ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE
March 6, 2002
3:20 p.m.

MEMBERS PRESENT

Representative Lisa Murkowski, Chair
Representative Andrew Halcro, Vice Chair
Representative Kevin Meyer
Representative Pete Kott
Representative Norman Rokeberg
Representative Harry Crawford
Representative Joe Hayes

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 418
"An Act amending the Alaska Corporations Code as it relates to delivery of annual reports, notice of shareholders' meetings, proxy statements, and other information to shareholders, and providing for electronic proxy voting."

- INFORMED THE COMMITTEE OF NEW INFORMATION
  [PREVIOUSLY MOVED CSHB 418(L&C) OUT OF COMMITTEE]

HOUSE BILL NO. 470
"An Act relating to common interest ownership; and providing for an effective date."

- MOVED CSHB 470(L&C) OUT OF COMMITTEE

HOUSE BILL NO. 395
"An Act prohibiting discrimination by credit rating or credit scoring in insurance rates; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 355
"An Act relating to the taxation of mobile telecommunications services by municipalities; and providing for an effective date."

- BILL HEARING CANCELED

HOUSE BILL NO. 182
"An Act relating to motor vehicles; and providing for an effective date."

- BILL HEARING POSTPONED

PREVIOUS ACTION

BILL: HB 470
SHORT TITLE:COMMON INTEREST OWNERSHIP
SPONSOR(S): REPRESENTATIVE(S)ROKEBERG

Jrn-Date	Jrn-Page		Action
02/19/02	2314	(H)	READ THE FIRST TIME - REFERRALS
02/19/02	2314	(H)	L&C
03/06/02		(H)	L&C AT 3:15 PM CAPITOL 17

BILL: HB 395
SHORT TITLE:INSURANCE DISCRIMINATION BY CREDIT RATING
SPONSOR(S): REPRESENTATIVE(S)CRAWFORD

Jrn-Date	Jrn-Page		Action
02/08/02	2183	(H)	READ THE FIRST TIME - REFERRALS
02/08/02	2183	(H)	L&C
02/08/02	2183	(H)	REFERRED TO LABOR & COMMERCE
03/06/02		(H)	L&C AT 3:15 PM CAPITOL 17

WITNESS REGISTER

JON FAULKNER, President
Land's End Acquisition Corporation
4786 Homer Spit Road
Homer, Alaska 99603
POSITION STATEMENT: Testified in support of HB 470.

BOB PETERSON
The Peterson Group Inc.
(No address provided)
Anchorage, Alaska
POSITION STATEMENT: Testified in support of HB 470.

CHARLES SPINELLI, President
Anchorage Home Builders Association;
and President
Spinelli Homes Inc.
9210 Vanguard Drive, Suite 102
Anchorage, Alaska 99507
POSITION STATEMENT: Testified in support of HB 470.

JESS HALL, Home Builder
PO Box 1987
Palmer, Alaska 99645
POSITION STATEMENT: Testified on HB 470.

ROBIN WARD, Legislative Co-chair
Alaska State Home Builders Association
6633 Brayton Drive
Anchorage, Alaska 99507
POSITION STATEMENT: Testified on HB 470.

DAVE D'AMATO, Staff
to Representative Crawford
Alaska State Legislature
Capitol Building, Room 426
Juneau, Alaska 99801
POSITION STATEMENT: Testified on behalf of the sponsor.

MARIE DARLIN
AARP
(No address provided)
Juneau, Alaska
POSITION STATEMENT: Testified in support of HB 395.

JOHN GEORGE
National Association of Independent Insurers
3328 Fritz Cove Road
Juneau, Alaska
POSITION STATEMENT: Provided information with regard to credit scoring and the impacts of HB 395.

BOB LOHR, Director
Division of Insurance
Department of Community & Economic Development
3601 C Street, Suite 1324
Anchorage, Alaska 99503-5948
POSITION STATEMENT: Testified in support of the concept behind HB 395.

SARAH McNAIR-GROVE, Actuary P/C
Division of Insurance
Department of Community & Economic Development
PO Box 110805
Juneau, Alaska 99811-0805
POSITION STATEMENT: Provided information with regard to the filings including credit scoring that the division has received.

MICHAEL LESSMEIER, Lobbyist
State Farm Insurance Company
Lessmeier & Winters
3000 Vintage Boulevard, Number 100
Juneau, Alaska 99801
POSITION STATEMENT: Testified that State Farm isn't using [credit scoring] to set rates in Alaska, and furthermore he didn't believe that the way State Farm is using [credit scoring] could be criticized.

ACTION NARRATIVE

TAPE 02-31, SIDE A
Number 001

CHAIR LISA MURKOWSKI called the House Labor and Commerce Standing Committee meeting to order at 3:20 p.m. Representatives Murkowski, Halcro, Meyer, Rokeberg, and Crawford were present at the call to order. Representatives Kott and Hayes arrived as the meeting was in progress.

HB 418-ELECTRONIC PROXY VOTING & NOTIFICATION

Number 023

CHAIR MURKOWSKI briefly brought attention to HOUSE BILL NO. 418, "An Act amending the Alaska Corporations Code as it relates to delivery of annual reports, notice of shareholders' meetings, proxy statements, and other information to shareholders, and providing for electronic proxy voting."

CHAIR MURKOWSKI informed the committee that she received an e-mail from Terry Elder in regards to HB 418. A question had been asked in committee as to what happens when shareholder dividends are not claimed. She said she has learned that once the property is presumed to have been abandoned and was unclaimed by the owner for more than seven years after becoming payable, provided that there have been at least seven dividend distributions or other payments made during the period, the

corporation is required to report it to the Department of Revenue. At that point the Department of Revenue assumes custody and control of the property and the cash is deposited into the general fund. She added that the person to whom the payment was initially made can make a claim against the Department of Revenue for the property after the fact, but it is a seven-year time period.

HB 470-COMMON INTEREST OWNERSHIP

Number 040

CHAIR MURKOWSKI announced that the committee would now hear HOUSE BILL NO. 470, "An Act relating to common interest ownership; and providing for an effective date."

REPRESENTATIVE ROKEBERG, sponsor, introduced HB 470 to the committee. He asked if the committee would consider adopting the proposed committee substitute (CS), Version F.

Number 053

REPRESENTATIVE HALCRO moved to adopt the CS for HB 470, version 22-LS1522\F, Kurtz, 2/25/02, as the working document. There being no objection, Version F was before the committee.

REPRESENTATIVE ROKEBERG offered that [HB 470] is a small technical change to the state statute [AS 34.08.580]. He said this particular provision of the Uniform Common Interest Ownership Act (UCIOA) is the controlling statutory title under which all condominium, cooperative, and public PUD (planned unit development) type of developments are controlled and regulated by the State of Alaska. He mentioned that this issue was brought to his attention by Mr. Jonathan Faulkner of Homer, Alaska, who is having difficulty with a new development at Land's End [Resort]. He mentioned that [HB 470] is consistent with work he has done with the Alaska Home Builders Association in trying to revise the UCIOA. He stated that provisions [in HB 470] address what's called the public offering statement (POS), which is the "technical fix".

Number 088

REPRESENTATIVE ROKEBERG said that the reason for introducing HB 470 is because the current law provides that a purchaser, prior to the conveyance of title, may cancel a purchase agreement within 15 days of receipt of a POS. He explained that a POS has

to be provided before closure can be made on a sale of a condominium, which becomes a problem, particularly in the presale of high-end condominiums. Under current statute, a POS, which includes the final legal as-built survey and legal description, cannot be provided until such time as the project is completed.

Number 111

REPRESENTATIVE ROKEBERG explained that in order to overcome that provision in the statute HB 470 simply [requires] that a preliminary version of the POS be provided such that it reasonably reflects the contents of the final POS. He mentioned that the CS added, in Section 2, page 3, line 29, the words "up to".

REPRESENTATIVE ROKEBERG said:

> What, in essence, we've done is set up a scenario in state statute where somebody could commit to buying an expensive condominium, wait for the presentation of the [POS] and then decline to buy it and reap profits from his denial of fulfilling his contract. That's not a good way to have the statute written. Hopefully that's not happened, but we need to correct it before it does.

REPRESENTATIVE ROKEBERG pointed out that many times it's very difficult to get construction financing if this statute is "over the head of the developer." He mentioned that there are people online who can testify to the practical impacts of this.

Number 141

CHAIR MURKOWSKI said that the only question that she has is regarding the wording "reasonably reflects", and asked if this language is [tantamount to] "substantially similar". How close does "reasonably reflect" have to be to the actual public offering [statement], she asked.

REPRESENTATIVE ROKEBERG said that he would have to defer to the drafter, but he would assume that "the reasonable standard would be accepted as the reasonable standard of basic common law." He [assumed] that the common practice would be that the basic POS would be provided except for those things that couldn't be included until the final as-built survey and other procedures

were completed. Because there are a number of units in a condominium project, there's a certain amount of continuity.

Number 164

JON FAULKNER, President, Land's End Acquisition Corporation, testified via teleconference. He said that he sent an e-mail to the committee members yesterday, and noticed today that at least two of the messages did not go through. He said that he would like to read the short letter.

CHAIR MURKOWSKI informed Mr. Faulkner that each committee member's packet includes a copy of his letter. She asked if he was referring to the letter dated February 26.

MR. FAULKNER clarified that it wasn't the same letter. He noted his agreement with Representative Rokeberg in that HB 470 is not a change in law but rather a clarification of an existing law that is vague. The law is vague because it leaves in doubt whether a POS can meet all the legal requirements if it is delivered in good faith prior to actual construction of the unit. He explained that HB 470 clarifies that a POS that reasonably reflects the data contained in the final recorded declaration, [when] delivered prior to construction, meets the intent of the law. Delivery Of a POS to a buyer prior to construction is standard practice. He highlighted that the 15-day right of rescission starts as soon as the POS is delivered and the deposit becomes non-refundable after the 15-day period. This is the negotiated protection that a developer needs in order to proceed with a large custom condominium project. He explained that under the existing law, a buyer could make a legal claim that the preliminary POS that he/she received prior to construction wasn't precisely accurate. Therefore, the contract would be voided because it didn't contain the precise square footages and the common interest allocations that are determined by an as-built survey.

Number 208

MR. FAULKNER mentioned that there has never been a claim brought before a court on this subject, and HB 470 would prevent that possibility in the future. The purpose of a POS and the 15-day right of rescission is to assure full disclosure to prevent pressure sales tactics that might result in a hasty decision from a buyer. This generally gives a buyer time to reflect on the cost and the risks of ownership. He offered that HB 470 does not compromise any of these purposes, but rather removes a

loophole which has the potential to cause huge losses to a developer. He said:

> Banks and financial institutions are aware of this loophole, as are contractors, and therefore when you go to sign a contract with the contractor or apply for financing to a bank, the question comes up, "What are you going to do if the buyer cancels your contract once you've already built the thing?" And you can't answer that, other than to say, "I've got $2 million in cash sitting in the bank," which not many developers do, and it's not a reasonable expectation.

Number 228

REPRESENTATIVE ROKEBERG asked Mr. Faulkner how difficult it is to obtain construction financing because of this loophole.

MR. FAULKNER said that it is more difficult to obtain construction financing with this loophole than without it. He said that banks do not look at the collateral of the contract to fund interim construction. Traditionally banks look at the net worth of the developer and the developer's track record. Although banks also look at the real estate, if the real estate isn't secured by an ironclad contract with performance guarantees, then a bank can't look to that. This results in the banks looking to the developer for the full net worth, exclusive of the project, to back the interim construction. He explained that the difficulty in obtaining financing is related to the strength of the developer. The effect is to limit interim construction financing for projects like [Land's End Resort] to the very large developers. Mr. Faulkner added that in Land's End's case obtaining financing hasn't been an "extreme" problem because of its significant assets in an ongoing enterprise. However, [the loophole] has definitely impacted its ability to obtain financing.

Number 255

BOB PETERSON, The Peterson Group Inc., testified via teleconference. He noted that he is a custom homebuilder and condominium developer in Anchorage. He said this area of statute has intimidated him because while he can provide a buyer with the preliminary POS, he can't record the plat and the consequent declarations to fulfill a fully amended POS until there is substantial completion of that building. He explained that "substantial completion" is defined as having the roof on

and all of the mechanicals in place. He said that at that point in a custom product there can be numerous changes unique to that particular buyer.

Number 273

MR. PETERSON said:

> Yet the way this was worded, until that point the buyer could take 15 days after you recorded the plat declarations and then cancel the contract, in which case the developer who's made all the changes in good faith, has a unique unit that may not be marketable.

MR. PETERSON mentioned that he has not run into this kind of problem with lower level units because those buyers barely afford them and they don't make many changes. Furthermore, the market time to resell a lower level unit is very small compared to a custom product. He pointed out that the developer doesn't normally record the plat until the unit is almost done because the statute states that the developer has to pay homeowners' association dues the month that the developer records the plat. Therefore, if a developer actually recorded a plat on a building that had the roof on and the mechanical in but there was four months to completion, the developer would be paying homeowners' association dues on each unit under construction, which makes it unaffordable to continue. "I support the changes that HB 470 is proposing, and I think that there's ... ethical and sound reasons to do that," he concluded.

Number 297

CHAIR MURKOWSKI asked Mr. Peterson if he views [HB 470] as a precaution to make sure that this problem doesn't arise in the future.

MR. PETERSON responded in the affirmative. He said that the current statute has never really made sense to him. Under the current statute, a developer who has agreed to build a custom unit for a buyer is stuck with that unit if the buyer decides, for any reason outside of the development, to move to Arizona and relieve himself/herself of the contract. He stated, "I believe that puts undue burden on the developer." He mentioned that although this hasn't happened to him yet, probability is not on his side.

Number 311

REPRESENTATIVE ROKEBERG asked Mr. Peterson if he thinks that his decisions regarding which projects to pursue are influenced by the way the law is currently written.

MR. PETERSON said, "Absolutely." He said that he built a high-end custom condominium project in Anchorage that was a financial disaster, but fortunately his lower-end units made up for that loss. He said, "Until some of these sorts of things get cleared up in statute, I am not interested in building a high-end unit that exposes me like that."

Number 323

CHARLES SPINELLI, President, Anchorage Home Builders Association; and President, Spinelli Homes Inc., testified in support of HB 470. He addressed the language in HB 470 that reads, "up to 10 percent" penalty. He said that he has been concerned with this language since the day he put out his first public offering statement in 1992 or 1993 "when this bill arrived on our doorstep." He said that at that time he was doing public offering statements in Eagle Crossing Subdivision or Park View Terrace Subdivision, and the monthly dues were somewhere around $15 or $20. He explained that the dues were basically just to cover some landscaping and common area insurance around the project. Mr. Spinelli said, "The homeowners were liable for ... about $160 a month in dues and if, by chance, I had forgotten to present them with the public offering statement, my penalty would have been 10 percent of the house price." He said that in those days the average sales price was probably $160,000, so his penalty would have been $16,000. He stated, "I think that's 100 years worth of dues because I forgot to give them a public offering statement."

MR. SPINELLI remarked that it is unfair to state that the developer will just pay the buyer 10 percent. He said that he isn't sure what procedure occurs to make that happen. Therefore, clarifying the language by adding the language "up to 10 percent" will make it "pretty clear that it's going to have to be judged on the merits of the case and that way everybody's treated fairly."

Number 357

REPRESENTATIVE ROKEBERG mentioned that it seems that the courts would have to assess the 10 percent because clearly there would be a dispute over a breach of contract. He said that according

to the statute the judge would have no choice but to award the 10 percent whether it was fair or not. He asked Mr. Spinelli if this is his interpretation.

MR. SPINELLI replied, "Yes."

REPRESENTATIVE ROKEBERG surmised, "So the reason for the 'up to' gives the judge the discretion to make an award based on the merits of the argument and the evidence presented in the courtroom."

MR. SPINELLI agreed and said, "Sort of like the penalty should fit the crime." Mr. Spinelli related that this is his second time as the president of the Home Builders Association, which provides him with information about what's current and what's going on. However, those people living in remote areas across the state [may be] are advised by attorneys who may not know the ins and outs of UCIOA.

Number 379

JESS HALL, Home Builder, said that he had the opportunity to learn about the Uniform Common Interest Ownership Act (UCIOA) about 6-8 months ago when he did a development for a subdivision in the [Matanuska-Susitna] Valley. He explained that he had an attorney draft up all the necessary documents because there was community property and he knew that he would have to set up a homeowners' association. However, after he was already in the project he found out that it actually fell under the UCIOA. After relating this to the attorney, the attorney said that he had never heard of [UCIOA] before. He talked to another attorney who also had no idea what UCIOA was either. "So that was a little concerning to me," he said.

MR. HALL said that he ended up with an attorney in Anchorage who specialized in this, who worked back through the process, and informed Mr. Hall about the 10 percent figure in statute. This was pretty interesting because he already had the first phase of the subdivision 100 percent complete and all of the people had already moved into the houses. He asked, "Would it be the lot that we sold since that's kind of the part that has the common ownership, or is the house you attach to the lot?" He noted his support of the addition of the language "up to 10 percent".

MR. HALL mentioned that if a developer makes a mistake it needs to be corrected. If it's going to go to a judge and jury, then they should probably decide where the mistake was. He pointed

out that all of the documents that he provided to the homeowners were basically exactly the same as the public offering statement, although there were a lot more documents. He said, "Some of the stuff that we would have had the homeowners' association do themselves as the owners of the common property should have actually been done on a piece of paper ahead of time instead of after."

Number 411

REPRESENTATIVE ROKEBERG asked Mr. Hall if he thinks medium or lower-end condominiums are affected by HB 470 and the UCIOA the same as high-end condominiums.

MR. HALL said that he hasn't built any condominiums since before UCIOA was enacted. He recalled that the last time he "did one was under the Horizontal Property Regime Act," which was more simple. He offered that he thinks that there is probably more concern for a developer of luxury condominiums than there would be for a developer of lower-end condominiums simply because the lower-end condominiums would be easier to resell. He said:

> Same way in a subdivision. ... I do single-family houses with maybe a common park or whatever in there. We're under that same situation where we build the house, we didn't hand out -- even if we did a public offering statement and we left one paper out, or inadvertently missed a couple of documents in there, then technically it's not the public offering statement. It has to be everything. You could still end up in that 10 percent situation. I don't know whether the "substantially complete" part would apply over to PUD like it does a condominium. But there certainly is some cross over in there.

Number 427

REPRESENTATIVE ROKEBERG asked Mr. Hall if he is still under UCIOA because he has a homeowners' association with detached houses.

MR. HALL responded in the affirmative, and explained that this is because there is a piece of property that everyone in the subdivision owns collectively.

REPRESENTATIVE ROKEBERG said, "The interpretation is that UCIOA applies to that type of an association."

MR. HALL stated, "That's what the other attorneys told me."

REPRESENTATIVE ROKEBERG interjected, "... POS and these other provisions and so forth also come into play?"

MR. HALL responded, "Everything in that Act is going to come into play."

REPRESENTATIVE ROKEBERG interjected, "The intention of the legislature when they did that was supposed to be condominiums, cooperatives, and PUDs, is what I understood."

Number 438

MR. HALL said that he spoke with a developer from the [Matanuska-Susitna] Valley last night who is not aware of [UCIOA]. He said that the developer has built a subdivision with about 20 single-family houses on one-acre lots, but there is a common piece of property big enough to put a subdivision sign on. Mr. Hall explained that a homeowners' association is going to be formed to pay taxes and liability insurance for that plot of ground that is 8 by 10 feet. He said that this developer had no idea there was a UCIOA. He said:

> So he's sitting there with 20 sold houses with people living in them, with the 10 percent possibility [that] if 20 people decide to get together and hire an attorney, he's bankrupt. He'd just file his papers and be gone. I don't [believe] that quite fits the intent of where UCIOA was. Maybe it's because we're not in Anchorage and we're not as familiar with talking about, and having attorneys come into ... meetings and talk about UCIOA. ... And kind of learning that process, we're just now starting to learn it....

Number 450

CHAIR MURKOWSKI said, "Perhaps we should suggest to the bar association [that] they have a continuing legal education seminar on UCIOA out in the Valley."

MR. HALL replied that he has made that suggestion a couple of times.

Number 454

ROBIN WARD, Legislative Co-Chair, Alaska State Home Builders Association, said, "This needs a comprehensive change, but as you said, it's about 54 pages long." She mentioned that [the Alaska State Home Builders Association has] fast-tracked the two items that were of concern. She said:

> I have to tell you that I did a little checking just before I left Anchorage. Almost one-half of the listings in MLS [Multiple Listing Service] right now are new construction, and two-thirds of those fall under this Act. Almost all of our new subdivisions have some kind of common property, whether it's a sign, whether it's a greenbelt, something. We were doing an awful lot of what's called 'site condos planned communities'. All of those fall under the Common Interest Ownership Act. So this for us in Anchorage is tremendous.
>
> I will tell you that it is moving out, and as you can tell, to the Valley. At least those of us in Anchorage know the law fairly well. It's very complex and it's up to interpretation in certain areas. But these outlaying areas do not. And there's going to be some mistakes made, and I can see it happening. ... The probability ... is not on our side. ... A mistake will happen and it will happen very soon and it will be very, very costly for a developer. So we're begging your indulgence to work on this bill.

Number 470

REPRESENTATIVE ROKEBERG requested that Ms. Ward "give a nutshell version of ... the [Horizontal Property Regime Act] that transitioned to UCIOA as a model act."

MS. WARD said:

> This was uniform legislation, ... and basically ... we were one of the very first states, I think, to adopt it in 1984. ... It is very complex. There were basically no changes. It was just adopted. They came out with model adoptions and amendments in 1994. Uniform amendments that have never been changed here either. That's one of the things we've been looking at; ... taking those along with what we call local amendments, things that fit Alaska for what we do, and

that's what will be in the comprehensive bill. But again, these were just the two that we pulled out that we felt needed to be fast-tracked.

Number 481

REPRESENTATIVE ROKEBERG mentioned that he is very disturbed when a detached home subdivision with common area property falls under UCIOA. He said, "It is my understanding that ... the intent was to keep it to those specific types of developments rather than just having a homeowners' association."

MS. WARD said, "Anything that has any common property, commonly owned by the owners of the subdivision or condominium. And a site condominium falls under that also, which we are building a lot of ... in Anchorage. All of that falls under..."

REPRESENTATIVE ROKEBERG interjected, and inquired about site condominiums.

MS. WARD explained that it's like a planned unit where one owns the house, but the land is owned by the [homeowners'] association. She said, "We can't do PUDs anymore, so we call them planned communities."

REPRESENTATIVE ROKEBERG asked, "Is that because of the way that that statute was drafted under the model act?"

MS. WARD specified that it's the way the uniform legislation was drafted.

Number 500

REPRESENTATIVE CRAWFORD stated his support for HB 470.

REPRESENTATIVE MEYER moved to report CSHB 470(L&C), version F, out of committee with individual recommendations and the accompanying zero fiscal note. There being no objection, CSHB 470(L&C) was moved from the House Labor and Commerce Standing Committee.

HB 395-INSURANCE DISCRIMINATION BY CREDIT RATING

CHAIR MURKOWSKI announced that the final issue before the committee would be HOUSE BILL NO. 395, "An Act prohibiting discrimination by credit rating or credit scoring in insurance rates; and providing for an effective date."

Number 520

REPRESENTATIVE CRAWFORD spoke as the sponsor of HB 395, which he said is a fair approach to insurance rating. He explained that HB 395 would prohibit insurance companies in Alaska from using credit scores in either underwriting or rate setting for car or home insurance. Using the credit rating and scoring for such is arbitrary and discriminatory. Representative Crawford pointed out that the committee packet should contain a letter from AARP. Retirees are the group least likely to use credit cards and have debt. The letter from AARP points out the five factors that are primarily used for credit scoring: payment history, amount of debt, credit account history, recent credit history, and types of credit. Therefore, a person who doesn't use much credit automatically receives a lower credit score and is put in this new class of people who receive higher interest rates. Such a situation is arbitrary and unfair.

Number 0540
DAVE D'AMATO, Staff to Representative Crawford, Alaska State Legislature, informed the committee that some of the issues laying behind the introduction of HB 395 involve an individual's right to privacy, the accuracy of the information compiled about an individual, and the access to that information. Mr. D'Amato pointed out that insurance regulations have a statutory mandate, AS 21.36.120, to protect consumers against unfair discrimination. However, Alaska doesn't protect its insurance consumers, even in the face of irrefutable evidence that insurance credit scoring is discriminatory. Such a situation is bad for individuals, businesses, and Alaska in general. Inevitably, the question regarding what class of people would be impacted by legislation arises. The class of people impacted by HB 395 can be broken into economic and cultural demographics that cross pollinate. Mr. D'Amato explained that the majority of Alaska's rural areas are populated by a minority ethnic group. Alaska has a large percentage of small- and medium-sized businesses and seasonal workers. Furthermore, Alaska has a one-trick-pony economy. That is, Alaska's reliance on oil exposes the average Alaskan to greater economic fluctuations.

MR. D'AMATO stated that credit scoring effects those with good credit and those with bad credit. For example, buying a house or car impacts an individual's stability as a purchaser. The insurance industry would argue that one is more stable if one hasn't recently purchased a house but has lived in a house for five or ten years. Mr. D'Amato expressed the hope that by the

end of his testimony he will have shown the committee that activity that one would consider normal and rational impacts one's credit rating. However, some classes of people are impacted in a disproportionate manner. The elderly is one such group. He directed attention to AARP's letter in support of HB 395.

TAPE 02-31, SIDE B

MR. D'AMATO informed the committee that AARP has made this issue one of its three main issues nationwide. Another class of people impacted by credit scoring are minorities, both rural and urban minorities. Although those minorities living in urban areas aren't necessarily subject to the discrimination found in rural areas, such as the lack of access to banks, they are still brought under discriminatory treatment by a process once known as red-lining. For example, the people in Mountain View pay more based on the region. Mr. D'Amato referred to the NAIC [National Association of Insurance Commissioners] winter meeting "Exhibit C", which includes a comparison of two zip codes by household income. That comparison shows that [the zip code] with the higher household income, 21210, has the lower premium [while the zip code with the lower household income, 21217, has the higher premium]. There is also a comparison of premium by population composition [the ratio of minority to white], which also has the essence of red-lining.

Number 0565

MR. D'AMATO, in response to Representative Halcro, informed the committee that the annual premium for zip code 21217 is $1,357 while the premium for zip code 21210 is $972. Additionally, divorces impact one's credit in several ways. Since a divorce often results in the dividing of community property, it places people into different positions of credit worthiness. Although one individual may not have been the primary breadwinner and didn't actually control the finances, that individual has, because the individual's personal life has gone awry, been classified [as not having good credit]. Other situations that impact one's credit rating could be related to layoffs or identity theft.

MR. D'AMATO summarized that credit rating can impact everyone [because it] replaces relevant performance-based criteria such as driver behavior. The old standard was that those who received tickets, had accidents, or filed false claims were those who faced higher insurance rates. There were also various

actuarial examples illustrating that certain classes of people produced riskier behavior. Those examples had to have a link between [certain classes of people and risky behavior]. However, [the current rating system] doesn't exactly show how the [correlation] is made because it's [said to be] proprietary information. In place of the relevant performance-based criteria arbitrary economic considerations are inserted. He explained that [credit scoring] says that anyone with a credit condition has to be considered under the new credit scoring.

Number 524

MR. D'AMATO turned to Exhibit F, which is a letter from an insurance sales person. This letter specifies that an individual with two DWIs (driving while intoxicated) and an accident within a five-and-a-half year period is still in the preferred market based on the individual's credit rating. Mr. D'Amato said, "It's my assertion to you that this is probably bad public policy." Furthermore, Mr. D'Amato charged that the [insurance industry] won't be able to provide any documents that illustrate causal links [between premiums and a person's predisposition for risky behaviors]. However, [the insurance industry] is able to provide correlative judgments if they exist. To that end, [the insurance industry] directs attention to a paper done by James E. Monaghan entitled, "The Impact of Personal Credit History on Loss Performance in Personal Lines". This paper is touted as a lesson in rate making. He referred the committee to the last paragraph of page 102 of the handout. He quoted the last paragraph as follows: "An outstanding issue that will likely remain outstanding is causality. Although arguments were put forward earlier in this paper which attempted to link financial management responsibility and future expected loss levels, such arguments are unsupported, even if reasonable, speculation." Additionally, on page 86 of this paper Mr. Monaghan says, "Explanation of these correlations, for the most part, cannot be found in the data assembled for this research. I would be remiss, however, if I did not at least attempt to set down those arguments which could be made suggesting reasonable causal links between an individual's bill paying history and expected loss experience for insured losses under a private passenger auto insurance policy." Mr. D'Amato explained that these quotes illustrate that Mr. Monaghan is going to leave out causality and correlation because those can't be proven. There is no proof [that] the discrimination [the insurance industry uses] is necessary. Although [the insurance industry] will provide charts regarding the loss that is being incurred for those with good credit versus bad credit, there is no

information with regard to the formulas that [calculated the loss and its relation to a person's credit rating]. Mr. D'Amato indicated that this information isn't provided not because it's proprietary. The insurance industry won't show that [credit rating] isn't discriminatory based on income or minority status.

Number 468

MR. D'AMATO informed the committee that he can prove that there are inaccuracies on credit reports, which have been reported to have a 1-70 percent variance. Therefore, the committee is being asked to rely on a formula that isn't available for review, and that formula relies on data that is 1-70 percent inaccurate. Mr. D'Amato then referred to a document entitled, "Regulators wary of rates based on third-party data". Twenty-five states are considering legislation similar to HB 395. He said that typically, the largest problem is that third-party information is inaccurate and unreliable and thus such data shouldn't be utilized to set rates.

MR. D'AMATO also informed the committee that there are arbitrary variables that effect one's credit report. For example, simply asking for a credit report too often will result in that individual being a poor credit risk because [the insurance industry] wouldn't know how much extra credit has been assigned to the individual. If an individual shops around for insurance and asks for ten different quotes, then each will request a credit report. The credit scoring agencies wouldn't clearly know how many of those inquiries resulted in an extension of credit. Therefore, the credit scoring agencies aren't sure how deep in debt an individual is until there is a payment history. Furthermore, Alaska's large rural population [most often] doesn't use the larger banks that report.

Number 436

MR. D'AMATO related his belief that there has been some blanket and patent discrimination. That is, people with bad credit but not bad driving histories are subsidizing bad drivers with good credit. Those who are most hurt [by credit scoring] are those on the fringe who are making normal credit decisions but have one thing impact their credit score. Mr. D'Amato alluded to the relation between credit scoring and a larger class of uninsured motorists. He said, "If credit scoring is allowed in underwriting, the effect of that is that individuals who are denied access to insurance will not get insurance."

MR. D'AMATO pointed out that Hawaii has been doing [what is proposed in HB 395] since 1983. Once this was implemented in Hawaii, there was no change in premiums. Furthermore, once the insurance industry sued, the state court upheld the state's position. Although the typical argument is that implementation of this will result in a flight of insurance carriers, he indicated that the market accommodates the situation, as was the case when seatbelts were required in automobiles.

MR. D'AMATO concluded by urging the committee to ask the insurance industry to show how it arrives at the correlation. He said that the insurance industry won't be able to bring forward anyone who has benefited from credit scoring. However, he said he could bring forward people who have been harmed from this program, and these people are from almost every socioeconomic class and ethnic group. Furthermore, it's factually inaccurate to suggest that anyone could have benefited from credit scoring because when the industry applied to [utilize] credit scoring in the insurance rates there was an application for a rate increase. Mr. D'Amato referred to a Phillip Morris study, Exhibit J, that he characterized as interesting. In closing, Mr. D'Amato reiterated that HB 395 simply limits the use of credit scoring in rating and underwriting.

Number 385

REPRESENTATIVE MEYER related his belief that the insurance companies are like jury selection, one of the few groups that [are allowed] to discriminate. Representative Meyer said he couldn't believe that the insurance industry would rely solely on one's credit report to set their auto rates. He asked if Mr. D'Amato was saying that a credit report is only one of the many factors that determines an individual's auto rate.

MR. D'AMATO said that no one can answer that question. However, the committee packet includes a recent situation in which a 26-year-old woman with a recent divorce and bankruptcy, but with no tickets, accidents, or claims was denied the opportunity to obtain credit by Allstate. In this case, the denial was based solely on the credit score. Mr. D'Amato remarked that this is an issue about subsidization. The insurance industry is only allowed to charge and profit so much. Therefore, the question is: who should be encouraged to behave in the manner they do, the individual with two DWIs or an individual who is divorced? He said he didn't know the answer and neither does anyone else.

REPRESENTATIVE MEYER asked, "Isn't that up to the Director of [the Division of] Insurance to determine how they charge the rates and why they're charging the rates that they do?"

MR. D'AMATO explained that the Director of the Division of Insurance is charged with ensuring that the rates that are set aren't unfairly discriminatory. How that conclusion is determined is up to the director. In communications with the director, [the division] hasn't been convinced [of the appropriateness of credit scoring].

REPRESENTATIVE MEYER remarked that maybe there is a direct correlation between an individual with a good credit rating and responsible driving habits. Perhaps, the auto [insurance] industry has such a correlation and it has been presented to the Division of Insurance. Representative Meyer didn't believe the insurance industry, which is a heavily regulated industry, could adversely discriminate against a certain group.

Number 341

REPRESENTATIVE HALCRO asked if the sponsor felt that the insurance companies should be allowed to maintain any proprietary information with regard to how a premium is set.

REPRESENTATIVE CRAWFORD replied yes. However, he pointed out that the Director of the Division of Insurance has told him that as long as there is no statute that prohibits the director from allowing this particular way of setting rates, then the director can't disallow it. Presently, there is no statute against [credit scoring] and thus it has been allowed.

REPRESENTATIVE HALCRO expressed concern that HB 395 specifies that the insurance industry can't factor in credit scoring when they set premiums.

REPRESENTATIVE CRAWFORD said that he doesn't believe that there is any causality with regard to credit scoring. For example, Representative Crawford related that all of the mortgage payments he made on September 9, 2002, reached their destination late due to the tragedy on September 11, 2002. Although he was able to get the late payment removed, he wasn't able to have that late payment removed from his credit rating. [Since that time] all of his insurance rates on his rental properties have risen by about 25 percent. He clarified that he couldn't say for sure that the aforementioned rise in insurance rates was due to credit scoring. Representative Crawford related his belief

that credit scores don't have much to do with whether a person has claims on their home insurance or whether a person has a good or bad driving record. Representative Crawford said he didn't believe that credit scoring is a good policy.

Number 294

REPRESENTATIVE ROKEBERG asked if [HB 395] would create a business opportunity for an insurance company that doesn't want to use [credit scoring].

MR. D'AMATO replied yes. This legislation could create a market in which the class of uninsured motorists could amount to 40-50 percent and a company could convince the legislature to mandate insurance. Then the company could enter the market and offer insurance to the uninsured motorists. Therefore, the market could correct this under such a scenario.

REPRESENTATIVE ROKEBERG remarked that his point is that the market is self-correcting. He related his understanding that the states that allow [credit scoring], such as Hawaii, were grandfathered in under the Federal Fair Credit Reporting Act (FCRA), which permits credit scoring. With regard to the testimony that 25 states are looking [at proposals such as HB 395], those states are reviewing these because they're not sure that it can be done because of the supremacy clause in the U.S. Constitution. He asked if the sponsor has reviewed the possibility that federal law may have preempted this.

MR. D'AMATO replied yes. Under FCRA, up until July 1, 2004, insurers can use credit information to pre-screen but not [to set] rates. However, there are no federal statutes that preempt a state's ability to set rate-making. The majority of the states reviewing this are principally considering rate-making.

Number 249

MARIE DARLIN, AARP, noted that the committee should have written testimony from AARP. The AARP doesn't believe that older individuals should be forced to pay higher insurance premiums simply because they don't use credit and thus don't build up a credit rating. Ms. Darlin announced AARP's support of HB 395.

REPRESENTATIVE KOTT asked if Ms. Darlin was aware of anyone within AARP that has been rejected [on the basis] of a credit rating.

MS. DARLIN replied no, not personally.

Number 217

JOHN GEORGE, National Association of Independent Insurers (NAII), informed the committee that NAII is a trade association of about 690 property casualty insurance companies. Since no one knows the formula that the insurance company is using, Mr. George said he didn't know how one could say that one factor is causing everyone's insurance [premium] to increase. Furthermore, all insurance companies don't use the same formula. Moreover, he didn't know how one could charge that [this formula] would have the same effect on everyone. Mr. George commented that insurance is very competitive and there are insurers who specialize in various types of insurance.

MR. GEORGE recalled testimony with regard to having mandatory auto insurance, which is the case currently. He informed the committee that the insurance companies would prefer that there wasn't mandatory auto insurance because of the assigned risk plan. Through the assigned risk plan anyone has the right to purchase auto insurance, and therefore anyone who has a license and an automobile can purchase insurance.

MR. GEORGE turned to the use of the term "credit score" and clarified that it's different than the credit score that the bank receives when an individual attempts to obtain a mortgage or car loan. Although the same credit agency may perform the credit score, the bank informs the agency with regard to the factors it wants to consider in their score. Mr. George said that he would prefer to call it the insurance risk score. He explained that the insurance risk score considers the same data, but different weights are placed on different aspects and this varies with the insurance company.

MR. GEORGE characterized the prior testimony as an indictment of the credit system. Although Mr. George said that he has seen the information that the inaccuracies on credit reports is between 1-70 percent, he feels that credit reports are fairly accurate when one views the inaccuracies in terms of material inaccuracies. He pointed out that the federal government has established laws allowing individuals to obtain their credit report and correct it. If the corrective system doesn't work, then the federal government should tighten it up. If this is an indictment of the entire system, then every entity that uses a credit score should be indicted. However, that doesn't seem to be the case, he said.

MR. GEORGE interpreted prior testimony to be an indictment of the Division of Insurance, which has approved some rates that are based on credit scoring. The division has great authority to review and examine insurance companies. As a former regulator, Mr. George noted his resentment of the indictment of the division. With regard to the Monaghan report, Mr. George clarified that it is merely a report. He directed attention to the following from page 103 of the Monaghan report, "The data reviewed in this study produced clear evidence of a strong correlation between credit history and future loss performance." An actuary doesn't review causation because it doesn't matter. "What matters is that you can come up with something that correlates very strongly with future losses. We don't care why they have the losses, we only care that they have them," he said. There is an extremely strong correlation [between credit scores and insurance risk].

Number 055

MR. GEORGE turned to the anecdotal examples that are often the most difficult to address because there is often another side of the story. He urged people with knowledge of such anecdotal stories to provide him with the names so that he could track down the person and uncover the problem. [The insurance industry] would like to fix the real problem so that this [credit scoring] information could be used in order to provide comfort that people are being charged the correct rate. Mr. George indicated that [credit scoring] is really an allocation of who is going to pay the premium not whether it will be collected. With regard to AARP's comment that [seniors] should pay less, a few years ago legislation was passed requiring insurance companies to give individuals over 55 years of age a discount. That discount isn't based on actuarial science.

TAPE 02-32, SIDE A

REPRESENTATIVE HALCRO asked if it would safe to say that in the insurance industry the premiums are different because the risks are different. For example, someone living in a bad neighborhood is going to pay more for insurance than someone living in a good neighborhood. He surmised that factors such as the type of car an individual drives to the crime rate where an individual lives are risks that are used to determine the premium.

MR. GEORGE replied yes. He said that the key piece of missing information in the information provided by Mr. D'Amato was the amount of losses. He turned to the suggestion that a particular race has more losses merely because the individuals are of a certain race and pointed out that the credit scores are quite blind to this because credit scores don't inquire as to an individual's ethnicity, religion, or earnings. Credit scores merely inquire as to how one manages his/her finances. In many instances, those with less money receive better scores than those with a lot of money.

CHAIR MURKOWSKI posed a situation in which an individual doesn't have a credit history, and asked if that individual wouldn't be able to avail themselves of any good credit discounts.

MR. GEORGE said that there are certainly positives and negatives. Those that pay on time receive positive points while those who don't pay on time and are turned over to collection agencies receive negative points. However, it's not necessarily negative that one has managed his/her credit by not using it. In fact, all insurance companies can, in their own formula, make an exception to accommodate such situations. Furthermore, a company could decide to target such a group for potential clients.

Number 091

REPRESENTATIVE ROKEBERG inquired as to the impact on rate structuring for property casualty since the September 11th incident.

MR. GEORGE answered that the property casualty industry is most affected by the lack of reinsurance or the substantial increases in reinsurance premium. The first knee-jerk reaction by the reinsurers was that they weren't going to cover terrorism and they wanted substantial increases. Mr. George pointed out that the rates for reinsurers are unregulated. Therefore, that is a serious problem. Although Allstate probably had a greater number of auto claims in New York than it would otherwise, it probably wasn't to the extent that it would dramatically drive the rates. One of the largest impacts to the rates is that insurance companies have to invest their surplus, which they're required to have in order to pay claims. In the past insurance companies could write insurance at 125 percent loss ratio and [make their 5 percent profit], but that isn't the case now.

REPRESENTATIVE ROKEBERG surmised that Mr. George is suggesting that one of the major squeezes on profitability of the industry is low interest rates and the loan bond is at less than 6 percent. Therefore, in order to increase profitability, the industry has to look at rate increases. With regard to profitability, Representative Rokeberg asked if there is a cycle in the property casualty business such that insurers drop rates in order to obtain market share and then certain entities are weeded out and ultimately rates are raised. He asked if the industry is currently in the raising rate cycle.

MR. GEORGE replied that Representative Rokeberg is correct. However, he said that it's even worse. He explained that if a company enters the market and cuts its rates in half and then the company can't make it, all of the other companies in the guarantee association are assessed and pay for those losses. Mr. George characterized the insurance industry as sort of a public utility, except there is strong competition and if one of the companies goes broke the others have to pay.

REPRESENTATIVE ROKEBERG recalled that Mr. D'Amato said he has irrefutable evidence that credit scoring is discriminatory. However, the statute specifies that "in rate making, the rates shall not be excessive, inadequate, or unfairly discriminatory." He related his understanding that discrimination is part of actuarial rate making; the issue is whether the discrimination is unfair.

MR. GEORGE agreed. Mr. George said that there are two scenarios. One scenario would be a situation in which everyone pays the same rate. The other scenario would be a situation in which each individual's life history is reviewed in order to determine his/her rate. The current system falls in between those two scenarios.

REPRESENTATIVE ROKEBERG asked, "Isn't the point of this bill to keep from harming consumers and driving rates up?" He recalled the testimony that [credit scoring] "separates" people and drives rates up for certain classes of people versus others.

MR. GEORGE informed the committee that what has been found is that many companies write more insurance policies than they would have written without the credit score, the insurance risk score, because of the greater comfort it provides. The goal is to assign the appropriate rate so that one group isn't unfairly subsidizing another group. Discrimination is fully accepted in insurance rating, it just shouldn't be unfair discrimination.

The most unfair situation would be one in which one group with low losses subsidizes another group with higher losses.

Number 191

REPRESENTATIVE CRAWFORD turned to Mr. George's comments characterizing Representative Crawford as indicting the Director of the Division of Insurance for not doing his job. He clarified that his comments were that the director didn't change [credit scoring] because there is no law that specifies that [credit scoring] is the wrong way to set rates. The people who aren't doing their job are the legislators who haven't made this policy call, he said. [This legislation] attempts to correct the situation.

REPRESENTATIVE CRAWFORD recalled when he shopped around for a mortgage company in order to receive lower rates. Shortly after deciding on a mortgage company, he decided to obtain a better credit card. However, the credit card company denied his request because he had too many inquiries on his credit rating. He asked if [credit scoring] is an appropriate criteria to set his home and auto insurance rates.

MR. GEORGE began by apologizing and specifying that his comments weren't a personal indictment. He said that he believes that the director has full authority to approve or disapprove the rates if they are unfair or can't be substantiated as appropriate. In regard to Representative Crawford's particular situation, he surmised that Representative Crawford was saying that the credit card company may have unfairly used [the credit scoring] information. He noted that FCRA includes safeguards so that errors can be corrected and thus he felt it should be incumbent upon lenders and insurers to consider the corrections or explanations.

MR. GEORGE turned to the unsolicited credit card offers, which do pull an individual's credit. However, he wasn't aware of anyone who used those for any insurance score because the individual didn't request those. Someone who applies for five credit cards is a different situation, he pointed out.

MR. GEORGE recalled that Mr. D'Amato had said that HB 395 would eliminate using credit scores for auto and home owners [insurance]. However, it would [also] eliminate credit scores for surety bonds, fidelity coverage, et cetera. Therefore, no credit could be used to underwrite for any line of insurance, which Mr. George characterized as an unintended consequence.

REPRESENTATIVE CRAWFORD remarked that the aforementioned was an unintended consequence that he would try to correct.

Number 281

BOB LOHR, Director, Division of Insurance, Department of Community & Economic Development (DCED), testified via teleconference in support of appropriate restrictions with regard to the use of credit scoring by insurance companies. Furthermore, the division supports the concept behind HB 395. The question regarding whether to out right prohibit the use of credit scoring by insurance companies is a legislative policy call. Mr. Lohr explained that presently the division reviews auto and home owner insurance rates and applies AS 21.39.030, and only approves rates that aren't excessive, inadequate, or unfairly discriminatory. Credit information and credit scoring was first approved for use in Alaska about four years ago. The division required extensive documentation from the insurance company to support its use. Currently, a total of seven insurance companies have approved auto rate filings that include the use of credit scoring. Since December 2000 the division has received 11 auto rate filings that have requested the use of credit information in rating applicants for insurance coverage. Of those, six haven't used [credit scoring] either because they were withdrawn or the insurance company removed credit scoring from the factor. Two auto filings were approved and the remaining filings are under review or have been disapproved. Of the four home owner filings requesting the use of credit information in rating applicants, three have removed credit scoring and the remaining filing is still under review.

MR. LOHR continued by informing the committee that two insurance companies also use credit scoring in the underwriting process. "Unlike the rating of insurance applications based on risk factors, the Division of Insurance does not have statutory authority to require prior approval of underwriting criteria; that is we don't have statutory authority over underwriting," he explained. As the use of credit scoring has increased, the division has received consumer complaints about its use. Several of those complaints state that policy holder rates increased simply because of the credit score not because of changes in driving factors. The insurance companies haven't been able to adequately explain why auto rates change because of credit history.

MR. LOHR pointed out that recently the Washington legislature has adopted legislation on the subject of credit scoring. That legislation does restrict the use of credit scores in evaluating the application by insurance companies. For example, for the underwriting considerations for cancellation and nonrenewal, the use of one's credit history will be entirely prohibited. Furthermore, current holders of policies won't lose their policy based on changes to their credit history while new customers can be denied coverage based on a credit history that is combined with other underwriting factors. Severe restrictions were placed on the absence of credit history, the number of credit inquiries, collection accounts identified with medical bills, the initial purchase of vehicles or homes, the use of a particular type of credit card, and the total line of credit held by a consumer. In summary, Mr. Lohr said that there are a number of approaches that attempt to construe the term "unfairly discriminatory" in the context of credit scoring used by insurers.

Number 349

CHAIR MURKOWSKI pointed out that the committee packet includes a document regarding what is happening in the State of Washington. This document also refers to not allowing credit scoring to be the sole criterion. She said she understood Mr. Lohr's testimony to relate that appropriate restrictions [to credit scoring] should be considered, but whether to have a complete prohibition is a policy call for the legislature.

REPRESENTATIVE HALCRO related his understanding that the division has the authority to review all rate filings. Therefore, if a company approaches the division with a rate based on credit scoring, the division has the ability to review whether it's fair.

MR. LOHR answered that such would be the case for most lines of insurance. For the lines of insurance that have been discussed, the division has the responsibility to determine that the rates aren't unfairly discriminatory. He noted that "unfairly discriminatory" is a fairly vague term. When these filings [that allowed credit scoring] were originally approved, the reviewers didn't find them to be unfairly discriminatory. Now that the filings have been approved, the burden is on the division to show that those rates are unfairly discriminatory. He acknowledged the potential for credit scoring to produce unfairly discriminatory rates. However, to actually show that such has happened would be far more difficult and [result in] a

pretentious and protracted proceeding, he predicted. In further response to Representative Halcro, Mr. Lohr confirmed that the division has denied some of the filings that were based on credit scoring.

Number 303

SARAH McNAIR-GROVE, Actuary P/C, Division of Insurance, Department of Community & Economic Development, addressed the 11 auto insurance filings that requested the use of credit information. Through the division's process, considerable time has been spent gathering information. The division spent over a year gathering information for one particular filing. She explained that once the division receives a filing it has 15 days to review it and send questions to the insurer. Therefore, the fact that the process has taken a year indicates that there have been substantial communications. She informed the committee that the insurer was asked to provide support justifying the use of the model, to specify which information is used from the credit report that goes into the model, and to [point out] the correlation those particular items have to loss experience and loss history. She noted that the division hasn't received some of the information that details what factors are taken off the credit report and how those go into the model because the insurers believe that information to be proprietary. Because the division couldn't make a determination, the insurer withdrew its filing in order to get some of the other pieces of the filing approved.

Number 400

REPRESENTATIVE HALCRO suggested that when insurers come to the division with a rate filing based on credit scoring, the insurers should have to "show their work." He viewed that as a better alternative than completely prohibiting credit scoring.

MR. McNAIR-GROVE explained that from the insurance company's point of view the current problem relates to the statute that says, "when a filing becomes effective, the filing and all of its supporting information is public." Because the insurance companies have worked hard on these filings or have purchased them from third party vendors who are the credit reporting agencies, they don't want this information disclosed to the public. Changing statute to allow the insurance companies to keep supporting information private is a policy call for the legislature.

CHAIR MURKOWSKI said she assumed that the division did receive the [proprietary supporting information] for those filings [using credit scoring] that the division approved.

MS. McNAIR-GROVE answered that because the insurance company wanted their filing approved, it provided the division with the [proprietary supporting information]. The first company that the division approved was able to provide the division with the information because it did its own in-house model.

CHAIR MURKOWSKI surmised then that Ms. McNair-Grove is suggesting that models obtained through a third party make it difficult to obtain the [proprietary supporting information].

MS. McNAIR-GROVE clarified that such would be partially true. She explained that a recent filing from Allstate was withdrawn. Although Allstate does its own proprietary model, it didn't want to make it public.

Number 424

REPRESENTATIVE HALCRO expressed concern with completely prohibiting the ability to use credit scoring. Those with excellent credit who are also a low risk should enjoy the benefit of lower premiums based on their credit scores. However, those with no credit or only one or two minor incidences on their credit report should have their ability to purchase coverage protected as well as the affordability of that coverage. He asked if narrowing the type of information the insurance companies had to supply to the division would be helpful.

MS. McNAIR-GROVE said, "I'm not sure that it's the information that they would have to supply to us; I think it's how they would use that information." She pointed out that the State of Washington is placing some limits on the difference in rates between the lowest and the highest. Although she said she wasn't suggesting that such be done, she felt that perhaps such limitations would be more helpful than specifying the information that has to be provided to the division.

Number 442

REPRESENTATIVE HAYES asked if an individual could obtain a listing of the nine companies that are using a model with credit scoring.

MS. McNAIR-GROVE replied yes, those filings are public information.

REPRESENTATIVE ROKEBERG related his understanding that the act of underwriting relates to whether a company will accept or deny a new client. He said he believes that those standards could be effected by the credit rating. Therefore, he asked whether HB 395 would prohibit the underwriting or selection of new business by insurers.

MR. LOHR explained that the current draft of HB 395 includes the notion of underwriting. However, if the goal of HB 395 is to prohibit the use of credit scoring in underwriting, the division would recommend an amendment that is directed to AS 21.36, which is a more appropriate location for underwriting restrictions.

REPRESENTATIVE ROKEBERG recalled Mr. Lohr's earlier testimony that the division doesn't have the authority to regulate the underwriting functions.

MR. LOHR said that currently he doesn't believe that the division has general authority to oversee or second guess the underwriting process by insurers. If it were to be addressed, he said he believes it would be precedent-setting.

REPRESENTATIVE ROKEBERG surmised that HB 395 is opening up a new area of government regulation.

Number 477

CHAIR MURKOWSKI referred to a document that notes that the NAIC appointed a group to review this issue of consumer credit reports in underwriting. She inquired as to whether Mr. Lohr had any information from that group.

MR. LOHR informed the committee that the group reviewing this issue will have a quarterly meeting in the next week to ten days. Mr. Lohr noted that he is the Alaska representative at that meeting and thus he intends to fully participate. In further response to Chair Murkowski, Mr. Lohr agreed that his participation will result in updates with regard to how other states are addressing this issue. He mentioned that today [the division] received the language of the State of Washington's bill. He offered to forward that language to the committee.

REPRESENTATIVE HALCRO asked if Mr. Lohr read HB 395 to apply to all lines of insurance, including commercial policies.

MR. LOHR said that HB 395 is broadly written and thus he believes it would apply to any lines of insurance over which the division has rate-making authority. However, commercial policies are somewhat in transition due to the provision in HB 184 that requires the division to adopt regulations addressing the subject of commercial deregulation by July 1, 2002.

REPRESENTATIVE ROKEBERG returned to the [NAIC] group that Mr. Lohr is part of and asked whether Mr. Lohr believes that a room full of insurance commissioners would have a philosophical bias to regulate more or less.

MR. LOHR characterized the aforementioned as a loaded question. From his experience he said that normally bureaucrats and regulators don't seek reductions in their authority. On the other hand, any discussions of this group will have input from the public. Therefore, any model regulations or legislation would receive the full input of the public, including heavy participation from the insurance industry.

Number 523

MICHAEL LESSMEIER, Lobbyist, State Farm Insurance Company, Lessmeier & Winters, noted that the committee packet should include a copy of the letter he sent to Senator Ben Stevens regarding identical legislation in the Senate. He informed the committee that State Farm currently writes approximately 24.4 percent of the automobile insurance premiums written in Alaska and almost 35 percent of the homeowner's insurance premiums. He felt that these statistics are important to keep in mind when there are charges that insurance companies are using [credit scoring] as a tool to raise rates. Mr. Lessmeier stated that State Farm isn't using [credit scoring] to set rates in Alaska. Furthermore, he said he didn't believe that the way State Farm is using [credit scoring] can be criticized.

MR. LESSMEIER turned to the question of who benefits from the proper use of [credit scoring]. He informed the committee that State Farm has a fire and casualty company that insures homeowners, an automobile company that insures those with automobile insurance, and a mutual company that deals with the preferred customers. For the automobile insurance, State Farm started using an underwriting score in February 2001 in Alaska. That underwriting score considers traditional underwriting criteria such as loss history, frequency of loss, and types of loss. The underwriting score also includes a factor that

considers certain elements of credit. However, this credit factor doesn't consider things such as past due medical or utility accounts. [The underwriting score] arrives as a single score and is used only for new business. Furthermore, [the underwriting score] is primarily used to write someone that the company wouldn't otherwise write because of the traditional underwriting criteria. He noted that there is a rare exception in which the [underwriting score] might be used to exclude someone. Use of the [underwriting score] resulted in State Farm more than doubling the new business that it wrote for automobile insurance. Through the use of [the underwriting score] we chose to write people that we wouldn't have otherwise written. Furthermore, [the underwriting score] has allowed State Farm to take those that would be in the standard company and move them to the mutual company. Therefore, State Farm views [the underwriting score] as positive and acceptable and thus would hate to see the legislature completely ban it. He estimated that last year the automobile side of State Farm wrote over 4,000 additional people. Perhaps not everyone was affected by this, but many probably were.

MR. LESSMEIER recalled that there has been much testimony with regard to whether bad credit causes a loss. He informed the committee that State Farm did a study that found a high correlation between those who mismanage their credit and increased risk. State Farm believes that strongly enough that it is willing to take that tool and justify writing risks that it wouldn't otherwise write. He said, "They wouldn't be doing that if they doubted the validity of the predictor." He related his belief that there is overwhelming statistical evidence that [credit scoring] is a valid predictor.

TAPE 02-32, SIDE B

MR. LESSMEIER characterized [credit scoring] as fair when it's used to identify a higher category of risk so that the rate-making process can result in the appropriate rate being applied. Therefore, people of one category of risk wouldn't be subsidizing people of another category of risk. Mr. Lessmeier related [State Farm's] position that [credit scoring] is [appropriate] and the real issue is in relation to abuses and how to stop those. He expressed curiosity with regard to whether the division has found any misuse of [credit scoring]. Mr. Lessmeier said he couldn't imagine why an insurer would want to "run off" long-time customers on the basis of a credit score.

MR. LESSMEIER turned to the litany of potential abuses that he has heard discussed. He pointed out that if there is an abuse in the rate applied to a particular group, that rate has already been approved by the division before being applied to anyone in the state. Therefore, the authority is there, and is present beyond merely approving the rate. Mr. Lessmeier recalled Senator Donley's unfair trade practices legislation last year. He said that it's an unfair trade practice for an insurer to make an arbitrary or unfair discrimination between insureds or property that share like risk characteristics. Therefore, if [credit scoring] is being misused, there are other statutory tools present to [address] and stop the misuse. Mr. Lessmeier related his belief that Representative Halcro's suggestion of a confidentiality provision would make the division's job easier.

MR. LESSMEIER reiterated his earlier testimony that many of the ways in which insurers use this information is different. For example, he understood that State Farm doesn't penalize an individual for not having credit activity. Mr. Lessmeier related his belief that the market place has worked well in Alaska and he believes it will continue to do so. Furthermore, he said he believes that the Division of Insurance has significant oversight to allow [credit scoring] to work properly and stop situations in which it isn't working properly. Therefore, Mr. Lessmeier encouraged the committee to not entirely prohibit the use of [credit scoring].

Number 533

REPRESENTATIVE HALCRO recalled Senator Donley's bill that provided the director of the division the ability to go after some unfair trade practices without having to prove a systematic trail of abuses. Therefore, the director could go after the first sign of abuse, which seems to address any abuse.

MR. LESSMEIER said he thinks the director has significant authority to stop anything that the director believes to be unfair. He indicated that directors have ways of stopping an unfair practice without going "to that point." He reiterated the need to document and stop specific abuses that can be documented. Furthermore, if the division needs a tool to help it with its regulatory authority, then let's provide the division with that tool. For example, Ms. McNair-Grove indicated that insurers may be reluctant to show the division their formula due to their belief that the formula is proprietary. If that fear could be removed via a guarantee of confidentiality, then it would seem that the division would have

an easier task of reviewing these filings. Mr. Lessmeier mentioned that he has had a client who has experienced problems with the lack of sufficient confidentiality laws. He reiterated State Farm's belief that taking the tool [of credit scoring], which does have value as a predictor and can be used appropriately, is bad for the insuring public in general.

Number 506

CHAIR MURKOWSKI requested that Ms. Lessmeier take the committee through how State Farm would deal with a senior citizen who doesn't have any active credit history. What would State Farm look at in order to place such an individual, she asked.

MR. LESSMEIER related his understanding that no credit activity wouldn't be a negative factor and the individual would still receive an underwriting score.

CHAIR MURKOWSKI surmised then that such an individual would enter State Farm at the same level as any other new applicant. Without a credit history, can a senior citizen "bump herself up" with regard to homeowner's insurance.

MR. LESSMEIER answered that State Farm only uses the underwriting score to improve someone's status for homeowner's insurance. Furthermore, that has only be utilized since September 2001 and, to his knowledge, has only been done in two instances. With regard to auto insurance, Mr. Lessmeier related his understanding that an individual without a credit history isn't penalized.

CHAIR MURKOWSKI said, "But they can't move up."

MR. LESSMEIER related that he didn't believe such an individual would be penalized in any way. Mr. Lessmeier said that the real question would be whether this individual would qualify for placement in the mutual company based on the other traditional underwriting criteria. He said he believes that such an individual would qualify for placement in the mutual company.

CHAIR MURKOWSKI recalled earlier testimony that an individual with some "black eyes" on their driving record, but with an excellent credit history could be placed in the preferred category. However, an individual with a clean driving record but not so good credit history might be treated differently.

MR. LESSMEIER said that he didn't believe that was referencing a State Farm applicant. He expressed disbelief that one's credit history could override two DUIs. Mr. Lessmeier related his understanding that the only way that State Farm would use credit history would be for an initial applicant in order to write that initial applicant when the company wouldn't otherwise or to place the client in the mutual company rather than the standard.

Number 464

CHAIR MURKOWSKI recalled Mr. Lessmeier's question regarding whether complaints filed with the division have been found to be valid with regard to the use of credit scoring.

MS. McNAIR-GROVE explained that the division is still looking into those complaints. The division has had difficulty in obtaining clear answers from the insurers with regard to the decisions they made. She said she didn't believe any of the complaints had reached investigation status at this point.

REPRESENTATIVE ROKEBERG recalled Ms. McNair-Grove's testimony regarding the number of companies that have applied, withdrawn, and were approved. He estimated that her figures meant that about 80 percent of the applicants either withdrew or weren't approved by the division. He asked if that is the normal rate of attrition.

MS. McNAIR-GROVE said that is a rather high rate that isn't a normal rate at which the division disapproves filings.

REPRESENTATIVE ROKEBERG commented that this is fairly telling in that it indicates that the division is fairly aggressive and doing its job.

MS. McNAIR-GROVE, in response to Chair Murkowski, related her belief that the high number of withdrawals is related to the use of the proprietary models that resulted in the companies not wanting to disclose that information.

Number 428

MR. LESSMEIER highlighted that he can only speak to what State Farm does, not the industry as a whole. He reiterated his belief that it's critical for the committee to know whether the division has seen a misuse of [credit scoring] by insurance companies in Alaska. If that misuse has occurred, it [would be helpful] to know how that misuse occurred. Only with that

information, can the determination be made as to how to correct it. Again, he said he didn't believe it would be wise to entirely preclude the use of a tool that has beneficial uses merely because of anecdotal evidence or evidence from other jurisdictions that may have different regulatory schemes.

MR. LESSMEIER highlighted the importance of knowing that overall, insurance rates are determined by the frequency and severity of loss. There have been suggestions [in the Senate] that rates in Hawaii are low due to the ban on the use of credit scoring. He related that any assertion to that effect reflects a misunderstanding of the factors that do influence insurance rates. The only thing credit scoring relates to is in regard to what business is written by what company and who pays.

REPRESENTATIVE ROKEBERG asked if Mr. Lessmeier is suggesting that because of FCRA, "we couldn't do what we're contemplating doing here."

MR. LESSMEIER replied that he believes part of what is being contemplated could be accomplished. He related his understanding of FCRA that even if [HB 395] is passed, some of the direct writers will use credit scoring in order to target those they want to solicit via the mail, which he likened to the unsolicited credit card applications. He didn't believe such could be stopped.

CHAIR MURKOWSKI remarked that some good issues have been raised such as Representative Halcro's suggestion for a guarantee of confidentiality and Representative Rokeberg's comments regarding the impact to the underwriter. Enough legitimate questions have been raised, and therefore she requested that the sponsor take under [advisement] and report back to the committee.

REPRESENTATIVE CRAWFORD announced his desire to review HB 395 and address the unintended consequences.

ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 6:04 p.m.