy.

The availability of insurance scores has given insurance companies the ability to use objective, highly skilled analyses of credit information in their underwriting and rating processes. The biases and limited expertise that individual underwriters brought to the examination of credit reports are eliminated by insurers’ use of insurance scores.

Insurance Scores vs. Credit Scores

Insurance scores are different than credit scores. Financial institutions and other businesses use credit scores to evaluate the likelihood that a person will repay a loan or make payments on a credit purchase. Personal lines insurance companies use insurance scores to evaluate the likelihood that a person will have an insured loss.

Credit scores and insurance scores may consider some of the same items in credit reports, but they do not consider exactly the same items. For example, credit scores typically consider a consumer’s income; insurance scores do not consider income. And when the same item of credit information is considered by both a credit score and an insurance score, the credit score and the insurance score will give the item different weights. Credit characteristics are weighted differently because the purposes of the credit score and the insurance score are completely different.

The distinction between a credit score and an insurance score explains the situation where a person is able to find homeowners insurance coverage but is unable to qualify for a home loan because of his or her credit score and also the rare situation where a person qualifies for a home loan but his or her application for homeowners insurance is denied by an insurance company because of the person’s insurance score. The credit score measures the likelihood that the person will make his or her home loan
payments. The insurance score measures the likelihood of future insurance losses based on an analysis of the person’s past financial behavior.

Underwriting and Rating Goals

Credit-based insurance scores are not a departure from the fundamental goals of insurance underwriting and rating. Personal lines insurance companies use insurance scores to better achieve the goals of objectivity, completeness, equity, efficiency, and insurance availability.

Objectivity

Leaving the evaluation of credit report information to the judgment of individual underwriters can potentially produce inconsistent and unfair results. Insurance scores are based on objective, unbiased analyses of credit information. Insurance scores eliminate individual biases from underwriting and rating. Credit-based insurance scores have nothing to do with “gut feeling” and insurance scores have no “good days” and “bad days.”

The objectivity that insurance scores add to the underwriting process does not mean that computers make underwriting decisions. An insurance score is simply a tool which underwriters use to help them make decisions which are consistent with the insurance company’s underwriting standards.

Completeness

Insurance scores supplement other underwriting and rating information. They help to give a more complete picture of a risk of loss.

Some information which insurers use to make underwriting and rating decisions has limitations. Insurance application information is subject to concealment, misrepresentation and negligence. Actuarial studies have found that as many as 75% of all claims in the Comprehensive Loss Underwriting Exchange (CLUE) Auto and Property reports are not disclosed on insurance applications.28 It is estimated that incorrect information results in an overall 10% premium inadequacy.29 Third-party data sources provide insurers with important information but they have some shortcomings. An Insurance Research Council study found that only 40% of the accidents which should have been in Motor Vehicle Records were actually there.30 Even insurance claims records do not capture the complete picture of a person’s accident experience. Some accidents are not entered into the CLUE system because no insurance coverage was involved. And not all insurance companies participate in the CLUE database.

Insurance applications, MVRs, and CLUE reports remain critical elements in insurance underwriting and rating. But that does not mean that these sources of information are complete. Insurance scores help insurers gain a more complete understanding of the risk of loss.

Equity

Insurers have a responsibility to continually refine their risk classifications and their rating procedures so that premiums reflect loss potential. In fact, competitive market pressures compel insurers to make sure that they use rates which are commensurate with the likelihood of loss. When rates do not reflect loss costs, some consumers must pay higher premiums to subsidize higher risk individuals.

There is an established relationship between credit-based insurance scores and loss ratio relativities. The reality is that aspects of a person’s credit history correlate to the likelihood that the person will have an insured loss covered by his or her automobile or homeowners insurance policy. If insurers are forced to ignore this reality, the result will be pricing inequity. Many consumers will have to pay more than they should be paying because insurers are prevented from considering the consumers’ true risk of loss.

Efficiency

Insurance scores make underwriting and rating more efficient. The availability of credit-based insurance scores streamlines the underwriting process and reduces costs. Ready access to credit-based insurance scores allows a company to decide that it will not order motor vehicle records or claim reports on new business applications above a certain insurance score, thereby saving underwriting costs. Or, an insurer may determine that it needs to focus more careful underwriting review and collect additional information on applicants who fall below a certain score.

By using insurance scores, insurers are able to make underwriting and pricing decisions quickly. This gives consumers immediate information for comparison shopping.

The efficiency and cost-saving which insurance scores provide allow insurers to hold down administrative expenses. Lower expenses result in lower premiums for consumers.

Availability

We recently surveyed a sample of NAII personal lines insurers on their use of credit information. A cross-section of members, ranging from large to small-sized insurers, participated in this survey. Those companies responding included AAA of Missouri, Allstate, American Family Mutual, Badger Mutual, Farmers Mutual Insurance Company of Nebraska, GuideOne Insurance Company, National General Insurance Company, Progressive, and USAA.

Survey results indicate that there are companies that currently use credit information to accept applicants, who probably would otherwise not be accepted, for personal auto or homeowners insurance coverage. Moreover, insurance companies are now renewing policies that probably would not be renewed, were it not for the use of credit information. Certain insurers have even stated that, as a result of using credit information, they are now more likely to write some cars and homes more aggressively, including cars and homes in urban areas.

Many policyholders are paying lower premiums because their insurers consider credit information. Some respondents to our survey said that more than half of their policyholders are in this category. Their estimated percentages of policyholders paying lower premiums as a result of their good credit histories range from 50% to 98% of total auto or homeowners policyholders. If credit information
could no longer be used, then this majority of policyholders – in some cases, an overwhelming majority – would have to pay higher premiums.

The insurers responding to our survey are only a sampling of companies. We are confident that there are other NAII members and certainly other insurers outside of the NAII membership that have found credit information as a way to make insurance coverage more available at lower premiums to more consumers. Clearly, policyholders have benefited from companies’ use of credit information, whether it be obtaining insurance, keeping insurance, or paying lower premiums for insurance.

There have been a lot of anecdotes and several theories offered about how the use of credit information may affect insurance markets. Insurance companies are not involved in anecdotes or theories. They are real businesses that are providing protection to millions of drivers and homeowners across the nation, in part at least, because the insurers have credit information as an available tool for underwriting and rating.

Too often the debate over insurers’ use of credit information has focused on the notion that insurance companies use insurance scores to reject people. But insurance companies are not in the business of not writing business. Insurance companies are in the business of writing policies covering cars and homes. Credit information gives insurers a tool to underwrite and fairly price personal lines coverages.

In insurance markets today, drivers with less than perfect driving records and homeowners whose houses may fall short of so-called “traditional” underwriting factors are being accepted and renewed by insurance companies because they have good credit histories.

Most people have good credit histories. The use of insurance scores by personal lines insurance companies gives people with favorable insurance scores a better chance to find insurance, and often find it at prices that save them money. On the other hand, restricting the use of credit information presents a real danger that consumers who are able to find fairly priced insurance protection today will not be able to find that insurance tomorrow.

Concerns about Insurers’ Use of Credit Information

Some concerns have been raised about insurers’ use of insurance scores. These concerns include the following:

1. There is no proven correlation between credit-based insurance scores and the risk of loss.

2. There is no proof that a person’s credit history causes insured losses.

3. Insurance scores discriminate against some consumers, especially low-income consumers and minorities.

4. Insurance scores simply overlap with variables already taken into account in an insurer’s underwriting and/or rating process.
5. Insurance scores are based on inaccurate credit data.

Correlation

The Casualty Actuarial Society awarded its 2000 Ratemaking Prize to James E. Monaghan for his paper, “The Impact of Personal Credit History on Loss Performance in Personal Lines.” Mr. Monaghan compiled a database of 170,000 automobile insurance policies. He then examined the credit history of the named insured in each of the policies in order to determine whether the insured’s credit characteristics correlated with the insured’s loss ratio relativity. Monaghan’s paper details how variations in each of the following credit characteristics correlates to variations in loss ratio relativity:

- amounts past due at least thirty days
- bankruptcies, tax liens, civil judgments and foreclosures
- collection records transferred to a collection agency
- status of trade lines (trade lines include credit cards, installment loans, student loans, etc.)
- age of oldest trade line
- non-promotional credit inquiries
- leverage ratio on revolving-type accounts
- revolving account limits

Monaghan’s conclusion is that each of these credit characteristics showed a “systematic predictive power” on loss ratio relativities.

Mr. Monaghan performed a similar analysis on a homeowners insurance database containing $120 million in earned premiums. His paper states the following conclusion:

“There were striking similarities between the auto and home databases with regard to credit impact on loss experience. The most significant difference seemed to be that derogatory information on a credit report for a homeowners policy had a more severe impact on loss performance. **** The similarities between the loss ratio relativities for [the homeowners and auto] profiles lends credence to the assertion that the impact of bill paying history on insured losses transcends line of business, and is not a characteristic attributable only to property policies and claims associated with them.”31

Mr. Monaghan’s finding of a correlation between particular credit characteristics and loss ratios is the concept on which insurance scores are based. An insurance score combines the

---

predictive power of a number of particular credit characteristics to produce an evaluation of risk of loss that is more accurate and fairer than the predictive power of any one credit characteristic. The correlation between insurance scores and loss ratios has been confirmed.

In 1996, at the request of the NAIC, Fair, Isaac retained Tillinghast-Towers Perrin to perform a regression analysis of Fair, Isaac’s insurance bureau scores and loss ratio relativities. The analysis considered data from nine companies (three auto carriers, five homeowners carriers and one personal property insurer). Tillinghast-Towers Perrin concluded:

“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.

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.”32

In December 1999, the Virginia Bureau of Insurance issued a report to the Virginia General Assembly on insurers’ use of credit information. The Bureau examined the development and application of Fair, Isaac’s scoring system and reached the following conclusion:

“Based on the Bureau’s findings, there appears to be concrete data indicating that a correlation exists between credit scores and losses. From this purely statistical perspective, therefore, the Bureau is unable to make a recommendation prohibiting the use of credit scores in the underwriting process.”33

The Casualty Actuarial Society paper, Tillinghast, and the Virginia Bureau of Insurance confirm the correlation between credit information and loss ratios. But perhaps the most convincing evidence of the correlation is the real world experience of insurance companies. Personal lines insurers used credit information in the past, and they are continuing to use credit information to underwrite and rate. Insurance companies are rational, economic entities. It would make no sense for companies to base their underwriting and rating decisions and their economic futures on information which fails to predict the likelihood of loss. The owners of an insurance company would not stand for the company’s continued use of information which does not correlate to loss ratios.

Causation

Some have argued that insurers’ use of credit information should be prohibited because no cause-and-effect relationship can be established between credit history and insured loss. This

33 Use of Credit Reports in Underwriting (Virginia Bureau of Insurance, 1999), p. 19.
demand for proof of causation is curious. Causality is not a precondition for any other risk classification. For example, driving record is a well-established risk classification for automobile insurance, but insurers are not required to prove that past driving accidents cause future accidents. Many states allow auto insurers to use marital status and good student status as risk classifications, but there is no expectation that marital status or poor grades cause accidents.

In his paper, James Monaghan mentions Section 5.2 of Actuarial Standards of Practice #12 which states the following:

“That causality cannot be made a requirement for risk classification systems.

Often, the term, ‘causality’ is not used in a rigorous sense of cause and effect, but in a general sense, implying the existence of a plausible relationship between the characteristics of a class and the hazard for which financial security is provided. For example, living in a river valley would not by itself cause a flood insurance claim, but it does bear a reasonable relationship to the hazard insured against, and thus would be a reasonable basis for classification.

Risk classification characteristics should be neither obscure nor irrelevant to the protection provided, but they need not exhibit a cause-and-effect relationship.” (emphasis added)

Therefore, according to established actuarial principles, causality cannot be made a requirement for a risk classification, but any risk characteristic “should be neither obscure nor irrelevant” to the likelihood of loss. There must be some reason why a characteristic relates to the likelihood of loss.

The link between credit history and loss potential has been studied by scholars independent of the insurance industry, in fields such as psychology, safety engineering, occupational medicine, consumer research, and risk perception. The studies offer two common sense theories on why

---

credit history relates to loss potential. First, stress related to credit problems may lead to negligent behavior which could evidence itself in driving and home maintenance. Second, financial irresponsibility may indicate a risk-taking personality. A person who is willing to take on the risks of high credit card debts is likely to be the same type of person who is willing to try to beat a red light or leave a needed repair go until next year.

Insurers use credit information because of its predictive power, not because of the reasons that explain its predictive power. One can agree or disagree with the reasons why credit information works, but the fact of its predictive value is clear. Nevertheless, it is significant that support for the link between credit information and loss potential exists in the academic literature and is intuitively satisfying.

Unfair Discrimination

The charge that insurance scores discriminate against low-income consumers and minorities is easy to make, but it is a charge that is not backed up by any facts.

The fact is that insurance scores only consider a person’s credit experience. Insurance scores do not consider any of the following information:

- Income
- Address
- Race
- Ethnic group
- Religion
- Gender
- Familial Status
- Handicap
- Nationality
- Age
- Marital Status

The 1997 NAIC white paper on the use of credit information considered charges that insurers’ use of credit histories has a disproportionate impact on protected classes. The paper could find no studies supporting the charge. The white paper states:

“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.”

The Virginia Bureau of Insurance’s report, mentioned above, analyzed whether the Fair, Isaac insurance scores result in discrimination based on income or race. The Bureau could find no support for charges of unfair discrimination. The Bureau’s report states:


“Thus, average credit scores, medium household incomes, and ratio make-up by zip code were analyzed to obtain a general indication of correlation. Nothing in this analysis leads the Bureau to the conclusion that income or race alone is a reliable predictor of credit scores thus making the use of credit scoring an ineffective tool for redlining.”

During the Market Conduct and Consumer Affairs (EX3) Subcommittee’s December 6, 1998 hearing on credit reports, Progressive Insurance Company and the American Insurance Association (AIA) presented testimony on the issue of unfair discrimination. Progressive reviewed insurance scores across different areas of population density. The data offered to the Subcommittee showed that insurance scores in densely populated areas were about the same as scores in sparsely populated areas. Thus, consumers living in urban areas have about the same distribution of insurance scores as consumers living in suburban and rural areas. The AIA study used census data to determine whether there was a correlation between insurance scores and income. The study showed that consumers with incomes below $30,000 and between $30,000 and $50,000 had insurance scores equivalent to consumers with incomes greater than $50,000. Thus, the AIA study showed no significant relationship between a person’s insurance score and his or her income.

**Overlapping Variables**

Critics of insurers’ use of credit information have argued that insurance scores simply duplicate other variables already being used by insurers and thus insurance scores have no independent predictive value. It is argued that the overlap of insurance scores with other variables results in unfairness to consumers.

In its 2001 study on insurance scoring, Conning & Company used the data in James Monaghan’s Casualty Actuarial Society paper to analyze the relationship between insurance scores and other automobile insurance rating variables. Conning found that insurance scores did not overlap with other variables. The study states:

“Conning concludes that, based on its careful review of the CAS study, the application of credit data to personal automobile insurance underwriting enables much better loss ratio predictions. When credit data were appended to traditional rating variables (i.e., driver age), there were significant differences in loss ratio performance – suggesting that credit data are not likely to overlap other rating variables significantly. Insurers conducting their own analysis of credit characteristics and loss ratio performance must examine their data carefully to determine if multicollinearity or spurious correlation is present.”

*emphasis added*

**Accuracy of Credit Data**

Thousands of businesses which have nothing to do with insurance use credit information every day. There are a few cries that these businesses should be prohibited from using credit data because the data is inaccurate. However, critics of insurance scores charge that insurers,

---

36 Virginia Bureau of Insurance, p. 16.
37 Insurance Scoring in Personal Automobile Insurance (Conning & Company, 2001, pp. 70-71.)
whose use of credit information is much more limited than many other businesses, should be barred from using credit data because the data is erroneous.

The accuracy of credit data stands up to scrutiny. Certainly credit data is at least as accurate as MVRs and claims reports which were discussed above. The 1996 amendments to the FCRA imposed additional requirements on consumer reporting agencies and credit reporters to assure the accuracy of credit information.\(^{38}\) The amendments also created strict time frames for investigating and correcting information which is disputed by consumers.\(^{39}\)

Research shows that the error rate in credit reports is low. Trans Union reviewed the experiences of 400,000 consumers whose insurance coverage was affected by the use of credit information. The company discovered that only 0.2% of the insurance consumers disputed the information in their credit reports. Furthermore, only 0.07% of these consumers required corrections to their credit reports.

**Conclusion**

During the deliberations on the NAIC white paper, several regulators cautioned against restricting insurers’ use of credit information. The white paper observes:

“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.\(^{40}\) (emphasis added)

The wisdom of these regulators should be heeded. The use of insurance scores for underwriting and rating has helped to make insurance coverage more available for millions of drivers and homeowners. Restrictions on the use of insurance scores should be approached with great caution.

Respectfully submitted by:

Samuel Sorich  
Vice President

---

\(^{40}\) National Association of Insurance Commissioners, p.4.
NAMIC TESTIMONY


Good afternoon, Chairman Ario, and members of the NAIC Market Conduct and Consumer Affairs (D) Committee. My name is David Reddick. I am the Market Regulation Manager for the National Association of Mutual Insurance Companies. NAMIC is a national trade association representing a diverse membership of more than 1,300 companies that collectively write about 40 percent of the property/casualty premium written in the United States.

NAMIC appreciates the opportunity to appear before this public hearing today to comment briefly on the insurance scoring issue. You should know that NAMIC wholeheartedly endorses using consumer credit histories to help insurance companies make underwriting and rating decisions about the personal auto and homeowners policies that they write in your states.

In the time allotted to me today, I want to focus on an aspect of insurance scoring that often troubles state insurance regulators. Regulators wonder -- as some have done here today -- whether the use of insurance scores differentiate between people based on income and whether this differentiation is a method for insurers to indirectly discriminate based on gender, race, nationality or religion.

This is an appropriate public policy question for state insurance regulators to ask, along with a second question of whether consumers are adequately informed about insurance scores.

Perhaps the best way to respond is to describe the credit report study that the Virginia Bureau of Insurance issued in 1999. Its genesis was a debate before the Virginia Senate Commerce and Labor Committee on Senate Bill 1321. The bill would have prohibited insurers from declining to issue or refusing to renew auto and homeowners policies based solely on credit information. Several agent groups complained that using insurance scores was a form of redlining.

Before considering any action on the bill, the Committee asked the Insurance Bureau to prepare a report on insurance scoring. The Bureau first met with representatives of Fair Isaac, who reviewed the factors that they use in their scoring model. Fair Isaac agreed to supply the Bureau with a minimum of 100 credit scores in each of 956 zip codes in Virginia. The Bureau next matched the average credit scores (701) in the zip codes to the most recent federal Census data. The Bureau then performed a regression analysis to measure the statistical significance of a set of dependent variables – credit scores – to separate, independent variables – income and race – to determine if there was any correlation.

What did the Bureau find? Let me read you their conclusion:

The Bureau analyzed the relationship between credit scores and income as well as the relationship between credit scores and race…Nothing in this analysis leads the Bureau to the conclusion that income or race alone is a reliable predictor of credit scores thus making the use of credit scoring an ineffective tool for redlining.
In other words, the Virginia Insurance Bureau determined that there was nothing in its analysis to suggest that insurance scores are unfairly discriminatory to consumers. The flip side is equally important. Credit scores have not been shown to be a reliable predictor of race and income.

Another study worth mentioning is one conducted by the American Insurance Association (AIA) in 1999. It analyzed income groups ranging from less than $15,000 to more than $125,000 annually. The AIA concluded that credit scores did not significantly correlate with income. In fact, the lowest income group had a better score than the higher income groups. Perhaps my fellow panelist, Mr. Snyder, may care to elaborate on the AIA findings during the Q & A period.

What these studies conclusively show and what you, as state insurance regulators, should keep in mind as you contemplate your next steps on this issue is that insurance scores do not unfairly discriminate on the basis of income or race.

Let me now comment briefly on the second public policy question. Are consumers adequately informed about their insurance scores? Probably not to everyone’s satisfaction, but let’s look at the Virginia Insurance Bureau study recommendations.

In its conclusion, the Bureau said that the insurance industry should take steps to educate consumers about the use of credit scores in the underwriting process. This is a worthwhile suggestion and one that is followed to large degree today by insurers, who are subject to the federal Fair Credit Reporting Act and certain state-specific requirements.

A second Virginia recommendation called for monitoring consumer complaints to identify abuses in insurance scoring. It is interesting to note that the Virginia Insurance Bureau, in studying its own consumer complaint files, found that less than one per cent of them involved insurance scores. Monitoring insurance scoring complaints also was a recommendation in the 1997 NAIC white paper on credit scoring.

The final Virginia recommendation reads:

If the Bureau finds over time that a significantly greater number of companies are refusing to issue or refusing to renew coverage solely on the basis of an adverse credit history, the Bureau will consider proposing legislation to prohibit this practice.

I quoted this recommendation verbatim because I believe the Committee should not overlook the finding upon which this statement is based. Of the top 100 auto and homeowner writers in Virginia who were surveyed as part of the Insurance Bureau’s report, only two percent in each line of business reported that they would non-renew solely on the basis of an adverse credit report.

As this Committee considers its new charge to examine insurance scoring next year, I implore each of you to take the time to review the very objective and thorough report prepared by the Virginia Insurance Bureau, as well as the AIA study. You will find that the conclusions reached by the Virginia Insurance Bureau on the issues of unfair discrimination and consumer education are thoughtful and credible and should present an excellent starting point for your own discussions.

Thank you for your attention. I am happy to answer any questions that you may have.