

**SB**

**320**

# FISCAL NOTE

STATE OF ALASKA  
2002 LEGISLATIVE SESSION

Fiscal Note Number: \_\_\_\_\_  
Bill Version: SB 320  
( ) Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: DCED  
Title Motor Vehicle Insurance & Repairs BRU Insurance (116)  
Component Insurance Operations  
Sponsor Senator Cowdery  
Requester Senate Transportation Component No. 354

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

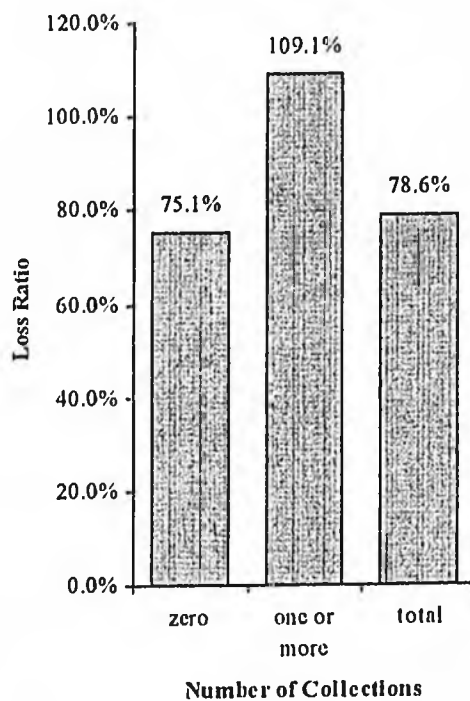
This bill has no fiscal impact on the operations of the department.

Prepared by: Bob Lohr, Director  
Division: Insurance  
Approved by: Deborah B. Sedwick, Commissioner  
Agency: Department of Community & Economic Development

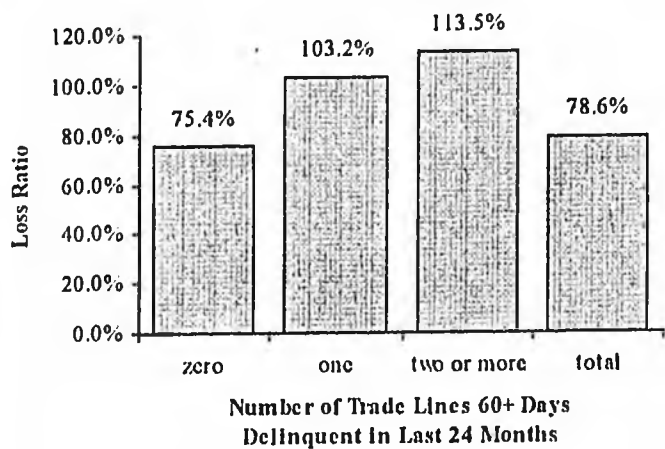
Phone 907-269-7896  
Date/Time 2/26/02 10:06 AM  
Date 2/26/2002

## Relationship of Three Credit Characteristics to Automobile Insurance Loss Ratios

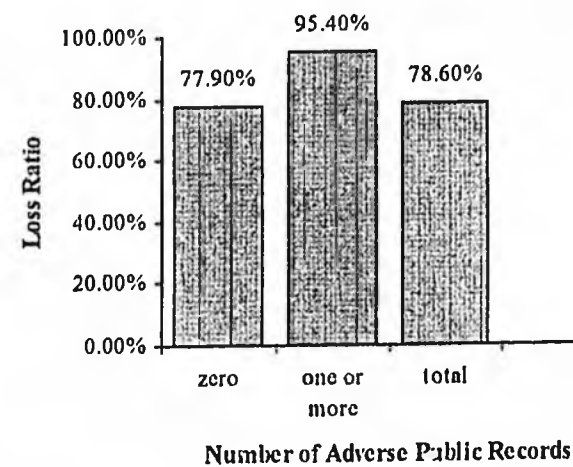
Relationship of Loss Ratio to Number of Collections



Relationship of Loss Ratio to Number of Credit Lines  
60+ Days Delinquent in Last 24 Months

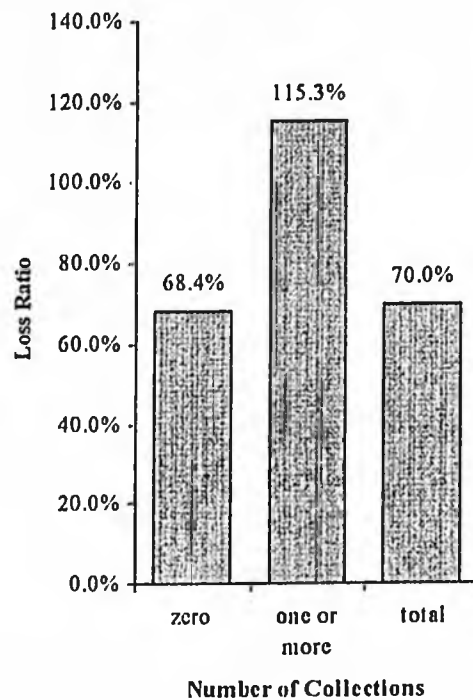


Relationship of Loss Ratio to Number of Adverse  
Public Records

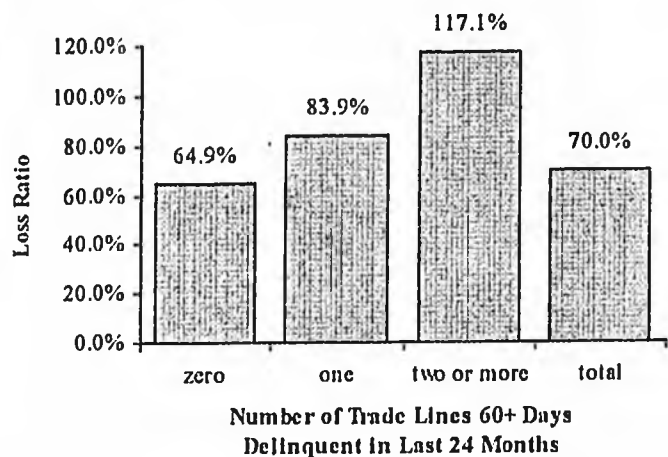


## Relationship of Three Credit Characteristics to Homeowners Insurance Loss Ratios

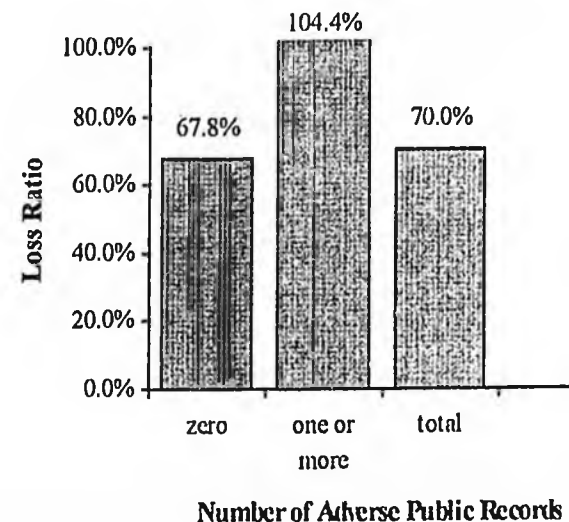
Relationship of Loss Ratio to Number of Collections



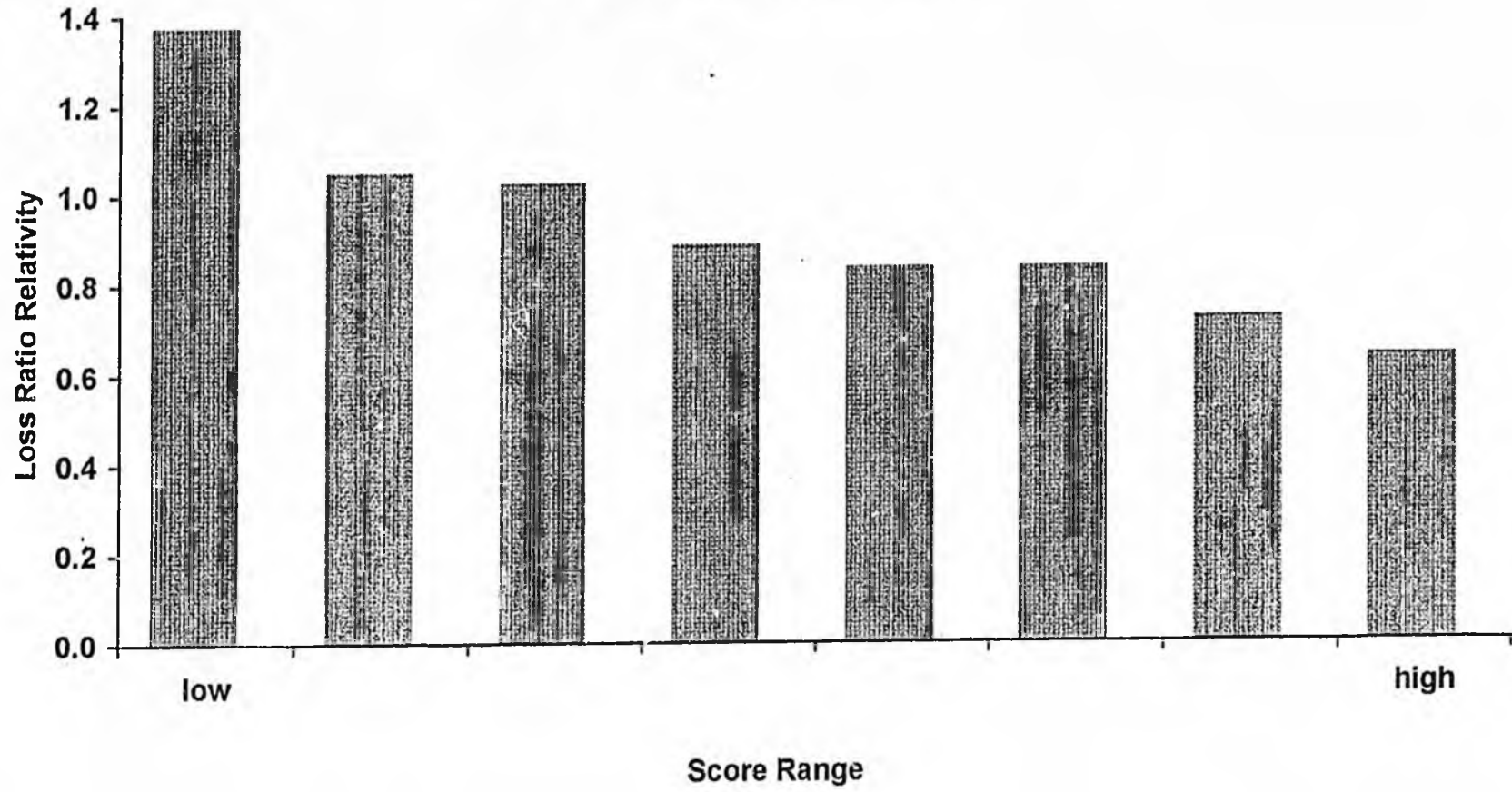
Relationship of Loss Ratio to Number of Credit Lines  
60+ Days Delinquent in Last 24 Months



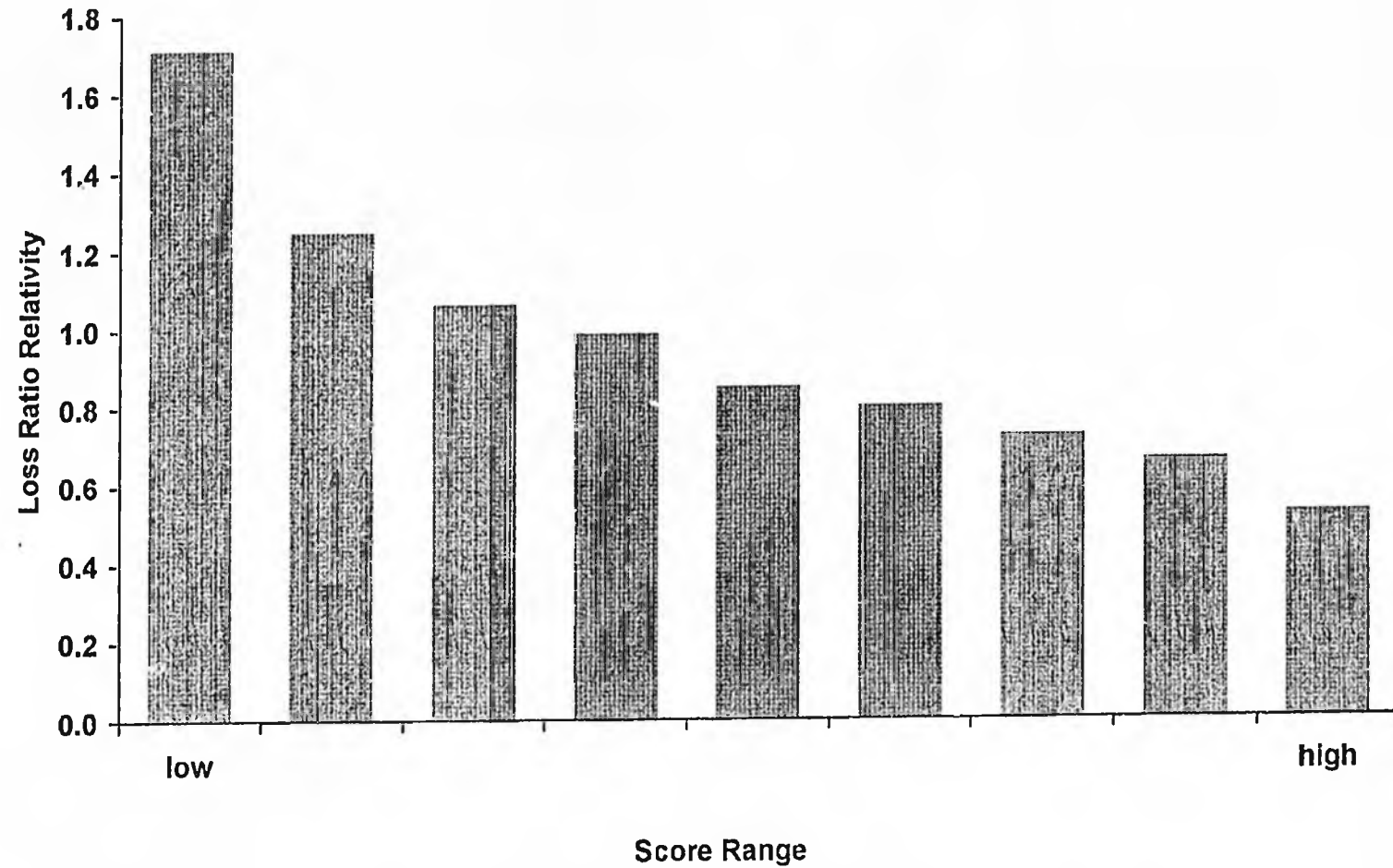
Relationship of Loss Ratio to Number of Adverse Public Records



### Personal Auto Insurance



### Homeowners Insurance



Michael Harrold  
Northwest Regional Manager

**Statement of the  
National Association of Independent Insurers  
to the  
Alaska Senate Transportation Committee  
Regarding Senate Bill 320**

February 28, 2002

The use of credit reports by auto and homeowners insurance companies is not a new idea. The federal Fair Credit Reporting Act was enacted in 1970. The Act specifies purposes for which credit reports may be used. The underwriting of personal insurance is expressly listed as one of the permitted uses of credit reports.

Thus, auto and homeowners insurers have been using credit reports for the past thirty years. However, until about eight years ago, credit reports were not widely used by insurers. About eight years ago the Fair, Isaac company made insurance scores based on credit available to insurers. Since then other companies, including some insurance companies themselves, have developed scoring systems.

There is a significant difference between an insurance score based on credit information and a credit score. Insurance scores are different than credit scores. Financial institutions, credit card companies, department stores, 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.

A credit score measures the likelihood that a person will make his or her loan payments. The insurance score measures the likelihood of future insurance losses.

Credit scores and insurance scores may consider some of the same items in a credit report, but the analysis is completely different. A credit score helps a bank predict whether a person will pay back a loan. An insurance score helps an insurance company predict whether or not a person will have a loss that is covered by an auto or homeowners insurance policy.

During the past decade, Fair, Isaac and some insurance companies have developed systems which analyze how certain credit characteristics relate to automobile and homeowners insurance losses. Credit-based insurance scores are the 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. These analyses have shown that some credit characteristics are related to the risk of loss.

For example, Graphs A and B, which are based on Fair, Isaac's initial research, show the relationship between delinquent accounts, adverse public records, and collections and the loss ratios for nearly one-half million insurance policies. Loss ratio is the ratio of losses to premiums. Loss ratio is generally expressed in terms of percentages – so if an insurance company paid \$70 in claims on a policyholder who paid \$100 in premiums, the loss ratio for the policyholder would be 70%.

The analyses of credit reports and loss ratios of millions of automobile and homeowners insurance policyholders 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. 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 credit information that goes into the development of insurance scores includes the following credit characteristics:

- amounts past due at least thirty days
- public records (bankruptcies, tax liens, civil judgments and foreclosures)
- collection records transferred to a collection agency
- outstanding debt
- age of oldest credit line
- new applications for credit
- types of credit in use (home loan, car loan, credit card)

Each of these factors is given a weight based on how well the factor relates to the likelihood of an insured loss. The factors are combined to produce an insurance score.

Those are some of the factors that go into an insurance score. Here are factors that are not included in an insurance score:

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

A person's insurance score is based on the application of the insurance scoring model to that person's individual credit report.

Each person's insurance score correlates to a level of loss ratio relativity. The general relationship between insurance scores and loss ratios is depicted in graphs C and D.

The existence of the correlation between insurance scores and risk of loss has been verified in numerous studies. A paper published one year ago by the Casualty Actuarial Society examined a database of nearly 200,000 automobile and homeowners insurance policies. The paper concluded that each of the three credit characteristics in graphs A and B showed "a systematic predictive power" on loss ratio relativities.

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."

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."

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. 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.

The fact that an insurance score based on credit information correlates to a person's risk of loss does not completely explain why car and homeowners insurance companies are using insurance scores. In fact, credit based insurance scores are not a departure from the fundamental goals of insurance underwriting and rating. Personal lines insurance companies are using 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." Instead, insurance scores are based on solid statistical data.

### *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 past claims are not disclosed on insurance applications. It is estimated that incorrect information results in an overall 10% premium inadequacy. Motor vehicle records 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 MVR's were actually there.

Insurance applications, MVRs, and other 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.

### *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.

### *Equity*

A fundamental principle of insurance is that the premium charged to a person should reflect that person's risk of loss. Insurers have a responsibility to continually refine their risk classifications and their rating procedures so that premiums reflect loss potential. 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 ratios. 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.

### *Availability*

The NAII recently surveyed some of our personal lines insurers on their use of credit information. We asked companies if credit information helps them to write more business.

Our 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. In addition, 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.

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.

February 28, 2002

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In 1996, the NAIC issued a white paper on the use of credit information. In the paper several regulators cautioned against restricting insurers' use of credit information. The white paper observed:

“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.” *(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 drivers and homeowners. Restrictions on the use of insurance scores should be approached with great caution.

Respectfully submitted by:

Michael Harrold  
Northwest Regional Manager

**Subject: SB 320**

**Date: Wed, 27 Feb 2002 19:32:08 -0600**

**From: "Larry Kibbee" <LKibbee@allianceai.org>**

**To: <Senator\_John\_Cowdery@legis.state.ak.us>**

February 27, 2002

Sen. John Cowdery  
Chairman, Senate Transportation Committee  
State Capitol, Room 101  
Juneau. AK 99801-1182

Dear Senator Cowdery:

The Alliance of American Insurers is an insurance trade association representing over 325 property/casualty insurers, some of whom do business in Alaska. I am the Vice President and Northwest Regional Manager for the association, with offices in LaConner, Washington.

The Senate Transportation Committee is scheduled to hear testimony on SB 320 on February 28. I can not be in Juneau to testify personally, but I would like to provide Alliance observations on the bill that I hope will be offered for the hearing record.

Section 1 deals with the process of providing a warranty to, and gaining the consent of, an insured if an aftermarket part is used to repair an automobile. I can't comment specifically on the warranty issue at this time because it is under review by our staff, but I can say that the Alliance does support the use of aftermarket parts that have been certified by the Certified Automobile Parts Association (CAPA). I read the bill to allow the use of certified aftermarket parts, and we would agree with that point.

Our major concern with the bill is in Section 2. By eliminating the right of an insurer to consider a person's credit history, or credit score, when determining rates for automobile insurance, the bill would penalize many good drivers in Alaska who currently pay lower premiums because of good credit histories. The bill would also create a system of subsidation, where good drivers would pay more to support the bad driving habits of those who are higher risks.

Alliance member companies, and other major companies that write auto insurance for your constituents, have learned by experience that a direct correlation exists between credit scores and insurance losses. In addition, the actuarial firm of Tillinghast-Towers Perrin completed an independent study on credit scores that has been included in a report by the National Association of Insurance Commissioners (NAIC). The study reviewed the automobile policies of several large insurers and found, with a better than 99 percent confidence level, that there is a clear relationship between credit scores and the likelihood of insurance claims. Credit scores have been compared to a measurement of care and responsibility. How one manages debt and financial obligation is actually a very good predictor of how one manages risk of loss.

The majority of people have good credit and resulting high credit scores. Those people will receive better rates overall than those drivers with a statistically higher chance of loss. One Alliance member company has used credit scores as a rating factor in over 20 states during the past four years.

It is their experience that fewer than 10 percent of policyholders get premium surcharges due to credit scores. The majority of policyholders

get premium reductions because of their good credit records.

Our experience also shows that credit scores do not discriminate against low income drivers or minorities. First of all, federal law is very specific about what factors may not be considered in an insurance credit score. They include: ethnicity, gender, religion, gender, marital status, nationality, age, income and address.

Some people have expressed concern that they will be unfairly discriminated against based on their income. Actually, people of all economic levels have good and bad credit records. A credit score is not a measure of wealth...it is a measure of responsible habits.

I would also like to point out that a lot of regulatory oversight and authority currently exists where the use of credit scoring is concerned. The federal Fair Credit Reporting Act includes specific procedural elements that insurers must follow in obtaining credit scores, and in notifying policyholders if an adverse action is taken because of credit histories. In your state, the Insurance Director has authority to deny the use of any rate, or rating plan, that is deemed excessive or unfairly discriminatory.

Finally, I would like to call your attention to the current legislative experience as sessions progress in states like Washington and Idaho. In Washington, legislators have rejected an initial legislative proposal that would have placed an arbitrary percentage cap on rates due to consideration of credit scores. In place of the rating cap, insurers and lawmakers have reached a compromise on certain elements of personal credit history that can not be used to develop the score used in the rating process.

In Idaho, the legislation has always allowed the use of credit scores in the rating process, but seeks only to determine the manner in which credit scores must be used in association with other variables to determine the auto rates for certain classes of business.

I urge you and other members of the Transportation Committee to look closely at the insurance credit scoring process before moving forward with legislation that would ban the use of a highly predictive factor in automobile insurance rate making. I offer you the experience of our member companies in examining the issue, and I am sending by FAX to your office an Alliance publication that discusses in detail the credit scoring factors that I have addressed in this letter.

Please be in touch if I can provide additional information on SB 320. I look forward to visiting with you soon on this issue in Juneau as the legislative session moves forward.

Larry E. Kibbee  
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Alliance of American Insurers  
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# SOLUTIONS

## Giving Credit Where Credit Is Due

*Credit scoring is a valuable underwriting and rating tool, but as controversy mounts, questions arise over what exactly it is, how insurance companies should use it, and how companies can address concerns regarding this tool.*

*Underwriting* is the systematic process by which insurers evaluate new applicants for insurance, as well as their current policyholders. Insurance companies and their policyholders both benefit when insurers make sound underwriting decisions since underwriting is the key ingredient to company solvency and fair pricing.

The underwriting process involves evaluating the applicant or policyholder (the "risk") by using objective information about the risk, selecting those risks eligible for coverage, classifying risks so that policyholders are grouped with those having similar characteristics and likelihood of loss, and rating the risk. Underwriters can never know with certainty which applicants will have numerous future claims, and which will have very few, or even no, claims. However, good underwriters are able to rely on their professional experience along with objective underwriting tools to predict the likelihood, and expected frequency with which, applicants or current policyholders will have claims. Those tools may include motor vehicle records, prior loss history reports, home inspections, and credit history or credit scores.

### What is Credit Scoring?

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.

*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 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.

### **How Does it Work?**

Insurers have relied upon credit reports and Dun and Bradstreet reports to determine the financial well-being of commercial risks for many years. But the application of credit information to automobile and homeowners underwriting and rating is still a comparatively new practice. There have been several studies documenting a clear correlation between credit score and chance of loss. Statistically, the higher the credit score, the lower the risk of loss. In fact, the statistical studies on the relationship between score and loss frequency are so convincing that opponents of insurer use of credit scores rarely contest their statistical validity.

Despite the statistical evidence, it may still be difficult to understand what credit has to do with risk of loss. What does credit have to do with driving habits or home maintenance? Credit scores reveal a picture of the individual's ability to handle and manage credit — they objectively measure such subjective concepts as responsibility and stability, allowing insurers to gain a more accurate picture of subsequent risk and potential losses. The use of credit reports, then, adds another level of sophistication to the underwriting process that allows insurers to underwrite their business with a higher degree of certainty.

### **Why Is Insurer Use of Credit Scoring So Controversial?**

Credit histories and credit scores have been available to insurers for use in their underwriting and rating decisions for many years. The Federal Fair Credit Reporting Act expressly granted insurers access to their customers credit information as far back as 1971.

However, since 1998, the number of insurers using credit scoring has more than doubled as evidence of its value as an underwriting and rating tool — that is, as an accurate predictor of future loss — continues to mount. A recent study by Conning and Co. found that 92

percent of the largest personal lines insurers are using credit scoring in underwriting and/or rating decisions.

But if the statistical validity of credit scores is widely accepted, and if so many insurers use credit scores, why has this become such an emotional issue? There have been several common concerns voiced by policyholders, insurance agents, consumer advocacy groups, legislators and regulators.

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. This just isn't so. Insurers are in the business of writing 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.

Insurers have also been charged by consumer advocates, policyholders, and even their own agents, with failing to be open and honest about how credit scoring is used. Until recently, consumers could not easily review their own credit scores and did not have much information on the process. Fortunately, insurers and independent scoring "modelers" have now gone to great lengths to "demystify" the process by better explaining to consumers how credit information is used in insurance, how credit scores are determined, 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 by claiming that it is discriminatory toward lower income individuals. In actuality, people of all economic levels have good and bad credit records, and insurers may use credit reports as a tool that increases fairness through the use of another objective standard. Further,

federal law prohibits the factors of ethnicity, religion, gender, marital status, nationality, age, income and address from being considered in a credit score.

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 considered by insurers. One large insurer recently confirmed that out of more than 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.

Privacy is another issue that has been raised in opposition to the use of credit reports. Today, more than ever, consumers are concerned with privacy and confidentiality of personal records. Fortunately, credit scoring actually allows an underwriter to carefully evaluate a risk *without* the disclosure of sensitive or private information. 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 should be assured that their insurer's use of a credit history will not jeopardize their privacy.

### Should Insurer Use of Credit Information be Prohibited?

Legislators and/or regulators in numerous states are currently evaluating insurer use of credit information. Many people have called for a prohibition on the use of credit information in the interest of "fairness" to all consumers. Actually, a prohibition on the use of credit information or credit scores would not be fair at all!

Several large companies have now tracked their experience with credit scores long enough to prove that more insureds benefit from the use of

credit scores than not. This means that if credit scores could not be used as an underwriting tool, a majority of policyholders would pay *more* than their fair share for insurance.

Further, the use of credit scoring does *not* make it difficult for people to buy insurance. Credit scoring allows insurers to more accurately underwrite and rate their business. And when insurers can evaluate applicants with greater confidence, they are able to accept many applicants they might not have accepted in the past. In short, the use of credit scoring may improve insurance availability.

Finally, it is important to remember that not all insurers will choose to use credit information in their underwriting and rating decisions. Consumers who strongly object to the use of credit information may seek insurers who do not use credit scoring.

### Future Political and Regulatory Outlook

Currently, legislators and/or regulators in at least half of the states are reviewing insurer use of credit scoring in personal lines underwriting. Even in some states where legislation was only recently enacted or regulation adopted, the practice is again under review. Despite all the evidence on the value of credit scoring, including evidence supporting improved rating treatment or product availability for the majority of policyholders, allegations still persist that use of credit is "bad public policy." But real company evidence that insureds directly *benefit* from the use of credit scoring may be more compelling to legislators or regulators than any of the currently available statistical studies. ■

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## Frequently Asked Questions

### ***What is an insurance credit score and how is it calculated?***

An insurance credit score, typically just referred to as a "credit score," is a number that is used to predict the likelihood of future insurance losses. The score is generated by entering specific information from one's financial history, including information related to outstanding debt, the length of one's credit history, late payments, bankruptcies or collections, and types of credit used, into a computer model designed to calculate a 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.

### ***How does a credit score relate to driving record?***

There is a proven statistical relationship between credit scores and insurance losses. The actuarial firm of Tillinghast-Towers Perrin completed an independent study on credit scores that has been accepted by the National Association of Insurance Commissioners. The study reviewed both the automobile and homeowners policies of several large insurers and found (with a better than 99 percent confidence level) that there is a clear relationship between credit score and likelihood of insurance claims.

Credit scores have been compared to a measurement of care and "responsibility." How one manages debt and financial obligation is actually a very good predictor of how one manages his or her risk of loss.

### ***How can policyholders benefit if insurers use credit scoring?***

The majority of people have good credit and resulting high credit scores. Those people will receive better rates overall than those drivers with a statistically higher chance of loss.

### ***Aren't credit scores just an excuse for insurance companies to cancel policies or charge higher rates to their policyholders?***

In fact, just the opposite is true. The use of credit scores adds another level of sophistication to the underwriting process that allows insurers to accept business with a higher degree of certainty. This means that credit information, when used as an underwriting tool, provides insurance companies with a greater opportunity to write business in all markets.

Insurers are looking to write more business, not less. Insurance is a very competitive business, and any company that would seek to cancel business or charge high rates wouldn't stay in business very long.

### ***Can consumers see their credit score?***

Yes. Several credit bureaus and vendors now make credit scores available to individuals for a small charge. In fact, some credit bureaus recommend that individuals review their own credit information at least yearly to check for any errors or incorrect information.

### ***Don't insurance credit scores allow insurance companies to discriminate against low-income drivers or minorities?***

Absolutely not. Federal law is very specific about what factors may not be considered in an insurance credit score. Ethnicity, religion, gender, marital status, nationality, age, income and address may not be included within an insurance credit score.

Many people have expressed concern that they will be unfairly discriminated against based on their income. Actually, people of all economic levels have good and bad credit records. A credit score is not a measure of wealth – it's a measure of responsible habits. Further, because credit scoring relies on real data and statistics, it provides an objective method of evaluating a risk – free from either intentional or unintentional subjective or judgmental bias.

### ***Doesn't the use of credit scores make it very difficult for people to buy insurance?***

No. Several large companies have now tracked their experience with credit scores long enough to prove that more insureds benefit from the use of credit scores than not. Credit scores allow insurers to more accurately underwrite and rate their business. And when insurers can evaluate applicants with greater confidence, they are able to accept many applicants that they might not have accepted in the past. In short, the use of credit scoring has improved insurance availability.

### ***Isn't insurer use of credit scores an invasion of consumer privacy?***

Credit scores provide the insurer only with a predictive numerical score – not with specific details as to credit history. Neither the underwriter nor the agent will know the details of the applicant or policyholder's credit history.

Sponsor Statement  
Committee Substitute for Senate Bill 320 (TRA)

"An Act prohibiting discrimination in insurance rates based on credit rating or credit scoring; and providing for an effective date."

CSSB 320 (TRA) relates to insurers using credit scoring and or rating in determining insurance policy rates and premiums. What does your credit score have to do with how much you pay for automobile insurance? EVERYTHING!

Currently Alaska allows credit scoring to be part of insurance company rating plans, in which underwriting and rate setting is done. The Alaska Division of Insurance has a statutory mandate (AS 21.36.120) to protect the Alaska consumer against discrimination. Every car and home insurance company in Alaska, except one, uses credit scoring. Companies believe this method is a way to predict risk in determining potential insurance losses. Credit has nothing to do with risk. The practice of using this data discriminates against certain types of consumers.

First of all, credit scores and credit reports are many times inaccurate and contain errors. They are also very difficult and cumbersome to correct. Divorced women are often disadvantaged, especially when left with a high debt-to-income ratio. A sudden illness or employment loss may influence credit. Minorities may not use credit the same way as others and some religions don't even believe in the use of credit. Personal circumstances become unimportant when basing rates on credit scores. This method of calculating insurance rates favors the wealthy due to low debt-to-income ratios. You can have a spotless driving record, but maybe your business failed or you have a serious medical condition in your family, or even an error on your credit report; any of these situations would make you unavailable for preferred insurance, and you will pay a lot more in premiums. People without any credit history usually pay up to 25% more. Small business owners may pay up to 40% more because they operate on a line of credit.

There are about 25 states currently considering banning the use of credit history in determining insurance rates. Hawaii banned this insurance underwriting and rate setting practice 15 years ago. Not only does Hawaii ban credit scoring, but they have gone so far as to eliminate age, gender, marital status, and length of driving experience, as well. Their premiums remain some of the lowest in the United States.

The insurance industry wants to utilize this easy method to raise rates. Because of epidemic credit problems throughout our society, this is an easy way to target consumers and raise premiums. Why are we punishing the 40-year old woman with a clean driving record simply because a divorce changed her credit status? Why are we raising the premiums of a 70-year old man with a clean driving record whose medical bills affected his credit history? Your driving record alone should be the factor for rate increases.

The bottom line is common sense. We have mandatory insurance laws in this state. By using credit scores we are making it even more difficult and expensive for the consumer to obtain insurance. Simply, SB 320 prohibits insurance companies in Alaska from using credit scores in either underwriting or rate setting practices.

22-LS1462J  
Ford  
2/26/02

**CS FOR SENATE BILL NO. 320(TRA)**  
**IN THE LEGISLATURE OF THE STATE OF ALASKA**  
**TWENTY-SECOND LEGISLATURE - SECOND SESSION**

**BY THE SENATE TRANSPORTATION COMMITTEE**

**Offered:**  
**Referred:**

**Sponsor(s): SENATOR COWDERY**

**A BILL**  
**FOR AN ACT ENTITLED**

1 **"An Act prohibiting discrimination in insurance rates based on credit rating or credit**  
2 **scoring; and providing for an effective date."**

3 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 **\* Section 1.** AS 21.39.030 is amended by adding a new subsection to read:

5 (d) An insurer or underwriter may not base a standard, rate, or rating plan for  
6 insurance, in whole or in part, directly or indirectly, upon a person's credit rating or  
7 credit scoring.

8 **\* Sec. 2.** This Act takes effect immediately under AS 01.10.070(c).



## Illinois Wins Top Spot In Economic Ranking

Illinois has displaced Michigan as the top state in a coveted economic-development ranking, thanks to a rules change.

Previously Site Selection magazine's Governor's Cup was awarded to the state landing the most new or expanded corporate facilities. That prompted smaller states to complain that bigger states had an unfair edge. For the 2001 rankings, to be announced today, nine additional criteria—including several per-capita measures—were added to "level the playing field," says Mark Arend, editor of the trade magazine published by Conway Data Inc. of Norcross, Ga.

Pam McDonough, director of the Illinois Department of Commerce and Community Affairs, agrees the new rules are "much fairer." She also credits new tax incentives, including a package that lured Boeing Co.'s corporate headquarters to Chicago from Seattle.

Officials in Michigan, which won the Governor's Cup for the past four years and would have won again if the rules hadn't changed, weren't as pleased. Kathleen Blake, senior vice president of business development for the Michigan Economic Development Corp., objects that the change was announced in November for a yearlong contest that ended in December. "They changed the rules at the 11th hour," she says. "We were shocked." Michigan tied for fourth with Virginia, behind Illinois, Kentucky and New York.

—Ken Gepfert

## Aiming at Credit Scoring

Indiana and Washington are likely to pass legislation to restrict the use of credit history in determining insurance rates and eligibility, according to insurance-industry officials.

These states are among 25 that are considering or expected to consider bills to ban or limit the controversial practice, known as credit scoring, which has become widespread in auto and homeowners insurance in recent years. The reason insurers like credit scoring: They have established a correlation that shows people with bad credit are more likely to suffer an insured loss, such as a car accident, than people with good credit.

The insurance lobby, which insists credit scoring is fair, objective and accurate, is fighting proposals to curb the practice. Critics, however, say credit scoring smacks of redlining—in which banks used neighborhood boundaries in evaluating loan requests to discriminate against the minorities and the poor.

## Economic Focus / Retail Sales

Percentage change from year earlier in retail sales (4th Qtr. 2001 vs. 4th Qtr. 2000)

### The Regions



### Biggest Gains

Texas	6.56%
New Mexico	6.35
Utah	6.33
Arkansas	6.31
Nevada	6.29

### Smallest Gains

Washington	3.47%
Hawaii	3.57
New Jersey	3.58
South Dakota	3.63
Nebraska	3.68

Source: Economy.com

## Buyers Through and Through

Consumers remained resilient spenders in many states during fourth quarter last year. The 5.2% gain in U.S. retail sales, compared with a year earlier, was caused partly by 0% auto-financing and other discounts. A big drop in gasoline prices and a record number of mortgage refinancings also gave consumers money to spend and outweighed layoff worries. Texas led in retail sales, partly because it was still adding jobs in the quarter. In Utah, sales were buoyed by preparations

for the Winter Olympics. New Mexico was boosted by increased spending at its military installations after the terrorist attacks. But recovery from the attacks' effects was uneven. Nevada started regaining some jobs lost to air-travel cutbacks, but continuing attack-related disruptions damped residents' willingness to spend in New York and Washington, D.C. Another damper in areas ranging from Boston to Seattle: hot housing markets that once fueled retail sales started to cool.

In Indiana, different versions of bills that would, at a minimum, prohibit using credit scores as the sole reason for canceling or denying coverage have passed each house of the legislature. And in Washington, bills to impose several restrictions on credit scoring, such as preventing insurers from penalizing people with no credit histories, have cleared the Senate and a key House committee.

—Robert Gavin

## Drug Crackdowns

Prompted by a spate of overdose deaths tied to abuse of painkiller OxyContin, several states are seeking to crack down on illegal use of prescription drugs.

Lawmakers in Florida, Kentucky, Ohio and Pennsylvania are considering a range of measures, including proposals to tighten physicians' standards for prescribing addictive pills, set up prescription-tracking systems to catch fraudulent users and strengthen sentencing laws for offenders. Maine has adopted tougher penalties for illegally selling OxyContin and other prescription drugs, according to the National Conference of State Legislatures, while government studies were launched in Louisiana and Virginia to study possible legislative action.

Reports of widespread OxyContin abuse first surfaced in Appalachia, where users were crushing the pill, then

snorting or injecting it. The Drug Enforcement Agency noted the painkiller was a probable factor in about 300 overdose deaths since January 2000. OxyContin maker Purdue Pharma LP, Stamford, Conn., says it supports measures that would more closely track patients seeking multiple prescriptions, and says it is developing an abuse-resistant painkiller.

—Will Pinkston

## Massive Layoffs Toll

The Northeast had the largest increase in workers losing their jobs in extended mass layoffs in the fourth quarter of 2001: The 65,305 layoffs were 70% more than those in the year-earlier quarter, new data from the Bureau of Labor Statistics shows. The South had a 40% increase in such layoffs, with 83,769. The agency tracks so-called mass layoffs, in which 50 or more workers are laid off in a single job cut, and extended layoffs, in which workers are out of a job for more than 30 days.

In sheer numbers, though, the Northeast still had the fewest total extended mass layoffs of the four regions. The West had the largest amount of workers laid off in large scale job cuts, with 178,000 layoffs, driven by job cuts in agricultural companies. Heavy construction layoffs helped give the Midwest the second highest number of layoffs: 154,367.

—Andrew Caffrey

*The Impact of Personal Credit History on Loss  
Performance in Personal Lines*

James E. Monaghan, ACAS, MAAA

#### *Claims Consciousness*

An insurer's loss experience measures dollars of loss which are paid on claims that are filed. The number of claims filed is less than the number of accidents that actually occur. Consider two risks that are identical in all ways (from an insurer's perspective) except for the fact that one manages their financial affairs much better than the other does. The risk who has a troubled financial history and condition is much more likely to be in debt and to a larger degree; the need for capital to satisfy financial obligations has a bearing on decisions made in many areas of his/her life. Suppose for example, that these two risks are both involved in an auto accident, involving no injuries, but causing property damage to their own vehicles which is some nominal amount (say, \$100) more than the deductible. The risk whose financial condition is more sound has a disincentive to file the claim. It may impact his/her rates at the next renewal; the time and effort involved may not be even worth the compensation obtained. The risk with the poorer record of financial management has a greater incentive to file the claim and obtain the compensation, as it has greater value to that individual.

#### *Fraud: Increased Severities*

Continuing with these same two risks, consider now the situation in which the damage to property was much greater than the deductible; the vehicles each sustained damage measuring in the thousands of dollars. If an auto repair technician suggested a relatively easy way of recouping the deductible for the insured, or the benefits of padding the repair costs, the individual under the greater financial pressure would be more susceptible to acquiesce. This does *not*, however, imply that risks with poor bill-paying histories have any less integrity than other risks. Some people would never commit fraud on any level; others would do so with no need for provocation or encouragement; still others could be convinced to do so only under the proper conditions. This argument only implies that any individual who *could* be induced to participate in this level of fraud would be more likely to do so if they were under financial pressure from other sources.

#### *Fraud: Increased Frequencies*

The presence of severe financial pressure could also produce claims that would not have existed otherwise. There is some segment of the population that either does or could view the insurance mechanism as a financial opportunity. Fraudulent claims in the form of staged accidents, phantom claimants, phantom vehicles or arson are a way that an individual can extract funds from the insurance mechanism. Once again, this argument does not imply anything about the integrity of a risk with poor bill-paying history. What it does assert is that an individual with severe financial pressure could look to all possible sources of funds to alleviate that pressure. Therefore, any individual who was capable of committing this type of fraud is more likely to do so given the existence of that financial pressure compared to the absence of it.

#### *Stress*

The assumption is made here that individuals who are under financial pressure from debt exist under a greater level of stress than average. This stress could exist from the associated worries over future impact of financial condition. Individuals under such stress may be less focused on proper operation of a motor vehicle and make them more susceptible to accidents resulting from chance occurrences or distraction. It would be useful if there were some other condition which could produce this same level of stress, for which loss data was available, to strengthen the argument. A few currently coded customer characteristics could be considered candidates. One such variable is number of children under the age of 16. One must first make the assumption that risks with three or more children under the age of 16 have a higher level of stress than average. Whether or not one agrees with that probably depends on whether or not they are a parent! In any case, the loss ratio for such risks reviewed in a 1993 research study was over 20 points higher than average. Another possible variable candidate could be self-employed risks. The added responsibilities and worries of a small business owner could imply that their level of stress is higher than average. From that same 1993 study, self-employed risks had a loss ratio which was roughly 15% higher than average.

It is important to make note that this list is not suggested as a menu from which to select the one correct answer. It is likely that the impact on losses of financial management history is a cumulative impact of some or all of these situations, as well as others not listed here.



*James Monaghan*

## Monaghan Wins Ratmaking Prize

James E. Monaghan, ACAS, MAAA, won the 2000 Ratmaking Prize for his paper, "The Impact of Personal Credit History on Loss Performance in Personal Lines." Monaghan has worked for Metropolitan Property and Casualty Insurance Company in Warwick, Rhode Island since 1987. He has been responsible for pricing, reserving, strategic planning, research, and developing expert systems. CAS President **Alice Gannon** presented the Ratmaking Prize and a check for \$1,000 to Monaghan. Papers can be viewed on the CAS Web Site at [www.casact.org/aboutcas/rtmkpriz.htm](http://www.casact.org/aboutcas/rtmkpriz.htm).

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See what you can save on your auto insurance.

Agent Find a

## How your credit history affects your auto and home insurance premiums

by Brendan McKenna  
insure.com

Does having bad credit make you a worse driver or a riskier homeowner?

Think you are paying too much?

Most people believe they are paying too much for their car insurance. To find out how your state ranks in comparison with others in your region and across the country, read Best and worst states for auto insurance premiums.

No, but your premium bills might make you believe that your insurance company thinks so.

According to a study by Conning and Co., more than 90 percent of auto insurance companies, and an increasing number of home insurers, use your credit information, filtered through a formula to create an "insurance risk score," to determine how likely you are

to file a claim on an insurance policy. More than half of those insurers use that information to determine how much to charge you in premiums.

Insurance risk scores are similar to credit risk scores — used by lenders to determine whether or not to approve a loan or line of credit — because both look at your credit information, but the two are *not* the same thing, says Craig Watts, a spokesperson for Fair, Isaac, and Co., whose insurance risk scores are used by about 300 insurers nationwide.

"Consumers are becoming more familiar with credit risk scoring, but insurance risk scoring is still fairly arcane," says Watts.

While both insurance scores and credit scores look at the same five characteristics of a person's credit

### A peak inside the "black box"

While Fair, Isaac & Co. will not release the details of their insurance risk scoring model to the public, spokesperson Craig Watts says that your credit score can give you an idea of your insurance risk

Term

Largest Of Ins: Insurance Cov 250,000

Plan Year 20

Gender M

Birthdate

Height

Private

No

Get (

characteristics of a person's credit report (see list at right), the data are weighted differently. This difference in weighting can swing 5 to 10 percent in each category.

"The biggest difference is that insurance risk scores look for stability, but credit risk scores look for a reliable pattern," says Watts. "Insurance scores are also more interested in how regularly you pay than in how much you already owe."

Insurers use these insurance scores to try to identify consumers who are consistent and reliable, as well as those who show a pattern of demonstrating common sense with money. Insurers say these people are less likely to file a claim on an insurance policy.

"We've studied millions of records and have found that there is a clear and reliable correlation between credit history and insurance risk," says Watts.

Allstate Insurance Co. and State Farm Mutual Auto Insurance Co., the nation's two largest auto and home insurers, have also noted this correlation and have developed their own insurance risk-scoring systems that incorporate credit information.

"We went in and looked at our data . . . to see if we could find differences between groups of people," says Mike Trevino, a spokesperson for Allstate. That analysis showed that people who have better credit — at least as reflected in their insurance scores — tend to file fewer claims, thus costing the insurer less money.

"Our feeling is that using credit information allows us to more fairly price our insurance," says Trevino. "Those that have better credit pay a lower rate."

#### Idea of your insurance risk score.

The five categories of your credit score are:

#### Past payment history (approx. 35%)

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

#### Amount of credit owed (approx. 30%)

How many accounts, what kind of accounts, and how close you are to your credit limits.

#### Length of time credit established (approx. 15%)

How long you have had credit accounts and how long you have had specific accounts.

#### New credit (approx. 10%)

Number and proportion of recently opened accounts, the number of credit inquiries, and the reestablishment of positive credit history after payment problems.

#### Types of credit established (approx. 10%)

The number and activity of various types of credit accounts including credit cards, retail store accounts, installment loans, and mortgages.

Insurers place importance on the factors that show long-term stability, so by demonstrating responsible use of credit and keeping your balances low, you should be able to improve your insurance score. That could translate into lower insurance premiums, if you've been impacted by a negative credit history in the past.

You can purchase your credit score, credit report, and tips on how to improve your score from [myFICO](http://myFICO.com), a Web site from Fair, Isaac & Co.

Dick Luedke, a spokesperson for State Farm, which uses credit information only in deciding whether or not to issue an insurance policy, points out that in some cases use of credit information has allowed State Farm to cover people that wouldn't ordinarily have qualified.

"Study after study has shown that credit history can be correlated with the likelihood that someone will file a claim," says Luedke. "We don't claim to have the definitive answer as to why there is a correlation, but we believe one exists."

### Correlations can't explain *why* insurance scoring works

Study after study has shown that credit history can be correlated with the likelihood that someone will file a claim.

That reasoning for using insurance risk scoring infuriates Georgia Insurance Commissioner John Oxendine, who is also a member of the Consumer Protection Working Group of the National Association of Insurance Commissioners.

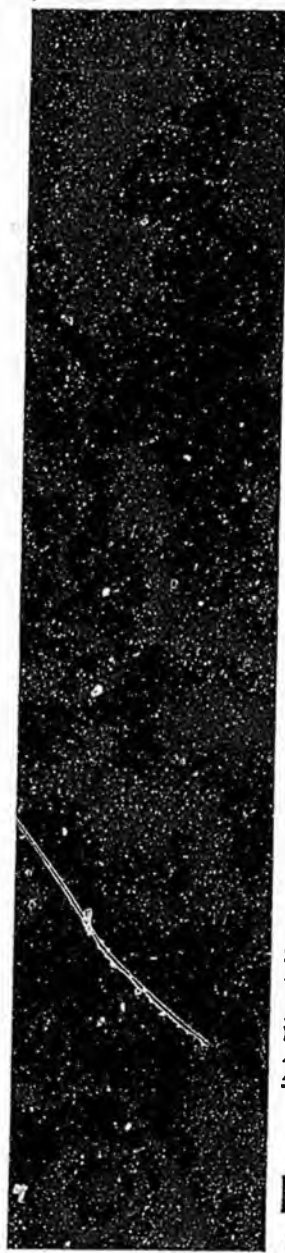
"I hear a lot of talk about correlation, but no talk about causation," says Oxendine. "Insurers don't have any reason for *why* scoring works, they just say 'correlation' over and over."

While Oxendine acknowledges that credit information — which has been used by some insurers for more than a decade — can be useful to insurance companies for avoiding insurance fraud-motivated arson and similar hazards, he places little faith in

computer-modeled insurance scores and statistical relationships.

"If you punch enough numbers through a computer you can get anything," says Oxendine. "It's time we learn about how it works and make sure the criteria they use are in the best interest of the public."

So far Oxendine has had little success in getting insurers to divulge their methods for calculating insurance risk scores. "The information currently available to consumers seems designed to limit their understanding of [insurance] scores," says Oxendine. "If you don't know the rules of the game, you can't protect yourself."



It isn't quite that simple, says Dan Kummer, an expert on credit information issues and the director of auto insurance for the National Association of Independent Insurers, a property/casualty trade organization that has been an outspoken advocate for the use of credit-based insurance risk scores for selling and pricing insurance.

The computer models used to generate insurance scores from credit information represent a tremendous investment of time and money for insurers and they don't want that proprietary information to be leaked to other companies, says Kummer.

"This is very disturbing — it's like a black box," counters consumer advocate J. Robert Hunter, the director of insurance for the Consumer Federation of America (CFA) and a former Texas Insurance Commissioner. "They haven't verified that minorities, people with disabilities, and the poor aren't discriminated against by these systems."

According to Kummer and Watts, insurance risk-scoring models *do not* discriminate. "In the studies we've done, we looked specifically at the scoring of low- to moderate-income and high minority areas," says Watts. "People in those areas score the same as in areas of higher income. We didn't see a pattern of indirect discrimination." **Go to Page 2: Growing pains and growing regulation**

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"If you punch enough numbers through a computer you can get anything."  
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*Last updated Dec. 4, 2001*

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## No credit history? It may raise your insurance

By Peter Lewis

Seattle Times consumer-affairs reporter

In the war of words over "credit scoring" — a contentious practice used by insurance companies to set rates for drivers and homeowners based on their credit history — there is at least one point of agreement among advocates and opponents:

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 <a href="#">Print this article</a>

Those without credit histories cannot enjoy the system's "benefits," meaning they pay as much as 25 percent more for insurance.

Comparing the number of adult Americans counted in the 2000 Census with the number of active-credit files maintained by major credit-reporting agencies, there appear to be between 4 million and 19 million Americans who are 18 and older without credit histories.

Critics of the credit industry say most of those are immigrants, older people, those who are culturally uncomfortable or distrustful of credit, certain religious groups or those too poor to qualify.

At its core, credit scoring is based on the belief there is a strong, statistical correlation between personal financial responsibility and the likelihood that someone will get into an accident or otherwise file a claim to recover losses.

As a result, the system works against people who cannot prove through records kept by credit agencies that they have managed their money responsibly.

The consequences of an absence of credit came to light in Yakima, where many Hispanics live, at a public hearing in October hosted by Washington state insurance commissioner Mike Kreidler.

Testifying on the subject was an insurance-agency owner, David Hargreaves of Yakima-based Argus Insurance. In a subsequent interview, Hargreaves said some Hispanics were forced to spend more on expensive policies because they lacked credit histories.

It's happened about a dozen times in the past year, he said, mostly in the last quarter, indicating the credit-scoring trend is on the upswing. "The biggest problem we have relative to the Hispanic population is that, culturally, they by and large pay cash and do not have an established credit history," Hargreaves said.

"Even though their 'credit' may be perfectly good, they pay in cash. By virtue of that, when we order a credit score, we get a 'no hit' or it shows 'no credit.' And depending on the various insurance companies, if they solely use credit scoring, then it's a negative, and they get placed in a more 'surcharged' market," he said.

Depending on the particular insurance company's policy, the resulting difference will cost clients without credit histories from 10 to 25 percent more for auto insurance, Hargreaves said.

Kreidler, the insurance commissioner, recounted the impact on Hispanics, among other groups, in a presentation for state lawmakers in November. He used the occasion to announce his intent to introduce legislation in the upcoming legislative session to curb the practice, which has become widespread in the industry.

Kreidler, who fears credit scoring could increase the number of uninsured motorists, wants to ban it as the sole criterion to cancel, nonrenew or deny coverage. He also wants to cap at 20 percent the premium differential tied to credit scoring.

Kreidler acted after listening to scores of consumers at four public hearings last fall. Some consumers questioned the reliability of the underlying data in credit reports, and the potentially discriminating impact of credit scoring on divorced people, those with sudden, staggering medical expenses and victims of identity theft.

### Even agents are frustrated

Credit scoring is an evolving technology that assigns a point value to attributes such as payment history, outstanding debt and the number and types of accounts. No two models are alike, and different companies can give more or less weight to the overall value of credit history vs. more traditional measures, such as driving history, accident records and claims.

Representatives of the insurance industry maintain that credit scoring is an objective, effective tool to place consumers into the appropriate risk categories. They further assert it permits companies to write more policies and to charge lower premiums for many consumers.

But because the companies do not spell out how they arrive at scores (they consider it intellectual property), some insurance agents have become frustrated trying to explain to customers decisions that neither agent nor customer fully understands. Also worrisome, agents say, is the move by some companies to cut underwriting costs by downgrading or ignoring traditional yardsticks.

Even the system's advocates acknowledge that consumers with no credit history become instant losers. "We're not penalizing anybody. But they (people without credit history) won't get a reward for having good credit," said Michael Harrold, northwest regional manager of the National Association of Independent Insurers, an industry trade group with more than 690 members who write \$98 billion in premiums annually.

### Discrimination seen

Among those apparently not getting a reward are members of certain ethnic and religious groups, including Hispanics, Asians, strictly observant Muslims and older Americans who lived through the Depression and do not believe in credit.

"Most immigrant communities have some kind of mechanism where people pool their money with each other to have capital to begin whatever projects they need," said KaYing Yang, executive director of Searac, a Seattle-based advocacy group for the Southeast Asian community. "I believe the Korean name is 'kae.'

"The question about credit is a serious one," Yang said. "People don't want to have debt in the cultures I'm aware of. At the end of the year, before the new year, they pay off debt." This is particularly common in the Vietnamese-American community, she said, "to start the new year fresh."

Then there are observant Muslims. The Koran outlaws the paying of interest. "To make money on money without working for it is not allowed," said Jamil Abdul Razaak, spokesman for Seattle's Idriss Mosque. There are many Muslims who overlook the prohibition out of necessity, he said. But some strict followers of the Koran could interpret ownership of a credit card as a violation, even if they do not allow finance charges to accrue, Razaak said.

Others have an aversion to credit because of their life experience. Bruce Reeves, lobbyist for the Senior Citizens Lobby, an Olympia-based advocacy group, said that many older people who went through the Depression "have a pretty jaundiced feeling about who we trust to do business with, and how we handle our money. A number of people don't have credit cards."

Birny Birnbaum, a former assistant insurance commissioner in Texas who now works as a consultant, maintains that credit scoring discriminates against the poor, who generally have a harder time qualifying for credit.

Pete McCorkell, a former vice president for Fair, Isaac, a California-based company that has developed some of the most heavily used credit-scoring models, acknowledged that poor people and minorities are turned down for credit more often than others. But he maintained such outcomes are based on sound data and represent an accurate assessment of the risks they pose.

Mike Trevino, a spokesman for Allstate Insurance, said his company insures customers without credit histories, but they pay more. They are charged more because data show that such customers "perform worse" than the average Allstate customer. In other words their "loss costs" tend to be 12 percent to 25 percent more than average.

Still, Trevino acknowledged that, intuitively, it feels funny to charge customers more for the absence of certain characteristics rather than for things they actually did, like piling up debt or having too many accidents.

Andy Schoenholtz, a professor at Georgetown University who has studied international immigration, said many immigrant groups "have no idea what the U.S. credit system is." They often come from places with no formal financial structures or where such institutions were reserved for the wealthy or business interests.

That does not mean that such people are not credit-worthy, Schoenholtz said. He says he believes that financial institutions need to figure out nontraditional ways of tracking the saving, spending and regular payments made by those in immigrant communities.

It's only smart business to do so, the professor added, because otherwise the financial institutions and insurance companies "are missing a market for themselves."

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# Comparison of Premium by Household Income

Maryland Division of Insurance

**INCOME**  
**\$45,998**

Premium =  
1.8%  
of Income

**Premium**  
**\$892**

Zip Code  
21210

**INCOME**  
**\$14,813**

Premium =  
9.2%  
of Income

**Premium**  
**\$1,357**

Zip Code  
21217

# Comparison of Premium by Population Composition

