

HB

47

CS FOR HOUSE BILL NO. 47()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:

Referred:

Sponsor(s): REPRESENTATIVES CHENAULT, Wolf, Stevens, Crawford

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to using credit rating or credit scoring for insurance purposes; and
2 providing for an effective date."

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

4 * Section 1. The uncodified law of the State of Alaska is amended by adding a new section
5 to read:

6 PURPOSE. The purpose of this Act is to regulate the use of credit information for
7 personal insurance so that consumers are afforded certain protections with respect to the use
8 of credit information.

9 * Sec. 2. AS 21.36 is amended by adding a new section to read:

10 Sec. 21.36.460. Use of credit information. (a) An insurer authorized to do
11 business in this state that uses credit information to underwrite or rate risks may not

12 (1) use an insurance score that is calculated using the income, sex,
13 address, zip code, ethnic group, religion, marital status, or nationality of the consumer
14 as a factor;

1 (2) deny, cancel, or not renew a policy of personal insurance solely on
2 the basis of credit information, without consideration of any other applicable
3 underwriting factor independent of credit information; this paragraph does not
4 authorize the use of factors prohibited under (1) of this subsection;

5 (3) base an insured's renewal rates for personal insurance solely on
6 credit information, without consideration of any other applicable factor independent of
7 credit information;

8 (4) take an adverse action against a consumer solely because the
9 consumer does not have a credit card account, without consideration of any other
10 applicable factor independent of credit information;

11 (5) consider an absence of credit information or an inability to
12 calculate an insurance score in underwriting or rating personal insurance, unless the
13 insurer does one of the following:

14 (A) treats the consumer as otherwise approved by the director if
15 the insurer presents information that the absence or inability relates to the risk
16 for the insurer;

17 (B) treats the consumer as if the applicant or insured had
18 neutral credit information, as defined by the insurer; or

19 (C) excludes the use of credit information as a factor and uses
20 only other underwriting criteria;

21 (6) take an adverse action against a consumer based on credit
22 information, unless an insurer obtains and uses a credit report issued or an insurance
23 score calculated within 90 days from the date the policy is first written or renewal is
24 issued;

25 (7) use credit information unless, not later than every 36 months
26 following the last time that the insurer obtained current credit information for the
27 insured, the insurer recalculates the insurance score or obtains an updated credit
28 report; notwithstanding the requirements of this paragraph,

29 (A) at annual renewal, on the request of a consumer or the
30 consumer's agent, the insurer shall again underwrite and rate the policy based
31 on a current credit report or insurance score; an insurer is not required to

1 recalculate the insurance score or obtain the updated credit report of a
2 consumer more frequently than once in a 12-month period;

3 (B) the insurer may obtain current credit information upon any
4 renewal before the 36 months if consistent with its underwriting guidelines;

5 (C) an insurer is not required to obtain current credit
6 information for an insured under the requirements of (A) of this paragraph if
7 one of the following applies:

8 (i) the insurer is treating the consumer as otherwise
9 approved by the director;

10 (ii) the insured is in the most favorably priced tier of the
11 insurer, within a group of affiliated insurers; however, the insurer may
12 order a credit report if consistent with the insurer's underwriting
13 guidelines;

14 (iii) credit was not used for underwriting or rating the
15 insured when the policy was initially written; however, the insurer may
16 use credit for underwriting or rating the insured upon renewal if
17 consistent with its underwriting guidelines; or

18 (iv) the insurer reevaluates the insured beginning not
19 later than 36 months after inception and thereafter based on other
20 underwriting or rating factors, excluding credit information;

21 (8) use the following as a negative factor in insurance scoring
22 methodology or in reviewing credit information for the purpose of underwriting or
23 rating a policy of personal insurance:

24 (A) credit inquiries not initiated by the consumer or inquiries
25 requested by the consumer for the consumer's own credit information;

26 (B) inquiries relating to insurance coverage if identified as an
27 insurance coverage inquiry on a consumer's credit report;

28 (C) collection accounts with a medical industry code if
29 identified as a medical collection account on the consumer's credit report;

30 (D) multiple lender inquiries if coded by the consumer
31 reporting agency on the consumer's credit report as being from the home

1 mortgage industry and made within 30 days of one another, unless only one
2 inquiry is considered; or

3 (E) multiple lender inquiries if coded by the consumer
4 reporting agency on the consumer's credit report as being from the automobile
5 lending industry and made within 30 days of one another, unless only one
6 inquiry is considered.

7 (b) If it is determined through the dispute resolution process established under
8 15 U.S.C. 1681i(a)(5) (Fair Credit Reporting Act) that the credit information of a
9 current insured was incorrect or incomplete and if the insurer receives notice of the
10 determination from the consumer reporting agency or the insured, the insurer shall
11 again underwrite and rate the consumer within 30 days after receiving the notice.
12 After again underwriting or rating the insured, the insurer shall make any adjustments
13 necessary, consistent with the insurer's underwriting and rating guidelines. If an
14 insurer determines that the insured has overpaid a premium, the insurer shall refund to
15 the insured the amount of overpayment calculated back to the last 12 months of
16 coverage or the actual policy period, whichever period is shorter.

17 (c) If an insurer writing personal insurance uses credit information in
18 underwriting or rating a consumer, the insurer or its agent shall disclose, on the
19 insurance application or at the time the insurance application is taken, that it may
20 obtain credit information in connection with the application. A disclosure shall be
21 written or provided to an applicant in the same medium as the application for
22 insurance. The insurer is not required to provide the disclosure statement required
23 under this subsection to an insured on a renewal policy if the consumer has previously
24 received a disclosure statement. An insurer's use of the following example disclosure
25 statement constitutes compliance with this subsection: "In connection with this
26 application for insurance, we may review your credit report or obtain or use a credit-
27 based insurance score based on the information contained in that credit report. We
28 may use a third party in connection with the development of your insurance score."

29 (d) If an insurer takes an adverse action based on credit information, the
30 insurer shall provide the notice as required in this subsection. The insurer shall
31 provide notice to the consumer

1 (1) as required under 15 U.S.C. 1681m(a) (Fair Credit Reporting Act)
2 that an adverse action has been taken; and

3 (2) explaining the reason for the adverse action; the reason must be
4 provided in sufficiently clear and specific language so that a person can identify the
5 basis for the insurer's decision to take an adverse action; the notification must include
6 a description of up to four factors that were the primary influences of the adverse
7 action; the use of generalized terms such as "poor credit history," "poor credit rating,"
8 or "poor insurance score" does not meet the explanation requirements of this
9 paragraph; standardized credit explanations provided by consumer reporting agencies
10 or other third-party vendors are presumed to comply with this paragraph.

11 (e) An insurer shall indemnify, defend, and hold the insurer's agents harmless
12 from all liability, fees, and costs arising out of or relating to the actions, errors, or
13 omissions of an agent who obtains or uses credit information or insurance scores for
14 an insurer if the agent follows the instructions of or procedures established by the
15 insurer and complies with any applicable law or regulation. This subsection does not
16 provide a consumer or other insured with a cause of action that does not exist in the
17 absence of this subsection.

18 (f) A consumer reporting agency may not provide or sell data or lists that
19 include information that, in whole or in part, was submitted in conjunction with an
20 insurance inquiry about a consumer's credit information or a request for a credit report
21 or insurance score. The restrictions provided in this subsection do not apply to data or
22 lists the consumer reporting agency supplies to an insurance agent from whom
23 information was received, an insurer on whose behalf the agent acted, or an insurer's
24 affiliates or holding companies. Nothing in this subsection shall be construed to
25 restrict an insurer from being able to obtain a claims history report or a motor vehicle
26 report. In this subsection, "information" includes the expiration dates of an insurance
27 policy or any other information that may identify time periods during which a
28 consumer's insurance may expire and the terms and conditions of the consumer's
29 insurance coverage.

30 (g) In this section,

31 (1) "adverse action" means a denial or cancellation of, an increase in a

1 charge for, or a reduction or other adverse or unfavorable change in the terms of
2 coverage or amount of insurance, existing or applied for, in connection with the
3 underwriting of personal insurance;

4 (2) "affiliate" means a company that controls, is controlled by, or is
5 under common control with another company;

6 (3) "applicant" means an individual who has applied to be covered by a
7 personal insurance policy with an insurer;

8 (4) "consumer" means

9 (A) an insured whose credit information is used or whose
10 insurance score is calculated in the underwriting or rating of a personal
11 insurance policy; or

12 (B) an applicant for a personal insurance policy;

13 (5) "consumer reporting agency" means a person that, for monetary
14 fees, dues, or on a cooperative nonprofit basis, regularly engages, in whole or in part,
15 in the practice of assembling or evaluating consumer credit information or other
16 information on consumers for the purpose of furnishing consumer reports to third
17 parties;

18 (6) "credit information" means credit-related information derived from
19 a credit report, found on a credit report, or provided on an application for personal
20 insurance; information that is not credit-related may not be considered "credit
21 information," regardless of whether it is contained in a credit report or in an
22 application or is used to calculate an insurance score;

23 (7) "credit report" means a written, oral, or other communication of
24 information by a consumer reporting agency bearing on a consumer's credit
25 worthiness, credit standing, or credit capacity that is used or expected to be used or
26 collected, in whole or in part, for the purpose of serving as a factor in determining
27 personal insurance premiums, eligibility for coverage, or tier placement;

28 (8) "insurance score" means a number or rating that is derived from an
29 algorithm, computer application, model, or other process that is based, in whole or in
30 part, on credit information for the purposes of predicting the future insurance loss
31 exposure of an individual applicant or insured;

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(9) "personal insurance" means

(A) private passenger automobile coverage;

(B) homeowner coverage, including mobile homeowner's, manufactured homeowner's, condominium owner's, and renter's coverage;

(C) noncommercial dwelling property coverage;

(D) earthquake coverage for a residence or personal property;

(E) personal liability and theft coverage;

(F) personal inland marine coverage;

(G) mechanical breakdown coverage for personal auto or home appliances; and

(H) boat, personal watercraft, snowmobile, and recreational vehicle coverage.

* **Sec. 3.** AS 21.39 is amended by adding a new section to read:

Sec. 21.39.035. Making of rates; personal insurance. (a) Credit information may not be used to determine personal insurance rates, premiums, or eligibility for coverage unless the insurance scoring models or scoring processes are filed with the director. Insurance scoring models include all attributes and factors used in the calculation of an insurance score.

(b) Information filed under (a) of this section

(1) is confidential, and the information is not subject to public inspection under AS 40.25.100 - 40.20.140;

(2) shall be considered a trade secret under AS 45.50.910; and

(3) may be made public by the director for the sole purpose of enforcement actions taken by the director.

(c) In this section,

(1) "credit information" has the meaning given in AS 21.36.460;

(2) "insurance score" has the meaning given in AS 21.36.460;

(3) "personal insurance" has the meaning given in AS 21.36.460.

* **Sec. 4.** Section 3 of this Act takes effect immediately under AS 01.10.070(c).

* **Sec. 5.** Except as provided in sec. 4 of this Act, this Act takes effect January 1, 2004.

23-LS0306D
Ford
4/2/03

CS FOR HOUSE BILL NO. 47(STA)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE STATE AFFAIRS COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVES CHENAULT, Wolf, Stevens, Crawford

A BILL
FOR AN ACT ENTITLED

1 **"An Act prohibiting discrimination by credit rating or credit scoring in certain**
2 **insurance rates; 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 in
6 whole or in part, directly or indirectly, upon a person's credit rating or credit scoring.

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

STATE OF ALASKA

**REPRESENTATIVE
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HOUSE OF REPRESENTATIVES

SPONSOR STATEMENT **HOUSE BILL 47**

This bill prevents the use of credit records as a basis for insurance rates. Credit scoring is not an equitable way to determine insurance viability.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB47
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: DCED
 Title Insurance Discrimination by BRU Insurance (116)
Credit Rating Component Insurance Operations
 Sponsor Representatives Chenault and Wolf
 Requester House State Affairs Component No. 354

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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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)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This legislation prohibits insurers from using credit information to rate insurance policies. To the extent that insurers currently use credit information in their rating plans, they will need to submit new filings to discontinue this practice. The division anticipates costs for reviewing any rate filings will be part of on-going operations.

Prepared by: Bob Lohr, Director Phone 907.269.7900
 Division: Division of Insurance Date/Time 2/5/03 5:23 PM
 Approved by: Edgar Blatchford, Commissioner Date 2/5/2003
 Agency: Department of Community & Economic Development

Insurance Credit Scoring in Alaska



FEBRUARY 21, 2003

**FRANK H. MURKOWSKI
GOVERNOR**

Edgar Blatchford
Commissioner

Stan Ridgeway
Acting Director

STATE OF ALASKA
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT

Division of Insurance

Introduction

In May 2002, at the request of Senator Kim Elton, then Director Bob Lohr agreed that the Division of Insurance (Division) would undertake a review of the insurance industry's use of a consumer's credit history for underwriting and rating personal lines insurance policies in Alaska.

This report is based on a survey the Division sent to all insurers writing homeowners or personal auto insurance in Alaska. The purpose of the survey was to give the Division a broad overview of how credit history impacts the Alaska market and to identify issues that would be reviewed more closely in market conduct examinations.¹

Summary of Conclusions

Based on the limited data received and evaluated so far, the use of insurance credit scoring in Alaska appears to have different effects on different groups of Alaskan insurance consumers. The survey data indicates that rural Alaska policyholders are more likely to be placed in the nonstandard markets than are urban policyholders. The survey data also suggests that there is a trend for older consumers to move from the preferred market to the standard market and even nonstandard market with increasing age. A determination whether the policyholder distribution between preferred, standard and nonstandard markets is due primarily to credit history or other underwriting and rating factors is premature. However, the limited data do suggest that unequal effects exist on consumers with varying income and ethnic characteristics. In the aggregate, consumers that reside in higher income/high percentage Caucasian zip codes may be less impacted by the use of the consumer's credit history.

Since insurers have the burden of justifying that the use of credit history does not violate Alaska's laws, some restriction on the use of credit history would protect the public.

What is insurance credit scoring?

An insurance credit score, sometimes referred to as a credit-based insurance score or insurance score, is a number developed from a mathematical algorithm or computer model based upon information taken from a consumer's credit report. This number is used by insurers to assist them in predicting a consumer's future loss potential.

An insurance credit score is calculated from a complex formula that uses information such as the number of bankruptcies, judgments or tax liens, the number of late payments, the number of accounts that are satisfactorily paid, the number of credit related inquiries, and the ratio of debt to account limits that appears on a consumer's credit report.

Insurance companies continually look for ways to reduce their expenses. One of the ways in which they do this is by reducing their exposure to risk. An insurer can reduce its exposure to risk by either not writing policies for consumers who present a high risk or by adequately pricing policies for the exposure level of the consumer. Insurers believe that using a consumer's credit history helps them more accurately evaluate risk and determine the right price for the consumer. This belief is based upon statistical analyses performed by insurers as well as by agencies that collect credit information. According to insurers, these statistical analyses show that there is a strong correlation between insurance risk and a consumer's credit-related behavior.

¹ As part of its study, the Division is also conducting market conduct examinations of three insurance companies related to their use of credit scoring. These market conduct examinations are not yet complete. Because Alaska statutes provide procedures for the examinee to comment on the examination report before the director adopts it, results from the market conduct examinations are not included in this report.

Issues of concern regarding credit scoring

Leading up to the Division's review of the use of credit scoring in Alaska, we heard concerns about credit scoring from consumers, insurance producers (agents and brokers) and the Legislature.

Consumer Issues

Consumers have expressed concern over an insurer's use of credit history for the following reasons:

1. A cause-and-effect relationship between an individual's credit related behavior and propensity to file insurance claims has not been demonstrated.
2. Access to credit history is considered an invasion of privacy and providing unique identifying information, such as a social security number, potentially exposes the consumer to identity theft.
3. Credit reports may contain incorrect information.
4. Correcting erroneous credit reports can be a long process.
5. Individuals who have exceptional life circumstances that adversely impact their credit (identity theft, medical-related debts, etc.) are doubly penalized.
6. Consumers who do not use credit may pay more for insurance than if their credit history were not considered.
7. Lack of information on what constitutes good or bad credit characteristics and the complexity of the process for calculating an insurance credit score does not allow a consumer to know if he or she is being treated fairly.
8. Shopping around for insurance may cause the consumer's credit rating for lending purposes to be lower if the lender considers the number of inquiries in calculating a credit score.

Producer Issues

Insurance producers have expressed concern over the use of credit history in rating and underwriting insurance policies for the following reasons:

1. Some insurers do not allow the producer to provide a premium quote if the consumer does not have a high enough insurance credit score.
2. Limited educational material is available to help the producer explain a very complex issue to a consumer.
3. Screening applicants for insurance coverage based upon credit history is just another means to redline² certain geographical areas or minority groups.
4. Asking for social security numbers and the inability to offer quotes without a credit check may erode the important relationship between a producer and the consumer.

Legislative Questions

1. Is correlation between credit history and loss potential sufficient support for the industry to be able to use a consumer's credit history or should the industry be required to also demonstrate causality?
2. Are victims of identity theft further victimized by credit scoring?
3. Does it make sense for a consumer to be able to qualify for a home loan but not be able to qualify for homeowner's insurance coverage?
4. Why do otherwise similarly situated consumers sometimes pay dramatically different premiums?
5. If consumers and regulators do not know the rules of the insurance credit scoring game, how can the interests of Alaskans be protected?

² Redlining is a term used to mean that a particular group of consumers is experiencing difficulty in obtaining insurance coverage. The most restrictive use of the term means that there is literally a line drawn on a map around a particular geographic area in which an insurer does not want to offer coverage.

6. Are there Fair Credit Reporting Act conflicts?
7. When insurance companies outsource insurance credit scoring are they able to adequately oversee the practice so that consumer interests are not at risk?
8. Why is it that insurance producers split with insurance companies on the issue of credit scoring?
9. Can the Division of Insurance ban the use of credit scoring in establishing rates?
10. Can the director of the Division of Insurance use the Division's rulemaking authority to find that the use of credit history in the underwriting process is an unfair trade practice?

Existing Regulatory Framework

Rates and Rating Plans

Alaska Statute (AS) 21.39 provides guidelines for acceptable rates and rating plans used in Alaska. AS 21.39.030 requires that a rate not be excessive, inadequate or unfairly discriminatory. AS 21.39.030 also requires that in making rates, insurers consider past and prospective loss experience, reasonable underwriting profit and expenses. If risk classifications are used, the insurer must demonstrate that the standards used for measuring differences in hazards or expenses have a probable effect on losses or expenses.

AS 21.39.040 requires every insurer to file with the director every rate, rating plan, rating schedule and rating rule that the insurer proposes to use. Each filing must include support for the proposed rates and rating plans to demonstrate that the filing meets the standards in AS 21.39.030. The director has authority to request additional information from the insurer to assist the director in determining if the filing meets these standards. The director may disapprove a filing unless it demonstrates that the proposed rates or rating plan are not excessive, inadequate or unfairly discriminatory. A filing and all supporting information is open to public inspection after the filing becomes effective.

AS 21.36, the trade practices chapter also would apply to rating plans and, in particular, prohibits unfair discrimination. Under AS 21.36.090(c):

A person may not make or permit arbitrary or unfair discrimination between insureds or property having like insuring or risk characteristics, in the premium or rates charged for a policy or contract of property, casualty, surety, marine, wet marine or transportation insurance, or in the dividends or other benefits payable on the insurance, or in the selection of it, or in any other terms and conditions of the insurance.

Beginning in 2002, the Division asked insurers who submit personal lines rate filings that include the use of credit history in their rating plans to comply with certain new minimum standards.³ These minimum standards were developed from testimony provided to the legislature during the 2002 legislative session. These minimum standards are:

1. An insurer should not impose a surcharge based on the absence of credit history or inability to determine the consumer's credit history.
2. An insurer should not use the number of inquiries, medical information, particular type of credit card, or total line of credit in determining a consumer's credit score.
3. If a policy is rated using disputed credit history, the insurer should re-rate the policy retroactive to the effective date of the policy if the consumer resolves the dispute under the Fair Credit Reporting Act process and notifies the insurer that the dispute has been resolved.

Two insurers revised their previously approved auto rating plans to comply with these minimum standards. One filing from a third insurer is under review by the Division at this time.

³ The Division also recommends similar minimum standards with respect to underwriting.

AS 21.39.090 requires that every insurer, upon written request by the insured, shall furnish to an insured all pertinent information concerning a rate. Each insurer must also provide a means for a person aggrieved by the application of the rating system an opportunity to be heard. The purpose of the hearing would be to review the manner in which the rating system has been applied to the aggrieved person. Under this provision, insureds have a right to know the insurer's standards for calculating rates. An insurer that elects to use credit history in calculating a consumer's insurance rate or premium needs to provide adequate information to the insured showing how that rate is calculated.

Underwriting

Underwriting is the process by which an insurer decides whether or not an applicant for insurance coverage will be issued an insurance policy. Each insurer may develop its own underwriting criteria for the type of risk the insurer wants to write. For example, an insurer may decide that it will not offer personal auto coverage for consumers who drive imported sports cars. This is an underwriting decision. Another insurer may decide that it will write consumers who drive imported sports cars, but will do so by charging these consumers higher rates. The decision to provide coverage for foreign sports cars is an underwriting decision. Charging the consumer a higher rate, and determining how much the surcharge will be, is a rating decision.

In some cases there is an overlap between underwriting and rating. This may occur when an insurer uses insurance credit scoring, as well as other more traditional underwriting and rating factors, as part of the process for determining the placement of the consumer into one of several companies owned by one insurer, insurer group, or an insurance holding company. An insurer may consider this an underwriting process primarily because the insurer is using the insurance credit score as an underwriting criterion that determines the company for which the consumer is qualified. However, if each company has also filed distinct rates for the risks covered by that company, the underwriting decision also becomes a rating decision.

For purposes of this report, underwriting includes the criteria an insurer uses to place an applicant in one of multiple affiliated insurers. Insurers are not required to file underwriting guidelines with the Division before the guidelines are used. However, the Division does have authority to regulate underwriting guidelines under AS 21.36.090(c). As noted above, this section states:

A person may not make or permit arbitrary or unfair discrimination between insureds or property having like insuring or risk characteristics, in the premium or rates charged for a policy or contract of property, casualty, surety, marine, wet marine or transportation insurance, or in the dividends or other benefits payable on the insurance, or in **the selection of it**, or in any other terms and conditions of the insurance. (emphasis added)

An underwriting guideline that is unfairly discriminatory would be regulated as an unfair trade practice. If the underwriting guideline were determined to violate Alaska laws, the Division would take administrative action to stop the practice. This procedure is in contrast to the rate filing procedures that require the Division's approval before the insurer can use a rate or rating plan.

Confidentiality Issues

Because insurers and third party vendors invest significant amounts of time and money to develop insurance credit scoring models, many insurers and third party vendors assert proprietary trade secret status for these models. Under Alaska's rating laws, information used by an insurer, as support for its rating plan becomes public information when the filing becomes effective. Several rate filings submitted to the Division were disapproved when the insurer did not provide adequate support for the model because they, or the third party vendor, did not want the model to become public.⁴

⁴ Insurers and third party vendors have generally expressed a willingness to allow insurance regulators access to their models, provided the regulators do not disclose the models to the public.

Unless the scoring models are open to scrutiny, only the insurers or the third party vendors who have developed the models, and have a vested interest in seeing that insurance credit scoring is used, will be able to know and analyze how the models are developed and how they impact the insurance buying public. There will be no studies of these models to independently validate the conclusions put forth by insurers and the credit industry. For a practice that raises so many concerns, independent validation of the models may be essential.

History of Insurance Credit Scoring in Alaska

The first rate filing proposing to use insurance credit scoring as a rating factor was submitted to the Division in May 1997 and approved by the Division to take effect in September 1998. A significant amount of correspondence between the Division and the insurer occurred before the filing was approved. Six additional insurer groups began using insurance credit scoring as a rating factor in 1999 and 2000. The Division has disapproved five filings proposing to use insurance credit scores for personal auto and three for homeowners because the insurers were unable or unwilling to provide adequate justification to support the use of credit history.

The use of credit history in underwriting has had a longer history in Alaska. Seven insurer groups use credit history in underwriting. One insurer group began using credit history in 1989 while others began using it between 1994 and 2001.

Summary of Credit Scoring Survey

The test of whether the use of credit history in insurance underwriting and rating complies with Alaska's insurance laws lies only partially in the theoretical support for how credit history correlates with loss history provided in rate filings. After a rating plan is in use, the actual market results must also demonstrate that the rating plan performs generally as predicted. With Alaska's unique population characteristics, genuine questions and concerns exist about the impact of credit history on Alaska's insurance buying public.

To help the Division assess this impact, all insurers that wrote either personal auto or homeowners business in Alaska during 2000 and 2001 were asked to complete a survey describing the insurer's use of credit history. In the survey, the Division told insurers that individual company data would be treated in accordance with the confidentiality standards in AS 21.06.060. However, insurers were also notified that the information obtained in the survey would be used to present a report to the legislature and aggregate data that do not identify individual company practices would be included in the report. Any information provided in the survey that is also publicly available in approved rate filings would remain public.

The insurers were asked to provide data related to zip codes, age, marital status, sex and market or tier. The analysis of the survey data is limited because the survey did not ask for individual policyholder data nor did it ask for demographics such as income or race, because insurers do not collect this information.

Because income and race data are not available, the Division used census data by zip code⁵ to identify both urban and rural zip codes with high and low median household income and various ethnic compositions to be used as a proxy for income and ethnicity of the policyholders. Data from all insurers writing business in a particular zip code were combined, whether the insurer uses credit history as an underwriting tool or as a rating factor so that an individual insurer's policyholder distribution cannot be determined from the data provided in this report.

Another proxy was needed for a consumer's credit history since the data received in the survey did not include individual policyholder data. Each insurer has its own unique way of using credit history

⁵ The census data were taken from <http://www.ehomes.com/ehome/buyers/neighborhoodprofile.asp?from=buyer>

in its rating plan or underwriting criteria; different insurers use different insurance credit scoring models and different insurers use different underwriting criteria to classify the risk level of their policyholders. In order to find a common theme that could be used to aggregate the survey data, and provide the necessary proxy for credit history, the Division focused on three broad categories of risk, preferred business, standard business and nonstandard business. Preferred business consists of those consumers that are seen to present the least risk to an insurer. Standard business is the average risk, and nonstandard business consists of those consumers the insurer believes have the highest level of risk.

The preferred business category would generally include policyholders with good credit history, standard business would generally include policyholders with average credit history and nonstandard business would generally include policyholders with poor credit history. The survey data were split among these categories based upon each insurer's own characterization of the type of business the insurer writes.

Because a consumer may be placed in a market based on the consumer's credit history in combination with other underwriting or rating factors, the categorization of preferred, standard or nonstandard market is only a rough approximation for credit history. For example, a consumer may be in the nonstandard market for reasons other than the consumer's credit history, while, generally, it would require good credit history for a consumer to be in the preferred market.

The survey asked for data for all years in which an insurer used credit history in rating or underwriting. The distributions by year for each insurer were very similar. For sake of efficiency, only personal auto data for 2001 is included in this report. This also allows the most companies to be included and minimizes the possibility of identifying individual company data.

Anchorage

Table I contains policyholder distributions for Anchorage. Some of the Anchorage zip codes had similar median household income and ethnic composition. Those zip codes with similar demographic characteristics were combined together to add credibility to some of the zip codes in which there were only a few policies. Two of the Anchorage zip codes, 99504 and 99516, had demographics that differed from the other zip codes, so these zip codes were not combined with any other zip code.

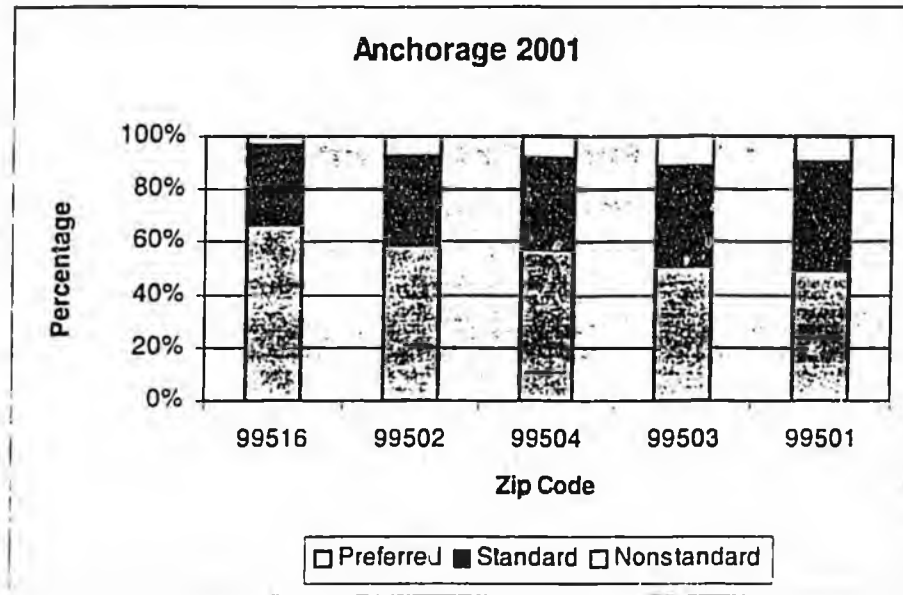
- Zip code Group A consists of zip codes 99501, 99509, 99510, 99511, 99512, 99513, 99514, 99520, 99521, 99522, 99523 and 99524.
- Zip code Group B consists of zip codes 99502, 99507, 99515 and 99518.
- Zip code Group C consists of zip codes 99503 and 99508.

The data in Table I indicates that the zip code that is predominantly Caucasian and has the highest income also has the highest percentage of preferred policyholders and the lowest percentage of nonstandard business. The zip code groups with the lowest median household income and largest ethnic population have the smallest percentages of preferred policyholders and the largest percentages of nonstandard business.

TABLE I

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99516	\$101,571	93%	67%	30%	3%
Group B	\$61,743 - \$69,275	83%-86%	59%	34%	7%
99504	\$55,095	80%	57%	35%	8%
Group C	\$41,048 - \$44,082	75%	51%	38%	11%
Group A	\$39,850	73%	50%	41%	10%

Figure I



Fairbanks

Table II contains data from Fairbanks. Except for Fairbanks zip code 99712, the zip codes are aggregated in a manner similar to that of the Anchorage zip codes.

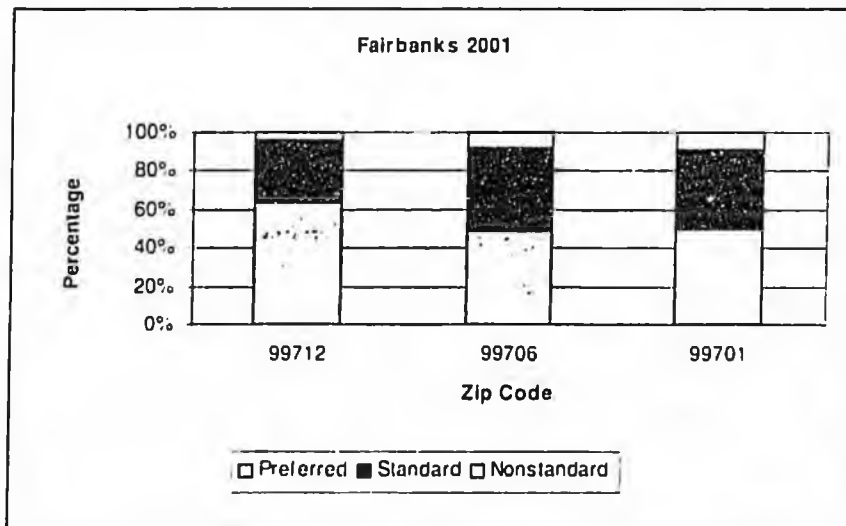
- Zip code Group D consists of zip codes 99706, 99707, 99708, 99709 and 99710.
- Zip code Group E consists of zip codes 99701 and 99711.

TABLE II

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99712	\$62,613	93%	63%	32%	4%
Group D	\$53,550	86%	49%	43%	8%
Group E	\$40,234	76%	50%	41%	9%

Fairbanks shows a similar distribution to that of Anchorage. The zip codes with higher income and a larger percentage Caucasian population have more preferred policyholders and fewer nonstandard policyholders than the remaining zip codes.

Figure II



Rural Alaska

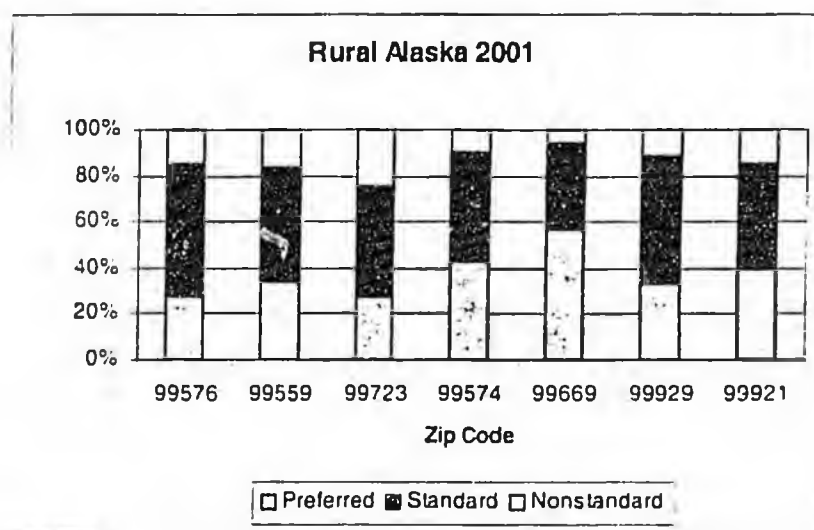
Table III contains data from rural Alaska. The policyholder distributions for rural Alaska are represented by some of the larger communities in various locations around the state: Dillingham (99576), Bethel (99559), Barrow(99723), Cordova (99574), Soldotna (99669), Wrangell (99929) and Craig (99921).

TABLE III

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99576	\$53,484	37%	28%	57%	15%
99559	\$51,119	32%	34%	49%	16%
99723	\$80,257	31%	28%	48%	24%
99574	\$72,711	84%	43%	47%	10%
99669	\$57,981	94%	57%	37%	6%
99929	\$51,879	80%	33%	56%	11%
99921	\$53,766	76%	40%	46%	15%

With the exception of Soldotna, rural Alaska generally has higher percentages of nonstandard business and lower percentages of preferred business than either Fairbanks or Anchorage.

Figure III



For comparison purposes to see how the use of credit history may have impacted the overall Alaska market, the survey also asked for the policyholder distribution for the year prior to the first use of credit history in either rating or underwriting. Because this is a different year for each insurer, the data in the following tables is from various years between 1996 and 1999 depending on the year in which the insurer first used credit history. The reason for combining different years is to minimize the possibility of identifying individual insurer experience.

The insurers included in Tables IV – VI below are somewhat different from the insurers included in TABLES I – III above. Different groups of insurers are combined because some insurers did not include data from the earlier years in the survey. Any attempt to compare the distributions in Tables I – III with Tables IV – VI must be done with great caution as they do not include the same insurers or the same policyholders. In addition, other rating and underwriting factors have not remained static over the years. Therefore, the criteria used to determine if a consumer qualifies as preferred, standard or nonstandard business varies over the time period from 1996 – 2001 and are not restricted just to the implementation of credit history as a rating or underwriting factor.

Anchorage Prior to Use of Credit History

TABLE IV

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99516	\$101,571	93%	65%	30%	5%
Group B	\$61,743 - \$69,275	83%-86%	55%	34%	11%
99504	\$55,095	80%	53%	35%	13%
Group C	\$41,048 - \$44,082	75%	49%	34%	17%
Group A	\$39,850	73%	47%	37%	16%

As is the case with the 2001 data, there is more nonstandard business and less preferred business in the lower income/ higher ethnic population zip codes. These zip codes also see a shift in the distribution of preferred and nonstandard business before and after insurers began using credit history, with a similar but smaller shift of business between markets in the highest income predominantly Caucasian zip code. Because of the limitations of the data supplied in the survey, no conclusion can be drawn to definitively conclude that the use of credit history is the reason that fewer policyholders are classified as nonstandard business in 2001 than before these insurers began using credit history.

Fairbanks Prior to Use of Credit History

TABLE V

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99712	\$62,613	93%	58%	35%	7%
Group D	\$53,550	86%	44%	45%	11%
Group E	\$40,234	76%	46%	40%	14%

The Fairbanks data shows results similar to that of the Anchorage data. Even before insurers began using credit history for rating or underwriting policyholders, the higher income predominantly Caucasian zip codes have higher percentages of preferred business than the lower income zip codes while the lower income/higher percentage ethnic zip codes tend to have more nonstandard business than the higher income zip codes.

Rural Alaska Prior to Use of Credit History

TABLE VI

Zip Code	Median Income	% Caucasian	Preferred	Standard	Nonstandard
99576	\$53,484	37%	19%	58%	22%
99559	\$51,119	32%	19%	52%	29%
99723	\$80,257	31%	17%	48%	35%
99574	\$72,711	84%	20%	55%	24%
99669	\$57,981	94%	48%	39%	13%
99929	\$51,879	80%	12%	70%	18%
99921	\$53,766	76%	19%	44%	36%

In spite of the fact that the aggregate data in Tables I - III is not entirely comparable with the aggregate data in Tables IV - VI, there are similarities in the risk distribution for the year prior to the implementation of the use of credit history (Tables IV - VI) with the 2001 distributions (Tables I - III). In general, higher income/lower minority zip codes have more preferred business than lower income/ higher minority zip codes, while lower income/higher minority zip codes tend to have more nonstandard policyholders. However, there are also differences in the distributions

shown in Tables I – III and Tables IV - VI. The largest difference is in the nonstandard market where a smaller percentage of business is classified as nonstandard in 2001. The question that cannot be answered from the survey data is the extent to which the smaller percentage of policyholders that are classified as nonstandard business in 2001 than before the use of credit history is due to the use of credit history or to other factors.

This data does not conclusively demonstrate that using a consumer's credit history allows more individuals to be classified as preferred or standard. The data does appear to indicate that the use of a consumer's credit history is causing some shifts in market distribution between preferred, standard and nonstandard business.

Whether these results are due entirely to the use of credit history or some other underwriting/rating factor cannot be determined from the data received from this survey. Some additional factors that may be contributing to this shift in market distribution are:

- 1) All of these insurers varied their other underwriting and rating criteria between the time they first started using credit and 2001. Therefore, the distributions may well reflect other changes in the insurers operations in addition to credit history.
- 2) The data in the tables above does not account for the possibility that some consumers may not have received an offer of coverage, at least in part because of the consumer's credit history. These consumers may either be leaving the voluntary market to obtain coverage in the assigned risk plan,⁶ moving to the few remaining insurers that do not use credit history or going without insurance.
- 3) The data in Tables I – III is from a different group of insurers than the data in Tables IV – VI.

Insurers have stated that when they use credit history they are able to write more business and renew policies that they might otherwise non-renew. To test this claim, the change in the number of policyholders written between 1999 and 2001 by insurers that use credit history was calculated from information provided in the survey. In the aggregate, for those insurers whose data is included in the tables above, the number of policyholders increased by approximately 8% from 1999 to 2001. However, several of the insurers are writing less business in 2001 than they did in 1999. Individual company results ranged from a decrease of 20% to an increase of 67% in the amount of business written over this time period.

Additional study with more detailed data would be needed to draw more definitive conclusions. Because the apparent redistribution of policyholders between preferred, standard and nonstandard markets occurs during a time period in which insurers are using credit history, the changes in classification of business between preferred, standard and nonstandard business may be due, at least in part, to the use of credit history. However, the data collected in the survey is not adequate to clearly determine the extent to which these changes are the result of the use of credit history.

To evaluate the effect of the uses of credit history on age, the survey data was again aggregated into three groups of preferred, standard and nonstandard business. The 2001 distribution of policyholders by age and risk characteristics, as demonstrated by preferred, standard or nonstandard classification is shown in Table VII. This data indicates that older consumers are overall less likely to be placed in a nonstandard market than the youngest consumers. However, there is a trend for older consumers to move from the preferred market to the standard market and even nonstandard with increasing age. Whether this trend is due to the individual's credit history or other rating factors cannot be determined from the data available in the survey.

⁶ The personal auto assigned risk pool has been growing annually since 1999 when there were 651 new applicants to the pool. In 2002, the pool received 1,159 new applications.

TABLE VII

Age Group	Preferred	Standard	Nonstandard
15-20	4%	39%	57%
21-30	15%	57%	29%
31-40	33%	53%	14%
41-50	43%	48%	9%
51-60	43%	50%	7%
61-70	52%	44%	4%
71-80	38%	57%	5%
81-90	19%	75%	6%
91-100	6%	77%	17%

The survey data did not categorize marital status other than by married or single, so the Division was unable to evaluate the effect that unfavorable credit history resulting from a divorce might have on underwriting or rating of an insurance policy.

A narrative summary of the responses to the survey is attached as Appendix A.

Appendix B contains a more detailed summary of insurer responses to specific questions. Each question is followed by a summary of the responses to that question. Survey questions that required the insurer to include an attachment or to include policyholder distributions are left blank in Appendix B.

Recommendations and Conclusions

Recommendations

1. *Is correlation between credit history and loss potential sufficient support for the industry to be able to use a consumer's credit history or should the industry be required to also demonstrate causality?*

Correlation alone may not be sufficient support for use of insurance credit scoring with respect to an insurer's underwriting and rating practices. This is why with respect to rate filings the Division has required insurers to establish more than a simple statistical correlation. In addition to being required to show a strong statistical correlation, insurers have been required to show fairness and reasonableness in the underlying assumptions and the methodology for determining a consumer's insurance credit score. The Division also reviews the manner in which the insurance credit score is used in the overall rating plan to evaluate possible unfairly discriminatory impacts. Insurers have been asked to justify that their use of a consumer's credit history does not unfairly discriminate among urban vs. rural insureds or by age. Further, insurers must show that any differences among risks (such as insureds with different insurance credit scores) can be demonstrated to have a probable effect upon losses or expenses. AS 21.30.030(4).

"Causality" might be an appropriate standard depending on how that term is applied. Under the American Academy of Actuaries (Academy) Actuarial Standard of Practice "Concerning Risk Classification,"⁷ if "causality" means establishing a "cause-and-effect" relationship between a risk classification (in this case, a classification based on an insurance credit score) and loss, it should not be made a requirement for a risk classification system because "cause-and-effect" is often impossible or impractical to prove statistically. According to the Academy, "causality" is appropriate when it is applied in a less rigorous sense, such as when an insurer is required to establish a plausible or reasonable relationship between characteristics of a classification and loss. In this regard, risk characteristics should be neither obscure nor irrelevant to the protection provided.

⁷ American Academy of Actuaries, Actuarial Standards Board, Actuarial Standard of Practice No. 12 "Concerning Risk Classification", October 12, 1989.

"Causality" also has been described as "the actual or implied behavioral relationship between a particular rating factor or loss potential." National Association of Insurance Commissioners (NAIC), *Report of the Rates and Rating Procedures Task Force of the Automobile Insurance Subcommittee, November, 1978* at 5-6, as quoted in *Hartford Accident and Indemnity Co. v. Insurance Commissioner*, 482 A.2d 542, 584 (Pa. 1984). As exemplified in the NAIC report, "the longer a vehicle is on the road, for example, the more likely it is that the vehicle may be involved in a random traffic accident; thus, daily and annual total mileage may be viewed a causal rating factor."

The use of credit history for underwriting and rating insurance policies is controversial, in part, because studies that show a strong correlation between credit history and loss experience do not also establish a cause-and-effect relationship.⁸ To require insurers to meet the rigorous definition of causality, that there is a clear and direct cause-and-effect relationship between a person's credit history and insurance loss experience would be difficult, if not impossible, to meet. Thus, requiring a rigorous definition for causality could be tantamount to banning outright the use of credit history for underwriting and rating purposes.

2. *Are victims of identity theft further victimized by credit scoring?*

If the identity theft results in the consumer receiving a less favorable insurance credit score than the consumer would have received without the identity theft, and this results in higher insurance premiums, then the consumer is further victimized by the use of insurance credit scoring. A solution would be to prohibit the insurer from using any disputed credit history that results from the identity theft and rerating or reunderwriting all policies that may have used the incorrect information.

3. *Does it make sense for a consumer to be able to qualify for a home loan but not be able to qualify for homeowner's insurance coverage?*

It seems counterintuitive that a consumer could qualify for a home loan but not qualify for homeowners insurance coverage when the reason for the denial is based upon the consumer's credit history. The difficulty is that financial institutions and insurers use different models to calculate a consumer's credit score because they want to measure different characteristics of the consumer. Financial institutions want to know if the consumer will pay back the loan. Insurers want to know if the consumer will file a claim. Although each model relies on the consumer's credit history, the algorithms are not the same. Still, it does appear anomalous. This anomaly could be addressed by prohibiting an insurer from basing an underwriting decision on credit information.

4. *Why do otherwise similarly situated consumers sometimes pay dramatically different premiums?*

One of Alaska's rating standards requires that rates not be unfairly discriminatory. Therefore, otherwise similarly situated consumers that obtain insurance from the same company should pay the same premium. However, Alaska law does not require that all insurers charge the same rates. An insurer may choose to offer coverage to different segments of the market. Insurers that write nonstandard business will generally have higher rates than insurers that write preferred business.

For insurers that use insurance credit scoring, rates may differ among companies because insurers use different insurance credit scoring models. In addition, each insurer incorporates the insurance credit score in different ways in their underwriting criteria or rating plans, thus

⁸ American Academy of Actuaries Risk Classification Subcommittee of the Property/Casualty Products, Pricing, and Market Committee November 15, 2002 report on "The Use of Credit History For Personal Lines of Insurance; Report to the National Association of Insurance Commissioners" p. 6, 13 and 18.

resulting in different premiums. Even though most insurers use credit history in conjunction with other underwriting and rating factors, the degree to which the final premium is dependent upon the consumer's credit history varies from consumer to consumer and from insurer to insurer. For a consumer who meets all other underwriting criteria for placement in the preferred tier or company except for the credit history requirement, the consumer's credit history may have significant weight for that particular consumer, depending on the insurer. For some consumers, their credit history may be the only factor that prevents them from receiving the best rate. Simply because an insurer uses underwriting factors in addition to the consumer's credit history does not mean that all factors carry the same weight in determining the final premium.

5. *If consumers and regulators do not know the rules of the credit scoring game, how can the interests of Alaskans be protected?*

If consumers do not understand how insurance credit scoring works or understand their rights, then they will not know how to determine if they are being treated fairly.

Many insurers provide educational material to their producers and the insurance buying public. However, 36% of the insurers responding to the survey do not have educational material, 52% do not explain the difference between an insurance credit score and a credit report, and 29% do not tell the consumer what attributes of his or her credit history contributes to an adverse action. An informed insurance buying public is better able to protect its interest. Insurers can assist by doing a better job of making the insurance credit scoring process more transparent to the insurance buying public. This would include making available materials that describe what criteria from the credit report are used in calculating an insurance credit score, explaining what types of behavior improve an insurance credit score and the types of behavior that negatively impact the insurance credit score. This information needs to be specific and based upon the credit history that served as the basis for the adverse action so that the consumer can apply it to his or her own situation.

The Division strives to protect Alaska's consumers by reviewing and analyzing the insurance credit scoring models used by insurers that propose to use insurance credit scoring in their rating plans. Some insurers have not provided this information to the Division because the developers of the insurance credit scoring models, insurers or third party vendors, do not want their models to become public information. They argue that being forced to disclose their models is a violation of their intellectual property or trade secret rights. Insurers that have not provided this information have had their filings disapproved. Making the insurance credit scoring models confidential would continue to allow the Division to review the models but it would limit the ability of consumers to get the same information to understand how their rates are determined and to know that they are being treated fairly. Requiring minimum standards for the models is a way to help protect the interests of Alaskan consumers.

Inaccurate credit history may result in an insurer assigning a higher rate to a consumer than would otherwise apply had the correct information been used. Inaccurate credit history may be due to the presence of inaccurate information as well as the absence of accurate information. Because correcting inaccurate credit history may sometimes take an extended period of time, one possible remedy for quickly reversing adverse actions would be for insurers to use credit history from all three of the major credit bureaus when the adverse action is the result of a disputed credit history. If there is a discrepancy between the credit history on file with the different credit bureaus, the credit history should not be used until the differences are reconciled. This would help to ensure that accurate information is used since information available from one credit bureau may differ from that at another credit bureau.

6. *Are there Fair Credit Reporting Act conflicts?*

The Fair Credit Reporting Act does not require insurers to get a consumer's permission to look at his or her credit history, but it does require insurers to notify consumers when adverse action is taken against the consumer and this action is based upon the consumer's credit history. Some insurers may not be providing adequate notice to consumers when adverse action is taken due to the consumer's credit history.

A representative from the Federal Trade Commission (FTC) addressed the Winter 2002 National Association of Insurance Commissioners meeting. He said the FTC took a very broad view of the definition of adverse action. Adverse action would include any action that results in a higher charge or less coverage to the consumer than if the credit history had been more favorable.⁹ Simply because an insurer says they are giving a discount to an insured based upon the insured's credit history does not mean the insurer is not taking adverse action against the consumer. In other words, if that discount does not result in the consumer receiving the best possible rate available from the insurer, but only an intermediate rate, the insurer may still be taking adverse action if the consumer would have received the best discount had the consumer's credit history been more favorable.

7. *When insurance companies outsource credit scoring are they able to adequately oversee the practice so that consumer interests are not at risk?*

Whether an insurer uses the services of a third party vendor or develops its own insurance credit scoring model, the insurer is ultimately responsible for the underwriting and rating systems that it uses. An insurer who uses a third party vendor may not rely upon the third party to ensure that the model meets the standards set out in Alaska law. When a consumer disputes credit history used by an insurer, the insurer sends the consumer to the credit reporting agency to resolve the dispute. This may be inconsistent with AS 21.39.090 that requires each insurer to provide a means for the consumer to be heard on the manner in which the rating system has been applied. One possible way in which the insurer can exercise more control over the practice would be to not include the use of disputed information, when the consumer can demonstrate that incorrect information has been used and not wait until the incorrect information has been corrected by the credit bureau.

8. *Why is it that insurance producers split with insurance companies on the issue of credit scoring?*

Not all producers agree on the use of credit history, either among themselves or with the insurers that they represent. Insurance producers are on the front line with consumers. They are placed in a position of having to explain a very difficult, controversial subject about which they may have minimal understanding or information to share with their client. As an example, it is the producer that must explain to a consumer with clean loss history that he or she cannot get the best available rate because of the consumer's unfavorable credit history.

At the same time, because the use of credit history is such a wide spread practice, some producers, particularly those who may only be able to offer coverage with one or two insurers, have concerns about the availability of these markets if limitations are placed on how an insurer can rate a policy.

9. *Can the Division of Insurance ban the use of credit scoring in establishing rates?*

The Division can ban the use of credit scoring in establishing rates if it is found to result in rates that are inadequate, excessive or unfairly discriminatory. For insurance credit scoring, the most critical issue is does it result in rates that are unfairly discriminatory. None of the models the Division has reviewed include income, location, race, religion or disability to calculate an insurance credit score.

⁹ Federal Trade Commission Stires-Ball staff opinion letter, March 1, 2000.

No study to date has adequately answered the question of whether the use of credit history results in rates that are higher, or lower, on average for a protected class of consumers or for consumers with lower incomes. In addition, the Alaska survey data does not identify whether the use of credit history acts in an unfairly discriminatory manner on individual policyholders. The information obtained in the Alaska survey suggests that it may have an impact, but the extent of the impact could not be determined from the information received in the survey.

AS 21.39.030(4) allows insurers to group risks by classifications for purposes of determining rates. The statute states that acceptable standards for measuring variations in hazards are those that can demonstrate they have a probable effect upon losses.

Based on information gathered to date, the Division cannot make a determination to impose an outright ban on the use of credit history. Without such a determination, legislative action would be needed to ban the use of insurance credit scoring in determining rates. Such action should also consider the implications of a ban related to the use of credit history in underwriting. Companion statutory changes would be needed in AS 21.36.

10. Can the director of the Division of Insurance use his rulemaking authority to find that the use of credit scoring in the underwriting process is an unfair trade practice?

The director might be able to use the Division's rulemaking authority under AS 21.36.150(d) to find that the use of credit scoring in the underwriting process is an unfair trade practice.

Conclusion

Based on the limited data received and evaluated so far, insurance credit scoring in Alaska appears to have different effects on different groups of Alaskan insurance consumers. In the aggregate, consumers that reside in higher income/high percentage Caucasian zip codes may be less impacted by the use of the consumer's credit history. It is premature to determine whether the policyholder distribution between preferred, standard and nonstandard markets is due primarily to credit history or to other underwriting and rating factors. However, the limited data does suggest that unequal effects exist on consumers with varying income and ethnic characteristics.

APPENDIX A

SUMMARY OF CREDIT SURVEY RESPONSES BY PERSONAL AUTOMOBILE AND HOMEOWNERS INSURANCE COMPANIES IN ALASKA

In August 2002, the Alaska Division of Insurance sent a survey entitled ALASKA DIVISION OF INSURANCE – INVESTIGATION ON THE USE OF CREDIT SCORES, INSURANCE SCORES, OR CREDIT HISTORY IN INSURANCE RATING AND UNDERWRITING to the 97 companies that provide personal automobile and homeowners coverage in Alaska. The survey is part of an effort by the Division to determine how a consumer's credit history is used in personal insurance. Companies were asked to respond with a completed survey for each line of business for which a consumer's credit history is considered.

To date, 91 companies, 94% of those contacted, have responded. Of these 27 were from companies that no longer write business in Alaska and, therefore, did not complete the survey. This summary is based on the remaining 64 company responses from active insurers. Because some companies responded for both automobile and homeowners insurance, a total of 79 survey responses were evaluated. The Division asked each individual insurer to respond to the survey rather than each insurer group. Therefore, the number of insurers indicating that they use credit history for rating purposes differs from the number of filings that have been submitted to the Division. Affiliated insurance companies, insurers in the same insurer group, frequently submit a combined rate filing.

The following definitions were used in the survey:

Credit score - A number developed from financial information using a statistical model. This term also includes an insurance score.

Credit information - Financial information such as bankruptcies and tax liens, but no conversion is made to a numerical score.

Credit history - Credit information and credit scoring

Of the 64 active personal auto or homeowners insurers who responded, 37 (58%) obtain a consumer's credit history. Of these 37 insurers, 22 companies use credit history for underwriting, 10 companies for rating, and 5 companies use it for both. At the time the survey responses were due, four companies had rate filings which proposed the use of credit history under review with the Division. Five other insurers indicated that they plan to begin using credit history within the next twelve months.

Underwriting decisions based on credit history, decisions that determine if a company will accept a risk, are made at the time a consumer seeks a premium quotation, at the time the application is considered for approval, or upon renewal of a policy. Some insurers will not provide a quote to a consumer who has an unfavorable credit history. Some insurers will base a decision to not renew a policy on the consumer's unfavorable credit history in combination with a risk-related factor such as claims history. The definition of unfavorable credit history, which marks an insured as a poor risk, can vary from insurer to insurer, with some insurers considering only a recent bankruptcy while other insurers consider an insurance credit score that is based upon an assortment of credit-related factors.

Rating decisions based on credit history are decisions that determine the price paid for coverage and are made at the time of application or at renewal. Some insurers automatically reevaluate the policyholder's credit history at renewal to ensure that the policyholder is placed in the correct market or tier. Other insurers only use credit history for new business, but will review the consumer's credit

history at the consumer's request to determine if a lower rate may be charged due to improved credit history.

Although insurance companies first began using consumer credit information in 1989, credit scoring was not implemented until 1994. Initially, companies considered the consumer's history of bankruptcy or judgments as part of a larger component that might be referred to as financial responsibility, financial stability, or personal responsibility. Other factors considered in this component were such things as home ownership, length of time at residence, or length of time with employer. By 1994 many companies had replaced this component with the numerical insurance credit score. The majority of companies use credit history for personal auto and homeowners coverage, but a few companies consider it for other types of personal insurance, such as boat owners, motorcycle, condominium owners, renters, and farm insurance.

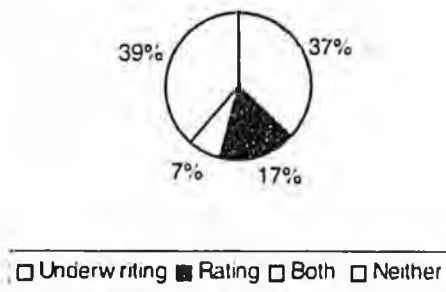
Of the companies using insurance credit scoring, 86% use a third-party vendor to provide their model. The companies are almost evenly split between the use of Choicepoint (53%) and Fair, Issac & Company, Inc. (47%). Many of the companies were either unaware of the details of the model used by their vendor or referred the Division to the vendor for details.

While information regarding the use of credit history was requested for underwriting, rating, solicitation, and company placement, six companies also disclosed its use in the policy reinstatement process. Credit history is not used by any of the companies to deny a claim or determine the amount of a claim payment. Two companies use credit history to determine a consumer's payment options.

Automobile Insurance

The highly competitive personal automobile insurance market appears to be the area where a consumer's credit history is most often considered. Of the 54 active automobile insurers who responded to the survey, 33 companies use credit history. Twenty companies use it for underwriting, 9 companies for rating, and by 4 companies for both underwriting and rating.

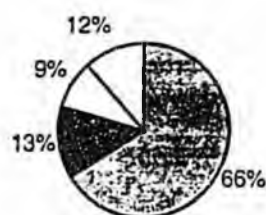
How Personal Auto Insurers Use
Credit History



While there are many insurers that do not use credit history for either rating or underwriting personal automobile insurance, these insurers comprise only approximately 12% of the market share. The ability of a consumer to obtain personal automobile coverage from one of these insurers may be limited.

Based on 2001 liability written premium market share, 66% of the market uses credit history in underwriting, 13% of the market uses credit history in rating, 9% of the market uses credit history for both rating and underwriting and 12% of the market does not use credit history.

**Use of Credit History By
Personal Auto Market Share**



□ Underwriting ■ Rating □ Both □ Neither

Eight-two percent of these companies write preferred business, 73% write standard, and 61% write non-standard or high risk. Insurers may provide coverage for these different groups by placing them in separate affiliated companies, by placing these different types of risk in one company through the use of tiers, or by using a combination of the two methods. A tier structure is used by 70% of the companies, but only 33% used this structure prior to the use of credit history. A multiple company structure is used by 73% of the companies and the use of credit history prompted no change in the use of this structure.

Only 42% of the companies provide guidelines to their producers and underwriters on the use of insurance credit scores. Generally, those insurers that do not provide guidelines on the use of credit history use an automated underwriting process and there is minimal review needed by the producer or underwriter to determine if an applicant will be offered coverage.

Consumer education is undertaken by some companies by providing educational material on the use of credit information (64%), by providing an explanation of the difference between a credit report and credit score (42%), or by providing a summary of the Fair Credit Reporting Act (48%). When questions or disputes arise regarding credit history, consumers are directed to the credit bureau (64%) or to Choicepoint (17%).

Underwriting

The Division recently has suggested to insurers that want to use credit history in underwriting to adhere to certain minimum standards. These minimum standards were developed from testimony provided to the legislature during the 2002 legislative session. The following provides a brief description of how the market currently addresses these standards.

1. The insurer should obtain the insured's permission to use credit information.

Some insurers notify the consumer that his or her credit history will be used in the underwriting or rating decision and others do not. The use of credit history is mandatory for 79% of the companies. Of those companies for which the use of credit history is mandatory, 9% will not provide a quote without credit history. If the applicant does not want his or her credit history to be used, 15% of the insurers will use all other relevant information to underwrite the policy and 7% will assign an intermediate tier or rate. The remaining insurers will either attempt to order the applicant's credit history anyway or provide a quote but not issue the policy until the credit history is obtained.

2. *The policy should not be nonrenewed in whole or in part based on credit information.*

Eighteen percent of the insurers use credit history as the sole criteria in underwriting or rating decisions. The other insurers use credit history in combination with other rating or underwriting factors.

Some insurers use credit history to retain a policyholder that they might otherwise non-renew because of loss experience if the insured's credit history is favorable suggesting that the likelihood of loss is low.

- 3 *An insurer should not deny coverage in whole or in part on the absence of credit history or the inability to determine credit history if the insurer has received accurate and complete information.*

Ten percent of the companies would not issue a policy if an applicant's credit history could not be determined.

4. *An insurer should not deny coverage based on the number of inquiries, medical information, particular type of credit card, or total line of credit.*

Due to contractual agreements with the vendors, all companies did not submit information regarding the models used by third party vendors. Because the information was not provided in the survey and the fact that the Division does not use a prior approval approach with underwriting factors, we are unable to determine the extent to which insurers may be in compliance with these standards.

Rating

The Division recently began asking insurers submitting rate filings that propose to use credit history in the rating plan to adhere to certain minimum standards. These standards were also developed from testimony before the legislature in the 2002 session. The following provides a brief description of how the market currently addresses these standards.

1. *An insurer should not impose a surcharge based on the absence of credit history or inability to determine the consumer's credit history.*

Although no company reported that a policy would be surcharged due to the absence of credit history or inability to determine credit history, three companies would not issue a policy and three companies would assign the worst possible credit score. Four insurers consider this situation as slightly unfavorable, three assign an average score which is eligible for all tiers, and one insurer ignores this factor by assigning a tier based on all other factors.

2. *An insurer should not use the number of inquiries, medical information, particular type of credit card, or total line of credit in determining an insured's credit score.*

Two insurers have revised their rating plans to use an insurance credit-scoring model that complies with these standards. Another filing is currently under review by the Division.

3. *If a policy is rated using disputed credit history, the insurer should re-rate the policy retroactive to the effective date of the policy if the consumer resolves the dispute under the Fair Credit Reporting Act process and notifies the insurer that the dispute has been resolved.*

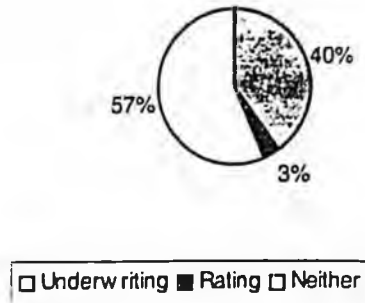
When corrected information is received, 10 of the insurers will apply the corrected information to all affected policies, 6 will apply the corrected information to the current policy only and 8 will only apply the corrected information if it results in lower rates for the

insured. Five of the companies will apply the corrected information to the current policy term plus the prior term.

Homeowners Insurance

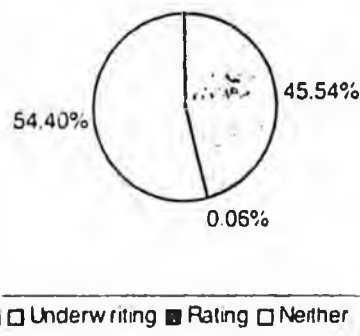
Of the 30 active homeowners insurers who responded to the survey, 13 (48%) use credit history. Credit history is used by 12 companies for underwriting and by 1 company for rating.

How Homeowners Insurers Use Credit History



The insurers that do not use credit history for either rating or underwriting comprise approximately 54% of the market share.

Use of Credit History By Homeowners Market Share



Ninety-one percent of these companies write preferred business, 91% write standard, and 45% write nonstandard or high risk. Insurers may provide coverage for these different groups by placing them in separate affiliated companies, by placing these different types of risk in one company through the use of tiers, or by using a combination of the two methods. A tier structure is used by 27% of the companies, but only 18% used this structure prior to using credit history. A multiple company structure is used by 64% of the companies and the use of credit history prompted no change in the use of this structure.

Only 64% of the companies provide guidelines to their producers and underwriters on the use of credit scores. Generally, those insurers that do not provide guidelines on the use of credit history use an automated underwriting process and there is minimal review needed by the producer or underwriter to determine if an applicant will be offered coverage.

Consumer education is undertaken by some companies by providing educational material on the use of credit information (73%), by providing an explanation of the difference between a credit report and a credit score (67%), or by providing a summary of the Fair Credit Reporting Act (45%). When questions or disputes arise regarding credit history, consumers are directed to the credit bureau (45%), Choicepoint (27%), or the Division of Insurance (9%).

Underwriting

The Division recently has suggested to insurers that want to use credit history in underwriting to adhere to certain minimum standards. These standards were developed from testimony before the legislature in the 2002 session. The following provides a brief description of how the market currently addresses these standards.

1. The insurer should obtain the insureds permission to use credit information.

The use of credit history is mandatory for all the companies surveyed. If an applicant or insured does not wish to have this information used, 36% of the companies will attempt to order it anyway.

2. The policy should not be nonrenewed in whole or in part based on credit information.

Seven percent of the insurers use credit history as the sole criteria in underwriting decisions, but no insurer uses credit history as the sole criteria in rating decisions. Some insurers use credit history to retain a policyholder that they might otherwise non-renew because of loss experience if the insured's credit history is favorable, suggesting that the likelihood for loss is low.

3. An insurer should not deny coverage in whole or in part on the absence of credit history or the inability to determine credit history if the insurer has received accurate and complete information.

Nine percent of the companies would not issue a policy if an applicant's credit history could not be determined.

4. An insurer should not deny coverage based on the number of inquiries, medical information, particular type of credit card, or total line of credit.

Due to contractual agreements with the vendors, all companies did not submit information regarding the models used by third party vendors. Because the information was not provided in the survey and the fact that the Division does not use a prior approval approach with underwriting factors, we are unable to determine the extent to which insurers may be in compliance with these standards.

Rating

Based on testimony before the 2002 legislative session, the Division recently began asking companies submitting rate filings that propose to use credit history in the rating plan to adhere to certain minimum standards.

1. *An insurer should not impose a surcharge based on the absence of credit history or inability to determine the consumer's credit history.*

Although no company reported that a policy would be surcharged due to the absence of credit history or inability to determine credit history, two companies would place coverage in an affiliated company. Two insurers will assign an average score which is eligible for all tiers, one insurer will assign an intermediate rate or tier, and one insurer will assign the best rate or tier.

2. *An insurer should not use the number of inquiries, medical information, particular type of credit card, or total line of credit in determining an insured's credit score.*

Two filings are currently under review. The insurance scoring model in each of these filings complies with these standards.

3. *If a policy is rated using disputed credit history, the insurer should re-rate the policy retroactive to the effective date of the policy if the consumer resolves the dispute under the Fair Credit Reporting Act process and notifies the insurer that the dispute has been resolved.*

When corrected information is received 4 of the companies will apply the corrected information to all affected policies, while 2 insurers will only apply the corrected information if it results in lower rates for the insured. None of the companies apply the corrected information to the current policy term only, but one of the companies will apply the information to the current policy term plus the prior term.

APPENDIX B

**ALASKA DIVISION OF INSURANCE
INVESTIGATION ON THE USE OF CREDIT SCORES, INSURANCE SCORES, OR
CREDIT HISTORY IN INSURANCE RATING AND UNDERWRITING**

This survey should be completed for each company and for each line of business that uses a consumer's credit history for rating or underwriting insurance products. For example, if a company uses credit history in both homeowners and personal auto insurance, complete two surveys, one for homeowners and one for auto.

You may include attachments if you need additional room to respond to the questions in the survey. All attachments should clearly display the survey question number, line of business and company name.

Please return completed surveys no later than September 30, 2002.

Line of Business _____

Company Name

Address

NAIC Group and Company Number

Name of Individual Completing Survey

Title

Signature

Telephone

Fax

E-mail

Fifty-two of the 79 survey responses are for personal auto business and 27 insurers submitted responses for homeowners business. The total responses for many of the questions may not equal the number of insurers who responded to the survey since many questions required that the insurer provide multiple answers and some insurers did not answer all questions. In addition, insurers that do not use credit history responded to only the first three questions. Responses reflect the companies' practices as of September 30, 2002.

In the following questions, credit score includes an insurance score, i.e., a number that is developed from financial information using a model. Credit information means the consideration of financial information, such as bankruptcies, tax liens, etc., that is not converted to a numerical score. Credit history includes both credit scoring and credit information.

1. Does your company use credit scores in:

Auto			
Underwriting	<u>12</u>	Yes	<u>35</u> No
Rating	<u>15</u>	Yes	<u>32</u> No
Solicitation	<u>12</u>	Yes	<u>39</u> No
Company placement	<u>21</u>	Yes	<u>30</u> No
Homeowners			
Underwriting	<u>4</u>	Yes	<u>22</u> No
Rating	<u>1</u>	Yes	<u>26</u> No
Solicitation	<u>1</u>	Yes	<u>25</u> No
Company placement	<u>4</u>	Yes	<u>22</u> No

2. Does your company use credit information in:

Auto			
Underwriting	<u>6</u>	Yes	<u>45</u> No
Rating	<u>2</u>	Yes	<u>49</u> No
Solicitation	<u>0</u>	Yes	<u>51</u> No
Company placement	<u>2</u>	Yes	<u>49</u> No
Homeowners			
Underwriting	<u>6</u>	Yes	<u>21</u> No
Rating	<u>0</u>	Yes	<u>27</u> No
Solicitation	<u>0</u>	Yes	<u>27</u> No
Company placement	<u>2</u>	Yes	<u>25</u> No

Note: If credit history is used as placement criteria in one of multiple affiliated companies, this would be included in company placement. If credit history is used as eligibility criteria for placement in a tier within one company, this would be included in rating. Solicitation includes direct writers and others who mail offers, or use other means to send advertising, to selected consumers based upon their credit history.

3. a) If you are not currently using credit scoring or credit information, do you plan to begin using it in the next 12 months?
 _____ Yes _____ No
- b) If your answer to a) is yes, are you considering its use in underwriting, rating, company placement, or solicitation and for what lines of business?

Three auto insurers plan to begin using credit history in underwriting in the next 12 months. Three homeowners insurers have rate filings pending approval from the Division. One homeowner insurer plans to begin using credit history in underwriting in the next 12 months.

If you answered yes to any part in questions #1, #2, or #3 continue with the following questions. Otherwise, sign the survey and return it to the Alaska Division of Insurance.

4. What lines of business use credit scoring or credit information for:

Underwriting: Personal auto, homeowners, boatowners, motorcycle, recreational vehicle, renter, condo, mobilehome, farm, landlord, residential fire, personal liability

Rating: Personal auto, motorcycle, homeowners

Solicitation: Personal auto, homeowners

Company placement: Personal auto, homeowners, renter

5. What type of business does your company write?

Auto
 27 Preferred
 24 Standard
 20 Non-standard (high-risk)
 Other (please specify) _____

Homeowners
 11 Preferred
 11 Standard
 5 Non-standard (high-risk)
 Other (please specify) _____

6. When did you first begin using credit scoring or credit information?

The first use of credit history in Alaska occurred in 1989 with two insurers using credit information. Insurance credit scoring was first used in 1994. Over the years more companies have continued to use credit history in underwriting or rating.

7. Is a credit score or credit information used as the sole criteria in decisions affecting a consumer? (Sole criteria means that if a consumer's credit score does not meet a certain threshold, or the consumer's credit information does not meet a specified standard, the consumer will be adversely affected. Other mitigating factors are not taken into consideration.)

Auto				
Underwriting	<u>3</u>	Yes	<u>31</u>	No
Rating	<u>2</u>	Yes	<u>29</u>	No
Solicitation	<u>0</u>	Yes	<u>35</u>	No
Company placement	<u>4</u>	Yes	<u>22</u>	No

Homeowners

Underwriting	4	Yes	10	No
Rating	0	Yes	13	No
Solicitation	0	Yes	14	No
Company placement	2	Yes	11	No

8. If credit history is not used as the sole criteria in rating or underwriting decisions, how much weight is it given? What other factors are considered in addition to credit history?

<u>Auto Weight</u>	<u>Number of Insurers</u>
50%	1
33%	4
1 of 3 factors used in combination*	1

*The weight is difficult to determine because the contribution of the credit component varies from policy to policy.

Examples of other underwriting factors used in conjunction with credit history for auto coverage:

- Prior liability limits
- Number of days lapse in coverage
- Existence (or non-existence) of prior insurance coverage
- Drivers age
- Accident and conviction record
- Number of miles driven
- Type of vehicle (age, make, model)
- The insurance limit and deductible selected for purchase
- Drivers occupation
- Losses
- Driving experience

Homeowners:

For homeowners, none of the respondents estimated the weight given to credit history. One insurer noted that credit history could be the sole reason to decline an applicant, but there are other underwriting standards for which they could also decline an applicant, such as prior losses, type of construction or property that does not comply with building codes.

Examples of other underwriting factors used in conjunction with credit history for homeowners coverage:

- Loss history
- Prior insurance coverage
- Age of home
- Fire protection class

CREDIT SCORING MODEL

9. Does your company use a credit-scoring model developed by a third party vendor or is the model developed in house?

Twelve auto insurers and four homeowners insurers develop their own insurance credit scoring model. Twenty-three auto insurers and 9 homeowners insurers use a model developed by a third party vendor. Three insurers develop a proprietary model in conjunction with a third party vendor.

10. If you use a third party vendor, who developed the model used by your company.

Auto

12 ChoicePoint

11 Fair, Isaac & Company, Inc.

Homeowners

5 ChoicePoint

4 Fair, Isaac & Company

11. If you use a third party vendor, identify the specific model.

12. Whether you use an in-house model or a third party vendor model, attach a list of all criteria that are included in the calculation of the credit score.

The criteria used in an insurance credit-scoring model vary by the particular model. The following credit attributes are some typical criteria used:

- Number of non-insurance inquiries
- Number of derogatory public records such as bankruptcies, judgments or tax liens
- Length of time since accounts were established
- Age of oldest trade (installment loan or revolving account)
- Number of trades paid on time
- Number of months since most recent charge off (attempt by a creditor to collect)
- Total number of non-closed auto loan trades
- Number of months a trade is overdue
- Number of inquiries for transactions initiated by consumer in last 6 months
- Total of balances on accounts
- Length of time accounts have been established
- Percent of accounts paid as agreed in last 24 months to total accounts
- Number of accounts opened in the last 12 months

13. Attach statistical support that demonstrates the relationship of each criteria used in the model to an insured's loss experience and that supports its inclusion in the model algorithm.
14. Attach statistical support that demonstrates the overall validity of the model and that it is an accurate predictor of loss experience. This support should include multi-variate analysis, or other appropriate statistical validation, not just loss ratios.

15. List any credit information that is not used in the model.

The credit attributes that are not used also vary by the particular model. Some models do not use the following items (but other models may use these items):

- Non-consumer initiated inquiries
- Multiple inquiries in a 30-day period for auto loans or mortgages
- Net worth
- Disputed items
- Items identified as medical
- The number or type of accounts
- Total balance or limits

UNDERWRITING

16. a) How many years of credit history affect underwriting or rating, either for inclusion in the credit scoring model or for other uses?

_____ 1 year

_____ 3 years

_____ 7 years

_____ 10 years

_____ Other (please specify) _____

- b) If the length of time depends on the type of information, include an explanation.

The number of years of credit history that affects underwriting or rating generally varies by type of information. Most insurers use all data that is available from the credit bureau. This includes adverse public records for 7 years and Chapter 7 bankruptcies for 10 years. Some insurers use inquiry information up to 24 months and others use it only for 6 months. Some insurers use only 5 years of credit history while others use 5 years only for bankruptcy, judgments, liens and foreclosures.

17. Does your company provide written guidelines to all your underwriters describing when credit history is to be requested and how it is to be used and evaluated?

Auto

- a) 14 Yes 17 No

Homeowners

- a) 9 Yes 6 No

- b) If yes, please provide a copy.

- c) If no, how do you ensure compliance with underwriting guidelines?

Those that do not have written guidelines generally have automated systems that do not allow for underwriter intervention.

18. Does your company provide written guidelines to all your producers describing when credit history is to be requested and how it is to be used and evaluated?

Auto

- a) 16 Yes 9 No

Homeowners

- a) 14 Yes 5 No

- b) If yes, please provide a copy.

c) If no, how do you ensure compliance with company requirements?

Those that do not have written guidelines generally have automated systems that do not allow for producer intervention. Some insurers are direct writers and do not sell insurance coverage through a producer.

19. a) Do you periodically re-underwrite or re-rate your insureds to determine if there have been any changes in their credit history that would give them a different rate or place them in a different company or tier?

Auto 7 Yes 26 No

Homeowners 2 Yes 11 No

b) How often do you re-underwrite or re-rate your insureds?

Auto

- 6 Only at the insured's request
- 2 Only at the producer's request
- 2 Automatically at each annual renewal
- 4 Automatically every two years
- 0 Only if credit worsens
- 0 Only if credit improves
- 0 Based on loss experience
- Other (please specify)

2 When requested by insured after correction to credit report

3 New business and first three renewals

Homeowners

- 0 Only at the producer's request
- 0 Automatically at each annual renewal
- 0 Automatically every two years
- 0 Only if credit worsens
- 0 Only if credit improves
- 3 Based on loss experience
- Other (please specify)

1 When requested by insured after correction to credit report

2 New business and first renewal only

20. Explain how you use credit history in your underwriting process.

Credit history is used in the underwriting process in various ways by different insurers. The following are some of the ways in which it is used:

- **Credit history is combined with traditional underwriting factors. Individuals with excellent credit history may be placed in a lower priced market than if traditional underwriting factors were used alone. Individuals with less than excellent credit are placed in a market based on the traditional underwriting factors, but those with the poorest credit cannot qualify for the preferred market.**

- **Credit history is used in conjunction with other factors such as driving record and prior insurance. Individuals with unsatisfactory credit history are not offered coverage unless their poor credit is due to extraordinary medical circumstances.**
- **Credit history is used only for new business company placement. Some insurers may deny coverage if the consumer's insurance credit score is below the insurers' acceptable threshold.**
- **Some insurers consider only detrimental credit occurrences such as bankruptcy and foreclosures.**
- **Some insurers use credit history only when the consumer has had prior non-catastrophe or non-weather related losses within a certain number of years.**

21. Do you use the same underwriting or rating criteria for your renewal business as for your new business? _____ Yes _____ No
Describe any differences.

Most insurers do not use the same underwriting or rating criteria for new and renewal business. Ten auto insurers use the same criteria for new and renewal business but only one homeowners insurer uses the same criteria. Sixteen auto and 11 homeowners insurers use different underwriting or rating criteria for new versus renewal business. This is primarily due to the fact that most insurers use credit history for market placement only on new business. Other insurers use different new and renewal underwriting or rating criteria for the following reasons:

- **Policies that may otherwise not be renewed may be renewed if the insured's credit history suggests that the likelihood of loss is low**
- **When factors other than credit, such as the number of losses, force a re-evaluation of the risk, the new business and renewal underwriting criteria are the same**
- **Credit history is not used after the second anniversary**

22. Attach an exhibit showing the number of policyholders, by year since the implementation of credit history, who received a different rate or different tier placement due to re-evaluation of credit information or credit score. This exhibit should indicate whether the insured received a higher rate or a lower rate, the tier or company placement change, and the amount of the rate change, due to a change in their credit history.

TIER STRUCTURE

23. Do you currently use a tier structure?

A tier rating structure is more prevalent among auto insurers than among homeowners insurers. Twenty-three auto insurers and three homeowners insurers use a tier structure. Twelve auto insurers and 12 homeowners insurers do not use a tier structure.

24. Did your company use a tier structure prior to the use of credit information or credit scoring?

Auto insurers that did not use a tier structure prior to the use of credit history were more likely to use a tier structure after they began using credit history than were homeowners insurers. Eleven auto insurers used a tier structure prior to using credit history and 25 did not. Only two homeowners insurers used a tier structure prior to using credit history and 11 did not.

25. Attach an exhibit describing the tier eligibility criteria prior to the use of credit history and the current eligibility criteria after the use of credit history. If you made any changes to these criteria, please give all intermediate criteria and the date on which the revisions took effect.
26. Attach an exhibit showing the number and distribution of policyholders in each tier by year since the implementation of credit history. If your company used a tier structure prior to the

use of credit information or credit scoring, also include a distribution of policyholders by tier for the year preceding the implementation of credit scores or credit information.

27. a) Attach an exhibit showing the number and distribution of policyholders by zip code and tier for each year since the implementation of credit history. If your company used a tier structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scores or credit information.
b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
28. a) Attach an exhibit showing the number and distribution of policyholders by age and tier for each year since the implementation of credit history. If your company used a tier structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scores or credit information.
b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
29. a) Attach an exhibit showing the number and distribution of policyholders by marital status and tier for each year since the implementation of credit history. If your company used a tier structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scores or credit information.
b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
30. a) Attach an exhibit showing the number and distribution of policyholders by sex and tier for each year since the implementation of credit history. If your company used a tier structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scores or credit information.
b) Attach similar exhibits for policyholders that were non-renewed and for declinations.

MULTIPLE COMPANY STRUCTURE

31. Do you currently use multiple companies that are preferred, standard and non-standard (multiple company structure)?

A multiple company structure is used equally by auto and homeowners insurers. Twenty-four auto insurers use a multiple company structure and 12 do not. Seven homeowners insurers use a multiple company structure and 8 do not.

32. Did your companies also use this structure prior to the use of credit information or credit scoring?

Prior to the use of credit history, 24 auto insurers used a multiple company structure while 5 homeowners insurers used a multiple company structure.

33. Attach an exhibit describing the underwriting criteria for each company prior to the use of credit history and the current criteria including the use of credit history. If you made any changes to these criteria, please give all intermediate criteria and the date on which the revisions took effect.
34. Attach an exhibit showing the number and distribution of policyholders in each company by year beginning with the year prior to the implementation of the use of credit scoring or credit information.

35. a) Attach an exhibit showing the number and distribution of policyholders by zip code and company for each year beginning with the year prior to the implementation of the use of credit scoring or credit information.
- b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
36. a) Attach an exhibit showing the number and distribution of policyholders by age and company for each year since the implementation of credit history. If your company used a multiple company structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scoring or credit information.
- b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
37. a) Attach an exhibit showing the number and distribution of policyholders by marital status and company for each year since the implementation of credit history. If your company used a multiple company structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scoring or credit information.
- b) Attach similar exhibits for policyholders that were non-renewed and for declinations.
38. a) Attach an exhibit showing the number and distribution of policyholders by sex and company for each year since the implementation of credit history. If your company used a multiple company structure prior to the use of credit information or credit scoring, also include the year preceding the implementation of credit scoring or credit information.
- b) Attach similar exhibits for policyholders that were non-renewed and for declinations.

DISCLOSURE

39. If adverse action is taken against a consumer because of credit history, how is the consumer notified of the adverse action?

Auto

- 7 Verbally by the producer
9 In writing by the producer
0 Verbally by the insurer
29 In writing by the insurer

Homeowners

- 3 Verbally by the producer
6 In writing by the producer
0 Verbally by the insurer
11 In writing by the insurer

40. If adverse action is taken against a consumer because of credit history, how often is the consumer notified of the adverse action?

Auto

- 15 Only at policy inception
7 Every renewal
 Other (please specify)
12 Whenever the adverse action is taken

Homeowners

- 6 Only at policy inception
- 0 Every renewal
- Other (please specify)
- 6 Whenever the adverse action is taken**
- 1 At declination**

41. Adverse action is defined as: (indicate all that apply)

Auto

- 2 Consumer is non-renewed
- 15 Consumer is not issued a policy
- 2 Consumer is cancelled
- 15 Consumer is not quoted a premium
- 2 Consumer is provided limited coverage
- 2 Consumer is given a surcharge
- 5 Consumer is not given a discount
- 15 Consumer is not given the best rate
- 8 Consumer is not placed in a preferred company
- 8 Consumer is not placed in a standard company
- 13 Consumer is not placed in a preferred tier
- 11 Consumer is not placed in a standard tier
- Other (please specify)
- 9 Consumer is placed in a higher rated tier or company due to credit history**

Homeowners

- 2 Consumer is non-renewed
- 11 Consumer is not issued a policy
- 3 Consumer is cancelled
- 7 Consumer is not quoted a premium
- 3 Consumer is provided limited coverage
- 2 Consumer is given a surcharge
- 2 Consumer is not given a discount
- 5 Consumer is not given the best rate
- 4 Consumer is not placed in a preferred company
- 4 Consumer is not placed in a standard company
- 4 Consumer is not placed in a preferred tier
- 4 Consumer is not placed in a standard tier
- Other (please specify)
- 1 Consumer is placed in a higher rated tier or company due to credit history**

42. If adverse action is taken against a consumer, are they told what attributes of their credit history contributed to the adverse action?

Twenty-one auto insurers and 13 homeowners insurers tell the consumer what attributes of the consumer's credit history contributed to the adverse action. Twelve auto insurers and 2 homeowners insurers do not. Most of the insurers indicated that this information is provided upon request by the insured.

43. When a consumer receives a premium increase, is the amount of the increase due to credit history or a change in credit score or credit information disclosed to the consumer?

No insurer discloses to a consumer the amount of a premium increase due to credit history.

44. Does your company provide educational material to your insureds on the use of credit scores or credit information in insurance rating and underwriting?

Auto
a) 21 Yes 14 No

Homeowners
a) 8 Yes 5 No

b) If your answer to a) is yes, describe the educational activities you use and attach any printed material you distribute.

c) Do you explain the difference between a credit report and a credit score?

Auto
14 Yes 19 No

Homeowners
8 Yes 5 No

45. Do you provide consumers with a summary of the Fair Credit Reporting Act?

Auto
16 Yes 17 No

Homeowners
7 Yes 7 No

46. Does your company provide information to consumers to assist them in making inquiries or complaints regarding the use of credit information?

Auto
a) 28 Yes 7 No

b) If yes, contact information is provided for:
0 Alaska Division of Insurance
0 Federal Trade Commission
21 Credit Bureau
 Other
1 Insurance company
7 ChoicePoint
1 Transunion National Disclosure Center

Homeowners
a) 10 Yes 4 No

b) If yes, contact information is provided for:
1 Alaska Division of Insurance
0 Federal Trade Commission
6 Credit Bureau
 Other
1 Insurance company
4 ChoicePoint

INCORRECT INFORMATION

47. a) Describe the procedures used by your company when a consumer notifies you of incorrect information contained in his or her credit report.

Most insurers direct the consumer to the credit bureau or credit reporting agency. When the consumer notifies the insurer that incorrect information is corrected the insurer will calculate a new credit score. Other insurers also inform the consumer of his or her right to obtain a free copy of the consumer's credit report.

- b) How long do you use credit information that the consumer has indicated is incorrect?

Auto

31 Until corrected following procedures outlined in the Fair Credit Reporting Act.

0 Not used at all, whether or not it has been corrected by the credit reporting agency.

Other (please specify)

7 Not used until a consumer filed challenge has been resolved

6 Excluded when items are flagged by the credit reporting agency as disputed

Homeowner

14 Until corrected following procedures outlined in the Fair Credit Reporting Act.

0 Not used at all, whether or not it has been corrected by the credit reporting agency.

Other (please specify)

4 Not used until a consumer filed challenge has been resolved

2 Excluded when items are flagged by the credit reporting agency as disputed

48. Does any corrective action, such as re-rating or re-underwriting, apply to the consumer's in-force policy only or does it apply to all policies, including previous policies that may have been issued based on incorrect information?

Auto

6 Current policy only

8 All policies affected by the incorrect information

8 All policies affected by the incorrect information only when the corrected score results in lower rates

Other (please specify)

5 The current and one prior policy term

7 Not used until a consumer filed challenged has been resolved

2 All policies when the incorrect information has been corrected

Homeowners

0 Current policy only

4 All policies affected by the incorrect information

2 All policies affected by the incorrect information only when the corrected score results in lower rates

Other (please specify)

1 The current and one prior policy term

4 Not used until a consumer filed challenged has been resolved

GENERAL PROCEDURES

49. What procedures are in place to protect the confidentiality of a consumer's credit history?

The primary means that insurers use to protect the confidentiality of a consumer's credit history is by obtaining only the insurance credit score through an automated process. Some insurers make the score available to their producers and underwriters while others do not. Five insurers indicated they have privacy guidelines, one insurer indicated the information is kept by management in a locked file, another insurer stores the information electronically and it is accessible only by password. One insurer indicated an underwriter might review the consumer's credit report at the request of the consumer.

50. Who has access to the consumer's credit history?

Auto

- 6 Producer (3 have access to credit information, 3 credit score only)
22 Underwriter (10 have access to credit information, 12 credit score only)
Other (please specify)
5 Employees with access to the policy file
3 Internal systems staff
1 Pricing staff
2 No one
3 Limited number of employees for complaint resolution, modeling, analysis, and programming
2 Agents are given the top four negative reasons, underwriters see the score and the top 4 negative reasons

Homeowners

- 5 Producer
12 Underwriter
2 Other (please specify)
2 Agents are given the top four negative reasons, underwriters see the score and the top 4 negative reasons

51. Is the use of credit information optional? _____ Yes _____ No

Auto

- 10 Yes 26 No

Homeowners

- 0 Yes 15 No

52. If the consumer does not want his or her credit information used, but meets all other eligibility criteria, how will the consumer be treated?

Auto

- 14 Not issued a policy
0 Non-renewed
0 Cancelled
0 Given the best rate or placed in the best tier
0 Given the worst rate or placed in the worst tier
2 Given some intermediate rate or placed in an intermediate tier
Other (please specify)
3 Given the base rate
4 Given a quote, but the policy will not be issued without using credit history

- 5 Placed in a market based on all other underwriting factors
- 3 Not given a quote
- 4 Attempt to order credit

Homeowners

- 6 _____ Not issued a policy
- 0 _____ Non-renewed
- 0 _____ Cancelled
- 0 _____ Given the best rate or placed in the best tier
- 0 _____ Given the worst rate or placed in the worst tier
- 0 _____ Given some intermediate rate or placed in an intermediate tier
- _____ Other (please specify)
- 3 **Given a quote, but the policy will not be issued without using credit history**
- 4 **Attempt to order credit**

53. If a consumer is a "no hit" (the company can find no credit information on the applicant), but meets all other eligibility criteria, how is the consumer treated?

Auto

- 3 _____ Not issued a policy
- 0 _____ Non-renewed
- 0 _____ Cancelled
- 3 _____ Given the best rate or placed in the best tier
- 0 _____ Given the worst rate or placed in the worst tier
- 9 _____ Given some intermediate rate or placed in an intermediate tier
- _____ Other (please specify)
- 7 **Assigned a mathematical weight**
- 1 **Offered coverage in another company**
- 5 **Placed in a company based on all other underwriting factors**
- 3 **Assigned the worst credit score category**
- 3 **Assigned an average credit score**

Homeowners

- 0 _____ Not issued a policy
- 0 _____ Non-renewed
- 0 _____ Cancelled
- 1 _____ Given the best rate or placed in the best tier
- 0 _____ Given the worst rate or placed in the worst tier
- 1 _____ Given some intermediate rate or placed in an intermediate tier
- _____ Other (please specify)
- 4 **Assigned a mathematical weight**
- 3 **Placed in a company based on all other underwriting factors**
- 2 **Assigned an average credit score**

54. If a consumer is a "no score" (the company is unable to calculate a credit score for the consumer), but meets all other eligibility criteria, how is the consumer treated?

Auto

- 1 _____ Not issued a policy
- 0 _____ Non-renewed
- 0 _____ Cancelled
- 1 _____ Given the best rate or placed in the best tier
- 0 _____ Given the worst rate or placed in the worst tier
- 9 _____ Given some intermediate rate or placed in an intermediate tier
- _____ Other (please specify)

- 7 Assigned a mathematical weight
- 1 Offered coverage in another company
- 5 Placed in a company based on all other underwriting factors
- 3 Assigned the worst credit score category
- 3 Assigned an average credit score
- 2 Given the best rate in a standard company

Homeowners

- 0 _____ Not issued a policy
- 0 _____ Non-renewed
- 0 _____ Cancelled
- 1 _____ Given the best rate or placed in the best tier
- 0 _____ Given the worst rate or placed in the worst tier
- 1 _____ Given some intermediate rate or placed in an intermediate tier
- _____ Other (please specify)
- 4 Assigned a mathematical weight
- 1 Placed in a company based on all other underwriting factors
- 2 Assigned an average credit score

55. When a policy is written for multiple insureds, whose credit history is considered in the rating or underwriting of the policy?

Auto

- 3 _____ The consumer with the best credit score
- 0 _____ The consumer with the worst credit score
- 11 _____ The consumer who is the first named insured
- 17 _____ The consumer who is the first named applicant
- 0 _____ All consumers and an average credit score is developed
- 1 _____ The consumer selected by the insured or applicant
- 0 _____ The husband's
- 0 _____ The wife's
- _____ Other (please specify)
- 2 First two applicants
- 3 Spouse when named insured is a no-hit or no-score
- 2 Person in household most likely to have complete credit history (usually oldest male driver under 65)

Homeowners

- 1 _____ The consumer with the best credit score
- 0 _____ The consumer with the worst credit score
- 5 _____ The consumer who is the first named insured
- 5 _____ The consumer who is the first named applicant
- 0 _____ All consumers and an average credit score is developed
- 0 _____ The consumer selected by the insured or applicant
- 0 _____ The husband's
- 0 _____ The wife's
- _____ Other (please specify)
- 2 First two applicants
- 3 Named insured and spouse

56. Is a consumer's credit score or credit information used as eligibility criteria for the type of payment plan offered to an insured?

One auto and one homeowners insurer use credit history to determine eligibility for the type of payment plan offered to the insured.

57. Is a consumer's credit score or credit information used in the decision to deny a claim?

No insurers use credit history to deny a claim.

58. Is a consumer's credit score or credit information used to settle a claim for a certain amount?

No insurers use credit history to settle a claim for a specified amount.

59. Describe any other uses that your company makes of credit history.

Automobile Insurance Companies
Active companies as of September 30, 2002

Credit Information Used For Underwriting

AIU Insurance Company (AIG)
Allstate Insurance Company
Company
Allstate Indemnity Company
Company
American Home Assurance Company (AIG)
American International Insurance Company (AIG)
Country Casualty Insurance Company
Country Mutual Insurance Company
Country Preferred Insurance Company
Electric Insurance Company
First National Insurance Company of America (SAFECO)
GEICO Casualty Insurance Company
GEICO General Insurance Company
GEICO Indemnity Company
General Insurance Company of America (SAFECO)
Government Employees Insurance Company
Insurance Company of the State of Pennsylvania (AIG)
Insurance Co.
National Union Fire Insurance Company of Pittsburgh (AIG)
SAFECO Insurance Company of America
SAFECO Insurance Company of Illinois
State Farm Fire and Casualty Company
State Farm Mutual Auto Insurance Company
United Services Automobile Association
USAA Casualty Insurance Company
USAA General Indemnity Company

Credit Information Used for Rating

American Economy Insurance Company (insurQuest)
American States Insurance Company (insurQuest)
Country Casualty Insurance Company
General Insurance Company of America (insurQuest)
Horace Mann Property & Casualty Insurance Company
Leader Insurance Company
Progressive Casualty Insurance Company
Progressive Northwestern Insurance Company
Progressive Specialty Insurance Company
United Services Automobile Association
USAA Casualty Insurance Company
USAA General Indemnity Company
Worldwide Insurance Company

Credit Information Not Used

American Bankers Insurance Company of Florida
American Family Home Insurance

American Manufacturers Mutual Insurance

American Modern Home Insurance Company
American Premier Insurance Company
American Protection Insurance Company
Amica Mutual Insurance Company
Cincinnati Insurance Company
Federal Insurance Company
Harleysville Insurance Company
Hartford Accident & Indemnity Company
Hartford Insurance Company of the Midwest
Horace Mann Insurance Company
Liberty Mutual Fire Insurance Company
Markel Insurance Company
Metropolitan Group Property & Casualty

Northland Casualty Company
Sentry Select Insurance Company
Teachers Insurance Company (Horace Mann)
Vigilant Insurance Company
Windsor Insurance Company

Homeowners Insurance Companies
Active companies as of September 30, 2002

Credit Information Used For Underwriting

Allstate Insurance Company
Allstate Indemnity Company
Armed Forces Insurance Exchange
Country Mutual Insurance Company
Electric Insurance Company
First National Insurance Company of America (SAFECO)
General Insurance Company of America (SAFECO)
Nationwide Mutual Fire Insurance Company
SAFECO Insurance Company of America
SAFECO Insurance Company of Illinois
Vesta Insurance Corporation

Credit Information Used for Rating

American International Insurance Company (AIG)

Credit Information Not Used

American Bankers Insurance Company of Florida
American Equity Insurance Company
American Manufacturers Mutual Insurance Company
American Protection Insurance Company
Cincinnati Insurance Company
Empire Fire & Marine Insurance Company
Federal Insurance Company
Hartford Insurance Company of the Midwest
Harleysville Insurance Company
Horace Mann Insurance Company
Liberty Mutual Fire Insurance Company
Metropolitan Group Property & Casualty Insurance Company
Sentry Select Insurance Company
State Farm Fire and Casualty Company
Umialik Insurance Company
United Services Automobile Association
USAA Casualty Insurance Company
Vigilant Insurance Company



Consumer Federation of America



**Credit Score Accuracy and Implications for Consumers
December 17, 2002**

**Consumer Federation of America
National Credit Reporting Association**

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I. About Privacy

The Consumer Federation of America (CFA) and the National Credit Reporting Association (NCRA) designed the details of this study with advice from legal counsel to ensure the methodology would comply with the requirements of the Fair Credit Reporting Act, Gramm Leach Bliley Act, and other consumer privacy laws. From the outset, each organization was mindful of the ethical spirit and intent of these consumer protection and privacy laws. In this day of rampant identification theft, we carefully evaluated each segment of the study workflow to ensure that we analyzed data extracted from the credit files without any trace of personal identifiers. Regarding consumer identity, all non-public, personal information data was completely "blind" as to a source for analysis. No names, addresses, social security numbers, dates of birth, account numbers, or any other item that could be used in any way to trace back to a specific consumer were revealed to or recorded by any third party outside trusted personnel of the consumer reporting agencies involved in the study. In one phase of the study the recorded data segment closest to the consumer was the postal zip code of their residence.

After CFA made a random selection of the time frame from which credit files were to be analyzed, a generic number was assigned to keep the nameless study data from each study file separated from other study files. No copies or partial copies of any credit reports, on paper or electronically, were removed from any credit reporting agency location. Anonymous credit scores and an analysis of the credit data, as reviewed by credit reporting agency personnel for security and industry knowledge, was supervised and recorded by the CFA researcher for tabulation. The data elements recorded in this study are insufficient to ever be used to track or identify any individual. Further, the analytical data recorded, if ever obtained by unscrupulous individuals, contains no information that could ever be used to try to defraud any of the consumers or creditors connected to the files in the study. Total anonymity to consumer identity and creditor accounts was, and will continue to be, strictly enforced.

II. The Growing Importance of Credit Scores

Consumer access to credit, housing, insurance, basic utility services, and even employment is increasingly determined by centralized records of credit history and automated interpretations of those records.

Credit histories in one form or another have long been an important factor in decisions to extend or deny credit to consumers¹. Historically, such decisions required a skilled, human evaluation of the information in an applicant's credit history to determine the likelihood that the applicant would repay a future loan in a timely manner. More recently, computer models have been developed to perform such evaluations. These models produce numerical credit scores that function as a shorthand version of an applicant's credit history to facilitate quick credit assessments.

During the second half of the 1990s, mortgage underwriting increasingly incorporated credit scores and other automated evaluations of credit histories. As of 1999, approximately 60 to 70 percent of all mortgages were underwritten using an automated evaluation of credit, and the share was rising².

The automated quantification of the information in credit reports has not simply been used to decide whether or not to extend credit, but has also been used to set prices and terms for mortgages and other consumer credit. In certain cases, even very small differences in scores can result in substantially higher interest rates, and less favorable loan terms on new loans. Credit scores are also used to determine the cost of private mortgage insurance, which protects the lender, not the consumer, from loss but is required on mortgages with down payments of less than twenty percent³. Lenders also review credit histories and/or credit scores to evaluate existing credit accounts, and use the information when deciding to change credit limits, interest rates, or other terms on those accounts.

In addition to lenders, potential landlords and employers may review credit histories and/or credit scores. Landlords may do so to determine if potential tenants are likely to pay their rent in a timely manner. Employers may review this information during a hiring process, especially for positions where employees are responsible for handling large sums of money. Utility providers, home telephone, and cell phone service providers also may request a credit report or credit score to decide whether or not to offer service to consumers.

Insurance companies have also begun using credit scores and similar insurance scores – that are derived from the same credit histories – when underwriting consumer applications for new insurance and renewals of existing policies. Credit information has

¹ Klein, Daniel. 2001. Credit Information Reporting. Why Free Speech is Vital to Social Accountability and Consumer Opportunity. *The Independent Review*. Volume V, number 3.

² Straka, John. 2000. A Shift in the Mortgage Landscape: the 1990s Move to Automated Credit Evaluations. *Journal of Housing Research*. Volume 11, Issue 2.

³ Harney, Ken. August 18, 2002. "Risk-based pricing brings a big rate hike for some." *Washington Post*.

been used as a basis to raise premiums, deny coverage for new customers, and deny renewals of existing customers – even in the absence of other risk factors, such as moving violations or accidents. Some providers claim that credit scores are also used to offer insurance coverage to consumers who have previously been denied, or to lower insurance rates. This is a highly contested issue that is under review in dozens of state legislatures and insurance commissions.

Thus, a consumer's credit record and corresponding credit score can determine access and pricing for the most fundamental financial and consumer services.

III. Controversial Issues Affecting Consumers

The expanded use of automated credit evaluations has brought changes to the marketplace that have benefited consumers. However, given the tremendous impact credit scores can have on consumers' ability to access and afford basic necessities, the increased application of this tool has also raised serious concerns about the potential harm it can cause.

A. Speed

The growth in use of credit scores has dramatically increased the speed at which many credit decisions can be made. Especially for consumers with relatively good credit, approvals for loans can be given in a fraction of the time previously required, without any manual review of the information. It is unlikely that underwriting the recent record volumes of mortgage originations would have been possible without the efficiencies provided by credit scoring.

B. Customized or Risk-Based Pricing

Credit scores, as a quantitative shorthand for credit histories, increase the potential for customized pricing of credit based on the risk an individual poses. Some argue that charging more to consumers defined as higher risk would remove some of the cost of risk carried by the general consumer population, and would allow for price reductions among consumers who pose less risk. Others argue that the savings have not been – and are unlikely to be – passed on to consumers who pose less risk, and scoring systems simply allow lenders to extract greater profits from consumers who do not attain target credit scores. The potential for increased profits from consumers whose credit is scored low also creates a disincentive to helping consumers correct errors in their credit records.

The increased speed at which underwriting decisions can be made has created pressure to complete credit applications more quickly. Some contend that the combination of this increased pace and the increased ability to customize the price charged based on credit allows lenders to approve a larger share of consumers for loans, but not necessarily at the best rates for which they qualify. While many consumers can feel overwhelmed by large credit based transactions, such as mortgage closings, consumers who do not have a solid understanding of credit scores, or who do not objectively know their creditworthiness, are even more vulnerable to high-pressure tactics to accept any offer of credit, regardless of terms, and may unnecessarily be charged higher rates.

C. Effect on Discrimination

Some have argued that increased reliance on automated reviews of credit has the potential to reduce discrimination in lending because the automation of decision-making removes or reduces the influence of subjective bias. Others have argued that the factors used to determine a credit score may not completely remove bias from approval and pricing decisions. Furthermore, lenders are still free to offer differential levels of

assistance in dealing with errors in credit records, or with other issues related to credit scores, such as providing rescoring services. Such discretionary assistance remains a potential source of bias in the approval process whether a consumer is underwritten with an automated system or with manual underwriting. Federal banking regulators do conduct examinations to ensure against overt discrimination on prohibited bases such as race, sex, marital status, or age in credit score design or in lenders' application of those scoring systems, such as through the use of overrides⁴.

D. Statistical Validity

Supporters of credit scoring note that credit scores have statistical validity, and are predictive of repayment behavior for large populations. However, this does not mean that credit data are error free, nor that credit scoring models are perfect predictors of individual creditworthiness; it only means that they work on average. While the systems do present an accurate risk profile of a large numbers of consumers, data users who manage large numbers of accounts priced by credit risk have a greater tolerance for errors in credit scoring systems than consumers do. Among those consumers who are inaccurately characterized, businesses can balance errors in their favor against errors in favor of consumers; so long as enough consumers are charged higher rates based on inflated risk assessments to cover the losses from those who are charged lower rates because the systems incorrectly identified them as low risk, these businesses will suffer no material harm. Consumers on the other hand do not have a similar tolerance for errors in transactions governed by credit reports and credit scores. If they are overcharged because of an error in the credit scoring system, there is no countervailing rebate to set the statistical scales even. Credit scores should not function as a lottery in which some consumers "win" by being viewed more favorably than they deserve to be, while others "lose" by being viewed less favorably than they should be.

While debate surrounding the broad implications of credit scoring continues, its use is already strongly established in the American financial services industry. Meanwhile, concern over the integrity of credit scoring itself focuses on two dimensions – the fairness of the models that interpret the data and the accuracy of the underlying credit related data.

E. Untested Scoring Formulas

Even if all credit data regarding consumers held at credit repositories were accurate, complete, and current, there would be significant concerns about the fairness of automated credit scoring programs. Converting the complex and often conflicting information contained in credit reports into a numerical shorthand is a complex process, and requires a significant number of interpretive decisions to be made at the design level. From determining the relative influence of various credit-related behaviors, to the process used to evaluate inconsistent information, there is a great potential for variance among scoring system designs.

⁴ See for example Appendix B of the Office of the Comptroller of the Currency's *Comptroller's Handbook for Compliance, Fair Lending Examination Procedures*, available at <http://www.occ.treas.gov/handbook/fairlep.pdf>

Despite the gatekeeper role that these scoring systems play regarding access to credit, housing, insurance, utilities, and employment, as well as pricing for those essentials, exactly how the formulas perform the transformation from credit report to credit score is a closely guarded secret. For consumers, regulators, and even industry participants who rely on the computations in their decision-making, the scoring models largely remain a "black box." No scholarly reviews of this extremely powerful market force have been permitted, and apart from reviews by federal banking regulators to protect against discrimination no government regulator has insisted that they be examined to ensure that they are adequate and fair.

Recently, after California passed a law requiring all consumers in the state to have access to their credit scores, several companies, including Fair, Isaac, and Company, Equifax, Experian, and Trans Union, Fannie Mae, and Freddie Mac have voluntarily provided general information about the information that is used to calculate a credit score or to evaluate a mortgage application, and how that information is generally weighted. In addition, for a fee, consumers can access score simulators that give some approximation of the impact of various behaviors on their credit scores.

F. Inaccurate credit reports

The most fundamental issue connected to credit scoring is the level of accuracy of the information that forms the basis for the scores. Regardless of whether lending and pricing decisions are made by a manual or automated review of a consumer's credit, the potential for inaccuracies in credit reports to result in loan denials or higher borrowing costs is a cause for concern. Several organizations have conducted studies and surveys to quantify the pervasiveness of credit report errors, with widely ranging findings regarding how many credit reports contain errors (from 0.2% to 70%).

A 1993 study by the Public Interest Research Group⁵ found that 29% of credit reports contained errors that could result in the denial of credit (defined as false delinquencies, or reports listing accounts or public records that did not belong to the consumer). The study also found that 41% of reports had incorrect demographic identifying information, and 20% were missing major credit cards, loans, or mortgages. In total, 70% of reports contained an error of some kind. This study asked 88 consumers to review their credit reports from each of the three major credit repositories for errors. A total of 133 reports were reviewed.

Consumers Union has conducted two surveys of credit reports in which consumers were asked to review their credit reports for accuracy. A 1991 survey⁶ found that 20% of credit reports contained a major inaccuracy that could affect a consumer's eligibility for credit, and 48% contained inaccurate information of some kind. In addition, almost half of survey respondents found that their reports omitted some of their current accounts. In

⁵ *Mistakes Do Happen*. Public Interest Research Group. March, 1998.

⁶ "Credit Reports: Getting it Half Right." *Consumer Reports*. July, 1991. p. 453.

this survey, 57 consumers reviewed total of 161 reports. A 2000 survey⁷ found that more than 50% of credit reports contained inaccuracies with the potential to result in a denial, or a higher cost of credit. The errors included mistaken identities, misapplied charges, uncorrected errors, misleading information, and variation between information reported by the various credit repositories. These results reflect the review of 63 reports by 25 consumers.

A 1992 study conducted by Arthur Andersen⁸, commissioned by the Associated Credit Bureaus (now known as the Consumer Data Industry Association) used a different methodology to conclude that the error rate was much lower. This study reviewed the behavior of 15,703 consumers who were denied credit based on a credit grantor's scoring system. From this sample, 1,223 consumers (7.8%) requested their credit report from the issuing credit repository, and 304 consumers (1.9% of the total sample) disputed the information on the report. Of these, 36 disputes (11.8% of those who disputed, or 0.2% of the total sample) resulted in reversals of the original credit denial.

A 1994 study conducted by the National Association of Independent Credit Reporting Agencies (now known as the National Credit Reporting Association) represents a third approach to the question of credit report accuracy. Examining a total of 1,710 files, this study reviewed a three-repository merged infile (which contains the credit reports from all three credit repositories), and conducted a two-repository Residential Mortgage Credit Report, or RMCR (in which all conflicting data in the two credit repository reports and the application form is verified with each creditor, and a consumer interview is conducted) for each file. The results showed missing, duplicated, and outdated information in credit files. Among the three-repository merged infiles: 29% of accounts, also known as trade lines or trades (past and current loans, lines of credit, collections, etc.), were duplicates, 15% of inquiries were duplicates, 26% of public records were duplicates, 19% had outdated trades, and 44% had missing information, such as balance or payment information. Among the RMCRs: 19% had trades added based on information from the loan application, 11% had trades added based on investigations, 16.5% had derogatory information deleted as a result of the investigation, 3% had trades removed because they did not belong to the borrower, and 2% had errors in public records corrected.

⁷ "Credit Reports: How do potential lenders see you?" *Consumer Reports*. July 2000. P. 52-3.

⁸ Described and cited in Klein, Daniel, and Jason Richner. 1992. "In Defense of the Credit Bureau." *Cato Journal*. Vol 12. Issue 2. pp. 393 - 411.

IV. How Does the System Work?

The complex system for reporting and reviewing credit involves a large number of participants who fall generally into one of six categories: consumers; data repositories; data users; data furnishers; credit reporting agencies; and analytical service providers. Approximately 190-200 million consumers have credit reports maintained by the three major credit repositories (Experian, Equifax, and Trans Union)⁹. Data users include lenders, insurers, landlords, utility companies, and employers, who review the credit information in consumers' credit reports to make decisions about extending and pricing credit, offering and pricing insurance policies, and providing utility services, rental housing, or offers of employment. Some, but not all, data users are also data furnishers, and regularly report information about consumers' accounts to the credit repositories, who add the information to consumers' credit reports. It is the understanding of the researchers that there is currently no legal requirement that any business report information to any credit bureau, although once a business furnishes data, there may be certain obligations that arise in connection with consumer disputes. In 1996, Congress recognized that errors by data furnishers contributed to credit reporting problems, so the Fair Credit Reporting Act was amended to impose accuracy duties on data furnishers. These duties are generally subject only to administrative enforcement under the FCRA, with no private right of action for consumers unless the data furnisher fails to comply with re-investigation duties.

Generally, insurers, landlords, utility companies, and employers do not provide positive account information to repositories, nor do all lenders. Also, data enters consumers' records from collection agencies that report on the status of accounts in collection, and

⁹ Credit repositories attempt to maintain the following information in their databases, but not all data is available or provided for every account, and different repositories may collect different levels of information, especially consumer identifying information:

Consumer identifying information (Consumer's name; social security number; date of birth; former names or aliases; current and former addresses; employer; income; position; and employer's address)
Public records information (source of information; date recorded; amount of liability; type of record (e.g. judgment, tax lien, or bankruptcy); docket number)

Collections information (collections company's name; date opened; last date verified or updated by collections company; date closed; the amount placed for collection; balance outstanding; name of original creditor; the method of payment (a numerical code indicating if the account is current, late, in collection, etc.); any remarks)

Creditor information (creditor's name; account number; level of responsibility for consumer to pay account (primary account holder, joint account, authorized user, etc.); type of loan (revolving, installment, mortgage, line of credit, etc.) or collateral for an installment loan; date opened; date of last activity; date closed or paid; highest amount ever owed by consumer; the credit limit on the account; the balance due; payment size and frequency; any amount past due; date of maximum delinquency; dollar amount of maximum delinquency; payment pattern for last 12-24 months (indicating for every month whether the account was paid as agreed, or late, and by how many days); the number of months reviewed; number of times account was late by 30, 60, or 90 days; the method of payment (a numerical code indicating if the account is current, late, in collection, etc.); any remarks)

Credit Inquiries (list of companies who have requested consumer credit information; date the inquiry was made)

Any consumer statement, such as an explanation of a dispute

from repository searches of public records such as bankruptcies, liens, and judgments. In addition, governments may report directly to the repositories if consumers fail to pay child support, have unpaid parking tickets, or have been overpaid for unemployment benefits. Credit reporting agencies assist some data users by consolidating information from the three credit repositories, and offering services to verify and update information in credit reports. Credit reporting agencies primarily facilitate and support the decision making process involved with mortgage underwriting. Credit reporting agencies and credit repositories both provide credit reports to data users, and are considered "consumer reporting agencies" under the Fair Credit Reporting Act. As consumer reporting agencies, these entities share certain obligations, some of which are described below. Analytic service providers also help data users interpret the information in consumers' files, and include companies such as Fair, Isaac, and Company, which produces analytical tools that generate credit scores, and the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, who produce tools that help lenders interpret credit information in conjunction with mortgage applications. Some lenders and mortgage insurance companies have also created tools that help them interpret credit information for mortgage applications.

A. Non-Mortgage Credit

When a consumer applies for non-mortgage credit, such as a credit card, unsecured line of credit, or installment loan (e.g. for an automobile, or furniture), the potential creditor (data user) can request a credit report (with or without a credit score) from one, two, or three of the credit repositories. A repository that receives such a request will send the credit report to the potential creditor, and record an inquiry on the consumer's credit report. The creditor can use the information in the credit report to help decide whether to extend or deny credit to the consumer, and what the interest rate and other fees will be for this credit. If the creditor accepts the application, they may then act as a data provider, and report information on the consumer's payment history to one, two, or three of the credit repositories. Generally account information can be both positive and negative. On-time payments have a positive influence while late payments have a negative influence. However, the amount of positive influence a consumer receives from a timely payment may vary based on the type of creditor. For example, timely payments to a prime credit card lender may have a greater positive influence on a score than timely payments to a lender considered less favorable, such as a furniture or consumer electronics store. If the creditor denies credit, or offers less than favorable terms, based on the credit report or score, federal laws require them to make certain disclosures to the consumer, including the name of the consumer reporting agency that supplied the credit report and how to contact the agency. For non-mortgage applications the consumer reporting agency is usually a credit repository. Once given this information, the consumer can contact the repository to request a copy of his or her credit report¹⁰. If the

¹⁰ However, the report the consumer receives may differ from the report that the lender reviewed. If consumers submit more comprehensive personal identifiers in their request for a report from the credit repository, they may not see the exact report that was used to underwrite their credit application, especially if the underwriter made any errors such as misspellings in the consumer's name or transposing digits in the consumer's social security number, or merely submitted an application with less information about the

consumer has suffered an adverse action based on the credit report, the copy must be provided by the repository free of charge. Consumers who have not suffered an adverse action can also review their credit reports at any time, but are subject to a fee of approximately \$9. Six states (Colorado, Georgia, Maryland, Massachusetts, New Jersey, and Vermont) require repositories to provide credit reports to consumers free of charge once a year upon request. Also, if a consumer is receiving welfare, is unemployed, or suspects that he or she is a victim of identity theft, the consumer may obtain a credit report free of charge. For an additional charge, the consumer can have a credit score computed and included with the credit report under any of these circumstances.

B. Employment and Services Other Than Loans

When a consumer applies for employment, or for a service that reviews credit histories, (such as insurance, an apartment rental, utilities, cell phone accounts) these data users may also request and receive a credit report and/or scores from one or more repositories, to be used to evaluate the consumer's application. Job applicants or employees must provide consent before a report is pulled, but other users derive a permissible purpose to review credit from the consumer's act of submitting an application, except in Vermont, where oral consent is required to review a credit report for credit uses.

However, while these entities will review credit, and approve or deny the application based on the credit report and/or score, they generally *do not* report positive account information back to the credit repositories. They often, however, indirectly report derogatory information by placing accounts for collection. Accounts that have been placed for collection will be reported to one or more of the credit repositories.

C. Other Data Providers

The reverse is true of collection agencies, which provide information to the repositories, but do not use credit data to evaluate consumer creditworthiness, although they may use information in credit reports to locate debtors. Repositories also obtain information by requesting it from public records and government entities and when certain government entities report directly to the repositories, such as for delinquent child or family support payments, unpaid parking tickets, or overpayments of unemployment benefits. Information from collection agencies and public records is primarily derogatory information, such as when an account was sent to collection, or a bankruptcy was filed, but may also include positive information such as the satisfaction of a bankruptcy or the repayment of a collection, and when such repayments occurred. Because government entities do not report information about bankruptcies, liens, civil suits, or judgments to repositories, the repositories are responsible for maintaining the accuracy of such public record information in credit records, such as whether a bankruptcy has been satisfied or a lien has been released. Any type of collection will have a negative impact on a credit history, regardless of whether the debt was related to an account for which a credit report was used to establish credit (e.g. for loans or utilities, as well as for child or family

consumer's identity. While there is no legal prohibition on lenders providing consumers with the actual credit report used in their decision-making process, there is likewise no requirement that they provide it.

support or parking tickets). Collections, either from a collection agency or other type of account, and public records will continue to have a negative impact after they have been paid or otherwise satisfied, although they will have a less negative impact if they are satisfied, and will have a less negative impact as time passes.

D. Mortgage Credit

The process is more complex for a mortgage transaction. When consumers apply for a mortgage, the mortgage lender (who may be a mortgage banker or mortgage broker) has a number of options that are influenced by what the lender intends to do with the loan after the closing. The lender can hold onto the loan and collect mortgage payments from the consumer until the loan is paid off (known as holding a loan in portfolio), thereby assuming all the risk for borrowers defaulting, or the lender can sell the loan to the secondary market. If a loan is sold, the originator loses the access to future profits from mortgage payments, but also, so long as the loan meets all the standards set forth by the purchaser of the loan, retains no risk should the borrower default. The originator retains the profits from the cost of the mortgage transaction and underwriting, and has a replenished supply of capital to make other loans. The two primary purchasers of loans in the secondary market are the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Lenders may also seek a government guarantee for the loan through the Federal Housing Administration (FHA) or Department of Veterans' Affairs (VA) programs.

1. Portfolio Loans

If a lender is not planning to sell the loan to the secondary market, that lender will usually order a merged credit report, which incorporates information from all three credit repositories, including the three credit scores. While a lender will generally use reports from all three repositories to underwrite a loan, it may use a single credit report to offer a pre-approval. Also, for second mortgages and lines of credit secured by the home, lenders generally underwrite using one credit report. There is no legal or regulatory requirement to use a certain number of credit reports to underwrite a mortgage. However, if a lender wishes to sell the loan on the secondary market, or receive an FHA or VA guarantee on the loan it may be required to follow certain protocols.

A lender planning to hold a loan in portfolio will order a merged credit report with scores from a credit reporting agency, passing on information about the consumer such as name, social security number, current and previous addresses. The credit reporting agency will then pass on the request to a merging company, which will request credit reports from all three credit repositories and will compile the information from each report returned to them, according to their merging logic (a set of automated commands designed to identify shared information and present the three reports in a summarized format). The individual credit reports as they read prior to merging and credit scores are also returned to credit reporting agency. The credit reporting agency will then supply this information to the lender.

Based on the information in this report, and other information such as the applicant's income and the loan to value ratio of the mortgage requested, a lender will decide whether or not to originate the loan, and at what price (interest rate, points, etc.). A number of companies, such as mortgage lenders Countrywide and GE Capital and mortgage insurers PMI Mortgage Insurance Company and Mortgage Guarantee Insurance Corporation, have developed automated underwriting (AU) systems that can provide automated evaluations of a loan application based on information from the consumer's credit report and additional information such as income and loan to value ratio.

If the lender is hesitant to originate a loan because of derogatory information in an applicant's credit report, and has reason to believe that it may be incorrect, or outdated, the lender can purchase a reinvestigation of the credit information from the credit reporting agency. This entails contacting original creditors, collection agencies, and government records clerks, to verify and update questionable information contained in the merged credit file. These services can mean corroborating as few as one entry in a credit file, or it can be a comprehensive review in which every entry with conflicting information is corroborated. An alternative called a Residential Mortgage Credit Report (RMCR) involves reviewing two or three credit repository reports, verifying all conflicting data in the credit repository reports and the application form with each creditor, updating any account with a balance over 90 days old, conducting a consumer interview, and other verification services. Such services provide more current information to a lender for their consideration when underwriting a mortgage, but they do not alter information maintained by any of the credit repositories, nor do they change a borrower's credit score¹¹. A credit reporting agency may have greater success obtaining clarification of inconsistencies in an applicant's record than the applicant would have acting on his or her own, and the credit reporting agency's reinvestigation is more likely to be trusted by the lender than the word of a consumer regarding current status of accounts. This service adds cost to the credit underwriting process (roughly \$50-100). For consumers who have credit scores far higher than the requirements to qualify, this would be an unnecessary service. However, for those who face loan denial, or dramatically higher borrowing costs because of errors in their reports, the savings over the life of the loan, or in some cases with a single mortgage payment, could more than compensate for the increased cost of this reinvestigation. After the reinvestigation, the credit reporting agency will provide the updated and verified information to a lender who can consider the information while making the final underwriting decision¹².

¹¹ When a reinvestigation produces changes in the information contained in a repository's credit report, the credit reporting agency is required to pass the information on to the repository within 30 days. However, once this occurs, there is no requirement that the repository update the consumer's credit file, nor a time frame within which they must respond. It would be far better for consumers if the credit repositories were under an obligation to update the consumer's file, or at the very least to respond with the results of their own reinvestigation within 30 days. In the mean time, the disputed information should be part of the credit report provided to any data users who request the file as the reinvestigation is underway.

¹² Lenders are not required to accept the results of a reinvestigation, and the automated underwriting systems of key secondary market actors Fannie Mac and Freddie Mac do not. Instead they require all changes to be made through a process known as rescoring, described in greater detail below.

2. Loans Sold in the Secondary Market

In the current marketplace, few loans are held in portfolio, especially those loans originated by brokers. Instead, many are sold into the secondary market to entities that bundle large numbers of mortgages into securities that are sold to investors – a process known as securitization. The major actors in this part of the market are the Government Sponsored Enterprises Fannie Mae and Freddie Mac, although a number of large national lenders also purchase and securitize loans. If mortgage originators can sell a loan, then they will have renewed capital to make another loan, and will still have profit derived from the costs charged to the consumer for the transaction. Thus selling a loan into the secondary market is an attractive option.

Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac have both developed automated underwriting systems which evaluate mortgage applications based on the information in credit reports, as well as additional information such as income and loan to value ratio, in a very short amount of time. Lenders can submit a loan application to these automated underwriting systems prior to approving a loan and receive an indication from the GSE that they will purchase the loan. Each GSE has a different protocol for submitting loan applications and for obtaining and using credit histories.

Automated underwriting (AU) systems do not approve or deny loans, but can provide an indication of whether a GSE will purchase the loan, and thereby assume the risk of default with respect to the loan. A lender can override an AU decision and underwrite the loan manually, but if they do so, they must agree to buy back the loan if it defaults and is found to have violated the purchaser's loan standards. While a loan with an AU approval that meets all the purchaser's standards and complies with the warranties of sale carries no risk for a lender or broker, a loan that has been approved by overriding AU standards does carry significant risk. Many loans are still manually underwritten, but the majority of applications are reviewed with an automated underwriting system, and this share is expected to grow in coming years.

Brokers are the dominant originators of loans, but they do not have the financial reserves of banks, thrifts, and other financial institutions. They rely on being able to sell their loans almost immediately. This is much more difficult without an AU approval. Also, the efficiencies of credit scoring and automated underwriting have made the loan approval process so fast for loans with good credit that the additional effort required to correct errors, or otherwise revisit the details of the loan file, acts as a substantial deterrent to mortgage lenders working on these loans. In this market, where record volumes of loans are being originated, there is a tremendous incentive to deal only with the loans that will be approved the fastest – the loans that pass the credit score/ automated underwriting test¹³.

¹³ The economic pressure on originators to underwrite loans that will require the least amount of work existed prior to the introduction of automated underwriting systems. However, the development of automated underwriting has made the process so quick for some loans that the relative additional time required to complete a more complicated loan is proportionally greater. Some have noted that decreasing

3. Credit Rescoring

If lenders wish to update or correct information in a credit report, the lender cannot use the reinvestigation process for portfolio loans outlined above and resubmit the loan through the automated underwriting systems of Fannie Mae and Freddie Mac. The reinvestigation process outlined above does not change the data on record at the repositories and only reports that contain credit scores and have been generated at the repository level are acceptable for submission to Fannie Mae's and Freddie Mac's automated underwriting systems. Lenders can choose to manually underwrite the loan and submit it with documentation of the errors in the first credit report.

If a lender is unwilling to underwrite the loan manually, and a consumer can afford to wait several weeks, the consumer can submit a dispute directly to the credit repository, and the repository has 30 days to respond to the dispute. However, if the borrower wishes to correct an error in an expedited time frame, lenders who submit loans through automatic underwriting systems would have to order a service known as *rescoring*. In this process, the credit reporting agency will obtain the necessary documentation regarding the disputed account or accounts and contact the rescoring department within the relevant repository. This department will verify the information provided to them by the credit reporting agency, either through spot checks, or by verification of every update, within a few days. After this process is complete, a new credit report with new credit scores can be requested, and the loan can be underwritten with the more current information. In addition, the information is changed at the repository level, and will be reflected in future credit reports for this consumer. This has recently become a very expensive service for a lender to purchase. Since the summer, two of the three repositories have increased prices for this service by as much as 400%¹⁴.

Regardless of how the underwriting takes place, if the loan is originated, the mortgage lender, or the entity holding and servicing the loan if it is sold, may become a data provider. The servicer will report information about consumer's payment behavior related to their mortgage to one, two, or three of the credit repositories, who will add this information to the credit report.

the time required to underwrite the easiest loans potentially frees underwriters to devote more time to more difficult loans.

¹⁴ According to reports from a number of credit reporting agencies, Transunion and Equifax have recently changed their pricing. Transunion previously charged \$5.00 per account entry, or trade line, regardless of whether the account to be updated was a joint or individual account. As of June of this year, Transunion charges \$20 per trade line to update an individual account, and \$25 to update a joint account. Equifax has recently increased the cost from approximately \$5 per rescore to \$15 per tradeline for a joint or individual account, or \$30 for a same day request. Both repositories have clearly stated that these costs are not to be passed on to the consumer. It is also of note that these two repositories compete with credit reporting agencies in offering rescoring services, and charge between \$8-10 per trade line to lenders who contact them directly.

4. Federal Housing Administration (FHA) and Department of Veterans' Affairs (VA) Loans

Lenders who wish to submit loans for an FHA or VA guarantee must also follow certain protocols regarding the submission of credit reports, but have a number of options to choose from. For example, the FHA program accepts either a three repository merged credit report, a Residential Mortgage Credit Report (RMCR), or applications processed through the automated underwriting systems of Fannie Mae and Freddie Mac. The RMCR option is required to be made available to consumers who dispute information contained in their credit reports¹⁵. In addition to the options offered to lenders submitting loans for FHA guarantees, the VA program accepts applications processed through the automated underwriting systems of PMI Mortgage Insurance Company and Countrywide¹⁶.

¹⁵ See FHA Lender's Handbook number 4155.1 chapter 2, section 4 "Credit Report Requirements," and Mortgage Letters 98-14 and 99-26, available at www.hudclips.org.

¹⁶ See VA Lender's Handbook, VA Pamphlet 26-7, available at <http://www.homeloans.va.gov/26-7.pdf>.

V. Study Design

A. Phase One

The first phase of the study consisted of a manual review of 1704 credit files, archived by credit reporting agencies. These files had been requested by mortgage lenders on behalf of consumers actively seeking mortgages. The three credit reporting agencies that generated these files are located in different regions of the country (West, Midwest, and East) and serve mortgage lenders in a total of 22 states.

Only archived credit files that had been generated by mortgage lender requests for reports and scores from all three major credit repositories (Experian, Equifax, and Trans Union) were included in the review. Files were included in the study by reviewing consecutive archived files dating from June 17 to June 20, 2002¹⁷.

Ensuring the anonymity of all data collected and examined for this study was a paramount concern for both CFA and NCRA. The data collection procedures were designed with particular care to ensure that no personal identifying information from these credit files was recorded for this study. No reports were provided in paper or electronic form, and no names, social security numbers, account numbers, addresses, or other consumer identifying information was recorded. All comments regarding inconsistencies were recorded in generic form. For example, the fact that digits in a social security number were transposed in one file would have been recorded, but the actual number would not have been. Similarly, if a consumer's file showed apparent confusion between credit data recorded under a consumer's first name and credit recorded under the consumer's middle name, this would have been noted, but the names would not have been recorded. While the files were being reviewed, the National Credit Reporting Association (NCRA) and the Consumer Federation of America (CFA) took precautions to limit the access to identifying information to the credit reporting agencies' representatives, who worked with a representative from the Consumer Federation of America in each office. The credit reporting agency representative retrieved the files, and conveyed only the relevant generic information verbally to the CFA representative for recording. As a result, the data examined for this study contains only generic information about variations in credit data, but does not link that data to any consumer or consumers.

For each file, the credit scores from each of the three major credit repositories were recorded. If a repository returned a report, but the report was not scored, or if the repository could not locate a report for the applicant, this information was also recorded. In addition, researchers noted if a file contained multiple reports from any repository, and recorded the scores for these reports, if the report was scored. Residential Mortgage Credit Reports (RMCRs), for which credit reporting agencies verify and update

¹⁷ For agencies that serve multiple time zones, additional measures were employed to include records from consumers in all regions. For example, every second file from one agency was reviewed rather than every file.

information in the credit report, were identified as such¹⁸. For joint application files, the applicant's and coapplicant's reports were treated as separate reports. Approximately 500 files that contained a credit score from each of the three repositories were recorded at each agency.

A major focus of the study was for those applicants closest to the boundary between the lower priced prime mortgage lending market and the higher priced subprime mortgage lending market, which, in addition to higher costs overall, exposes borrowers to greater risks of predatory lending. A large variance between scores on a consumer's file is a likely indication of drastically incomplete and/or incorrect information in that consumer's credit reports, and a cause for concern. For those closest to the boundary between prime and subprime, generally considered to be a credit score of 620, the impact of even small variances can be severe and translate directly into a greater financial burden.

Thus, more detailed information about each file was recorded: 1) if the file had widely varying scores among repositories (defined as a range of 50 points or greater between the high and low score); 2) if the file was near the threshold between prime and subprime classification with a substantial variance between scores (defined as having a middle score between 575 and 630, and a range between high and low scores greater than 30 points); or 3) if the file was directly at the threshold between prime and subprime classification (defined as having a high score above 620, and a low score below 620). For files that met these criteria, the four primary factors contributing to the credit score, provided by each repository as part of the credit report, were recorded.

Finally, if the file met criterion 2 (had a middle score between 575 and 630, and a range between high and low scores greater than 30 points), or if the file had a variation in scores of more than 90 points, the specifics of the three credit reports were reviewed in an attempt to identify any obvious inconsistencies between the repositories. When possible, researchers made a determination based on this review of whether any inconsistencies seemed likely to be artificially lowering or raising the score reported by one or more repositories.

B. Phase Two

The goal of Phase Two was to test the representational validity of the findings in Phase One by comparing key statistics from that sample of credit files with the same statistics for a much larger sample of credit files. Specifically, the goal was to compare the range among credit scores, and the frequency of explanations provided to consumers.

This phase of the study reviewed credit scores and the explanations for those scores provided by the repositories for a separate sample of 502,623 archived credit files. This larger sample was collected electronically and did not involve a manual review of each file. As with the first phase, these files had been requested by mortgage lenders on behalf of consumers actively seeking mortgages, and only credit files generated by a request for

¹⁸ Conducting and RMCR does not affect the credit scores, and when in depth reviews of the reports were conducted on RMCRs, the comments referred to the status of the report prior to updates or verification.

the reports and scores from all three major credit repositories (Experian, Equifax, and Trans Union) were included.

If a repository returned an unscored report, or if the repository could not locate a report for the applicant, this information was recorded. In addition, the presence of multiple reports from any repository and the scores for these reports, if scored, were recorded. For joint application files, the applicant's and coapplicant's reports were treated as separate reports.

For this phase of the study, the zip code for each file was recorded, as was information about the type of services requested for each file, and the version of the scoring model used to calculate each score. By matching zip codes with states, it was possible to determine the geography represented by these files. Phase Two analyzed files from every state and territory in the nation, with a wide distribution of files from all regions. (34% from the Northeast, 27% from the Southeast, 30% from the Midwest, 6% from the West¹⁹, 4% with no zip code information to indicate a state, and 0.08% from U.S. territories.)

Unlike the files in Phase One, which constitute a snapshot of the profile of consumers seeking mortgage credit over just several days, the files reviewed in Phase Two date from December 8, 2000 to September 20, 2002.

C. Phase Three

Phase Three explored the prevalence of specific errors in a representative sample of credit reports, and attempted to quantify how many files contained inconsistent, missing, or duplicated information. Researchers used a 10% sample of all files reviewed at one site in Phase One and reviewed account data and public records data for errors of omission (information not reported by all repositories) and errors of commission (inconsistent information between repositories, or duplicated information on a single repository).

This phase tabulated how many consumer files were missing accounts on at least one repository report that appeared on other repository reports, treating accounts of different type and status separately. The same criteria used to tabulate missing accounts were used to tabulate the number of files that contained duplicate reports of accounts on a single repository report.

¹⁹ The researchers were concerned that there were disproportionately fewer files from the western region, particularly a disproportionately low number of files from California. However, subsequent analysis showed that key statistics and distribution of score ranges for the files from this region, and from California specifically, were virtually identical to those for the entire sample. Therefore, the researchers are confident that this under-representation is not introducing any bias into the findings. (The regions were defined as follows: Northeast: ME, NH, VT, NY, MA, CT, RI, PA, NJ, DE, DC, MD, WV, VA. Southeast: NC, SC, GA, TN, KY, AL, MS, FL, LA, AR, TX, OK. Midwest: OH, IN, IL, MI, WI, MN, ND, SD, IA, MO, NE, KS. West: AZ, NM, MT, WY, CO, UT, NV, CA, ID, OR, WA, AK, HI. Territories: GU, PR, VI.)

The seven types of accounts identified were mortgages, other installment loans, revolving accounts, other accounts not in collection, medical collections, child support collections, and other collections or charge offs. The researchers differentiated between the status of each non-collection account on the repository or repositories that did report the account. For accounts other than collections and charge offs (mortgages, other installment loans, revolving accounts, other accounts not in collection), the researchers differentiated between accounts that had no derogatory information, accounts that had late payments, accounts that had conflicting information regarding late payments on two repositories, and accounts that had inconsistent information regarding default. In addition, researchers noted if a mortgage had gone to foreclosure, and if a revolving account had been reported lost or stolen.

Files with duplicate or missing public records were tabulated, differentiating by type and status as well. Researchers tabulated missing and duplicate bankruptcy filings, liens, judgments, and civil suit filings, differentiating between two categories of status, those that had been filed, and those that had been recorded as released, satisfied, dismissed, or paid.

In addition to determining the number of files with missing and duplicate accounts, the researchers tabulated the number of files that contained certain inconsistencies between the three repositories regarding account details for accounts reported by all three. The inconsistencies of interest were: the number of payments recorded as 30 days late; the number of payments recorded as 60 days late; the number of payments recorded as 90 days late; the balance reported on revolving accounts or accounts in collection; the credit limit reported on revolving accounts; the past due amount; the method of payment (a code indicating if the account is currently being paid as agreed, is currently late, was late, but is now paid, etc.); the date of last activity on defaulted accounts; and the type of account. Finally, the researchers tabulated the number of files that reported a defaulted account, but did not report the date of last activity on that account.

VI. Findings

A. Phase One

1. Almost One in Ten Files was Missing a Credit Score from at Least One Repository.

Of the 1704 unique files reviewed, 1545 files had at least one score reported from each major credit repository. The remaining 159 reports were excluded from the statistical analysis because of one or more missing scores. Table 1 details the status of the files included and excluded from the analysis.

Table 1. Status of Files Reviewed in Phase One.

1390 Files with exactly 3 repositories scored, with no additional scores or unscored reports
114 Files with 3 repositories scored but with additional scores and unscored reports
41 Files with 3 repositories scored but with additional unscored reports
<hr/> 1545 Subtotal: number of files with 3 bureau scores -- included in analysis
58 Files with only 2 repositories scored*
26 Files with only 1 repository scored*
62 Files with no repositories scored*
13 Duplicate files, test files or other errors that were thrown out
<hr/> 159 Subtotal: number of files excluded from analysis
<hr/> <hr/> 1704 Total Files Reviewed

* Unscored files include cases where no file was returned (no hit on information input during request) as well as cases for which a file was returned but not scored.

2. A Substantial Number of Files Met the Criteria for Further Review.

Of those 1545 files that had valid scores from each repository, 591 files, or 38%, were flagged for further review, based on the three predefined criteria outlined in the previous section and below.

Of the 1545 valid files:

1. 453 files, or 29%, had a range of 50 points or more between the highest and lowest scores.
2. 175 files, or 11%, had a middle score between 575 and 630 and had a range of 30 points or more between the highest and lowest scores.
3. 250 files, or 16%, had high scores above 620 and low scores below 620.

These numbers do not total 591 because many files met multiple criteria. Table 2 provides more detail on the number of files that met each of the criteria.

Table 2. Number of Files that met Criteria for Further Review in Phase One

Met Criterion 1	453
Met Criterion 1 only	273
Met Criteria 1 and 2 only	29
Met Criteria 1 and 3 only	79
Met all three Criteria	72
Met Criterion 2	175
Met Criterion 2 only	39
Met Criteria 1 and 2 only	29
Met Criteria 2 and 3 only	35
Met all three Criteria	72
Met Criterion 3	250
Met Criterion 3 only	64
Met Criteria 3 and 1 only	79
Met Criteria 3 and 2 only	35
Met all three Criteria	72
Met any of the three Criteria	591

3. Numerous Files Contained Additional Repository Reports and Information not Relevant to the Consumer's Credit History.

Each file examined had been generated from a request for a merged file that included one report and one score from each repository. However, one in ten files (155 out of 1545) contained at least one, but as many as three, additional repository reports. These reports were not duplicate copies of reports, nor were they residual reports from previous applications for credit. These additional reports were returned from the same simultaneous request that produced the other reports in the file. For 114 of the files with additional reports, at least one, but as many as three of these additional reports also contained a credit score. It was unclear to researchers exactly how various systems would interpret these additional repository reports.

In some cases, an additional repository report was clearly reporting the credit activity of a separate person (no accounts from the additional report appeared on the three primary reports, and vice versa). However, it was very common for the additional report to contain a mixture of credit information, some of which belonged to the applicant, and some of which clearly did not. In some cases, applicants had split files that appeared to be the result of applying for credit under variations of their name.

Common reasons for returning additional repository reports included:

- ? Confusion between generations with the same name (Jr., Sr., II, III, etc.).
- ? Mixed files with similar names, but different social security numbers.
- ? Mixed files with matching social security numbers, but different names.
- ? Mixed files that listed accounts recorded under the applicant's name, but with the social security number of the co-applicant.
- ? Name variations that appeared to contain transposed first and middle names.
- ? Files that appeared to be tracking credit under an applicant's nickname.
- ? Spelling errors in the name.
- ? Transposing digits in the social security number.
- ? An account reporting the consumer as deceased.

4. Scores Reported by the Three Repositories for a Given Consumer Varied Substantially.

The review found considerable variability among scores returned by the three credit repositories. Because the repositories all use the scoring model provided by Fair, Isaac, and Company, this considerable variability among scores suggests considerable differences in the information maintained by each repository. Fair, Isaac, and Company attribute variations in credit scores to variations in credit data²⁰. However, some have suggested that variations in credit scores may be occurring because not all data users are adopting new versions of the scoring model simultaneously. Researchers explored this concern using the data collected for Phase Two, and found the impact of different scoring models to be negligible.

Only one out of five files (328, or 21%) could be considered extremely consistent, with a range of fewer than 20 points between the highest and lowest scores. One in three files (475, or 31%) had a range of 50 points or greater between scores, and one in twenty files (81, or 5%) had a range of 100 points or greater between scores.

The average (mean) range between highest and lowest scores was 43 points, and the median range was 36 points. These statistics were reasonably consistent among the three regions²¹.

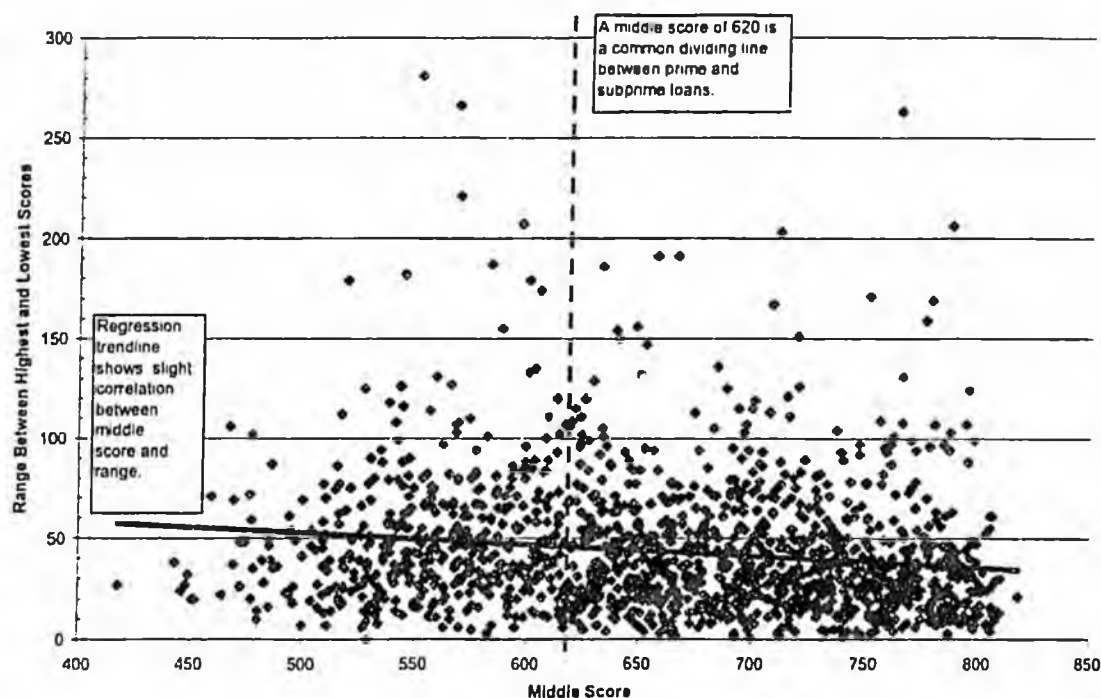
Files with good and bad credit both appear susceptible to large point ranges, although consumers with poor credit may be slightly more susceptible. Chart 1 compares the middle score of all files with the range between the highest and the lowest score for that file. The middle score is often the score used for loan approval. On this chart there is slight correlation between middle score and score variability. The regression trendline, which in this case estimates the average score range for each middle score, is relatively flat, but is higher for files with worse overall credit. This means that, on average, files with low middle scores have slightly greater variability among their scores, relative to files with high middle scores.

For example, for a middle score of 550, the regression line has a value of 50, meaning that the average range between high and low scores for files with a middle score of 550 is 50 points. In comparison, the average range between high and low scores for files with a middle score of 700 is 40 points. Thus, files with a middle score that is 150 points lower have an average score variability that is 10 points greater.

²⁰ Fair Isaac, and Company address the question of differing information at the three repositories as part of the explanation of how credit scoring works on their consumer oriented website, myFICO.com, stating: "Your score may be different at each of the three main credit reporting agencies: The FICO score from each credit reporting agency considers only the data in your credit report at that agency. If your current scores from the three credit reporting agencies are different, it's probably because the information those agencies have on you differs." (<http://www.myfico.com/myfico/CreditCentral/ScoringWorks.asp>)

²¹ In the Eastern region, the mean range was 40 and the median range was 33. In the Midwestern region, the mean range was 43 and the median range was 36. In the Western region, the mean range was 46 and the median range was 38.

Chart 1. Middle Score v. Range Between Scores



5. Reports Contained Limited Information to Help Consumers Understand the Principal Reasons for their Credit Scores.

If a consumer is subject to an adverse action because of information in a credit report, federal laws (the Fair Credit Reporting Act and the Equal Credit Opportunity Act) require the lender to make certain disclosures. Adverse actions include, among other things, denial of credit, or denial of favorable terms on credit. The required disclosures include statements that an adverse action has occurred and that the decision was based in part or entirely on a credit report and the specific, principal reasons for the adverse action (generally four reasons are given)²².

Thus, each repository report contains the four principal reasons contributing to the score returned, as identified by the automated process that calculated the score. The three repositories have approximately forty standard reasons that can be provided through this process. However, a mere four reasons were provided as the primary contributing reason on 82% of the reports reviewed (i.e. the reports in the 591 files that met any of the criteria for further review outlined in the study design). The four most frequently returned explanations for a consumer's score, with the frequency with which they occurred, were:

²² National Consumer Law Center, *Fair Credit Reporting Act, Fourth Edition*. 2000.

- ? "Serious delinquency, and derogatory public record or collection filed" (37% of all explanations).
- ? "Serious delinquency" (20% of all explanations).
- ? "Proportion of balances to credit limits is too high on bank revolving or other revolving accounts" (15% of all explanations).
- ? "Derogatory public record or collection filed" (10% of all explanations).

It is important to note that three of the explanations ("Serious delinquency," "Derogatory public record or collection filed," and "Serious delinquency, and derogatory public record or collection filed") convey at least partially redundant information. These three explanations alone constituted 67% of all primary reasons provided.

6. In Depth Reviews Revealed Significant Errors and Inconsistencies, Some of Which were Likely Artificially Lowering Consumer Credit Scores, and Some of Which were Likely Artificially Raising Consumer Credit Scores.

In depth reviews were done of files that met the second criterion for further review (had a middle score between 575 and 630 and a range between high and low score of more than 30 points), or if the file had a range between scores of more than 90 points. In each case, researchers attempted to identify any obvious inconsistencies between the account level data on each of the repository reports, determine whether these inconsistencies were the result of omissions, or if they reflected conflicting credit data, and make a determination of whether the scores were likely being artificially inflated or artificially deflated by these inconsistencies.

There are obvious limitations to what the researchers could conclude during in depth reviews of credit file details without the aid of either creditors or consumers to corroborate or contest inconsistencies. The researchers attempted to approach these evaluations in as conservative a manner as possible; for example when derogatory information, such as a collection, was reported on only one repository, researchers tended to assume that the derogatory information was correct. However, when finer details were inconsistent, such as the current payment status of a given account, the more recent information was usually assumed to be correct. In total, 258 files were reviewed in depth.

For approximately half of the files reviewed in depth (146 files, or 57%), researchers were unable to identify clearly whether inconsistencies in the reports were resulting in an artificially higher or artificially lower score. In many cases this was because there were large numbers of derogatory accounts, reported in various combinations by one, two, or three of the credit repositories. For those files for which a determination was made, an even split existed between files for which one or two scores were likely artificially high (56 files, or 22%) and files for which one or two scores were likely artificially low (56 files, or 22%). Thus, at least one in five at risk borrowers, but likely many more, are likely being penalized because of an inaccurate credit report or credit score. Similarly, at least one in five at risk borrowers is likely benefiting from inflated scores because of

incomplete credit information. However, these figures are based on the assumption that, in the absence of contradictory information, all information that was reported by only one repository was accurate. The figures likely underestimate the actual number of borrowers who are at risk because they do not account for information that is simply incorrect, does not belong to the borrower, or has been contested and removed from one or two repositories, but not from all three.

While this finding suggests a certain statistical equilibrium between the harm and benefit that obvious omissions, mistakes, and inconsistencies may be causing to consumers on the macro level, credit scores are purported to offer consumer-specific evaluations, and are used to generate customer-specific prices and decisions. Lenders suffer little harm so long as there is such statistical equilibrium because the large number of consumers they serve allows them to benefit from the countervailing impact of these errors on a given pool of loans. Consumers, on the other hand, have one score for every purchase, and do not benefit from such statistical averaging. Given the number of decisions regarding access and pricing of essential services that rely on these scores, their determination should not be a lottery in which some consumers "win" because derogatory information is omitted while other consumers "lose" because erroneous, contradictory, outdated, or duplicated information is reported in their credit history. Rather, scores should be determined fairly and based on complete, current, and accurate information.

B. Phase Two

The second phase of the study examined the scores and primary factors contributing to the score, as identified by the repositories, from 502,623 files compiled from electronic records. Examining this very large sample allowed for a corroboration of some of the findings of Phase One among a larger population, roughly equivalent to a 0.25% sample, or one out of every 400 consumers with credit reports. Furthermore, because no details of the report were recorded beyond the credit scores and primary reasons for the scores, zip code data could be included without fear of recording excessive personal identifying information. This allowed for verification that the sample had broad geographical representation.

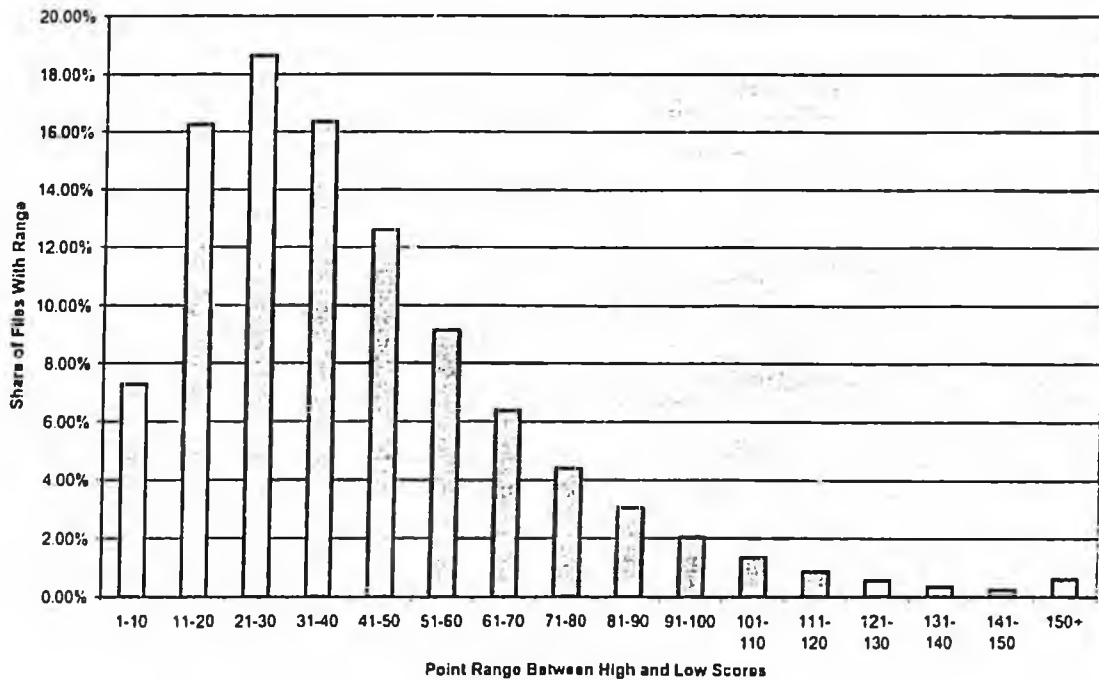
1. Scores Reported by the Three Repositories for a Given Consumer Varied Substantially.

The key findings from Phase Two are very similar to the findings from Phase One. Just fewer than one out of four files (105,324 files, or 24%, compared to 21% in Phase One) could be considered extremely consistent, with a range of 20 points or fewer between the highest and lowest scores. One in three files (129,284 files, or 29%, compared to 31% in Phase One) had a range of 50 points or greater between scores, and one in twenty-five files (17,626 files, or 4%, compared to 5% in Phase One) had a range of 100 points or greater between scores.

The average (mean) range between high and low score was 41 (compared to 43 in Phase One). The median range between high and low score was 35 (compared to 36 in Phase

One). Chart 2 is a histogram showing the share of files for which the range between highest and lowest score fell into 10 point bands up to 150, and the number of files for which the range exceeded 150.

Chart 2. Frequency of Ranges Between High and Low Score for Phase Two



2. Reports Scored With Different Versions of Scoring Software Reflected Almost No Difference in Overall Variability of Credit Scores.

As mentioned in the findings for Phase One, some have suggested that score variability can be explained by the fact that different versions of the Fair, Isaac, and Company scoring software may be in use in the marketplace as data users transition to a new version. The data collected in Phase Two allowed researchers to assess this and determine that the fact that reports were scored with different versions of the scoring models did not have an impact on the overall variability of credit scores in this study.

Fair, Isaac, and Company produces the software for all three repositories, but each repository refers to the scoring software by a different name. When Experian adopts a new version of the software, they discontinue the previous version (for example when they switched from a version Experian referred to as "Fair Isaac" to a version Experian referred to as "Experian/Fair Isaac Risk Model"), but users of Trans Union and Equifax software must update to the newest software version themselves, and there can be more than one version of the software in use at a given time. The sample examined in Phase Two reflected the use of two different versions of scoring software to score reports from Trans Union and Equifax. Trans Union reports were scored by an older version titled

"Empirica" and a newer version titled "New Empirica." Equifax reports were scored by an older version titled "Beacon" and a newer version titled "Beacon 96"²³.

The use of different scoring models had a nearly imperceptible effect on variation among scores. Only three combinations of scoring models occurred in the sample. Reports scored with the two older versions, "Empirica" and "Beacon," had an average range between the highest and lowest credit score of 39.61 points, and a median range of 33 points. Reports scored with "Empirica" and "Beacon 96" had an average range of 40.85 points, and a median range of 34 points. Reports scored with "New Empirica" and "Beacon 96" had an average range of 41.59 points, and a median range of 36 points. Comparing these statistics to the overall statistics for Phase Two (an average range of 41 points and median range of 35 points) shows that the influence of different scoring models is negligible, and if anything, the newer models resulted in a slightly greater variation among scores.

Recent commentary suggests that a new version of the software, "Next Generation FICO," which Equifax will refer to as "Pinnacle," Trans Union will refer to as "Precision" and Experian will refer to as "Experian/ Fair Isaac Advanced Risk Score," may produce significantly different scores from earlier models, but has not been widely adopted in the marketplace²⁴. The impact of this new scoring tool is deserving of attention. However, none of the reports in this analysis were scored with this version of the scoring software.

3. Reports Contained Limited Information to Help Consumers Understand the Principal Reasons for their Credit Scores.

As in Phase One, a very limited number of standardized responses represented the vast majority of all explanations provided to consumers about their credit scores. The same four explanations that were predominant in Phase One were predominant in Phase Two, but in Phase Two a fifth code was returned with significant frequency.

Three explanations ("Serious delinquency," "Derogatory public record or collection filed," and "Serious delinquency, and derogatory public record or collection filed") represented 50% of the primary explanations provided (compared to 67% in Phase One). The explanation "Proportion of balances to credit limits is too high on bank revolving or other revolving accounts" represented 18% of the primary explanations provided (compared to 15% in Phase One). While these explanations constituted a very large share of all the principal explanations (7 out of 10), a fifth explanation also constituted a significant share. The explanation "Length of time accounts have been established" represented 8% of all the primary explanations provided (compared to 5% in Phase One).

²³ In addition, 0.3% of files scored by TransUnion were scored by a version titled "Horizon," approximately 6% of files scored by all three repositories did not identify the version of the software used for scoring, and an extremely small number of files (approximately 0.03%) were scored by a non-mortgage model, such as an auto model or a bankruptcy model.

²⁴ Harney, Ken. "Get Upgraded Credit Scoring." Washington Post, November 23, 2002, and "Lenders Slow to Adopt New FICO Scoring Model," Washington Post, November 30, 2002.

It is worth noting that the four principal reasons for credit scores were on every file included in the analysis in Phase Two, while Phase One only recorded the explanations for those that met the criteria for further review.

C. Phase Three – Specific Types of Errors

The dramatic ranges between credit scores uncovered in Phases One and Two seem to indicate wide ranging inconsistencies between the information on each repository for a given consumer. Phase Three attempted to quantify how many consumer files contain errors, and of what kind. Errors of omission (information not being reported by all repositories) and errors of commission (inconsistent information between repositories, or duplicated information on a single repository) were both considered. Researchers recorded how many consumer files contained at least one of each category of errors identified.

Phase Three re-examined a 10% randomly selected sample of the files reviewed at one of the sites from Phase One. In this sample of 51 three-repository merge files, errors of omission and commission were both rampant. Table 3 lists the categories of errors, the number of files that contained such errors, and the percentage of files that contained such errors.

This examination of the frequency with which certain errors occur is not intended to imply that the occurrence of any one of these errors alone will necessarily reclassify a consumer into a more expensive pricing class. The actual impact of any one of these errors will depend upon what other information exists in the consumer's credit report. Any error with the potential to lower a consumer's credit score will generally have a greater effect on "thinner" files, or files that have less information. Also, if a report has no derogatory entries, the first piece of derogatory information will very likely have a more severe negative impact on a consumer's apparent creditworthiness than the same information would have on a file with multiple derogatory entries. However, it is possible for a single derogatory entry to have a dramatic effect on a consumer's score, whether or not it is accurate. If that consumer is near the threshold for a less favorable pricing class, it is very possible and probable that an error or errors in that consumer's credit history could have a substantial material impact. Furthermore, most reports reviewed contained more than a single error, and the cumulative effect of multiple errors increases the likelihood of material impact on consumers.

The sample size in Phase Three is the smallest of the three phases, due primarily to the time required to review files in sufficient depth to identify specific errors. The researchers recognize that the statistics from this phase have limitations and it is difficult to make definitive statements about the frequencies with which specific errors occur in the population at large based on these findings. However, this phase does document strikingly high levels of errors and provides evidence that at the very least a significant minority in the general population are at risk for a variety of errors of commission and omission.

Table 3. Types of Errors, and Number and Percentage of Files Containing Such Errors

Type of Account	Status	Omission		Commission			
		Number of Files Missing Such Acct.	% of Files Missing Such Acct.	Number of Files with Such Acct. Duplicated	% of Files with Such Acct. Duplicated	Number of Files with Inconsistent Info	% of files with Inconsistent Info
Mortgage	No Derogatory Info	17	33.3%	1	2.0%		
Mortgage	Late Payments	1	2.0%		0.0%		
Mortgage	Inconsistent Lates btw Repositories	1	2.0%		0.0%		
Mortgage	Inconsistent, one shows Default		0.0%		0.0%		
Mortgage	Foreclosure	2	3.9%	1	2.0%		
Other Installment	No Derogatory Info	34	66.7%	4	7.8%		
Other Installment	Late Payments	3	5.9%		0.0%		
Other Installment	Inconsistent Lates btw Repositories	2	3.9%	1	2.0%		
Other Installment	Inconsistent, one shows Default	1	2.0%		0.0%		
Revolving	No Derogatory Info	40	78.4%	9	17.6%		
Revolving	Late Payments	6	11.8%		0.0%		
Revolving	Inconsistent Lates	2	3.9%		0.0%		
Revolving	Inconsistent, one shows Default	4	7.8%		0.0%		
Revolving	Missing Lost or Stolen	8	15.7%		0.0%		
Other	No Derogatory Info	8	15.7%	1	2.0%		
Other	Late Payments		0.0%		0.0%		
Other	Inconsistent Lates btw Repositories		0.0%		0.0%		
Other	Inconsistent, one shows Default		0.0%		0.0%		
Collection Medical	Collection/ Chargeoff	10	19.6%		0.0%		
Collection Child Support	Collection/ Chargeoff	1	2.0%		0.0%		
Other Collection or Chargeoff	Collection/ Chargeoff	13	25.5%	3	5.9%		
Bankruptcy	Filed		0.0%		0.0%		
Bankruptcy	Released/Satisfied/Dismissed/Paid	5	9.8%	1	2.0%		
Lien	Filed	4	7.8%		0.0%		
Lien	Released/Satisfied/Dismissed/Paid	2	3.9%		0.0%		
Judgement	Filed	3	5.9%		0.0%		
Judgement	Released/Satisfied/Dismissed/Paid	2	3.9%		0.0%		
Civil Suit	Filed		0.0%		0.0%		
Civil Suit	Dismissed	1	2.0%		0.0%		
	# 30 Late					22	43.1%
	# 60 Late					15	29.4%
	# 90 Late					12	23.5%
	Balance on Revolving Accts or Collections					42	82.4%
	Credit Limit on Revolving Accts					49	96.1%
	Past Due Amount					9	17.6%
	Current Method of Payment					31	60.8%
	Type of Account					11	21.6%
	Last Activity on Defaulted					13	25.5%
	No Last Activity Date on defaulted accounts	11	21.6%				

1. Significance and Frequency of Errors of Omission

Incomplete reporting of information, or an error of omission, can make a consumer appear either more credit worthy or less credit worthy, depending on the nature of the information that is omitted. When a derogatory account, such as a collection, late payment, charge off, or public record is omitted, the consumer's record will appear less risky, and the consumer's credit score will likely be artificially high. However, when a positive account, such as a mortgage, auto loan, or credit card account that has been paid as agreed, is omitted, this responsible credit behavior will not be conveyed and the consumer's credit score will likely be artificially low.

Positive account information is especially important for consumers who are just beginning to establish credit, or who are working to re-establish their credit rating after bankruptcy. Omitting positive information can have a dramatically negative impact on such consumers. Failure to report positive accounts can deflate scores, or even make it impossible for the scoring model to produce a score. Such outcomes make it more difficult to enter or return to the prime lending marketplace, relegating affected consumers to the higher priced subprime market.

Because of the limitations of the study, researchers were unable to determine definitively whether many of these errors were errors of omission. For example, researchers could not be certain that accounts appearing on one report only were the result of omissions by the other two repositories, or if the accounts appeared as the result of merging errors, or compiling errors on that one repository (and actually did not belong to the consumer), or if they had been contested and removed from some repositories but not removed from all three. In the absence of evidence that presented a contradiction, researchers conservatively treated information appearing only on one or two repositories as an error of omission.

a) More Files Contained Omissions of Positive Information than Contained Omissions of Derogatory Information, but Omissions of All Kinds were Common.

Accounts that had never been late, and which have great significance for determining a credit score, were omitted with extremely high frequency. Omitted revolving accounts with no derogatory information were noted on the largest number of consumer files. Nearly eight out of ten files (78.4%) were missing a revolving account in good standing. In addition, one file out of three (33.3%) was missing a mortgage account that had never been late, and two files out of three (66.7%) were missing another type of installment account that had never been paid late. Other accounts with no derogatory information, such as non-revolving credit cards, were missing on 15.7% of all files.

Omissions of accounts with late payments, but which had not been sent to collection, were less frequent than omissions of positive accounts. Still, one in ten files (11.8%),

was missing a revolving account with late payments reported, and many (7.8%) were missing revolving accounts that were being reported as defaulted by one of the two repositories that reported the account. Half that number (3.9%) contained conflicting information about late payments on revolving accounts reported by two repositories. A much smaller number of files were missing mortgages or installment accounts that had been late at some time in the past, or that had conflicting information regarding late payments, but 3.9% of files omitted a foreclosure.

The most commonly omitted derogatory information was for various types of collections. Child support collection omissions were rare (2% of files), but one out of five files (19.6%) omitted a medical collection, and one out of four files (25.5%) omitted a collection of some other kind.

b) Medical Collections Raise Special Concerns Regarding Appropriateness and Privacy.

Medical collections, as a subset of collections that were often not reported on all three repositories, deserve special attention. Disputes between consumers, health insurance companies, and medical care providers occur frequently, and can be of extended duration. Many medical bills are referred to collection agencies during these disputes but are ultimately paid by insurers. Therefore, if all the relevant facts were known these collections could very likely be errors of commission, rather than errors of omission, as they may not accurately reflect consumer debt repayment behavior.

Another issue noted by researchers related to medical collections was the high degree of information that can be inferred from the information in medical collection entries listed on a consumer's credit report. The names of many medical creditors are specific enough to allow for identification of categories of treatment. For example, information in collection entries identified categories of medicine, such as perinatology, and neonatal health clinics. This could have especially significant ramifications if full credit reports are reviewed by potential and current employers, who may infer from such collections that an applicant, or employee, has an unusually sick newborn, and may be more likely to be called away from the office²⁵. In other cases, consumers may simply wish not to have the fact that they have sought treatment for other very private matters (such as treatments for fertility, mental health, or AIDS) to be readily discernible by anyone who reviews their credit record.

Section 604 (g) of the Fair Credit Reporting Act states that "A consumer reporting agency shall not furnish for employment purposes, or in connection with a credit or insurance transaction, a consumer report that contains medical information about a consumer, unless the consumer consents to the furnishing of the report." However, consumers have complained about the difficulty of identifying the original creditors for collection accounts that appear on their files, and best practices have been proposed by

²⁵ It is the researchers' understanding that current market practices do not permit employers to view the same level of detail that is provided to potential lenders. Employer credit reports generally do not contain the notations on collection entries that would allow them to make such medical inferences.

the Consumer Data Industry Association that attempt to strike a balance between protecting consumers' medical information and providing enough information to allow consumers to identify the original source of debts. Furthermore, it is the Researchers' understanding that in Massachusetts, the original creditor must be listed for every collection account.

c) Public Record Information was Frequently Omitted, Including Both Information that Would Likely Increase Credit Scores and Information that Would Likely Decrease Scores.

One in ten files had an omitted date of fulfillment for a bankruptcy, an omission that almost certainly lowered the corresponding credit scores. Several files also contained reports that omitted liens, both satisfied (3.9%) and unsatisfied (7.8%), and judgments, both satisfied (3.9%) and unsatisfied (5.9%). One file contained a dismissed civil law suit that was reported to one repository only.

Given the dramatic frequency of omissions of both positive information (such as mortgages) and derogatory information (such as collections and public records) it is clear that errors of omission have the potential to undermine the accuracy of consumer credit records and, by extension, credit scores. It should be noted that true errors of omission (excluding unrelated account information that is erroneously captured by one repository and disputes which have not resulted in removal of information from all three repositories) are most likely the fault of the creditor, not the credit repository. If a data provider, be it a collection agency or major national bank credit card, decides not to report information to all three repositories, then the repositories do not know the information and cannot report it.

2. Errors of Commission

Also of great concern to consumers is the frequency with which errors of commission, or inclusion of incorrect information, occur in credit reports. A credit report with incorrect derogatory information makes a consumer appear to be a greater lending risk and will likely artificially lower the consumer's credit score. In addition, duplicate reporting of accounts can have an impact on a consumer's scores.

Again, because the researchers did not have the benefit of knowing the consumers' credit histories, we were limited in the errors of commission that we could identify. Only in cases where repositories were reporting conflicting details on an account could researchers identify with certainty that at least one repository was incorrect. Even with these limitations, the findings are troubling.

a) Many Consumer Files Contained Conflicting Information Regarding the Consumer's Record of Late Payments.

In 43.1% of the files, reports regarding the same accounts conflicted regarding how often the consumer had been late by 30 days. In nearly one out of three cases (29.4%), there

was conflicting information about how many times the consumer had been 60 days late, and conflicting information regarding the number of times an account had gone to 90 days late in one out of four consumer files (23.5%). Late payments, especially on recent accounts, can be very detrimental to a consumer's credit score. Delinquencies are identified as major contributing reasons for a consumer's score on the majority of reports.

In some cases, but by no means in all, different numbers of late payments may be the result of the timing of record updating procedures by the repositories. For example, one repository may have information on an account that is current as of June, whereas another repository may only have received or loaded information current as of May. However, this phenomenon would only explain variations for accounts that are currently past due, and not for the significant number of files that were currently reported as paid on time, but had discrepancies in the historical count of late payments. Furthermore, regardless of a repository's particular timing, a consumer will be evaluated on the information available at the time of application.

b) Reporting of Account Balances was Inconsistent

Inconsistencies regarding the balance on revolving accounts or collections appeared on 82.4% of files, and inconsistencies regarding an account's credit limit appeared on 96.1% of files. These particular numbers are presented with one qualification. The software used to review reports presents information in a field titled "credit limit/high credit." Researchers acknowledge that the raw data may contain separate information regarding the high credit (the highest amount ever charged on this account) and the credit limit (the amount of credit made available by the creditor) and the observations regarding inaccuracies in these fields may not reflect the data used to derive credit scores. However, even with this qualification, there are reasons to be concerned about incorrect reporting of balances or credit limits. Credit card lenders have an incentive to obscure the real credit limit from credit reports, as a means of retaining existing borrowers. If a credit card lender reports a credit limit as lower than the actual limit (for example by reporting the high credit as the credit limit) the borrower will appear to be closer to "maxing-out" their credit, and will appear less attractive to competing credit card lenders. Thus, the consumer will be less likely to receive competing offers. Such misreporting also poses a significant risk to consumers' overall credit rating. The practice of deliberately refusing to report complete and accurate account information in order to obscure consumers' credit has drawn repeated condemnation from John Hawke, the Comptroller of the Currency²⁶. There is good reason to be concerned, given that one of

²⁶ In a May 5, 1999 speech before Neighborhood Housing Services of New York, Hawke stated, "Subprime loans can't become a vehicle for upward mobility if creditors in the broader credit market lack access to consumer credit history. Yet, a growing number of subprime lenders have adopted a policy of refusing to report credit line and loan payment information to the credit bureaus - without letting borrowers know about it. Some make no bones about their motives: good customers that pay subprime rates are too valuable to lose to their competitors. So they try to keep the identity and history of these customers a closely guarded secret" (<http://www.occ.treas.gov/ftp/release/99-41a.doc>). He reiterated these concerns in a June 9, 1999 speech before the Consumer Bankers Association, condemning the objectionable practice of non-reporting and noting that, "failure to report may not be explicitly illegal. But it can readily be

the most frequently provided explanations for a consumer's credit score is that the "proportion of balances to credit limits is too high on bank revolving or other revolving accounts." This is the primary explanation listed on approximately one out of six reports.

c) Contradictory or Missing Dates Occurred Frequently and Have the Potential to Distort a Consumer's Record.

Because more recent credit activity is more influential in determining a credit score, it is important that the relevant dates on accounts be accurate. This is primarily true for accounts that have gone into default. Creditors track the date of last activity on consumer accounts, but, because most creditors report to repositories in large batches of data on many accounts, credit repositories also track a second date – the last date the information was reported by the data provider. If a data provider fails to report any information in the date of last activity data field, the scoring software will assume that the date last reported is the date of last activity. Thus, if a consumer has an account that defaulted several years ago, but otherwise has good credit, under normal circumstances the relative impact of this account will diminish over time. However, if there is no date of last activity reported, this default will seem perpetually as recent as the last submission of a batch of data from that provider. One in five consumer files (21.6%) contained a defaulted account that did not report a date of last activity. One in four files (25.5%) contained contradictory information regarding the date of last activity.

d) Duplicate Reporting of Accounts did not Appear to be as Widespread as Many of the Other Errors Noted in this Investigation.

When accounts were reported multiple times by a single credit repository, they tended to be accounts that had no derogatory information, which may provide an artificial boost to a consumer's credit scores by giving the impression that the consumer has successfully managed more credit than he or she actually has, but may also lower a consumer's credit score by increasing their apparent overall debt load. Also, on 5.9% of files a collection was reported more than once on a single credit report, likely artificially lowering the score. This was usually the result of a collection being reported by the original creditor as well as a collection agency that had taken over the account.

Further contradictions existed regarding the method of payment (whether an account was current, late, charged off, in collection, etc.) on 60.8% of files, the type of account (revolving, installment, mortgage) on 21.6% of files, and the past due amount on 17.6% of files.

3. Merging and Compilation Errors

Credit data are complex, and accurate interpretation of it can sometimes take a considerable amount of time and effort. When credit reporting agencies and credit users

characterized as unfair; it may well be deceptive, and – in any context – it's abusive" (<http://www.occ.treas.gov/ftp/release/99-51a.doc>).

review merged reports, they employ software to help organize and simplify the information, so the user can quickly assess the unique information contained in each repository without having to sift through the same information reported by another repository. The design of a tool to do such work involves making certain choices, which can lead to significantly different results. For example, some merging software is designed to present the details for a given account from one of the three repositories to a credit user, and "hide" the other two repositories reports. Other software utilizes a merging logic that takes some information from each repository report to create an amalgam of the information in each credit report. This one example of a design decision can result in a very different presentation of the same raw data to a credit reporting agency or credit user.

The discussion of duplicate and mixed files in Phase One already illustrated that a large number of errors enter the credit reporting system when the automated software used by the credit repositories compiles information about credit users. Use of nicknames, misspellings, transposed social security numbers, and mixed files that report information under one person's name, but match that name to a spouse's social security number, are all examples of variations that can result from an automated interpretation of complex and sometimes contradictory personal identifying data. Software designers must make explicit choices about how to interpret this data, and what form the output will take. For one in ten files, the result was an additional repository report and/or an additional credit score.

A similar potential for error exists when automated systems interpret multiple reports, merging the three credit reports into a single representative report. This process attempts to reconcile the voluminous inconsistencies between repositories for account level information. Given the difficulties that are apparent from the attempts to reconcile individual consumer information, the importance of ensuring a fair and rigorous merging logic for any compilation software is clear.

These concerns raise many questions. How exactly does a software program that collects information from multiple credit repositories interpret conflicting or duplicated information? How much variation can a given software package consider before an account entry is treated as a separate account? How many creditors are trying to game the marketplace by not reporting complete or accurate information about consumers – in effect making consumers appear less creditworthy than they actually are to other potential creditors, in a bid to protect their customer base?

We do not raise these problems to advocate an end to use of multiple repository reports. In fact, use of multiple credit scores serves as a control against errors of omission. (All of the errors of omission identified in this study were identified because of the use of multiple repository reports.) On the contrary, we identify these problems to illustrate that there are difficult choices that must be made when developing all of the components of the interconnected system that evaluates credit. Given the lack of oversight of this dimension of the market, there is a very real potential for developers to make choices that

result in a system that is unfair to consumers in general or to a certain segment of consumers, such as those nearest the threshold between prime and subprime.

VII. Conclusions and Implications of the Findings for Consumers

A. Credit scores and the information in credit reports vary significantly among repositories.

The scores based on data from the three repositories can vary dramatically for all consumers regardless of whether they have generally good or bad credit histories. Approximately one out of every three files (31%) had a range of 50 points or greater, and one out of twenty reports had a range of 100 points or greater (5%). The average range between high and low scores was 43 points (median range was 36).

The wide range in credit scores reflects a similarly broad variation in the data contained in each repository report for a given consumer. Significant accounts, such as mortgages, credit cards, collections, and public records, were regularly omitted from one or more credit repository reports. In addition, for most consumers, the details of accounts that are reported by all three repositories are unlikely to be completely consistent. Information about late payments, the balance and credit limit on revolving accounts, and the current status of accounts are among errors that occur frequently.

B. Many consumers are unharmed by these variations, and some probably benefit from them.

Consumers with very good credit histories, whose credit scores place them firmly above the cutoff for the most favorable product terms, are as likely as any other consumer to have variation between credit scores. However, as long as that variation does not result in scores that are lower than the qualifying score for the best terms for credit, insurance, or any other product or service underwritten by their credit score, there will be no material harm. The number of consumers in this category is somewhat unclear and depends upon the products being sought and the qualifying scores for those products.

Furthermore, those near the boundary between pricing ranges, such as the division between the prime and subprime mortgage markets, who have errors that artificially raise their scores may be artificially classified as lower risk. As a result, such consumers have the potential to reap some benefit from the inconsistencies.

C. However, tens of millions of consumers are at risk of being penalized for incorrect information in their credit report, in the form of increased costs or decreased access to credit and vital services.

We estimate that tens of millions of consumers are at risk of being penalized by inaccurate credit report information and incorrect credit scores. Between 190 and 200 million Americans, or nearly every adult consumer, has a credit report that can be scored to produce a credit score. Businesses from mortgage lenders to utility providers increasingly have established pricing structures in which the charge for the loan or service corresponds to a credit score range. Errors in credit reports that lower a consumer's credit score can place that consumer into a more expensive pricing range than

he or she deserves to be in. Credit scores below a certain cutoff point can even disqualify consumers outright.

Looking at the mortgage market as an example, the two most significant ranges are defined by a credit score of 620. Whether a consumer's credit score is above 620 or below 620 determines if the consumer qualifies for²⁷ the lower priced prime market, or if the consumer will be limited to subprime market, which imposes higher borrowing costs, often requires larger down payments, and exposes consumers to abusive predatory lending practices. In addition to this primary division in the prime and subprime mortgage markets, there are secondary pricing ranges. According to the consumer focused website of Fair, Isaac, and Company (www.myfico.com), consumers with a score between 720 and 850 will qualify for the lowest interest rates, but there are at least four different pricing ranges in the prime market and at least two in the subprime market. Consumers with a score between 700 and 719 will be charged higher borrowing costs than those in the highest score range. Prices similarly increase for scores between 675 and 699, and between 620 and 674. Within the subprime market, the two pricing ranges identified by Fair, Isaac, and Company are from 560 to 619 and from 500 to 559.

This study focused on consumers at risk for misclassification into the subprime market due to inaccurate information in their credit report and found that one in five consumers (20.5%) is at risk. We have defined at risk consumers as either having a middle credit score between 575 and 630 with a score variance of greater than 30 points, or as having a high score above 620 and a low score below 620. Among these at risk consumers, based on our analysis of files, we estimate that at least one in five (22%) is likely being penalized with lower scores than deserved because of errors or inconsistencies in his or her credit report that are clear enough to be noticed by an outside observer unfamiliar with that consumer's debt payment history. (We also estimate that at least one in five (22%) has scores that are likely too high due to a lack of reporting by creditors to all repositories.) The remaining sixty percent of at risk consumers have credit reports without errors clear enough to allow an outside observer to determine whether their credit scores are artificially low or artificially high. We strongly suspect that a significant share of these at risk consumers also have artificially low credit scores due to errors in their reports that they would be able to identify if given the opportunity.

While the findings suggest that there may be some statistical equilibrium between those consumers who have artificially high scores and those who have artificially low scores, such statistical averaging is irrelevant to the individual consumer who is penalized based on errors in his or her credit report. Credit scores are purported to offer consumer specific evaluations of credit and do result in consumers specific decisions regarding pricing and availability for the essentials of daily life and economic activity.

Consumers may be harmed by both errors of commission and errors of omission. Errors of commission can lower a consumer's score in situations such as when incorrect

²⁷ Because of the aggressive sales tactics of subprime and predatory lenders, many consumers who have credit scores above 620 have subprime loans, although they could have qualified for less expensive prime loans. This is an important but separate issue.

information or mixed files add the credit history of others to a consumer's report. Errors of omission can lower a consumer's score when the record does not contain full and accurate information regarding existing accounts paid as agreed.

Those consumers on the threshold of subprime status face particularly dire consequences from this lack of precision. Falling below the cutoff score for a prime rate mortgage can add a tremendous financial burden to these threshold consumers and make it more difficult to meet this and other financial obligations. Interest rates on loans with an "A-" designation, the designation for subprime loans just below prime cutoff, can be more than 3.25% higher than prime loans. Thus, over the life of a 30 year, \$150,000 mortgage²⁸, a borrower who is incorrectly placed into a 9.84% "A-" loan would pay \$317,516.53 in interest, compared to \$193,450.30 in interest payments if that borrower obtained a 6.56% prime loan – a difference of \$124,066.23 in interest payments²⁹.

We conservatively estimate that 40 million consumers (twenty percent of the 200 million with credit reports) are at risk of being misclassified into the subprime mortgage market, and at least 8 million (twenty percent of these at risk consumers) would be misclassified as subprime upon application, but the actual numbers are likely much higher. These numbers do not even attempt to quantify the number of consumers who are being overcharged because errors pushed them into a higher pricing range within the prime or subprime markets. Furthermore, consumers with errors in their credit reports and artificially low credit scores are penalized in a number of markets in addition to the mortgage market. These figures do not address the consumers penalized with higher credit card interest rates, more expensive insurance, or those denied insurance, housing, utility service, or employment (an application of credit scoring we expect to increase in frequency) on the basis of erroneous credit scores.

D. Almost one in ten consumers runs the risk of being excluded from the credit marketplace altogether because of incomplete records, duplicate reports, and mixed files.

If a consumer has very little credit history, or is rebuilding credit after a bankruptcy, every positive account that they can establish is vital for creating a record that has sufficient information to be scored. If a lender requests scores for a consumer, but a repository is unable to return a score (as was the case for approximately one out of ten files reviewed in this study), that lender may choose to set aside the customer's application and focus on an application with enough credit to be scored and priced with minimal work. This is especially likely during periods of heavy volume, such as the prolonged refinancing boom currently occurring. Even if a lender later returns to the file that was set aside once volumes have subsided (perhaps because of seasonal fluctuations in home buying activity, or because interest rates have risen), the consumer will have suffered substantial harm by being excluded even temporarily from the marketplace.

²⁸ The Federal Housing Finance Board's *Monthly Interest Rate Survey* reports that the national average loan amount for conventional home purchase loans closed during June of 2001 was \$151,000.

²⁹ Interest rates as reported by *Inside B & C Lending* for 30 year Fixed Rate Mortgages for "A-" Credit (par pricing), and "A" Credit respectively, as of July 14.

Consumers may not understand the implications of incomplete reporting or non-reporting by their creditors, and would have little leverage to force their creditors to report up to date information anyway.

Similarly, consumers generally have no control over the inclusion in their credit files of duplicate reports, or mixed information not belonging to them. The only person in a position to tell if a credit repository's compilation system incorrectly groups unconnected information with a consumer, or to assess why their credit record was not scored, is the lender. But there is no requirement that the lender share the report or score with the consumer. Furthermore, if the lender incorrectly enters the identifying information, during a credit review, either leaving out information such as social security number, generation (Jr., Sr., etc.), or mistyping the applicant's name or other information, the lender may be contributing to the problem. If a consumer later requests a copy of his or her credit file after denial, he or she will often be required to provide more comprehensive information than the original data user. This means that the report eventually provided to the consumer may have a lower propensity of errors than the version used to evaluate his or her application. This is especially true for non-mortgage credit, or mortgage credit underwritten with files ordered directly from one or more credit repositories. If a mortgage lender ordered a merged credit report from a credit reporting agency that merged the files into a new report, and after being denied the borrower requests a copy of the credit report from that agency, the agency has an obligation to give the consumer the merged credit report.

The treatment of unscored files is a very serious question. How do automated credit reviews treat files that contain extra scores, or extra reports that are unscored? One in ten requests fails to return a score from each repository. As many requests return one score from each repository, but also return additional files that may or may not be scored. If automated credit reviews reject additional files, as many as two in ten consumers could be excluded from the credit market outright because of these problems.

E. The use of information from all three repositories in mortgage lending protects consumers and creditors from being negatively affected by errors of omission, but it may increase the negative impact on consumers of errors of commission.

The use of information from all three repositories on mortgage underwriting offers consumers and creditors protection against errors of omission by introducing the maximum available information to the scoring and underwriting process. However, errors of commission actually occur on more files than do errors of omission, and there are a number of different approaches to using information from three repositories for underwriting purposes. Without a chance for borrowers to review their reports for errors of commission at the time of underwriting, and without oversight of how the information is merged and presented, the use of multiple repository sources of data can produce a result that is harmful to consumers.

F. Consumers are not given useful and timely information about their credit.

1. Standardized, generic explanations do not provide sufficient information for consumers to address inconsistencies and contradictions, let alone outright errors.

Approximately 7 in 10 credit reports indicated that the primary factor contributing to the score was "serious delinquency, derogatory public record, or collection filed," or some subset or combination of these factors, without providing any information about which specific accounts were responsible for the low scores. In many cases, it is not even clear whether a delinquency, public record, or collection was responsible for the score. In addition approximately one in six reports indicated that the primary reason for the score was that the proportion of revolving balances to revolving credit limits was too high. These two relatively generic explanations were reported as the primary reason for a derogatory score on more than 8 out of 10 reports reviewed.

The vague information provided by these explanations is too general to be helpful. Nearly all consumers near the subprime border have had some activity in their past that may fall under the broad terminology "serious delinquency, derogatory public record, or collection filed," almost by definition. If their credit records were more favorable, they would not be so close to the subprime threshold. Such borrowers may accept this generic justification for a low score more readily than consumers with generally good credit. Thus, the consumers who are most likely to be penalized by errors are the least likely to challenge these imprecise explanations. Because threshold consumers are not provided the specific account information that is lowering their scores, they are not given the tools to identify and correct possible errors. The situation would likely be different if consumers had access to the full credit reports and scores used to underwrite their loan applications, with an indication of which accounts had the largest negative effect on their scores. If this were the case, consumers would have a much more legitimate opportunity to identify and challenge any errors.

The credit report is a rare type of consumer product. Consumers pay for it during mortgage underwriting, and are rewarded or penalized on the basis of it, but are not even allowed to look at it, much less keep a copy for their records. Furthermore, consumers can understandably view the report as "theirs" because it is purportedly a record of their behavior.

2. Consumers outside of California have no affirmative right to know their credit scores.

Credit scoring is a shorthand that allows lenders to more quickly assess the complex information in a consumer credit report. However, with the exception of California residents, consumers are not guaranteed access to their credit scores, although they are permitted to purchase copies of the underlying data. Thus, consumers are placed at a disadvantage relative to lenders when it comes to evaluating their own credit-worthiness. When Californians gained access to their scores, many lenders across the country did

begin making the scores available. As with the specific credit report used to evaluate an application, consumers are charged for the additional cost of obtaining a credit score for underwriting, but have no guarantee that they will be able to view the specific score used to underwrite their loan. Currently, all three repositories allow consumers to purchase scores in conjunction with credit reports, but prior to the passage of the California law requiring this, the repositories resisted providing scores to consumers.

G. Private companies without significant oversight are setting, or at the very least heavily influencing, the rules of the marketplace for essential consumer services that base decisions on credit scores.

Companies, such as Fair, Isaac, and Company, have produced credit scoring software that is increasingly used in the marketplace to determine access and pricing for the essentials of daily life and economic activity. Consumers have no choice regarding how lenders or other data users evaluate their credit, and widespread and increasing use of credit scoring systems that evaluate applications for credit, mortgages, insurance, tenancy and even employment is a fact of the marketplace. Scoring systems incorporate many complex decisions regarding the interpretation and treatment of information that can be contradictory, incomplete, duplicative, or erroneous. There is great potential for these systems to incorporate inappropriate decisions that result in consumer harm, especially as models originally designed to evaluate credit applications are adapted to evaluate applications for services completely unrelated to credit behavior.

Despite the tremendous and growing influence of automated credit evaluations, no government entity has recognized and acted on the clear need for ongoing, timely review of these software systems to determine their accuracy, fairness and appropriate application. Many decision-makers who use scoring systems to evaluate consumer applications do not even understand the systems themselves and cannot explain them to consumers. Thus, while decision-makers are increasingly relying on programs that they do not understand, no public entity is guaranteeing the validity and fairness of such programs. Without independent review and oversight of this market force, consumers are, literally, left to the devices of the system developers.

H. Certain information in credit reports has the potential to cause breaches of consumers' medical privacy.

Many credit report entries regarding medical collections contained enough information to infer medical details about consumers, such as the type of treatment they had received. The ability to discern from a credit report that a consumer may have received treatment from a neonatal clinic, a fertility clinic, a mental health provider, or an AIDS clinic has serious implications for medical privacy, and could potentially facilitate discriminatory treatment. While section 604 (g) of the Fair Credit Reporting Act prohibits furnishing of medical data in connection with employment, credit, or insurance transactions, consumers also complain that reporting collection accounts without identifying the original creditor makes it difficult for consumers to decipher their own reports. It is the understanding of researchers that current market practices limit the level of detail in

reports provided to employers, aggregating information in such a way that individual creditors are not identified, and an employer would be unlikely to be able to make specific inferences about an applicant's or employee's medical condition. Nonetheless, the presence of this information among the data held at the repository level is troubling and deserving of further attention.

VIII. How to Improve the System

A. Require creditors to immediately provide to any consumer who experiences an adverse action as a result of their credit reports or credit scores a copy of the credit reports and scores used to arrive at that decision free of charge and permit disputes to be immediately resubmitted for reconsideration.

All consumers who experience an adverse action based on one or more credit reports or scores (such as having a loan or insurance application denied, being charged higher than prime rates, or receiving less favorable terms) should immediately be given a copy of both the full report or reports used to derive that score and the related credit scores without having to pay any additional fee. These reports should identify any entries that are lowering the consumer's score and indicate the impact (either the point value deducted for that entry or the proportional impact of that entry relative to other derogatory entries in the report). The consumer should then be allowed to identify any errors or out of date information, provide documentation, and be reevaluated for prime rates.

The additional cost to lenders and businesses of providing these reports immediately would be minimal. Since they already possess the report in paper or electronic form, they would merely have to copy or print this report.

Simply providing consumers with the name and contact information of the consumer reporting agency or agencies that provided the information used to arrive at the decision is insufficient because it creates an unnecessary obstacle and, especially for non-mortgage applications, the report a consumer will receive after submitting a request may very likely differ from the report the creditor reviewed. Errors from duplicate scores and/or mixed reports that may result from incomplete or incorrect keying of information during the file request will not be apparent if the consumer correctly requests his or her file. One in ten consumer applications results in an additional report being returned by the repository.

B. Require decisions based on a single repository's credit report or credit score that result in anything less than the most favorable pricing to immediately trigger a re-evaluation based on all three repositories at no additional cost.

Lenders and other credit data users have a desire to keep their underwriting costs low. This is a legitimate desire so long as consumers are not harmed in the process. Some reduce costs by underwriting certain decisions with only one credit report. For example, a lender may offer pre-approval letters based on only one report, or underwrite home equity lines of credit or second mortgages with a single report. Given the wide range between scores for a typical consumer and the frequency with which major accounts are omitted from credit reports, such practices have serious negative implications for consumers.

Measures should be put in place to protect consumers from any negative impact resulting from such underwriting practices. A simple solution would be to require all decisions based on credit to use information from all three repositories. However, this could result in higher costs and reduced availability of products such as pre-approval letters that are beneficial to consumers.

Alternatively, lenders and other credit data users could be permitted to continue underwriting based on one report, so long as any adverse impact based on information from a single repository immediately triggers a re-evaluation with information from all three repositories at no additional cost to the consumer. In this manner, businesses could continue to save on underwriting costs for consumers with very good credit, but consumers with less than perfect credit would not be forced to continue to pay a high price for inaccuracies, inconsistencies, or incompleteness on any one credit report.

C. Strengthen requirements for complete and accurate reporting of account information to credit repositories, and maintenance of consumer data by the repositories, with adequate oversight and penalties for non-compliance.

Many errors in credit reports can be attributed to the practices of creditors and other credit data users rather than to repositories. For example, some data furnishers may not report to every credit bureau. Others may consciously misreport or omit information regarding an account in order to prevent other lenders from approaching a valuable customer with competing offers (such as credit card lenders not reporting the true available credit amount so that the borrower appears to have a much higher debt-to-available credit ratio and appears to pose greater risk when other lenders review the credit report). Appropriate government entities such as the Federal Trade Commission and federal banking regulators should require accurate and complete reporting of credit information to the repositories by any entity that uses credit data to make evaluations and conduct regular examinations for compliance. In addition to scrutinizing reporting entities, a government entity (such as the Federal Trade Commission) should audit the repositories' records on a regular basis to identify data furnishers who report incomplete or incorrect information to the repositories. Such activity should be subject to fines or other penalties for non-compliance. These audits should also assess the overall accuracy of data maintained by the credit repositories, with appropriate fines or other penalties for inaccuracy.

Some may perceive tension between consumers' interest in keeping their information private and their interest in having evaluations of their creditworthiness be based on an accurate record of their past behavior. However, consumers generally object to information sharing for secondary purposes, not in the regulated Fair Credit Reporting Act context, provided it is subject to Fair Information Practices. The cost of incorrect information is high, and it is possible to simultaneously serve both consumer interests reasonably well.

Not all providers of consumer services use credit records or credit scores to determine consumer eligibility, or pricing. However, those that do should be required to complete

the cycle of information and report complete and accurate information back to the credit repositories. Information about any account that was underwritten with a report from one or more credit repositories should be reported to those repositories as frequently as the consumer is obligated to make payments. Collection agencies should be required to report on the status of collections at least once every six months.

D. Establish meaningful oversight of the development of credit scoring systems.

Despite the fact that consumer access to, and pricing for, vital services such as mortgages, general consumer credit, insurance, rental housing, and utilities is increasingly dictated by the automated evaluation of credit, there is no government oversight of the design of these systems. The calculations behind credit scores, a fact of life for the American consumer, remain shrouded in secrecy.

The design of credit scoring systems involves a number of deliberate choices that can have a dramatic impact on consumers and can result in systems that are flawed or unfair. These choices can range from determining the relative impact of various consumer actions to establishing the system defaults for cases where information such as date of last activity is not reported, to designing the logic for interpreting public records or contradictory information reported for an account.

A wide variety of entities have developed scoring models³⁰, including Fair Isaac and Company, large mortgage lenders (such as Countrywide and GE Capital), the Federal Housing Administration and Department of Veterans Affairs loan guarantee programs, the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, private mortgage insurance companies (such as PMI Mortgage Insurance Company and Mortgage Guarantee Insurance Corporation), and insurance companies. However, the only federal review of the fairness of any such models was a HUD review of the GSE systems conducted in 2000, the findings of which are expected to be released soon³¹. While the delayed release will limit the relevance of this review because the GSEs have made significant changes to their automated underwriting systems since the review was conducted, we recommend other agencies follow this example and conduct full reviews of all scoring systems in the marketplace.

We recommend that appropriate government agencies, such as HUD, the Federal Trade Commission, and state insurance departments conduct regular, comprehensive evaluations of the validity and fairness of all credit scoring systems, including any automated mortgage underwriting systems, insurance underwriting systems, tenant and employee screening systems, or any other systems or software that uses credit data as part of its evaluation of consumers, and report to Congress with its findings. These evaluations should be conducted and released in a timely fashion so that developers can react to any recommendations and so the reviews do not become outdated as new versions of scoring software are developed and distributed. Strong oversight of scoring

³⁰ Straka, John. 2000. A Shift in the Mortgage Landscape: the 1990s Move to Automated Credit Evaluations. *Journal of Housing Research*. Volume 11, Issue 2.

³¹ Felsenthal, Mark. "HUD Secretary - mortgage software bias study out soon." Reuters. October 22, 2002.

systems that identifies and protects consumers from any abuses will foster consumer confidence in these powerful and increasingly utilized evaluation tools.

E. Address important questions and conduct further research.

In the course of conducting this study, several questions arose which are not comprehensively addressed in this report, but are deserving of further attention and research. This report primarily addresses the impact of wide variations in credit scores and credit data on consumers who are seeking credit – particularly mortgages. Future studies should explore the impact of these variations on insurance availability and affordability, given the recent, dramatic increase in the use of credit scores as an insurance underwriting tool. In addition, further research should address the impact of data and credit score variations on consumers as a result of other applications, such as tenant screening and employee screening. Additional research could assess the value to consumers of fee-based credit monitoring services.

Other topics raised in this report, but not exhaustively addressed, include determining the value to consumers of credit re-scoring relative to other means of credit data validation, the impact of anti-competitive market forces surrounding credit re-scoring, the privacy concerns surrounding the appearance of medical related information in credit reports, and ways to protect consumers from abusive applications of such medical information. The FTC should promptly develop and require a mechanism to obscure medical debtor names in credit reports.

The Fair Credit Reporting Act prohibits states from enacting any laws that provide protections beyond those guaranteed by federal statute. On January 1, 2004 this provision will expire, although the federal law will otherwise remain in place. Contrary to some characterizations, the entire act will not “sunset” on this date. This prohibition on supplemental state protections should not be extended, and if any changes to the Fair Credit Reporting Act are to be made at the federal level, they should result in greater consumer protections and address the problems raised in this and other research.

IX. Recommendations for Consumers

Many of the concerns raised by this study address structural issues regarding the system of reporting and evaluating credit, which are beyond the scope of most consumers to influence. However, there are some steps consumers can take to reduce the likelihood of errors occurring, or to address them when they arise.

- ? Maintain consistency in credit applications: use your full legal name when applying for credit. If you have a generational title (Sr., Jr., III) always specify this.
- ? Review your credit record regularly by purchasing a credit report and score from each major credit repository once a year. The repositories can be contacted at the following phone numbers and website addresses: Equifax (800) 685-1111 or www.equifax.com; Experian (888) EXPERIAN or www.experian.com; Trans Union (800) 888-4213 or www.transunion.com.
- ? Prior to applying for a mortgage, consider obtaining a current copy of your credit report and score from each major repository, and review it for errors.
- ? Dispute any errors that appear on your credit report by contacting the credit repository. However, avoid "credit repair" businesses that claim to be able to erase valid items in consumers' credit histories.
- ? Don't underrate your credit. Ask for specifics if a lender tells you that you have bad credit and don't qualify. Currently lenders do not have to tell you the specifics, or show you the credit report that they review, but they are permitted to. If a lender refuses to talk to you about the specifics of your credit report, consider a different lender.
- ? If you have complaints about your credit report and are unable to have them quickly resolved, contact the Federal Trade Commission at 1-877-FTC-HELP or www.ftc.gov.



**State of Washington
Office of Insurance Commissioner**

Mike Kreidler, Insurance Commissioner

A Report to the Legislature

Effect of Credit Scoring on Auto Insurance Underwriting and Pricing

Submitted By: The Office of Insurance Commissioner

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EXECUTIVE SUMMARY

In 2002 the Washington State Legislature passed ESHB 2544, restricting the use of credit scoring in personal lines of insurance underwriting. ESHB 2544 also directed the Insurance Commissioner to produce two studies, on the effects of credit scoring before and after ESHB 2544. To conduct the first study mandated by ESHB 2544, the Office of the Insurance Commissioner hired independent research and consulting services – PRR, Inc, and Washington State University's the Social and Economic Sciences Research Center, affiliated with Washington State University.

Three insurance companies each provided data on several thousand randomly chosen consumers. The insurance company data included

- age,
- gender,
- residential zip code,
- date policies started, and
- credit scores and/or rate classifications.

About 1,000 of each firm's consumers were contacted by phone. The phone survey gathered information about

- ethnicity,
- marital status,
- income level, and
- for 212 people whose policies had been cancelled because of low credit scores, information about how cancellation affected them, and how difficult it was to find replacement insurance.

Each of the three insurance companies used a different credit-scoring model. Only one insurance company had cancelled policies solely because of credit scores, and that practice had already been discontinued when the study began.

The purpose of the study was to find out whether credit scoring has unequal impacts on specific demographic groups – not to determine whether low credit scores correlate with higher loss ratios, or whether the use of credit scoring is inherently fair or unfair to individual consumers, or how accurate credit history information is.

This study has very specific limitations:

- Because practices vary widely from one insurance company to another, findings about credit scoring in one firm may not apply to others. Principal variations include:
 - The credit scoring model used;
 - The population to which it is applied, and

- The role of credit scoring in setting rates and assigning consumers to risk pools.
- Insurance companies vary in the way they set rates for people who do not have enough credit history to compute a credit score. Some companies view this as a negative factor, while others consider it a neutral factor.
- Certain ethnic groups in Washington have relatively few older people, making it difficult to compare them with other ethnic groups in the same age range.
- Washington has a low overall percentage of people of color, which limits the accuracy of the data for specific ethnic groups such as Native Americans.
- The study was based on records of insurance company customers, so it does not provide information about people who were refused insurance based on credit scores.
- This study does not examine whether the credit information used to set rates is accurate.

FINDINGS OF THE STUDY

The demographic patterns discerned by the study are:

1. Age is the most significant factor. In almost every analysis, older drivers have, on average, higher credit scores, lower credit-based rate assignments, and less likelihood of lacking a valid credit score.
2. Income is also a significant factor. Credit scores and premium costs improve as income rises. People in the lowest income categories – less than \$20,000 per year and between \$20,000 and \$35,000 per year – often experienced higher premiums and lower credit scores. More people in lower income categories also lacked sufficient credit history to have a credit score.
3. Ethnicity was found to be significant in some cases, but because of differences among the three firms studied and the small number of ethnic minorities in the samples, the data are not broadly conclusive. In general, Asian/Pacific Islanders had credit scores more similar to whites than to other minorities. When other minority groups had significant differences from whites, the differences were in the direction of higher premiums. In the sample of cases where insurance was cancelled based on credit score, minorities who were not Asian/Pacific Islanders had greater difficulty finding replacement insurance, and were more likely to experience a lapse in insurance while they searched for a new policy.
4. The analysis also considered gender, marital status and location, but for these factors, significant unequal effects were far less frequent.

RECOMMENDATIONS

This study indicates that there is a need for examination of more companies and larger samples of consumers. Unequal effects are too common to be random events, but too varied across different insurers' situations for a clear pattern to emerge. Results vary too much from firm to firm to support a clear estimate of the overall size or pattern of unequal impacts on people of color, but the limited data studied do suggest that such impacts may exist. Data also indicate that low income people are more likely than higher income people to have their premiums raised as a result of credit scores.

Other aspects of credit scoring outside the scope of the data in this study – such as insurer refusals based on credit scores, and inaccuracy in credit scores – should also be investigated.

BACKGROUND

Since the mid-1990s, many insurance companies have been using consumer credit history as one of the factors they consider when they make decisions about how much to charge for auto, homeowners' and renters' insurance, and when to cancel or non-renew insurance policies.

Because credit scoring increases premiums for some people and reduces premiums for others, this practice has generated vigorous debate. Questions have been raised about the validity of credit history as a predictor of risk, its fundamental fairness, and the impact of credit scoring on people of color and the poor.

Insurance companies contend that there is a correlation between lower credit scores¹ and higher loss ratios. Therefore, insurers argue, using credit history is fair, and benefits consumers whose good credit scores indicate lower risks. Insurance companies also argue that using consumer credit history is non-discriminatory because it is "color blind," and because there is no consistent correlation between level of income and credit score.

Consumer groups contend, however, that while credit scoring may not be intentionally discriminatory against people of color and the poor, it may nonetheless produce disparate impacts that unjustly harm these groups. Consumer groups also note that the data in credit reports are often inaccurate, and that the process for correcting inaccuracies is cumbersome and time-consuming, especially for those whose time is already stretched by work and family obligations.

Moreover, credit scoring models and how they are used vary from one insurance company to another. Therefore, it can be very difficult for consumers to know how they are affected when credit scores are used as one element in a complex formula for determining rates or assigning consumers to risk pools.

Since 1996, insurers' use of credit scoring has increased, and so has the intensity of the debate about this practice. In 2002, 26 state legislatures considered bills to regulate or restrict this practice, and The Washington State Legislature adopted ESHB 2544. (Described in more detail below.)

In 2001, the National Association of Insurance Commissioners (NAIC) formed a work group to study this issue, to develop regulatory options, to provide consumer information, and to consult with the Federal Trade Commission (FTC) and the American Academy of Actuaries. Washington Insurance Commissioner Mike Kreidler co-chairs this work group.

The NAIC workgroup has already achieved two specific changes:

- The FTC has reiterated, in a strong public statement, that insurers must provide notice to consumers when an action, which is based on credit score, adversely affects them. Prior to this statement, insurers maintained that certain actions, such as not offering the lowest price, were not necessarily adverse actions.
- At the request of the NAIC, the American Academy of Actuaries has evaluated four studies on insurance credit scoring. They concluded that these studies do not directly address the issue of whether this practice has a disparate impact on people of color and/or the poor. This is significant because insurance companies have cited these studies as evidence that insurance credit scoring does *not* have a disparate impact.

¹ Credit scores used in insurance are not the same as determinations of "credit worthiness" for mortgages, credit cards, or other loans. Credit scores are based on the same raw credit information used for those purposes. However, the various components of credit history are considered or "weighted" differently for insurance purposes than they are for credit worthiness. Which particular components of credit activity are considered, and the relative weighting of each component, depend upon which of many different statistical scoring models are used.

According to the Washington State Office of the Insurance Commissioner (OIC), consumers have submitted 374 written complaints involving credit issues between 1989 and 2003, and 82% of these complaints were received between 1997 and 2002. The OIC also reports 1,164 consumer phone calls about the use of credit scoring. In addition, the OIC has received numerous calls from concerned insurance agents about their inability to find insurance for people they believe to be good risks, but who have less than perfect credit scores.

The following accounts indicate why some Washington residents are concerned about the use of credit scoring in insurance:

- A Lacey couple was denied the best credit score because they pay all their credit cards in full each month.
- A Seattle man suffered injuries from an accident involving a drunk driver. After twelve surgeries and steep medical bills, he and his wife missed some payments on their bills. The wife is frustrated because she feels she shouldn't have to pay as much for their insurance as the person with the DUI.
- A Seattle area divorced mother sought bankruptcy protection when her ex-husband defaulted on his business debts and she was in danger of losing her home. Now, because of her ex-husband's actions, her credit score has plummeted and she is required to pay much more for her insurance.
- An American citizen established good credit in Canada, where he lived for 21 years. He recently moved to Washington and is having trouble finding reasonably priced auto insurance because insurers claim he has no credit history.
- A 50-year-old woman who has never had a traffic accident or a ticket was laid off from an Air Force installation where she had worked for 23 years. Her credit suffered because of her unemployment.
- A firefighter had to file bankruptcy during a dispute over his parents' estate because his brother was embezzling assets. Subsequently, he was not renewed by his insurance company because of his credit score.

ESHB 2544

In 2002, Insurance Commissioner Mike Kreidler, Attorney General Christine Gregoire, and Governor Gary Locke requested legislation restricting the use of credit scoring in personal lines of underwriting and rate-making.² In response to this request, the 2002 Washington State Legislature enacted ESHB 2544, now codified in RCW 48.18.545 (effective January 1, 2003) and 48.19.035 (effective June 30, 2003).

ESHB 2544 restricts the use of credit scoring in several ways:

1. Insurance companies may not cancel or non-renew a person's insurance solely because of his or her credit history;
2. Credit history may not be the principal basis for denial of insurance;
3. The calculation of credit scores may not include

² Personal lines of insurance include home, auto, and renter's insurance.

- the number of credit inquiries;
- medical bills;
- the initial purchase or financing of a vehicle or home;
- the type of credit, debit, or charge card;
- total available credit;
- disputed credit items (once resolved in the consumer's favor); and,
- lack of credit history, unless actuarial data show that the resulting rates are not excessive or discriminatory.

In September, 2002, the Insurance Commissioner issued rules to implement the new law. The rules define and further clarify the notices that must be provided to consumers when an adverse action is taken against them based on credit history. The rules also specifically direct insurers to file their credit scoring models with the Insurance Commissioner. Under the terms of ESHB 2544, these credit-scoring models are considered proprietary information that will be kept confidential unless the Insurance Commissioner undertakes an enforcement action.

ESHB 2544 also directs the Insurance Commissioner to produce two studies – the first due in January, 2003, and the second due a year later. The first study is a review and analysis of insurance credit scoring that includes:

1. The types of consumers who benefit from or are harmed by the use of credit history as a basis for insurance rating and underwriting;
2. The extent to which the use of credit scoring affects rates charged;
3. Whether insurance credit scoring results in discrimination against the poor or people of color.

This study focuses solely on auto insurance, and is designed primarily to address the third of these topics: effects upon the poor and people of color. In addition, it provides some information about the first topic – the general pattern of positive and negative effects from credit scoring.

The second report, due in January, 2004, will analyze how the implementation of ESHB 2544 has affected consumers.

METHODOLOGY

Credit reporting agencies, which are regulated by the Federal Fair Credit Reporting Act, sell credit-scoring services to insurance companies. These credit scores are used by insurers to decide whom to insure and how much premium to charge. A credit-scoring model takes personal credit history, and converts that data to a "credit score" using a complicated statistical formula.

These models are based on past patterns of credit behavior that have been correlated with insurance claims. Although credit-scoring models use the same raw data on which credit worthiness is determined for mortgages, credit cards, and other loans, they use it somewhat differently. The various components of credit history are considered or "weighted" differently for insurance purposes than they are for credit worthiness. The particular components of credit activity considered, and the relative weighting of each component, depend upon which of many different statistical scoring models is used.

This study collected empirical evidence on the demographics of credit scoring, and evaluated the incidence of credit scoring effects on certain demographic groups.

The data used in this study were based on records of policyholders who were insured by three insurance companies. Because of this reliance on customer records, this study cannot assess the impact of underwriting actions where individuals were denied coverage, nor of situations where an individual was quoted such a high price for coverage that they chose not to buy it from that insurer.

The statistical models used for computing credit scores are very complicated, and are considered proprietary assets by credit reporting agencies. Many variations of credit scoring models exist, and insurers often request that models be customized to fit their customer base, service area, and underwriting practices. Thus, there is no single credit-scoring model about which definitive conclusions can be reached. For examples of the factors used in credit scoring models see Appendix A. Different insurers use these factors in different ways in underwriting and pricing.

The primary focus of the analyses in this report was the relationship of negative effects to ethnicity or income characteristics. In both cases, analyses were done on an age-adjusted basis. Multivariate models also evaluated the possibility of effects by gender, marital status, and location.³

The results of this study begin to describe the range of possible results from credit scoring, but are directly applicable only to the three firms whose customer data was used.

None of these analyses could determine whether the shifts in costs (lower costs for people with higher credit scores; higher costs for those with lower or no credit scores) for a specific demographic group were correlated with higher risks or claims for that group. This study examines the question of *whether the cost shifting affected all demographic groups equally*.

DATA

Three insurance companies each provided data on several thousand randomly chosen consumers. Each of the three insurance companies used a different credit scoring model. Only one insurance company had cancelled policies solely because of credit scores, and that practice had already been discontinued when the study began.

³ Two location distinctions were tested: Eastern Washington versus Western Washington, and inside a federal Metropolitan Statistical Area versus outside such areas. Federal Metropolitan Statistical Areas include counties with either major urban centers or significant suburban populations related to major urban centers.

The insurance company data included

- age,
- gender,
- residential zip code,
- date policies started, and
- credit scores and/or rate classifications.

About 1,000 of each firm's consumers were contacted by phone. The phone survey gathered information about

- ethnicity,
- marital status,
- income level, and
- for 212 people whose policies had been cancelled because of low credit scores, information about how cancellation affected them, and how difficult it was to find replacement insurance.

STATISTICAL METHODS

The primary statistical methods used were linear and logistic multivariate regressions. Linear regressions calculate the best statistical "fit" among factors when they have arithmetic relationships; for example, when one factor tends to rise whenever another falls. Linear regressions were used to estimate the relationship between demographic characteristics and numerical outcomes or measures, such as credit scores or discounts. Logistic regressions calculate the best statistical "fit" among factors that influence a probability. For example, the models estimate how much an increase in a particular factor changes the probability of an outcome event. Logistical regressions were used to estimate relationships when the outcome under study was a categorical yes/no, such as being placed with a higher cost pool, having no usable credit file, or having a policy cancelled.⁴

Multivariate regressions are used to simultaneously estimate the strength of multiple relationships among factors. For example, success in some sports may be a function of an athlete's physical characteristics, such as height and speed. Because longer legs cover more ground, the two often go together – but not always. Separately comparing performance by height and by speed will overestimate the effect of each. A multivariate approach produces a pair of simultaneous estimates for the separate contribution of each factor without "double counting" the same performance for someone who is both tall and fast.

Multivariate procedures are essential to this study because of the inter-relationship of age with income and ethnicity. Income generally rises with age, up until retirement age. In Washington State's population, many ethnic minorities have arrived in substantial numbers over the last few decades. As a result, there are relatively few older minority members in the population. If data are considered only by ethnicity, any

⁴ In many cases, stepwise regression procedures were used. With stepwise regression, factors are added sequentially to the model. At each step, all of the statistically significant factors not yet included are tested for inclusion in the model equation. The factor which most improves the fit of the model is then added. This process is repeated and continues until all not-yet-included factors would not be statistically significant if added to the model. The standard probability value of .05 was used as the statistical significance criterion.

practice where older individuals have better results than younger ones can be misinterpreted as having a negative effect on minorities.

Because there is a substantial history in law and practice supporting higher risks and therefore higher premiums for younger drivers, age effects that favored older drivers were treated differently in this study from other demographic patterns. Analyses to detect other patterns were done on an "age-adjusted" basis so that age-related patterns were not mistakenly classified as unequal effects on groups based on income, race, gender, marital status or location.

Sample Size and Frequency of Response

The sampling frames for telephone surveying were developed from contact information for random samples of customers from each of the three firms. The first step was to use the services of Experian to check and update the telephone numbers for those in the lists. This step resulted in approximately 10% of the telephone numbers being updated.

The goal was to obtain a response rate of approximately 50%. Names were initially selected from the sample lists, and then five attempts to reach those telephone numbers were conducted on various days of the week and at various times of the day to control for sampling bias. Additional potential respondents were randomly selected from the sample lists only after five attempts without a successful interview, or when a disconnected or wrong number was determined to be non-traceable.

Non-Response to Specific Questions

Some of the survey respondents declined to answer specific demographic questions. In some cases, the respondent was not the policyholder and did not know some of the requested information. The following table indicates the "decline" and "don't know" percentages for the income question. Refusal and "don't know" rates on all the other items were substantially lower. These results are consistent with typical refusal rates for such demographic questions. In fact, the refusal rate for the income question was about half of what is normally experienced.

Figure 1
Percentage Who Answered Refused or Don't Know

	Firm 1		Firm 2	Firm 3
	Cancelled/High Score	General Sample		
Income	10.70%	7.5%%	8.80%	8.90%

Developing and Selecting Regression Models

Although the questions posed for this study appear clear and direct, answering them is complicated. Each insurer had different practices and provided different data. Company policies changed in important ways during period under study. The relationship between credit scores and factors such as income can take several different forms,⁵ which expands analysis beyond a single test of a single variable. The results presented in this report

⁵ Credit score might double when income doubles. Or, credit score might rise whenever income rises, but not at a constant rate. As an example, doubling a low income might be associated with a credit score increase of 50%, while doubling a middle income might be associated with a much smaller credit score increase, like 20%. Or very low-income individuals might have lower credit scores than middle and upper income individuals, among whom income makes no difference at all.

were selected after investigation of many alternatives as providing the most accurate and representative picture of the relationship between credit scoring and demographic characteristics in these samples.

STRENGTH OF THE RESULTS

The multivariate regression models only explain a fraction of the variance in score or discount found in the sample population. The strength of the relationship estimated in multivariate models are measured using a statistic called R-squared. If there is no correlation, the R-squared would be 0. If the model combined several factors to produce an exact prediction of each policyholder's score or discount, the R-squared would be 1.0. R-squares for the regressions for this report range roughly from 0.04 to a 0.3, with most between .05 and 0.15. (See Appendices C through E) This indicates that while there are statistically detectable patterns in the demographics of credit scoring, most of the variation among individual scores is due to random chance or other factors not in this data.

Some of the correlations with specific factors are strong and consistent. In particular, there is a strong positive correlation with age: older individuals tend to have more positive credit scores and score-influenced insurance effects. Other correlations are not as strong, as noted in the discussion of individual analyses.

THE ANALYSIS

FIRM I

Questions

The first review involved three questions:

- Are credit scores independent of demographics?
- What were the effects of credit-based policy cancellations?
- What is the pattern of credit scores among this insurer's policyholders?

Structure

Policyholder information was provided which covered three periods, during which the company had three different policies on the use of credit scores.

- 1- Period One: For a time, the company was terminating coverage of some policyholders based on negative credit score information. A sample of policyholders cancelled during this period was provided.
- 2- Period Two: The company discontinued credit-based cancellations, but continued to acquire credit scores on all policyholders and applicants, using this information for risk and rate assignment. A random sample of all policyholders was provided for this period. In addition, a sample of very high credit score policyholders was provided for this period. This sample was used for comparison with the cancelled policyholders.
- 3- Period Three: The company shifted to using credit scores selectively, acquiring this information only on a fraction of new applicants. How these individuals were selected or how the information was used is not known. A small random sample of policyholders who were first covered during this period was included.

Cancelled and High Score Samples

The samples surveyed included cancelled policy holders ($n = 212$), as well as those with the highest credit scores ($n = 217$), providing a margin of error of approximately of $\pm 5\%$ for a yes/no question.⁶ The response rates for those cancelled and for those with high scores were 66% and 71% (respectively), of those whom the interviewers tried to contact.

General Sample

The survey of the general sample of policyholders resulted in 996 responses. The response rate was 61% of those whom the interviewers tried to contact. This sample sizes provided a margin of error of approximately ± 3 percent for a yes/no question.

Data Provided

In addition to age, gender, and zip code, the insurer also included credit scores and policy start dates.⁷ Three separate samples were provided:

- 1- Policyholders previously cancelled because of low credit scores
- 2- Current policyholders with very high credit scores, and

⁶ This means that we can be 95% confident that the survey results for a typical yes/no question are within $\pm 5\%$ of the results we would get if we surveyed the entire population. A confidence level of 95% means that only once in 20 times would we be wrong in making this assumption.

⁷ As well as some driving record information that did not play a major role in this analysis.

3- A random sample of current policyholders.

Period 1

Demographics of Cancellation

To determine whether credit scores were independent of demographic characteristics, the sample of cancelled policyholders was compared with a sample of policyholders from the extreme high end of the credit score spectrum. Credit scores ranged over a scale of about 560 points. The threshold for policy cancellation included the bottom 0-150 points on that scale.⁸ The sample of very highest credit scores were all within 20 points of the maximum, ranging from 540 to 560.

The dominating statistical difference was age. There was almost no overlap in the ages of the two groups. Ninety percent of the cancelled policyholders were under 55; in contrast, 93% of the highest scoring policyholders were over 65. Given this near-total separation of the two groups, there was very little potential to determine what other differences existed between the groups.⁹

These two samples were so different that we can conclude that credit scoring is definitely not totally independent of demographic characteristics. However, age differences so dominate this comparison that no definitive conclusions could be reached about possible demographic differences other than by age.

Survey Data on Cancellations in Period One

The phone survey asked cancelled policyholders additional questions about the consequences of cancellations. The key results were:

- Five percent of those cancelled could not obtain replacement coverage.
- Over a quarter experienced a period of no coverage between the expiration of the cancelled policy and obtaining a replacement policy. This had a particular (statistically significant) impact on minorities. Minority cancelled policyholders more often reported a period of lapse in insurance coverage between cancellation and obtaining new coverage. A substantial 54.3% among minorities reported a lapse in insurance coverage, compared to 24.2% of whites.
- Over 40% reported that obtaining replacement insurance was "very difficult." Higher premiums and applications to multiple insurers often resulted.
- Less than half reported that the letters they received from insurers adequately explained the reasons for cancellation.
- Over one quarter of those cancelled for low credit scores had no "incidents" in the insurer's records, though some had been with the insurer for more than ten years. Seventeen percent of apparently accident-free cancelled policyholders were minorities.

⁸ Some additional cases with higher credit scores were also coded as having been cancelled for credit score reasons, although their recorded credit score was above the cancellation cutoff indicated by the firm.

⁹ To the very limited extent that the two samples overlapped, the cancelled policyholders included more minorities, more single/divorced/separated individuals, and more very low-income individuals. However, the dissimilarity of the samples makes these findings inconclusive.

Period Two

Period Two had the largest sample of any of the three policy periods covered in the data.

Credit Score

In Period Two, non-zero credit scores varied over a range of about 535 points.¹⁰ Age was the dominant demographic factor associated with credit scores.¹¹ On an age-adjusted basis, there was no statistically significant relationship between credit scores and ethnicity or income.

Score of Zero

Inadequate credit files resulted in scores of zero, which presumably had a negative effect on rate classification. The only statistically significant association was that very low-income policyholders were much more likely to have insufficient credit history. Overall, only about one in 25 policyholders had a zero score, but for those in the lowest income group (less than \$25,000 annual income), those probabilities shift to one in five.

Period Three

Credit scoring was only performed selectively, and the sample was too small to determine either the demographics of those selected for credit scoring or the patterns of their scores.

FIRM 2

Questions

Based on the findings from the first review, the principal questions were to determine the demographic pattern of both credit scores and the economic effects of those scores. Effects on policyholders with scores of "zero" due to inadequate credit history were identified as requiring separate analysis.

Structure

Firm 2's application of credit scoring was the simplest to analyze. Results for this firm have the fewest technical complications. This firm used credit scores to determine discount percentages from rates otherwise determined by traditional underwriting criteria, so the effect of credit scores is clearly represented by the distribution of discounts. The firm did not implement other major changes in rate setting at the time they implemented credit scoring. As a result, there is a substantial population of policyholders carried forward from the pre-credit scoring period.

This firm also had a significant number of policyholders with insufficient credit files. After discussion with the Office of the Insurance Commissioner when they filed their rating plan, the firm chose to rate such individuals at approximately the average discount given to all other customers. So, although we have separately analyzed the demographics associated with their "zero score" policyholders, it is not clear that having a "zero score" has a negative impact on those insured by this particular firm.

Sample

The survey resulted in 1,000 responses. Among those contacted, 72.6% agreed to participate. This constituted 43.3% of those whom the interviewers tried to contact. This sample size provided a margin of error of approximately +/- 3 percent for a yes/no question.

Data Provided

In addition to age, gender, and zip code, the insurer provided data on credit score, rate category, discount,

¹⁰ This credit score scale did not start at 1, but at an arbitrary higher number.

¹¹ On average, every ten years of age was associated with an increase in credit scores of approximately 37 points (out of 535).

score order date, unusable thin or nonexistent credit record, and policy start date.¹²

Analyses

Premium¹³

Rate adjustments based on credit scores ranged from 17 % below average to 33% above average. Age was the more strongly correlated with credit-based rate adjustments than any other demographic factor considered.

Ethnicity

There were statistically significant differences, on an age-adjusted basis, for two ethnic groups, when compared with the majority ethnic group, Caucasians:

Credit scoring affected rates for two ethnic groups:¹⁴

- Rates for Asian/Pacific Island policyholders were reduced by about 5.5% of the average rate, relative to whites of similar age.
- Rates for Native Americans were higher by about 15.8% of the average rate, relative to whites of similar age.

Income

Credit scoring raised the average costs for poor policyholders relative to affluent policyholders. Across the entire income range, better-off policyholders had more favorable rate adjustments on average.

The poorest policyholders (under-\$20,000 annual income) averaged rate increases of about 4% relative to the rates charged the \$50,000 to \$75,000 income group. Policyholders in the top category, \$150,000 and up annually, averaged rate declines of about 4% relative to the \$50,000 to \$75,000 income group. These differences are adjusted to compare individuals of similar age.

Combination of Ethnicity and Income

Because ethnicity is associated with lower incomes among this firm's customers, the two effects cannot simply be added together to calculate, for example, the total average effect for policyholders who are both Native American and poor. The effects are slightly overlapping. So, on average, credit scoring raises the rates of poor Native Americans more than the rates of other low-income policyholders, but by less than the sum of 4 % and 15.5%.¹⁵

Zero Score

Ethnicity

After adjusting for the differences in the age composition of ethnic groups, there were no statistically

¹² As well as some driving record information not used in this analysis.

¹³ This analysis for effects on premium adjustments considered only those with non-zero credit scores.

¹⁴ Two different age adjustments were fitted, with nearly identical results.

¹⁵ The overlap reduces the effect to about 1.3 percentage points less than the sum of the separate effects. Low income Native American averaged about a 14.4% increase, relative to the low-income white population. The income effect declines slightly in the combined regression estimating both ethnicity and income. Credit scoring is estimated to have raised average rates for very low income Native Americans by about 18.2% relative to mid-income (\$50-\$75,000) white policyholders of similar age.

significant differences in the proportions of different ethnic groups who had a zero credit score.

Income

Credit scores of zero were more common among policyholders in the two lowest income categories. The overall probability of having a zero score was 28%. If a person had that average probability (28%) at middle and upper income levels, at low-income levels the same person would have a higher likelihood of a zero score:

- 48% if the group had annual incomes between \$20,000 and \$35,000, and
- 76% if the group had annual incomes between \$20,000 and \$35,000.

FIRM 3

Sample

The survey resulted in 978 responses. Among those contacted, 87.0% agreed to participate. This constituted 63.0% of those whom the interviewers tried to contact. This sample provided a margin of error of approximately ± 3 percent for a yes/no question.

Questions

Based on the findings from the first review, the principal questions were to determine the demographic pattern of both credit scores and the economic effects of those scores. Effects on policyholders with scores of "zero" due to inadequate credit history were identified as requiring separate analysis.

Structure

This firm uses credit scoring in two ways.

- First, in combination with other traditional underwriting factors, credit scores are used to assign applicants to either the standard risk pool or a higher-cost pool. Of the sample reached by phone interviewers, 362 had been placed in the non-standard higher rate pool, and 616 with the standard rate pool.
- Second, within each pool, a credit-based score is assigned, and this score is used as a starting point for determining a premium rate.

Data Provided

In addition to age, gender, zip code, and policy binder date, the insurer provided data on the insurance pool customers were placed in, and which of five "bands" or tiers their credit score placed them in.¹⁶ There was no identification of individuals with insufficient credit files to generate a score. However, the insurer places such policyholders in the next-to-lowest band, with premiums higher than average, but lower than their maximum. Therefore, the analysis of premiums shifts for this firm examines two effects of credit scoring in combination. It analyses the combined effect of both the direct influence through credit scores and the indirect influence through classification of those with score of zero due to inadequate credit history.

Analyses

Assignment to Risk Pool

The first step, assignment to regular or high-cost pools, was evaluated for demographic patterns. However, this step involves not only credit information, but also other driving-related data. Therefore, we cannot conclude that any identified unequal impacts were caused by credit scoring. These impacts might result, partly or entirely, from the driving and insurance histories of the firm's customers, and not from their credit scores.

¹⁶ Also included was information on type of insurance and final premium classification, which was not used in this analysis.

The effects of this combined credit and driving evaluation are quite marked demographically. People were more likely to have credit scores of zero if they were young, poorer, African American and/or Hispanic.¹⁷ However, because this is not a purely credit-based determination, it cannot be concluded that this unequal impact results from credit scoring.

Premium Levels

The firm's premium rating process, which relies solely on credit scoring, was evaluated separately for each of the two insurance pools.

Lower Cost Pool- Ethnicity

Credit score information raised Hispanic policyholders' rates by an average of 4% of average premiums, relative to white policyholders of similar age.¹⁸

Lower Cost Pool- Income

There was no statistically significant connection between income and rate adjustments based on credit information, with or without adjustment for differences in age distribution.

High Cost Pool- Ethnicity

Credit score rating raised rates for two ethnic groups:

- For Blacks, by 5.6% of average premium, relative to whites of similar age,
- For Native Americans, by 8.6% of average premium, relative to whites of similar age.

High Cost Pool Income

There was no general correlation between income and credit score rate adjustments across all income levels. However, for those with incomes below \$20,000, analyses consistently indicated rates about 2% above other income groups, even with adjustments for age and ethnicity. While this difference was consistent, it was not always statistically significant, depending on the technical specifics of the model.

High Cost Pool Overlap of Ethnicity and Income

In a combined analysis including ethnicity, age and income, the effects do not cancel each other out. So the results can be thought of as additive.¹⁹

See Appendix E for coefficients and regression details.

¹⁷ The proportion of individuals placed in the higher cost pool was 37%, or overall odds of about 3-to-5. If a white person of a particular age had this average probability (37%) of having a zero score, an otherwise similar black person had a 60% probability, and a Hispanic person, a 69% probability. If a person with a \$65,000 annual income had the average probability of a zero score (37%), the average person of the same age with an income of \$30,000 would have a 50% probability of a zero score.

¹⁸ Small numbers of ethnic minorities, and the refusal of some of those few to provide income information, made it impossible to measure the possible interaction of ethnicity and income with any certainty.

¹⁹ In fact, the estimated difference for African-Americans and Native Americans gets slightly larger in the combined analysis. The combined effect for poor African-Americans is 8.5%, and the combined effect for poor Native Americans is 11.3%. Paradoxically, while the factor for Native Americans both gets larger it also exceeds the statistical significance limit of .05, rising to .066. One of the consequences of the relatively low numbers of minority groups in the samples is that small changes in data or analytic models can change the results of statistical significance tests.

CONCLUSIONS

Based on these analyses, it is probable that credit-scoring impacts are not equally distributed across demographic groups. In almost every multivariate analysis, some groups were significantly associated with differential effects that have economic consequences. Although there were considerable differences among the models, it did not appear to be mere random variation.

The demographic effects varied significantly among the three insurers studied. Assuming that these three insurers are representative of insurers in general, substantial variation among insurers should be generally expected. Based on the variations found in these three firms, and on a limited literature review, variation in effects is likely due to differences in:

- a. The credit scoring model used,
- b. The population to which it is applied, and
- c. The role credit scoring has in the insurer's underwriting and ratemaking processes.

Therefore, an overall conclusion that credit scoring generally does or does not have a particular consistent, quantifiable, unequal negative effect on certain demographic groups is premature. Possible negative effects will have to be directly evaluated using data on the outcomes for each insurer's practices and clientele, at least until there is more understanding of when and why particular unequal impacts result.

Classification based on credit score is not identical to classifying people based purely on demographic groupings. Rather, demographically unequal impacts appear to be significant side effects of credit scoring. No large demographic group has uniformly low credit scores. However, low credit scores may be much more common in some groups than others.

There are other potential negative consequences of credit scoring that are beyond this study's scope. Possible demographic inequality in decision about whom to insure is one such possibility. Erroneously identifying individuals for higher risks and premiums based on information unrelated to risks is another. Another possibility is inaccurate credit scores due to inaccurate information in the credit history systems.

SPECIFIC DEMOGRAPHIC PATTERNS

Age is Most Significant

In most analyses, older drivers had, on average, higher credit scores and lower probability of a zero credit score.²⁰ Because this pattern favors older drivers, and using youth as a risk factor for auto insurance has well-established legitimacy, age was considered mostly as an adjustment factor when analyzing the correlations of other characteristics with credit scores. Analyses for patterns in other demographic characteristics were done on an age-adjusted basis, except where testing demonstrated that age was not a significant factor.

Other Key Characteristics

Possible negative effects on ethnic minorities and low-income individuals were of particular concern in this study. The relationship of income and ethnicity to credit scores was much less consistent than the relationship between age and credit scores. It is possible that one implementation of credit scoring has significant effects in these areas, while another implementation does not. Larger samples and studies of additional insurers might clarify the patterns among these factors.

²⁰ There is some evidence that the age effect flattens at the lower end, and that those under 30 do not have worse credit associated scores and impacts than those aged 30-40, but this is complicated by age-related differences in the percentages not having a usable credit score.

1. Income

Income was the second most frequent factor of statistical significance, whether as a general tendency for credit scores to get better with rising income, or as a tendency for those in the lowest one or two income categories to have negative effects.²¹ In some cases, lower income was also associated with higher probability of receiving a zero credit score due to lack of credit history.

2. Ethnicity

Ethnicity was also found to be a statistically significant factor in several cases. However, the relatively small numbers of ethnic minorities, and the number of refusals and unclassifiable survey responses made this very difficult to pin down. In general, the Asian/Pacific Islander individuals had credit effects more similar to whites than to other people of color. For non-Asian/Pacific Islander minorities, in those cases in which ethnicity differences were found to be significant, the differences were in the direction of higher costs for ethnic minorities.²²

Other Factors Insignificant

Statistically significant results for gender, marital status and location were sufficiently infrequent that, if these three firms are a representative sample, less attention needs to be paid to possible patterns of negative effects for these groups. However, other reports indicate that some other insurers include credit information on additional drivers beyond the named policyholder in their credit scoring processes. It would be important to fully evaluate possible gender and marital status factors in studying insurers employing such practices.

²¹ The lowest categories were "less than \$20,000 per year" and "\$20,000 to \$35,000 per year."

²² The consistency with which estimated effects for most minorities were in the direction of higher costs is one of the reasons this report recommends serious study and further investigation with larger samples. While estimated ethnicity effects often failed to pass tests for statistical significance, they were almost always in the direction of higher costs for minorities, except for Asian/Pacific Islanders.

APPENDIX A

TRANSUNION REASON CODES FOR NEGATIVE OR DEROGATORY CREDIT REPORTS

Excessive or unknown amount owed on accounts
Recent delinquency
Absence of revolving credit accounts
Too many accounts with balances
Too many finance company accounts
Too many recent credit checks
Too many new accounts
Proportion of revolving balances to revolving credit limits is too high or there are no revolving credit accounts
Excessive amount owed on revolving accounts
Insufficient length of revolving credit history
Delinquency date too recent (or date unknown)
Insufficient length of credit history
Delinquency
Recent derogatory public record or collection
Past due balances
Delinquency, derogatory public record or collection
Presence of collection accounts
Too many revolving accounts with balances
Date of last credit check too recent or unknown
Insufficient time since most recent account established
Unfavorable number of installment loan accounts
Too many installment loan accounts with outstanding balances
Insufficient time since most recent installment loan established
Too many accounts with high credit amounts
Proportion of loan balances to installment loan amounts is too high
Unfavorable number of real estate accounts
Too many new or existing finance company accounts
Prior installment loan delinquency or no installment loans present
Unfavorable percentage or open revolving accounts to all other accounts
Presence of delinquency, public record or collection
Delinquency on open revolving accounts
Finance company account opened recently
Unfavorable number of accounts
Unfavorable length of time since most recent retail account opened
Too many recently active finance company accounts
Unfavorable number of recently active accounts
Unfavorable number of revolving or open accounts
Unfavorable number of adverse public records

APPENDIX B

RANGE OF DEMOGRAPHICS IN THREE INSURERS' CLIENTELE*

Race	Low	High
Black	0.3%	3.3%
Hispanic	1.5%	7.4%
Caucasian	77.3%	94.3%
Asian/Pacific Islander	2.6%	9.1%
Native American	0.8%	1.5%
Multi-Racial	0.4%	1.1%
Other	0.4%	0.7%
Marital Status		
Single, Divorced, Separated	22.5%	44.9%
Married/Widowed	55.1%	77.5%
Gender		
Male	46.6%	66.0%
Female	34.0%	53.4%
Geography		
In Eastern Washington	13.0%	16.2%
In Metropolitan Statistical Area	76.0%	85.2%
Age Distribution		
Under 30	6.4%	30.1%
Between 30 & 40	11.4%	26.7%
Between 40 & 50	21.1%	28.3%
Between 50 & 60	13.7%	22.5%
Between 60 & 70	5.5%	17.2%
70 & Up	3.9%	17.2%
Annual Income		
Under \$20,000	13.0%	23.9%
\$20,000-\$35,000	19.2%	27.1%
\$35,000-\$50,000	20.8%	23.1%
\$50,000-\$75,000	16.7%	21.3%
\$75,000-\$100,000	5.4%	11.5%
\$100,000-\$150,000	2.9%	7.6%
Over \$150,000	2.3%	4.2%

*Estimated from Telephone Survey Samples

APPENDIX C

FIRM 1 REGRESSIONS FOR EFFECT ON CREDIT SCORE

Notes:

The dependent variable is credit score
 Credit scores varied by 535 points, from lowest to highest

Ethnicity and Income

Notes:

Both Ethnicity and Income were not found to have statistically significant correlations with credit scores in this case.

Correlation with Age and other factors is shown in the regression described below.

	Linear Regression
Sample N	889
R Square	0.303
Adjusted R Square	0.300

	Unstandardized Coefficients	Standard Error Of Coefficient	Standardized Coefficients	T-Statistic	Range Of Values	Sig.
Age at Rating	3.696	0.199	0.529	18.620	22-98	0.000
Married Female	15.790	5.865	0.076	2.692	0-1	0.007
Eastern Washington	-17.820	7.747	-0.065	-2.300	0-1	0.022
Constant	518.528	11.064		46.864		

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation of Change in score

Notes:

The Coefficients for Married Females and Eastern Washington residents are directly interpretable as:

- Plus 16 points on average for married women, after adjusting for age and proportion living in Eastern Washington
- Minus 18 points on average for Eastern Washington residents, after adjusting for age & proportion of married females

The results for married females apply to those cases in which they are the lead policyholder or "named insured".

Example Used in Footnote

	Coefficient (Change per one unit of the Factor)	Shift Measured in Years of Age difference	Credit Score Points
Age at Rating	3.696	10	37.0

FIRM 1 REGRESSION FOR HAVING A CREDIT SCORE OF ZERO DUE TO INADEQUATE CREDIT HISTORY

Ethnicity

Evidence That Correlations With Ethnicity Are Not Statistically Significant At This Sample Size

Note: The dependent variable is the categorical outcome of having a credit score of zero. Coding 1= having a score of zero.

	Logistic Regression
Sample N	917
Cox & Snell R Square	0.015
Nagelkerke R Square	0.053

	Raw Coefficient	Standard Error	Wald Statistic	Range Of Values	Significance	Exponentiated Coefficient
Age	-0.163	0.061	7.117	22-98	0.008	0.850
Age Squared	0.002	0.001	8.949	484-9604	0.003	1.002
African American	-4.597	34.879	0.017	0-1	0.895	0.010
Hispanic	-4.997	16.591	0.091	0-1	0.763	0.007
Asian/Pacific Islander	0.917	0.775	1.400	0-1	0.237	2.502
Native American	-4.830	30.055	0.026	0-1	0.872	0.008
Multi-Ethnic	-4.692	21.321	0.048	0-1	0.826	0.009
Constant	0.471	1.643	0.082	1.000	0.775	1.601

*Bolded entries in the first and last columns indicate statistically significant variables.

Income

Note: The dependent variable is the categorical outcome of having a credit score of zero. Coding 1= having a score of zero.

Logistic Regression:	
Sample N	847
Cox & Snell R Square	0.026
Nagelkerke R Square	0.094

	Raw Coefficient	Standard Error	Wald Statistic	Range Of Values	Significance	Exponentiated Coefficient
Income less than \$20,000	1.865	0.367	25.900	0-1	0.000	6.458
Constant	-3.690	0.239	239.195		0.000	0.025

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation Of Odds And Probability Shifts For Example In Text

	Typical Probability	Probability Expressed As Odds Ratio Relative To 1	Exponentiated Coefficient	Odds Ratio With Characteristic (Relative To 1)	New Odds Ratio Expressed As Probability
Income less than \$20,000	0.04	0.042	6.458	0.269	21.2%

APPENDIX D

FIRM 2 REGRESSIONS FOR PREMIUM SHIFT

Ethnicity

Notes:

The dependent variable is percentage reduction in premium down from maximum rates.

Credit based rate adjustments ranged to 32 % below maximum, which translates as from 17% below average premium to 33% above average premium.

	Linear Regression
Sample N	767
R Square	0.058
Adjusted R Square	0.055

	Unstandardized Coefficients	Standard Error of Coefficient	Standardized Coefficients	T- statistic	Range of Values	Sig.
African American	-3.755	3.127	-0.042	-1.201	0-1	0.230
Hispanic	-2.688	1.999	-0.047	-1.345	0-1	0.179
Asian/Pacific Islander	4.110	1.914	0.075	2.147	0-1	0.032
Native American	-11.827	3.133	-0.131	-3.775	0-1	0.000
Age at Rating	0.250	0.039	0.273	6.367	16-91	0.000
Age less than 30	2.967	1.414	0.090	2.098	0-1	0.036
Constant	14.598	1.890		7.722		0.000

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation of Change in Rates

Note: Each percentage point below maximum translates to 1.333 percentage points relative to the average rate, which is 75% of the maximum.

	Coefficient	Conversion Factor From Percent Of Maximum To Percent Of Average	Change In Premium Expressed As Percent Of Average
Asian/Pacific Islander	4.110	1.333	-5.5%
Native American	-11.827	1.333	15.8%

Income

First Version of Age Adjustment

	Linear Regression
Sample N	767
R Square	0.072
Adjusted R Square	0.068

	Unstandardized Coefficients	Standard Error Of Coefficient	Standardized Coefficients	T-Statistic	Range Of Values	Sig.
Income	0.966	0.283	0.121	3.419	1-7	0.001
Age at Rating	0.263	0.039	0.288	6.679	16-91	0.000
Age less than 30	3.710	1.438	0.113	2.581	0-1	0.010
Constant	10.923	2.106		5.187		0.000

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation of Change in Rates

Note: Each percentage point below maximum translates to 1.333 percentage points relative to the average rate, which is 75% of the maximum.

	Coefficient (Change Per One Unit Of The Factor)	Shift As Measured In Number Of Income Groups		Conversion Factor From Percent Of Maximum To Percent Of Average	Change In Premium Expressed As Percent Of Average
Income	0.966	3.000	2.898	1.333	-3.9%

Second Version of Age Adjustment

	Linear Regression
Sample N	767
R Square	0.076
Adjusted R Square	0.072

	Unstandardized Coefficients	Standard Error Of Coefficient	Standardized Coefficients	T-Statistic	Range Of Values	Sig.
Income	1.017	0.283	0.127	3.590	1-7	0.000
Age at Rating-Squared	0.006	0.002	0.619	3.190	256->8281	0.001
Age at Rating	-0.354	0.178	-0.387	-1.992	16-91	0.047
Constant	25.822	3.922		6.584		0.000

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation of Change in Rates

Note: Each percentage point below maximum translates to 1.333 percentage points relative to the average rate, which is 75% of the maximum.

	Coefficient (Change Per One Unit Of The Factor)	Shift As Measured In Number Of Income Groups		Conversion Factor From Percent Of Maximum To Percent Of Average	Change In Premium Expressed As Percent Of Average
Income	1.017	3.000	3.050	1.333	-4.1%

Example of Combined Regression for Both Income and Ethnicity, Age-Adjusted

	Linear Regression
Sample N	767
R Square	0.101
Adjusted R Square	0.093

	Unstandardized Coefficients	Standard Error of Coefficient	Standardized Coefficients	T-Statistic	Range of Values	Sig.
Income	0.944	0.283	0.118	3.337		0.001
Age at Rating-Squared	0.006	0.002	0.620	3.228		0.001
Age at Rating	-0.361	0.176	-0.395	-2.050		0.041
African American	-3.783	3.101	-0.042	-1.220		0.223
Hispanic	-2.244	1.983	-0.039	-1.132		0.258
Asian/Pacific Islander	4.550	1.903	0.083	2.390		0.017
Native American	-10.798	3.127	-0.120	-3.453		0.001
Constant	26.439	3.912		6.758		0.000

*Bolded entries in the first and last columns indicate statistically significant variables.

Calculation of Change in Rates

Note: Each percentage point below maximum translates to 1.333 percentage points relative to the average rate, which is 75% of the maximum.

	Coefficient (Change Per One Unit Of The Factor)	Shift As Measured In Number Of Income Groups		Conversion Factor From Percent Of Maximum To Percent Of Average	Change In Premium Expressed As Percent Of Average
Income	0.944	3.000	2.831	1.333	-3.8%

	Coefficient	Conversion Factor From Percent Of Maximum To Percent Of Average	Change In Premium Expressed As Percent Of Average
Asian/Pacific Islander	4.550	1.333	6.1%
Native American	-10.790	1.333	-14.4%

FIRM 2 REGRESSION FOR HAVING A CREDIT SCORE OF ZERO DUE TO INADEQUATE CREDIT HISTORY

Ethnicity

Evidence That Correlations With Ethnicity Are Not Statistically Significant At This Sample Size

Note: The dependent variable is the categorical outcome of having a credit score of zero. Coding 1= having a score of zero.

	Logistic Regression
Sample N	957
Cox & Snell R Square	0.020
Nagelkerke R Square	0.039

	Raw Coefficient	Standard Error	Wald Statistic	Range Of Values	Significance	Exponentiated Coefficient
Age less than 30	0.740	0.240	9.472	0-1	0.002	2.096
African American	0.897	0.582	2.378	0-1	0.123	2.453
Hispanic	0.675	0.376	3.213	0-1	0.073	1.963
Asian/Pacific Islander	0.520	0.389	1.787	0-1	0.181	1.682
Native American	-5.194	9.385	0.306	0-1	0.580	0.006
Multi-Ethnic	-0.036	1.074	0.001	0-1	0.973	0.964
Constant	-2.247	0.125	321.619		0.000	0.106

Income

Note: The dependent variable is the categorical outcome of having a credit score of zero. Coding 1= having a score of zero.

	Logistic Regression
Sample N	883
Cox & Snell R Square	0.067
Nagelkerke R Square	0.129

	Raw Coefficient	Standard Error	Wald Statistic	Range of Values	Significance	Exponentiated Coefficient
Income Less Than \$20,000	2.073	0.291	50.923	0-1	0.000	7.952
Income \$20,000 To \$35,000	0.851	0.321	7.534	0-1	0.006	2.413
Income \$75,000 To \$100,000	0.926	0.468	3.921	0-1	0.048	2.524
Constant	-3.023	0.241	156.876		0.000	0.049

*Bolded entries in the last two columns indicate statistically significant variables.

Notes:

The statistically significant results for the \$75,000-\$100,000 income category are anomalous, and no explanation has been suggested.

Age adjustment was not significant in this particular model: in other versions, an adjustment for age under 30 was significant, but inclusion of this adjustment does not substantially change the income effects.

	Typical Probability	Probability Expressed As Odds Ratio Relative To 1	Exponentiated Coefficient	Odds Ratio With Characteristic (Relative To 1)	New Odds Ratio Expressed As Probability
Income Less Than \$20,000	28.0%	0.389	7.952	3.092	75.6%
Income \$20,000 To \$35,000	28.0%	0.389	2.413	0.938	48.4%

APPENDIX E

FIRM 3 REGRESSION FOR ASSIGNMENT TO HIGH OR LOW RISK INSURANCE POOL

Ethnicity and Income

CAUTION: Risk pool assignment is based on a combination of credit factors and traditional auto insurance factors such as driving and insurance history. The outcomes analyzed in this regression may partly or entirely result from factors other than credit history.

Combined Ethnicity and Income Regression, Age-Adjusted

Note: The dependent variable is the categorical outcome of being placed in the high risk/high cost pool. Coding 1= hi pool.

	Logistic Regression
Sample N	862
Cox & Snell R Square	0.111
Nagelkerke R Square	0.151

	Raw Coefficient	Standard Error	Wald Statistic	Range of Values	Significance	Exponentiated Coefficient
African American	0.931	0.409	5.181	0-1	0.023	2.537
Hispanic	1.316	0.296	19.810	0-1	0.000	3.728
Asian/Pacific Islander	-0.155	0.265	0.341	0-1	0.559	0.856
Native American	-0.527	0.690	0.584	0-1	0.445	0.590
Multi-Ethnic	-0.087	0.670	0.017	0-1	0.896	0.916
Age at Rating	-0.027	0.005	25.904	18-86	0.000	0.974
Income Group	-0.268	0.054	24.646	0-1	0.000	0.765
Constant	1.168	0.243	23.137		0.000	3.216

Bolded entries in the last two columns indicate statistically significant variables.

Calculation Of Odds And Probability Shifts For Examples

Notes:

Odds ratios for ethnicity are relative to odds for whites.

Odds ratios for income apply to shifting between any two income levels up or down the income scale. The regression coefficients are expressed for movement up the scale. For movement down the income scale, exponentiated coefficients invert (1 divided by the exponentiated coefficient).

	Typical Probability	Probability Expressed As Odds Ratio Relative To 1	Exponentiated Coefficient	Odds Ratio With Characteristic (Relative To 1)	New Odds Ratio Expressed As Probability
African American	37.0%	0.587	2.537	1.490	59.8%
Hispanic	37.0%	0.587	3.728	2.190	68.6%

	Typical Probability	Probability Expressed As Odds Ratio Relative To 1	Exponentiated Coefficient	Change Measured In Number Of Income Categories	Exponentiated Coefficient For That Number Of Units Of Change	Odds Ratio After Shift In Characteristic (Relative To 1)	New Odds Ratio Expressed As Probability
Income- Upwards	37.0%	0.587	0.765	2.000	0.585	0.343	25.6%
Income- Downwards	37.0%	0.587	1.308	2.000	1.711	1.005	50.1%

FIRM 3 REGRESSION FOR SCORE IN LOW RISK INSURANCE POOL

Ethnicity

Note: The dependent variable is rating tiers 1 through five. Tier number five has the highest premiums.

	Linear Regression
Sample N	579
R Square	0.096
Adjusted R Square	0.088

	Unstandardized Coefficients	Standard Error of Coefficient	Standardized Coefficients	T-statistic	Range of Values	Sig.
African American	0.454	0.298	0.061	1.523	0-1	0.128
Hispanic	0.539	0.246	0.088	2.195	0-1	0.029
Asian/Pacific Islander	-0.110	0.157	-0.028	-0.701	0-1	0.484
Native American	0.271	0.370	0.029	0.731	0-1	0.465
Age at Rating	-0.021	0.003	-0.288	-7.169	19-86	0.000
Constant	3.296	0.139		23.710		0.000

*Bolded entries in the last two columns indicate statistically significant variables.

Calculation of Change in Rates

Note: For each rating tier, premiums rise by about 6% of maximum rates, or about 7.3% of average rates

	Coefficient	Premium Increase Per Tier	Percentage Premium Increase
Hispanic	0.539	0.073	3.9%

Income

There are no significant results correlating income with tier classification in the risk pool.

FIRM 3 REGRESSION FOR SCORE IN HIGH RISK INSURANCE POOL

Ethnicity

Note: The dependent variable is rating tiers one through five. Tier number five has the highest premiums.

	Linear Regression
Sample N	341
R Square	0.070
Adjusted R Square	0.056

	Unstandardized Coefficients	Standard Error Of Coefficient	Standardized Coefficients	T-Statistic	Range Of Values	Sig.
African American	0.773	0.291	0.141	2.655	0-1	0.008
Hispanic	0.121	0.178	0.036	0.678	0-1	0.498
Asian/Pacific Islander	0.000	0.226	0.000	0.002	0-1	0.998
Native American	1.170	0.570	0.109	2.051	0-1	0.041
Age at Rating	-0.016	0.004	-0.189	-3.539	18-84	0.000
Constant	2.994	0.178		16.780		0.000

*Bolded entries in the last two columns indicate statistically significant variables.

Calculation of Change in Rates

Note: For each rating tier, premiums rise by about 6% of maximum rates, or about 7.3% of average rates

	Coefficient	Premium Increase Per Tier	Percentage Premium Increase
African American	0.772660487	0.073	5.64%
Native American	1.170093545	0.073	8.54%

Ethnicity and Income Combined

Note: The dependent variable is rating tiers one through five. Tier number five has the highest premiums.

Linear Regression	
Sample N	325
R Square	0.080
Adjusted R Square	0.063

	Unstandardized Coefficients	Standard Error Of Coefficient	Standardized Coefficients	T-Statistic	Range Of Values	Sig.
African American	0.850	0.302	0.153	2.814	0-1	0.005
Hispanic	0.075	0.185	0.022	0.407	0-1	0.684
Asian/Pacific Islander	-0.035	0.232	-0.008	-0.152	0-1	0.879
Native American	1.218	0.660	0.100	1.847	0-1	0.066
Age at Rating	-0.015	0.005	-0.177	-3.201	18-84	0.002
Income less than \$20,000	0.289	0.139	0.115	2.082	0-1	0.038
Constant	2.877	0.197		14.603		0.000

*Bolded entries in the last two columns indicate statistically significant variables.

Calculation Of Change In Rates For Examples Used In The Report

Note: For each rating tier, premiums rise by about 6% of maximum rates, or about 7.3% of average rates

	Coefficient	Premium Increase Per Tier	Percentage Premium Increase
African American	0.850	0.073	6.20%
Native American	1.218	0.073	8.89%
Income Less Than \$20,000	0.289244437	0.073	2.11%

APPENDIX F

GLOSSARY OF TERMS

Overall Terms and Definitions

Constant – Both linear and logistic regressions include statistics for “constant” factors. They are included here for sake of completeness in description of the regressions, and not because they have policy implications. They can be thought of as the score or probability that is estimated for the starting or reference combination of characteristics, the one to which the shifts indicated by all the other factors are relative. Constant terms are required in order to calculate the estimated probability for a specific combination of characteristics.

Dependent Variable – The dependent variable is the outcome for which correlated factors are to be identified and quantified in the regression model.

Income Group – In all of the surveys, income information was collected by the categories below. Although these categories are not of perfectly equal size, it was treated as a linear variable in analysis. Use of both Age and Age-Squared factors should have permitted the regression to correctly identify patterns of correlation with income in spite of the fact that the group intervals widened as income rose.

- 1 Under \$20,000
- 2 \$20,000 to less than \$35,000
- 3 \$35,000 to less than \$50,000
- 4 \$50,000 to less than \$75,000
- 5 \$75,000 to less than \$100,000
- 6 \$100,000 to less than \$150,000
- 7 \$150,000 and above

Sample N – The number of policyholder records that were usable for that analysis: they belonged to the group being analyzed and had no missing values for the variables used.

Significance – The probability that the pattern represented by the coefficient for this factor really doesn't exist in the overall population, but is due to random chance producing a sample that has a pattern. This report used the criterion that only results with probabilities of error of 5% or less were considered statistically significant. This corresponds to a value of .05 in the Significance columns of the coefficient tables.

Standard Error – The interval plus or minus around any estimate which defines the area we are 95% confident includes the true value.

Linear Regression Terms

Linear Regression – This is a method for quantifying the simultaneous strength of association of several factors with an outcome which can be quantified on a numerical scale. The most common linear method, Ordinary Least Squares (OLS), was used.

R Square, Adjusted R Square – These are the two standard measures of the explanatory power of a Linear Regression. They both are on a zero-to-one scale, and give different mathematical approximations of what percentage of the variance in the outcome the model explains. In comparing the power or accuracy of regressions, R squares from different formulas should not be contrasted with each other: compare unadjusted scores to unadjusted scores, and adjusted scores to adjusted scores.

Standardized Coefficient – This is a measure of the overall significance of a factor in the model. Neither significance statistics nor the magnitude of an unstandardized coefficient are unambiguous measures of the significance of a factor in the explanatory power of a regression. For example, a factor may have a large effect (coefficient) and be highly significant, but have little overall significance because it is present in only a few cases, and therefore contributes only a small amount to overall accuracy.

T-Statistic – Another standard measure of statistical significance.

Unstandardized Coefficients – This expresses the strength of the correlation, scaled so that it corresponds to the scale on which the factor was measured. It can be directly multiplied times units of the factor in order to estimate how the dependent variable varies with a given variation in the factor. For categorical factors, such as being male, the unstandardized coefficient is the average difference the factor is associated with, adjusted for other factors in the model.

Logistic Regression Terms

Exponentiated Coefficient – Exponentiated logistic coefficients represent the shift in odds ratios correlated with a one-unit change in a correlated factor. To apply an exponentiated coefficient, express the probability of the outcome in the absence of that characteristic in terms of the odds in favor of the outcome, and multiply the numerator of the odds ratio to calculate how that factor shifts odds.

A shift by more than one unit in one of these factors is not additive, but has a power form. For example, if the exponentiated coefficient for age is 0.9, the coefficient for being three years older is 0.9 cubed, or $0.9 \times 0.9 \times 0.9$.

As an example, take a case in which the regression sets a variable "female=1" for being female, so lacking that factor indicates being male. If the odds that males will have a credit score of zero are 1-to-4, and the exponentiated coefficient for females is 0.5, then the odds for females are .5-to-4, or 1-to-8.

Any probability that can be expressed as a percentage, can also be expressed as an odds ratio: 75% is 3-to-1, 50% 1-to-1, and 10% is 1-to-9 in favor. Note that these are odds, or odds ratios, not probabilities or proportions. Odds of 1-to-4 is "one out of five" or a 20% probability. Odds of 1-to-8 is "one out of nine" or an 11.1% probability. Odds that a coin will land heads-up are 1-to-1, and odds that a person was born on a Monday are 1-to-6.

Raw Coefficient – These are the mathematical coefficients as generated by the regression model. They have a direct mathematical relationship to the Exponentiated Coefficients, as described above.

Logistic Regression – This is a method for quantifying the simultaneous strength of association of multiple factors with an outcome that is “categorical” – that is, it cannot be quantified on a numerical scale. Categorical outcomes are either true or false, there are no intermediate values. The strength of a factor’s association with a categorical outcome is described in terms of how it is associated with the probability or likelihood of that outcome.

Nagelkerke R Square, Cox & Snell R Square – These are two standard measures of the explanatory power of a Logistic regression. They both are on a zero-to-one scale, and give different mathematical approximations of what percentage of the variance in the outcome the model explains. The “percentage of variance explained” is not as straightforward a concept in dealing with categorical dependent variables. In comparing the power or accuracy of regressions, R squares from different formulas should not be contrasted with each other: compare a Nagelkerke with a Nagelkerke, and a Cox & Snell score with a Cox & Snell score.

Wald Statistic – This is a measure of the overall strength of a factor in the model. Neither significance statistics nor the magnitude of a raw coefficient are unambiguous measures of the significance of a factor in the overall power of a regression. For example, a factor may have a large effect (coefficient) and be highly significant, but have little overall significance because it is present in only a few cases, and therefore improves overall accuracy only a small amount.

Logistic Regression – This is a method for quantifying the simultaneous strength of association of multiple factors with an outcome that is “categorical” – that is, it cannot be quantified on a numerical scale. Categorical outcomes are either true or false, there are no intermediate values. The strength of a factor’s association with a categorical outcome is described in terms of how it is associated with the probability or likelihood of that outcome.

Nagelkerke R Square, Cox & Snell R Square – These are two standard measures of the explanatory power of a Logistic regression. They both are on a zero-to-one scale, and give different mathematical approximations of what percentage of the variance in the outcome the model explains. The “percentage of variance explained” is not as straightforward a concept in dealing with categorical dependent variables. In comparing the power or accuracy of regressions, R squares from different formulas should not be contrasted with each other: compare a Nagelkerke with a Nagelkerke, and a Cox & Snell score with a Cox & Snell score.

Wald Statistic – This is a measure of the overall strength of a factor in the model. Neither significance statistics nor the magnitude of a raw coefficient are unambiguous measures of the significance of a factor in the overall power of a regression. For example, a factor may have a large effect (coefficient) and be highly significant, but have little overall significance because it is present in only a few cases, and therefore improves overall accuracy only a small amount.

APPENDIX G

TELEPHONE SURVEY – LONG VERSION

Q.1 Record Source : Which list is this from ?

	(7)
Cancelled Policy Holders ..	1
Current Policy Holders	2

Q.2 Hello. I'm calling on behalf of the Office of the State Insurance Commissioner. I want to assure you this is not a sales call. May I please speak with _____ (the policy holder)?

	(8)
Yes ..	1
No	2

Q.3 Am I speaking with the Policy Holder, Someone who can speak for the policy holder, or neither ?

	(9)
Policy holder	1
Someone who can speak for the policyholder ..	2
Neither	3

[IF THE ANSWER TO QUESTION 3 IS 1 OR 2, THEN SKIP TO QUESTION 9]

Q.4 Can I speak with the policyholder ?

	(10)
Yes ..	1
No	2

[IF THE ANSWER TO QUESTION 4 IS 1, THEN SKIP TO QUESTION 9]

Q.5 (If No) "Is someone else available who could speak for the policyholder about his/her/your auto insurance?"

	(11)
Yes ..	1
No	2

[IF THE ANSWER TO QUESTION 5 IS 2-3, THEN SKIP TO QUESTION 35]

Q.6 (If Yes) – Who is that person?

_____ (5-105)

Q.7 Can we speak to them or should we call back at another time?

(12)
Speak 1
Call Back .. 2

[IF THE ANSWER TO QUESTION 7 IS NOT 2, THEN SKIP TO QUESTION 9]

Q.8 When would be a good time to call back ?

(106-206)

[IF THE ANSWER TO QUESTION 7 IS 2, THEN SKIP TO QUESTION 35]

Q.9 The Insurance Commissioner recently sent a letter asking for your help in investigating auto insurance cancellations. I'd like to ask you several questions that will help him determine if certain practices should be prohibited. This will take no more than 7 minutes of your time. Your answers will be kept strictly confidential, and combined with other responses to protect your identity. Your responses will not be revealed to your insurance company or to anyone else. (record call disposition)

(5-6)
Call Back-Appointment 01
Call Back NO-appointment .. 02
Respondent not available 03
Refusal to participate 04
-- 05
Communication Barrier 06
Continue Survey 07
-- 08
-- 09
-- 10

[IF THE ANSWER TO QUESTION 9 IS NOT 7, THEN SKIP TO QUESTION 35]

Q.10 (Record gender - ask if respondent is not policyholder or name is ambiguous)

(13)
Male 1
Female .. 2

[IF THE ANSWER TO QUESTION 1 IS NOT 1, THEN SKIP TO QUESTION 12]

Q.11 Firm 1 reported that they cancelled or declined to renew your auto insurance within the last year, is this correct?

(14)
Yes 1
No 2
Don't know .. 3

[IF THE ANSWER IS 2-3, THEN SKIP TO QUESTION 27]

[IF THE ANSWER TO QUESTION 1 IS NOT 2, THEN SKIP TO QUESTION 13]

Q.12 Firm 1 reported that you have auto insurance with them, is this correct?

(15)
Yes1
No2
Don't know ..3

[IF THE ANSWER IS NOT 1, THEN SKIP TO QUESTION 35]

[IF THE ANSWER TO QUESTION 1 IS 2, THEN SKIP TO QUESTION 27]

Q.13 Did you receive a letter from the insurance company explaining why you (they) were denied auto insurance?

(16)
Yes1
No2
Don't know ..3

[IF THE ANSWER TO QUESTION 13 IS NOT 1, THEN SKIP TO QUESTION 15]

Q.14 Did the letter adequately explain why you (they) were denied auto insurance?

(17)
Yes1
No2
Don't know ..3

Q.15 On a scale of 1 to 10 (with 1 being not difficult at all and 10 being extremely difficult) how difficult has it been for you (or policyholder) to find new auto insurance coverage?

Difficulty _____ (42-43)

Q.16 How many insurance companies did you (or policyholder) have to contact? _____

Number of companies (0 for Don't Know). _____ (19-20)

Q.17 Were you (or policyholder) able to obtain replacement coverage?

(21)
Yes1
No2
Waiting to hear if approved .. 3
Don't know4

[IF THE ANSWER IS 3, THEN SKIP TO QUESTION 25]

Q.18 Was there a period of time between the expiration of your former policy and the replacement policy?

(22)
Yes1
No2
Don't know ..3

Q.19 How much more or less do you (or policyholder) pay per month for this coverage compared to the previous coverage? (INTERVIEWER - IF RESPONDENT GIVES A 6 MONTH OR ANNUAL PREMIUM AMOUNT, CONVERT TO MONTHLY AMOUNT)

Amount (negative for less, 0 for same, blank for don't _____) (23-27)

Q.20 Is the auto insurance coverage on the new policy different from the coverage on the old policy?

(34)
Yes1
No2
Don't know ..3

Q.21 Does the new policy cover more drivers, fewer drivers, or the same number of drivers as the old policy?

(35)
Fewer1
Same2
More3
Don't know ..4

Q.22 Does the new policy cover more, fewer or the same number of vehicles?

(36)
Fewer1
Same2
More3
Don't know ..4

Q.23 Is the deductible on the new policy lower, higher, or the same?

(37)
Lower1
Same2
Higher3
Don't know ..4

Q.24 Is the collision coverage the same on the new policy?

(38)
Yes1
No2
Didn't have collision on previous policy...3
Don't know4

Q.25 Can you tell me what company you (or policyholder) are now insured with? (Do Not Read, check the one that applies)

(40-41)
Not currently insured 01
Pemco 02
Safeco 03
Allstate 04
State Farm 05

Geico	06
Progressive	07
American Express	08
Nations	09
Other (please specify)	10
Insure Quest	11
Oregon Mutual	12
Financial Indemity	13
Farmers	14
Hartford	15
Nationwide	16
Uniguard	17
National	18
Diaryland	19
Valley Insurance	20
Grange	21
Allied	22
Amica	23
Metropolitian Life	24
GMAC	25
CNA	26
Unitrin	27
Omni	28
Quest	29
United	30
Kemper	31
American Commerce	32
Windsor	33
USAA	34
AIG	35
Lunatrend	36
QBE Insurance Group	37
AAA	38
Owsley Insurance	39
Viking	40
Simon Financial Group	41
JBR	42
Encompass	43
General	44
Vancouver Insurance	45
Horace Mann	46
County Company Insurance ..	47
E Surance	48
Mutual Of Omaha	49
Interquest	50
DON'T KNOW/REFUSED.....	99

Q.26 OTHER : Can you tell me what company you (or policyholder) are now insured with? (Do Not Read, check the one that applies)

(207-307)

Q.27 Can you please tell me if you (or policyholder) are...

(60)	
Married	1
Single	2
Divorced	3
Widowed	4
Seperated	5
Other (please specify) ..	6

Q.28 OTHER: Can you please tell me if you (or policyholder) are...

(308-358)

Q.29 Is your (or policyholder's) age:

(61)
Under 161
16 - 242
25 - 343
35 - 444
45 - 545
55 - 646
65 - 747
75 and older ..8
Refuse9

Q.30 How do (does) you (or policyholder) identify your (policyholder's) race or ethnicity:
(INTERVIEWER - DO NOT READ THE LIST. ACCEPT MULTIPLE ANSWERS)

(64-83)
Black/ African American 01
Spanish/ Hispanic/Latino 02
Mexican, Mexican Am., Chicano, Puerto Rican, Cuban .. 03
Other Spanish/ Hispanic/Latino (Please specify) 04
White/Caucasian 05
American Indian or Alaska Native (Please specify) 06
Native Hawaiian, Guamanian or Chamorro, Samoan 07
Other Pacific Islander (Please specify) 08
Asian Indian 09
Chinese 10
Filipino 11
Japanese 12
Korean 13
Vietnamese 14
Other Asian (Please specify). 15
Other race (Please specify) 16
Multiracial 17
Refuse 18
Native American 20

Q.31 OTHER : How do (does) you (or policyholder) identify your (policyholder's) race or ethnicity:

(359-409)

Q.32 Which of the following income categories applies to your (or policyholder's) individual total annual income for 2000?

(84)
Under \$20,0001
\$20,000 - \$34,9992
\$35,000 - \$49,9993
\$50,000 - \$74,9994
\$75,000 - \$99,9995
\$100,000-149,9996
\$150,000 and above ..7
Refuse8

Q.33 Would you like to receive a report from the Insurance Commissioner about the outcome of our research?

(85)
Yes ..1
No2

[IF THE ANSWER TO QUESTION 33 IS NOT 1, THEN SKIP TO QUESTION 35]

Q.34 Name and Address

_____ (410-510)

Q.35 That is all the questions I have for you. Thank you for taking the time to participate in this research. (Interviewer ID#)

APPENDIX H

TELEPHONE SURVEY – SHORT VERSION

Q.1 Record Source : Which list is this from ?

(7)
Cancelled Policy Holders ..1
Current Policy Holders2

Q.2 Hello. I'm calling on behalf of the Office of the State Insurance Commissioner. I want to assure you this is not a sales call. May I please speak with _____ (the policy holder)?

(8)
Yes ..1
No2

Q.3 Am I speaking with the Policy Holder, Someone who can speak for the policy holder, or neither ?

(9)
Policy holder 1
Someone who can speak for the policyholder .. 2
Neither 3

[IF THE ANSWER TO QUESTION 3 IS 1 OR 2, THEN SKIP TO QUESTION 9]

Q.4 Can I speak with the policyholder ?

(10)
Yes ..1
No2

[IF THE ANSWER TO QUESTION 4 IS 1, THEN SKIP TO QUESTION 9]

Q.5 (If No) "Is someone else available who could speak for the policyholder about his/her/your auto insurance?"

(11)
Yes ..1
No2

[IF THE ANSWER TO QUESTION 5 IS 2-3, THEN SKIP TO QUESTION 35]

Q.6 (If Yes) – Who is that person?

_____ (5-105)

Q.7 Can we speak to them or should we call back at another time?

(12)
 Speak1
 Call Back ..2

[IF THE ANSWER TO QUESTION 7 IS NOT 2, THEN SKIP TO QUESTION 9]

Q.8 When would be a good time to call back ?

_____ (106-206)

[IF THE ANSWER TO QUESTION 7 IS 2, THEN SKIP TO QUESTION 35]

Q.9 The Insurance Commissioner recently sent a letter asking for your help in investigating auto insurance cancellations. I'd like to ask you several questions that will help him determine if certain practices should be prohibited. This will take no more than 7 minutes of your time. Your answers will be kept strictly confidential, and combined with other responses to protect your identity. Your responses will not be revealed to your insurance company or to anyone else. (record call disposition)

(5-6)
 Call Back-Appointment 01
 Call Back NO-appointment .. 02
 Respondent not available 03
 Refusal to participate 04
 -- 05
 Communication Barrier 06
 Continue Survey 07
 -- 08
 -- 09
 -- 10

[IF THE ANSWER TO QUESTION 9 IS NOT 7, THEN SKIP TO QUESTION 35]

Q.10 (Record gender - ask if respondent is not policyholder or name is ambiguous)

(13)
 Male 1
 Female ..2

[IF THE ANSWER TO QUESTION 1 IS NOT 1, THEN SKIP TO QUESTION 12]

Q.11 Can you please tell me if you (or policyholder) are...

(60)
 Married1
 Single2
 Divorced3
 Widowed4
 Separated5
 Other (please specify) ..6

Q.12 OTHER: Can you please tell me if you (or policyholder) are...

Q.13 Is your (or policyholder's) age:

- (61)
- Under 16 1
- 16 - 24 2
- 25 - 34 3
- 35 - 44 4
- 45 - 54 5
- 55 - 64 6
- 65 - 74 7
- 75 and older ..8
- Refuse 9

Q.14 How do (does) you (or policyholder) identify your (policyholder's) race or ethnicity:
(INTERVIEWER - DO NOT READ THE LIST. ACCEPT MULTIPLE ANSWERS)

- (64-83)
- Black/ African American 01
- Spanish/ Hispanic/Latino 02
- Mexican, Mexican Am., Chicano, Puerto Rican, Cuban .. 03
- Other Spanish/ Hispanic/Latino (Please specify) 04
- White/Caucasian 05
- American Indian or Alaska Native (Please specify) 06
- Native Hawaiian, Guamanian or Chamorro, Samoan 07
- Other Pacific Islander (Please specify) 08
- Asia : Indian 09
- Chinese 10
- Filipino 11
- Japanese 12
- Korean 13
- Vietnamese 14
- Other Asian (Please specify) 15
- Other race (Please specify) 16
- Multiracial 17
- Refuse 18
- Native American 20

Q.15 OTHER : How do (does) you (or policyholder) identify your (policyholder's) race or ethnicity:

(359-409)

Q.16 Which of the following income categories applies to your (or policyholder's) individual total annual income for 2000?

- (84)
- Under \$20,000 1
- \$20,000 - \$34,9992
- \$35,000 - \$49,9993
- \$50,000 - \$74,9994
- \$75,000 - \$99,9995
- \$100,000-149,9996
- \$150,000 and above ..7
- Refuse8

Q.17 Would you like to receive a report from the Insurance Commissioner about the outcome of our research?

(85)
Yes ..1
No2

[IF THE ANSWER TO QUESTION 33 IS NOT 1, THEN SKIP TO QUESTION 35]

Q.18 Name and Address

_____ (410-510)

Q.19 That is all the questions I have for you. Thank you for taking the time to participate in this research. (Interviewer ID#)

Comparison of CS for SB 320 22-LS1462\T 4/30/02 with Washington legislation and NCOIL

CS for SB 320	Washington Legislation	CS for HB395	NCOIL
UNDERWRITING			
<p>An insurer may not use credit scoring unless the insurer obtains permission from the applicant (<i>not clear what happens when the consumer says no. Does the insurer have to offer coverage using other underwriting factors only or can the insurer refuse coverage?</i>)</p>			<p>Section 7: insurer or agent shall disclose on the application or at time application is taken that credit information may be obtained (<i>disclosure language should clearly state whether or not the insurer is using credit, not just that the insurer may use credit</i>)</p>
<p>Adverse action based on credit history requires written notification and explanation to the applicant or insured. It must inform the consumer of their right to a free copy of the credit report and request reconsideration of the adverse action if there are errors. Requires information on how credit scores can be improved. (<i>Add language that the explanation must be clear and specific</i>)</p>	<p>Similar but does not require information on how to improve credit score.</p>	<p>p.1, 5-12 Similar to SB 320 but does not require information on how to improve credit score</p>	<p>Section 8: if adverse action is taken the insurer shall provide notification in accordance with FCRA. Provide consumer with reason for adverse action in clear and specific language including up to 4 primary factors influencing the adverse action decision. Standard language from third party vendors are deemed to comply with this requirement. (<i>the standard language is not clear and specific and it is difficult to explicitly identify what caused the adverse action from the third party language</i>)</p>

<p>The insurer shall provide the consumer with the opportunity to identify errors and to request reconsideration of the adverse action.</p>			
	<p>An insurer shall not cancel or nonrenew coverage based in whole or in part on credit history.</p>	<p>p.1, 13-14; p.2, 1-2 An insurer may not cancel or fail to renew coverage based in whole or in part on credit history.</p>	<p>Section 5.B: An insurer shall not cancel or nonrenew solely on the basis of credit information without consideration of other applicable underwriting factors independent of credit information. <i>(AS 21.36.210 already includes very restricted reasons for canceling a personal lines policy. Including cancellation for credit and other underwriting factors may be broadening the protections already available in AK laws. Also, "solely" is problematic language. Any trivial reason, along with credit, could be used to cancel or nonrenew)</i></p>
<p>Credit history may be used to deny coverage only in combination with other substantive underwriting factors.</p>	<p>Credit history may be used to deny coverage only in combination with other substantive underwriting factors.</p>	<p>p.2, 3-9 Same</p>	<p>Section 5.B: An insurer shall not deny coverage solely on the basis of credit information without consideration of other applicable underwriting factors independent of credit information. <i>(Similar effect as SB 320 but "solely" should be deleted)</i></p>

<p>An application may be rejected within the first 60 days. <i>(Similar to existing provisions in AS 21.36.210. AAG's advice is to eliminate this section as it duplicates existing statute.)</i></p>	<p>Same</p>	<p>p.2, 10-12 Same</p>	
<p>An insurer may not deny coverage based in whole or in part on the absence of credit history or the inability to determine credit history if the insurer has received accurate and complete information.</p>	<p>Same</p>	<p>p.2, 13-17 Same</p>	<p>Section 5.E: an insurer shall not consider absence of credit information or inability to calculate a credit score unless one of the following occurs: 1. Treat consumer as approved by director; 2. Treat consumer as if the credit was neutral; or 3. Exclude credit and use only other underwriting criteria. <i>(option 1 appears to make NCOIL a little weaker than SB320)</i></p>
	<p>An insurer may not deny coverage based on the number of credit inquiries; medical information; initial purchase of vehicle or house</p>	<p>p. 2, 18-26 Same</p>	<p>Section 5.H: An insurer may not use as a negative factor in underwriting credit inquiries not initiated by the consumer or inquiries requested by the consumer for his or her own credit information; inquiries relating to insurance coverage; medical accounts; multiple lender inquiries from home mortgage industry or auto lending industry made within a 30-day period (1 inquiry may be used). <i>(Can they be used to benefit consumer?)</i></p>

	An insurer may not deny coverage based on a particular type of credit card	Same	Section 5.D: An insurer may not take adverse action solely because consumer does not have a credit card account. (<i>"Solely" is still an issue</i>)
	Prohibits denying coverage based on the total available line of credit but allows the total amount of outstanding debt to total line of credit	p.2, 27 Prohibits denying coverage based on the total available line of credit.	
			Section 5.A: An insurer shall not use a credit score that uses income, gender, address, zip code, ethnicity, religion, marital status or nationality as a factor.
			Section 9: Requires filing of model used for underwriting. Allows 3 rd party to file on behalf of insurers. Provides for confidentiality of model.
If disputed credit history is used to determine eligibility for coverage, the insurer shall reissue or rerate the policy retroactive to the effective date if the consumer resolves the dispute under the FCRA process and notifies the insurer the dispute has been resolved.	Same	Same	Section 6: If through FCRA dispute resolution process it is determined incorrect information was used, the insurer shall re-underwrite the consumer within 30 days. (<i>A stronger dispute resolution process that includes the insurer, not just the credit reporting agency should be considered. The FCRA process is sometimes difficult and lengthy.</i>)

<p><i>(A stronger dispute resolution process that includes the insurer, not just the credit reporting agency should be considered. The FCRA process is sometimes difficult and lengthy.)</i></p>			
			<p>Section 5.F: An insurer may not take adverse action in underwriting unless credit report is issued or score is calculated within 90 days from the date the policy is written or renewed.</p>
			<p>Section 5.G: An insurer shall not use credit information for underwriting unless not later than 36 months following the last time credit information was obtained, the insurer recalculates the score or updates the credit report.</p>
			<p>Section 5.G: At request of consumer or agent, the insurer shall re-underwrite the consumer based upon current credit information; insurer may use credit on any renewal before 36 months. An insurer does not need to use current credit information if 1) the consumer is being treated as approved by director; 2) the insured is in the</p>

			most favorably priced tier; 3) credit was not used when policy was initially written; or 4) policy is re-underwritten no later than 36 months based on other underwriting factors excluding credit information.
Adverse action is defined by FCRA as well as explicit language identifying types of adverse actions.	Same	Same	Adverse action is explicitly defined. Definition does not refer to FCRA.
RATING			
Requires filing of credit scoring model at the director's request. <i>(We will ask for the model. Removing the optional provision will speed up the review process.)</i>	Similar, but filing of model is mandatory.	Same as Washington	Section 9: Requires filing of model used for rating.
Requires filing data supporting the validity of the model.			
Makes model confidential	Same	Same	Section 9: Provides for confidentiality of model.
Allows the insurer to disclose the filed information.			
Prohibits the use of gender, race, nationality or religion; and unfair discrimination			Section 5.A: An insurer shall not use a credit score that uses income, gender, address, zip code, ethnicity, religion, marital status or nationality as a factor.

Prohibits credit history that results in unfair discrimination (<i>Already prohibited in AS 21.39.030</i>)			
			Section 5.C: An insurer may not base a renewal rate solely upon credit information without considering other factors independent of credit. (<i>What does "solely" mean? If there are other factors but the only one the consumer does not meet is credit, is that decision solely based on credit?</i>)
Allows the absence of credit history or inability to determine the consumer's credit history in calculating premiums or rates if the insurer files actuarial data.	Same	Same	Section 5.E: an insurer shall not consider absence of credit information or inability to calculate a credit score unless one of the following occurs: 1. Treat consumer as approved by director; 2. Treat consumer as if the credit was neutral; or 3. Exclude credit and use only other underwriting criteria.
Prohibits using the number of marketing promotional or insurance inquiries	Prohibits the use of the number of credit inquiries.	Same as Washington	Section 5.H: An insurer may not use as a negative factor in rating credit inquiries not initiated by the consumer or inquiries requested by the consumer for his or her own credit information; inquiries relating to insurance coverage (<i>Appears to allow the</i>

			<i>use if they have a positive effect on the consumer)</i>
Prohibits credit history based on collection accounts identified with a medical code	Same	Same	Section 5.H.3: An insurer may not use as a negative factor in rating collection accounts with a medical industry code. <i>(This appears to allow medical accounts if they will have a positive effect on the consumer)</i>
Allows the use of inquiries related to auto or mortgage financing, but all inquiries in a 30-day period must be considered one inquiry			Section 5.H.4, 5: An insurer may not use multiple lender inquiries from the home mortgage industry or auto lending industry made within 30 days of one another (1 inquiry may be used).
	Prohibits the use of the initial purchase of a vehicle or house and particular type of credit card	Same as Washington	
Prohibits the use of the consumer's total available line of credit but does allow the amount of debt in relation to the total line of credit.	Same	Same	
			Section 5.F: An insurer may not take adverse action in rating unless credit report is issued or score is calculated within 90 days from the date the policy is written or renewed.

			Section 5.G: An insurer shall not use credit information for rating unless not later than 36 months following the last time credit information was obtained, the insurer recalculates the score or updates the credit report.
			Section 5.G: At request of consumer or agent, the insurer shall re-rate the consumer based upon current credit information; insurer may use credit on any renewal rate before 36 months. An insurer does not need to use current credit information if 1) the consumer is being treated as approved by director; 2) the insured is in the most favorably priced tier; 3) credit was not used when policy was initially written; or 4) policy is re-underwritten no later than 36 months based on other underwriting factors excluding credit information.
If a consumer is charged higher premiums due to disputed credit history, the insurer shall re-rate the policy retroactive to the effective date of the policy if the consumer resolves the dispute under the	Same	Same	Section 6: If through FCRA dispute resolution process it is determined that incorrect information has been used, the insurer shall re-rate the policy within 30 days. Any overpayment shall be calculated back to the shorter of either the last 12 months or the actual

<p>FCRA process and notifies the insurer that the dispute has been resolved. <i>(A stronger dispute resolution process that involves the insurer should be considered. Some insurers go back further than the current policy)</i></p>			<p>policy period. <i>(A stronger dispute resolution process that involves the insurer should be considered. The FCRA process is sometimes lengthy and difficult. Some insurers goes back further than the current policy)</i></p>
<p>MISCELLANEOUS PROVISIONS</p>			
<p>Requires a report to the legislature related to the use of credit history</p>	<p>Requires a report to the legislature related to the use of credit history.</p>	<p>Requires a report to the legislature related to the use of credit history</p>	
			<p>Section 10: Provides for indemnification of producers.</p>
			<p>Section 11: Prohibits selling data or lists based on information obtained in conjunction with insurance inquiries</p>
<p>Adds flood insurance to definition of personal insurance</p>		<p>Same as CS 320</p>	

Statement of the Progressive Group Regarding the Use of Credit in Auto Insurance Underwriting

The Progressive group (Progressive) is the largest writer of private passenger auto insurance through independent agents and the fourth largest auto insurer in the country. Progressive does business in 48 states (not in Massachusetts or New Jersey) and is represented by more than 30,000 independent agencies throughout the country.

Using credit as an underwriting factor has allowed Progressive - and our agents - to offer more accurate and lower rates to more people. Since Progressive began using credit, we have been able to offer standard and preferred rate levels to many consumers who otherwise would have been eligible only for nonstandard rates. Frequently, consumers unable to meet traditional underwriting guidelines (i.e. prior insurance) are able to get a better rate because credit is a component of the underwriting process. Progressive never uses credit to reject a consumer or to cancel or raise the rates of an existing policyholder.

Progressive has worked hard to use credit responsibly and to make the process of using it as transparent to agents as possible so that their workflow is not interrupted. Nevertheless, the use of credit for insurance underwriting purposes is undergoing scrutiny in a number of states. Progressive urges independent agents to work with us to assure that the responsible use of credit is not jeopardized. It is a valuable tool that has helped agents write - and retain - more business.

A Few Key Facts

- Credit has been proven to be a very powerful and independent predictor of future loss. The use of credit provides an additional predictive factor, one not offered by other variables. This is supported by Progressive data and research undertaken by a number of groups including *Fair, Isaac*. In addition, a 1999 study by the Virginia Bureau of Insurance indicated that "... in every case where insurers have proposed to use credit scoring as a rating factor and have been able to provide sufficient data to the Bureau's actuaries, the use of credit scoring has been found to be statistically correlated to losses."
- Many direct and captive companies use credit to prescreen mailing lists. If the use of credit were to be eliminated or unreasonably restricted at the state level, the federal Fair Credit Reporting Act (FCRA) would still permit these companies to prescreen lists for solicitation. This would give these companies a competitive advantage over independent agents by allowing them to specifically target - and write - more profitable, higher retention business.
- Credit scores focus mainly on a person's bill-paying behavior. If a consumer has been responsible in his or her use of credit, it will reflect positively on the score. Further, credit reports do not contain any information on income, race, color, creed, physical handicap or disability.
- Mortgage vendors and insurance companies use different scoring algorithms and a credit score that a mortgage company uses is not the same thing as an "insurance score or financial responsibility score" used by insurance companies.
- The use of credit as one underwriting variable allows insurance companies - and agents - to offer more accurate and oftentimes lower rates to more consumers. Restricting its use would cause auto insurance rates to increase for many consumers.

Implementing Proactive Business Practices on the Use of Credit

Progressive believes that it is important for companies to exercise leadership in tailoring their use of credit to respond to the concerns that have been raised by consumers, agents and regulators.

Progressive has already implemented these policies and procedures on the use of credit:

- Credit history is not used to cancel, non-renew or refuse to insure someone. Offering to write a policy in an affiliated company with identical coverage and terms is not considered a refusal to insure, cancellation, or non-renewal.
- Credit information that is disputed by the consumer with the credit-reporting agency is not considered in the insurance scoring algorithm.
- Disclosure to persons seeking a quote that credit information is obtained as part of the underwriting process. In the case of business written by independent agents, the agent is asked to make this disclosure. The disclosure is given in writing or in the same medium as the application.
- Insurance inquiry information and non-consumer initiated inquiries are not used as a component of the insurance scoring algorithm.
- An individual's personally identifiable credit information is not disclosed to any third party, including independent agents.
- At the request of an applicant or insured, a recalculation of premium is undertaken upon notice by a credit-reporting agency that the credit information provided was inaccurate or incomplete.
- An applicant or insured who suffers an adverse action or underwriting decision as a result of the use of credit information is advised of the means by which he or she may obtain a free copy of his or her credit report.
- Reason codes that explain how credit information adversely affected an applicant or insured's underwriting are provided at the applicant or insured's request.
- Credit is confirmed as part of initial underwriting to become a Progressive policyholder. In some states, once a customer has been with Progressive for two years, we may review the policy in order to determine if you are eligible for a lower rate. In these cases, we do confirm credit again as well as reviewing the entire risk (i.e., pulling MVR reports). If the customer is eligible for a lower rate, we will offer it to the consumer. We will not move the policy to a higher rate unless required to do so by law.
- The decision to request a credit report or use an insurance credit score will be reasonably related to Progressive's business and will not be made based in whole or in part upon race, color, creed, marital status, sex, national origin, religion, place of residency, blindness or any other physical handicap or disability.
- Progressive will not request a credit report or use an insurance score for any arbitrary, capricious, or unfairly discriminatory reason.

Progressive believes in and is actively work towards the following to further respond to concerns that have been raised with industry practices.

- A new, easy to understand, credit model that we will openly share with consumers, agents, customers, regulators, legislators and the media. Among other things, the model will:
 - a. Eliminate from consideration medical debts and personally guaranteed business debts
 - b. Further segment the population of consumers with insufficient or no credit history, based on objective criteria (e.g. insured age), to more accurately match the price of coverage to the underlying cost.

- Where required or encouraged by state regulators, we will file the scoring algorithm and not request trade secret protection.
- A credit assistance team, with a toll-free phone number to Progressive, for consumers and agents to call to assist them with concerns about the credit process. The team will be able to:
 - a. Provide a personalized report to applicants describing how their score on each of the variables considered in the credit-scoring algorithm compares to the average. The report will include a more informative and useful explanation that we're able to give today on how their credit information may have adversely affected underwriting.
 - b. Provide reasonable credit exceptions based upon prior credit history for persons whose credit information is unduly influenced by extraordinary life events (i.e., catastrophic injury, death of a spouse, business loss etc.).
 - c. Upon request, facilitate the process whereby a consumer interacts with the credit-reporting agency in order to request corrections. While we cannot contact the agency directly on behalf of the consumer, we will educate and advise them on the process, what to expect, etc.

Reasonable Regulation Regarding the Use of Credit

The responsible use of credit in underwriting is good for consumers and independent agents. Progressive believes that existing laws and regulations already provide state insurance departments with reasonable regulatory authority with respect to the use of credit in underwriting. We are hopeful that states will give the industry the opportunity to implement new policies and procedures that respond to the concerns that have been raised before considering further regulation. However, Progressive will support reasonable state guidelines that reflect the practices outlined above.

Counterproductive Regulation

Certain regulations, if implemented, would destroy the ability to use credit in the underwriting process. The result would be less accurate pricing and the loss of more competitive rates for the two-thirds of Progressive customers who benefit today from the use of credit. In addition, direct and captive companies could continue to use credit to prescreen mailings under provisions in the FCRA and thus would have a competitive advantage over the agency companies.

We ask agents to join us in opposing the following types of regulation:

- An outright prohibition of the use of credit in underwriting.
- Burdensome operational requirements for the use of credit information such as requiring written consent or written disclosures before credit information can be obtained, requiring that reasons for adverse action be provided to each customer (instead of at the request of a customer), and any other provisions that would make it impossible to efficiently conduct our business or provide consumers with information about our use of credit.
- Prohibitions against using specific types of credit information with respect to the calculation or completion of a credit score, i.e., numbers of late pays (limited exceptions for medical debts or items in dispute are acceptable).
- Requirements that insurers evaluate the accuracy of credit information in response to objections or concerns raised by an insured. Rather, companies should have the ability to implement reasonable business practices such as the toll-free number and ombudsman role previously mentioned to handle consumer concerns.
- Requirements that "no hit" or "thin files" be treated as neutral or average credit.
- Prescribed limits or caps on credit score based rates or tier differentials.

While the use of credit in underwriting and rating is expressly permitted under the Fair Credit Reporting Act (FCRA), Progressive is committed to working with state legislators and regulators to find common ground that results in reasonable regulation of the use of credit. We invite independent agents to join us.

T H E

TRANS UNION

C R E D I T
R E P O R T

TRAINING GUIDE

 **TRANS UNION**

TRANS UNION CREDIT REPORT FIELDS

1 INQUIRY INFORMATION

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

2 DEMOGRAPHIC INFORMATION

Helps you verify consumer identification by providing:

- Consumer's name, plus any known aliases.
- Current address and date reported.
- Up to two previous addresses, date reported on first previous address.
- Social security number.
- If available, date of birth, telephone number and most current employer, one previous employer, including addresses, position, income and date employment was verified, reported and/or hired.

SPECIAL MESSAGES

Highlights specific credit file conditions that may include:

- Suspected fraud, as indicated by TRANS ALERT or HAWK.
- Presence of consumer statement.
- No subject found.
- 1 • A TRANS ALERT message appears when the input address, SSN or surname does not match what is on file; or when a minimum of four inquiries have been made against the file within the last 60 days.
- 4 • HAWK messages (optional) appear if address, phone number or SSN have been used in suspected fraudulent activity; or if the information is inappropriate on an application, such as a commercial or institutional address; or if the SSN has not been issued by the Social Security Administration or is that of a deceased person as reported by the Social Security Administration.

MODEL PROFILE

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

- 3 • Risk score factors are displayed numerically or in text. Up to four factors are disclosed with EMPIRICA, NEW DELPHI, PATROL and ASSIST. These factors are displayed in order based on their relative impact on the final score.
- 1 • ***ALERT*** appears after model profile heading when MOP 7 or greater, a negative public record or a collection is present on the file.
- 7 • *** NEW DELPHI *** predicts the likelihood of an applicant becoming bankrupt within the next 12 months.

CREDIT SUMMARY

Provides a "snapshot" of all activity on the consumer's credit report.

- Available as an option covering either total file history or 12-month file history.
- "Total File History" or "12 Month History" will print in the upper right hand corner of the credit summary depending on the option chosen.

From left to right, headers in the first row read as follows:

- 8 Total number of public records.
- 3 Total number of collection accounts; accounts with a Kinds-Of-Business (KOB) code of "Y".
- 15 Total number of accounts with a current manner of payment (MOP) 2 or greater.
- 11 HISTORICAL NEGATIVE: Derived from the payment pattern field. Displayed in tt-iii format.
tt=Total number of accounts with an historical MOP 2 or greater.
iii=Total number of times MOP 2 or greater ratings have historically occurred. Excludes current MOP.
- 12 Total number of trades. TRD value is the sum of RVL, INST, MTG and OPN values.
- 13 Total number of revolving and/or check credit accounts (Account types "R" and "C").
- 14 Total number of installment accounts (Account type "I").
- 15 Total number of mortgage accounts (Account type "M").
- 16 Total number of open accounts (Account type "O").
- 17 Total number of inquiries.

From left to right, headers on the second row read as follows:

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

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

25 PUBLIC RECORD

Public record information is maintained on a consumer's file in compliance with the Fair Credit Reporting Act (FCRA). This information is obtained from county, state and federal courts and provides notification of:

- Civil judgements or tax liens reported for the consumer over the past 7 years.
- Bankruptcies the consumer has filed during the past 10 years.
- Public record information includes the source, type of public record, date the public record was reported to the credit bureau, any liabilities, the ECOA designator; (see the "codes page" that follows for more details) court location, any assets and the date the public record was paid (if applicable). Also lists the docket number, the plaintiff and attorney involved in the case.

CREDIT REPORT

GOI duncan,elizabeth*2 9932,,woodbine,,chicago,il,60693*5 001-01-0418**

TRANS UNION CREDIT REPORT

① <FOR> <SUB NAME> <MKT SUB> <INFILE> <DATE> <TIME>
 (1) D248 ABC DEPT STORE 06 CH 4/74 2/15/97 09:36CT

<SUBJECT> <SSN> <BIRTH DATE>
 ② DUNCAN, ELIZABETH 002-02-2222 2/53
 <ALSO KNOWN AS> <TELEPHONE>
 COOK, ELIZABETH 555-5555

<CURRENT ADDRESS> <DATE RPTD>
 9932 WOODBINE, #9B CHICAGO IL. 60693 1/96

<FORMER ADDRESS> <DATE RPTD>
 10 N. CAMINO, OAKLAND CA. 94583 4/94

<CURRENT EMPLOYER AND ADDRESS> <POSITION> <INCOME> <VERE> <RPTD> <HIRE>
 MARRIOTT HOTELS CONCIERGE
 8638 GRAND, ANYTOWN IL. 32500Y 3/96 3/96 3/93

SPECIAL MESSAGES

- ③ ***TRANS-ALERT: INPUT SSN DOES NOT MATCH FILE SSN***
- ④ ***HAWK-ALERT: INPUT SSN ISSUED: 1936 - 1950; ST: NH
 FILE SSN NOT ISSUED BY SOCIAL SECURITY ADMINISTRATION***

MODEL PROFILE

- ⑦ ***NEW DELPHI ALERT: SCORE ⑥-775: 26, 03, 06, 25 ***

CREDIT SUMMARY

TOTAL FILE HISTORY

⑧ PR=1 ⑨ COL=1 ⑩ NEG=1 ⑪ HSTNEG=1-6 ⑫ TRD=2 ⑬ RVL=1 ⑭ INST=1 ⑮ MTG=0 ⑯ OPN=0 ⑰ INQ=2
 ⑱ HIGH CRED ⑲ CRED LIM ⑳ BALANCE ㉑ PAST DUE ㉒ MONTHLY PAY AVAILABLE

REVOLVING:	\$500	\$1000	\$100	\$	\$20	⑳90%
INSTALLMENT:	\$16.0K	\$	\$12.4K	\$1974	\$282	
⑳ TOTALS:	\$16.5K	\$1000	\$12.5K	\$1974	\$302	

PUBLIC RECORDS

SOURCE	DATE	LIAB	ECOA	ASSETS	DOCKET#
TYPE			COURT	LOC	PLAINTIFF/ATTORNEY
Z 4932059	10/95R	\$13.0K	C	\$0	93B38521
CHAPTER 11 BANKRUPTCY			CHICAGO, IL		R. SMITH/D. WINSLOW

COLLECTIONS

SUBNAME	SUBCODE	ECOA	OPENED	CLOSED	\$PLACED	CREDITOR	MOP
ACCOUNT#			VERIFIED		BALANCE	REMARKS	
ADVANCED COL	Y 999C004	I	5/93	5/93F	\$2500	ABC BANK	09P
12345			4/96A		\$1000	MAKING PAYMENTS	

TRADES

① SUBNAME	② SUBCODE	③ OPENED	④ HIGHCRED	⑤ TERMS	⑥ MAXDELO	⑦ PAYPAT	1-12	⑧ MOP
⑨ ACCOUNT#		⑩ VERIFIED	⑪ CREDLIM	⑫ PASTDUE	⑬ AMT-MOP	⑭ PAYPAT	13-24	
⑯ ECOA	⑰ COLLATRL/LOANTYP	⑱ CLSD/PD	⑲ BALANCE	⑳ REMARKS		㉑ MO	30/60/90	
AMERICAN BK B	6661001	10/94	\$16.0K	60M282	1/96	545543211111		I05
9876543210		4/96V		\$1974	\$1974	05 11111111		
I	AUTOMOBILE		\$12.4K	*CONTACT SUBSCRIBER		19V	1/ 1/ 5	
FILENES	D 3847002	8/91	\$500	MIN20		111111111111		R01
2212345678		3/96V	\$1000			111111111111		
C	/CREDITCARD		\$100			24V	0/ 0/ 0	

INQUIRIES

DATE	SUBCODE	SUBNAME	DATE	SUBCODE	SUBNAME
4/17/96	DCH248	ABC DEPT STORE	3/7/96	BPH9999	TEST BANK

⑫ END OF CREDIT REPORT - SERVICED BY :
 TRANS UNION NNN-NNN-NNNN
 PO BOX 390, SPRINGFIELD, PA. 19064

TRANS UNION CREDIT REPORT FIELDS

25 COLLECTIONS

Identifies consumer accounts that have been transferred to a professional debt-collecting firm.

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

TRADES

Provides an on-going historical and current record of the consumer's buying and payment activities.

- Trades are available sorted by most derogatory followed by date verified or vice-versa.
- Payment pattern is available displaying either 12 or 24 months.

Trade information includes the following:

- 27 Abbreviated name of credit grantor with whom consumer has an account.
- 28 Consumer's account number with the credit grantor.
- 29 ECOA indicates responsibility for paying the account; (see the "codes page" that follows for more details).
- 30 Credit Grantor's Kinds-Of-Business designator and Trans Union-assigned reporting subscriber number (see the "codes page" that follows for more details).
- 31 Collateral for an installment loan or type of loan.
- 32 Date the account was opened.
- 33 Date of last activity on the account; (see the "codes page" that follows for more details).
- 34 Date an account was closed or paid out.
- 35 Highest amount ever owed by the consumer on that account.
- 36 Maximum amount of credit approved by credit grantor.
- 37 Balance owed as of date verified or closed.
- 38 Number of payments, payment frequency, and dollar amount agreed upon.
- 39 Amount past due as of date verified or closed.
- 40 Explanation of dispute or account credit condition, as reported by the credit grantor.
- 41 Date on which the maximum level of delinquency for that account occurred.
- 42 Dollar amount of consumer's maximum delinquency and the manner of payment rating at the time.
- 43 Manner of payment (MOP) for the 12 most recent months. Payment pattern reads from the left to right, with the most recent verified entry on the left of the first line. The pattern then works its way back in time. There are six different characters that may appear in the payment pattern. These are MOP values 1 through 5 and X, which are those reported by the credit grantor. The X is inserted by Trans Union if the following conditions occur:
 - Automated data was not received from the credit grantor for that month.

- The account is reported as disputed by the consumer. In this case, an X is placed in the left-hand (most recent) position and the three next most recent values are changed to an X. This is done to ensure full compliance with the Fair Credit Billing Act.

- Any MOP other than 1 through 5 was received; for example, 00, UR or UC.
- 44 Manner of payment for the 12 months preceding those reported under PAYPAT 1-12. (See 43 for explanation.)
 - 45 4 - column display; describing payment history.
 - MO=Number of months reviewed
 - 30 = Number of times over 30 days late
 - 60 = Number of times over 60 days late
 - 90 = Number of times over 90 days late
 - 46 Type of account (R, I, M, O, C) and manner of payment code at which the account is currently reported; (see the "codes page" that follows for more details).

47 INQUIRIES

Displays which companies have viewed the consumer's credit file over the last 2 years. Includes date the inquiry occurred, inquiring subscriber's Trans Union-assigned account number and name.

- Available in a one or two column display.
- If two column, inquiries are displayed either left to right or top to bottom, by date.

48 "REPORT SERVICED BY"

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

FIELDS NOT DISPLAYED IN SAMPLE REPORT

CONSUMER STATEMENT, when provided, will appear at the bottom of the report.

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

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

OPTIONAL MODELS AVAILABLE

EMPIRICA® predicts the likelihood of an applicant becoming delinquent within the next 24 months.

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

REWARD™ rank orders delinquent accounts by estimated repayment dollars within 6 months.

TIE® estimates individual consumer income.

PATROL™ measures the likelihood of a consumer carrying required collateral insurance.

ASSIST™ rank orders insurance consumers on the basis of the predicted loss ratio for a score range group.

**THE FOLLOWING IS A SAMPLE REPORT
DISPLAYING A 12 MONTH PAYMENT PATTERN.**

SPECIAL MESSAGES

TRANS-ALERT: INPUT SSN DOES NOT MATCH FILE SSN
 ***HAWK-ALERT: INPUT SSN ISSUED: 1936 - 1950; ST: NH
 FILE SSN NOT ISSUED BY SOCIAL SECURITY ADMINISTRATION***

MODEL PROFILE * * * ALERT
 NEW DELPHI ALERT: SCORE +775: 26, 03, 06, 25 *

CREDIT SUMMARY * * * TOTAL FILE HISTORY
 PR=1 COL=1 NEG=1 HSTNEG=1-6 TRD=2 RVL=1 INST=1 MTG=0 OPN=0 INQ=2
 HIGH CRED CRED LIM BALANCE PAST DUE MNTHLY PAY AVAILABLE
 REVOLVING: \$500 \$1000 \$100 \$ \$20 90%
 INSTALLMENT: \$16.0K \$ \$12.4K \$1974 \$282
 TOTALS: \$16.5K \$1000 \$12.5K \$1974 \$302

PUBLIC RECORDS

SOURCE	DATE	LIAB	ECOA	ASSETS	DOCKET#
TYPE			COURT LOC		PLAINTIFF/ATTORNEY
Z 4932059	10/95R	\$13.0K	C	\$0	93B38521
CHAPTER 11	BANKRUPTCY		CHICAGO, IL		R. SMITH/D. WINSLOW

COLLECTIONS

SUBNAME	SUBCODE	ECOA	OPENED	CLOSED	\$PLACED	CREDITOR	MOP
ACCOUNT#			VERIFIED		BALANCE	REMARKS	
ADVANCED COL Y 999C004		I	5/93	5/93F	\$2500	ABC BANK	09P
12345			4/96A		\$1000	MAKING PAYMENTS	

TRADES
 ① SUBNAME ④ SUBCODE ⑤ HIGHCRED ⑧ CREDLIM ⑪ BALANCE ⑬ PASTDUE ⑮ PAYPAT 1-12 MOP
 ② ACCOUNT# ⑦ OPENED ⑨ VERIFIED CLSD/PD TERMS ⑫ MAXDELQNCY
 ③ ECOA COLLATRL/LOANTYP ⑩ REMARKS ⑭ MO 30/60/90

AMERICAN BK B 6661001 \$16.0K \$12.4K \$1974 543323211111 I05
 9876543210 5/94 12/95A 60M282 12/95 \$1974 05
 I NISSAN MAXIMA CONTACT SUBSCRIBER 19V 2/ 3/ 2

FILENES D 3847002 \$500 \$1000 \$100 111111111111 R01
 2212345678 4/91 12/95A MIN 20
 C /CREDIT CARD 48V 0/ 0/ 0

INQUIRIES

DATE	SUBCODE	SUBNAME	DATE	SUBCODE	SUBNAME
4/17/96	DCH248	ABC DEPT STORE	3/7/96	BPH9999	TEST BANK

END OF CREDIT REPORT - SERVICED BY:
 TRANS UNION NNN-NNN-NNNN
 PO BOX 390, SPRINGFIELD, FA. 19064

When the 12-month payment pattern option is selected instead of the 24-month pattern, the headers in the trade section display in a slightly different format.

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

- ⑩ Explanation of dispute or account credit condition, as reported from the credit grantor.
- ⑪ Balance owed as of date verified or closed.
- ⑫ Date an account was closed or paid out.
- ⑬ Amount past due as of date verified or closed.
- ⑭ Number of payments, payment frequency, and dollar amount agreed upon.
- ⑮ Manner of payment for the last 12 months.
- ⑯ Date on which the maximum level of delinquency for that account occurred, dollar amount of maximum delinquency and the MOP Rating at that time.
- ⑰ 4 - column display; describing payment history.
 MO=Number of months reviewed
 30 = Number of times over 30 days late
 60 = Number of times over 60 days late
 90 = Number of times over 90 days late
- ⑱ Type of account (R, I, M, O, C) and manner of payment code at which the account is currently reported; (see the "codes page" that follows for more details).

Trans Union Credit Report Codes

ECOA INQUIRY AND ACCOUNT DESIGNATORS

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

TYPE OF ACCOUNT

- O Open Account (30, 60 or 90 days)
- R Revolving or Option
- I Installment
- M Mortgage
- C Check credit (line of credit)

A CONFIDENTIAL REPORT—FOR INTERNAL USE ONLY

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

DATE INDICATORS

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

MOP CURRENT MANNER OF PAYMENT

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

KINDS OF BUSINESS CLASSIFICATION

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

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TransUnion ASSIST[®] 2.0 Scoring Factors

Positive Characteristics

Code		Code	
001	Favorable amount owed on accounts (+)	023	Favorable time since most recent installment loan established (+)
002	No recent delinquency (+)	024	Favorable number of accounts with large high credit amounts (+)
003	Presence of revolving credit accounts (+)	025	Proportion of loan balances to installment loan amounts is favorable (+)
004	Favorable number of accounts with outstanding balances (+)	026	Favorable number of real estate accounts (+)
005	Favorable number of finance accounts (+)	027	Favorable number of new or existing finance company accounts (+)
006	Favorable number of recent credit checks (+)	028	No delinquency ever on installment loans (+)
007	Favorable number of new accounts (+)	029	Favorable percentage of open revolving accounts to all other accounts (+)
008	Proportion of revolving balances to revolving credit limits is favorable (+)	030	Favorable number of accounts (+)
009	Favorable amount owed on revolving accounts (+)	031	No delinquency on open revolving accounts (+)
010	Favorable length of revolving credit history (+)	032	Favorable length of time since most recent finance company account opened (+)
011	No past delinquency or favorable length of time since last delinquency (+)	033	Favorable number of accounts (+)
012	Favorable length of credit history (+)	034	Favorable time since most recent retail account opened or none present (+)
013	No current or past delinquencies (+)	035	No finance company accounts or no recently active finance company accounts (+)
015	Minimal or no past due balances (+)	036	Favorable number of recently active accounts (+)
017	Absence of collection accounts (+)	037	Favorable number of revolving or open accounts (+)
018	Favorable number of revolving accounts with balances (+)	038	Favorable number of adverse public records (+)
019	Favorable time since last credit check (+)	039	Favorable number of accounts currently paid as agreed (+)
020	Favorable time since most recent account established (+)	040	Favorable time since last collection (+)
021	Favorable number of installment loan accounts (+)	041	Favorable time since last adverse public record (+)
022	Favorable number of installment loan accounts with outstanding balances (+)		

Negative Characteristics

Code	
051	Excessive or unknown amount owed on accounts (-)
052	Recent delinquency (-)
053	Absence of revolving credit accounts (-)
054	Too many accounts with balances (-)
055	Too many finance company accounts (-)
056	Too many recent credit checks (-)
057	Too many new accounts (-)
058	Proportion of revolving balances to revolving credit limits is too high or there are no revolving credit accounts (-)
059	Excessive amount owed on revolving accounts (-)
060	Insufficient length of revolving credit history (-)
061	Delinquency date too recent (or date unknown) (-)
062	Insufficient length of credit history (-)
063	Delinquency (-)
065	Past due balances (-)
067	Presence of collection accounts (-)
068	Too many revolving accounts with balances (-)
069	Date of last credit check too recent or unknown (-)
070	Insufficient time since most recent account established (-)
071	Unfavorable number of installment loan accounts (-)
072	Too many installment loan accounts with outstanding balances (-)

Code	
073	Insufficient time since most recent installment loan established (-)
074	Too many accounts with high credit amounts (-)
075	Proportion of loan balances to installment loan amounts is too high (-)
076	Unfavorable number of real estate accounts (-)
077	Too many new or existing finance company accounts (-)
078	Prior installment loan delinquency or no installment loans present (-)
079	Unfavorable percentage of open revolving accounts to all other accounts (-)
080	Presence of delinquency, public record or collection (-)
081	Delinquency on open revolving accounts (-)
082	Finance company account opened recently (-)
083	Unfavorable number of accounts (-)
084	Unfavorable length of time since most recent retail account opened (-)
085	Too many recent active finance company accounts (-)
086	Unfavorable number of recently active accounts (-)
087	Unfavorable number of revolving or open accounts (-)
088	Unfavorable number of adverse public records (-)
089	Unfavorable number of accounts currently paid as agreed (-)
090	Recent collection (-)
091	Recent adverse public record (-)

ASSIST[®] ALERT message occurs when a credit file contains one or more of the following: previous bankruptcy, derogatory public record, collection activity or an MOP of 7 or higher.

ASSIST NOT SCORED: DECEASED message occurs when the subject's Social Security number matches the Social Security Administration's deceased Social Security number file.

ASSIST NOT SCORED: INSUFFICIENT CREDIT message occurs when a credit file does not contain a tradeline reported for at least six months and a tradeline within the last six months.



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INS002 08/02

2001 ALASKA PROPERTY AND CASUALTY MARKET SHARE

3/29
Duty

03 - FARMOWNERS MULTIPLE PERIL (\$000)

COMPANY NAME	PERCENT OF MARKET	DIRECT PREMIUMS WRITTEN
Clarendon Natl Ins Co	57.38	491
Country Mut Ins Co	37.26	319
Umialik Ins Co	3.06	26
Markel Ins Co	1.83	16
Insurance Co of North Amer	0.47	4
TOTAL FOR TOP 5 RANKED INSURERS	100.00	857
TOTAL FOR ALL 8 INSURERS WRITING THIS LINE	100.00	857

04 - HOMEOWNERS MULTIPLE PERIL (\$000)

COMPANY NAME	PERCENT OF MARKET	DIRECT PREMIUMS WRITTEN
State Farm Fire and Cas Co	34.44	26,839
Allstate Ins Co	29.35	22,871
Safeco Ins Co of Amer	5.85	4,559
United Services Auto Assoc	5.69	4,431
Horace Mann Ins Co	4.48	3,490
Umialik Ins Co	4.34	3,384
Foremost Ins Co	2.63	2,046
USAA Cas Ins Co	2.19	1,706
Country Mut Ins Co	2.08	1,620
Vesta Ins Corp	2.07	1,614
American Manufacturers Mut Ins Co	1.58	1,232
Nationwide Mut Fire Ins Co	1.42	1,106
Allstate Ind Co	0.95	739
Hartford Ins Co of The Midwest	0.75	587
Armed Forces Ins Exchange	0.29	228
Associated Ind Corp	0.29	223
General Ins Co of Amer	0.22	168
State Farm General Ins Co	0.20	160
Foremost Property & Cas Ins Co	0.19	146
Firemans Fund Ins Co	0.16	124
TOTAL FOR TOP 20 RANKED INSURERS	99.17	77,274
TOTAL FOR ALL 57 INSURERS WRITING THIS LINE	100.00	77,921

2001 ALASKA PROPERTY AND CASUALTY MARKET SHARE

19.1 - 19.2 - PRIVATE PASSENGER AUTO NO-FAULT AND LIABILITY (\$000)

COMPANY NAME	PERCENT OF MARKET	DIRECT PREMIUMS WRITTEN
State Farm Mut Auto Ins Co	23.19	38,817
Allstate Ins Co	19.24	32,209
United Services Auto Assoc	5.45	9,118
Allstate Ind Co	3.77	6,311
Leader Ins Co	3.72	6,229
State Farm Fire and Cas Co	3.70	6,186
Progressive Specialty Ins Co	3.58	5,997
Geico General Ins Co	3.22	5,383
Government Employees Ins Co	2.95	4,941
USAA Cas Ins Co	2.80	4,692
Geico Cas Co	2.50	4,186
Geico Ind Co	2.38	3,985
AAA Mountain West Ins	2.26	3,780
Progressive Northwestern Ins Co	1.97	3,302
Safeco Ins Co of IL	1.86	3,117
Progressive Cas Ins Co	1.75	2,935
Integon Ind Corp	1.42	2,369
Nationwide Mut Ins Co	1.41	2,365
Hartford Ins Co of The Midwest	1.38	2,306
Nationwide Mut Fire Ins Co	1.18	1,983
<hr/>		
TOTAL FOR TOP 20 RANKED INSURERS	89.75	150,212
TOTAL FOR ALL 98 INSURERS WRITING THIS LINE	100.00	167,368

19.3 - 19.4 COMMERCIAL AUTO NO-FAULT AND LIABILITY (\$000)

COMPANY NAME	PERCENT OF MARKET	DIRECT PREMIUMS WRITTEN
Alaska Nat Ins Co	17.52	5,499
National Cas Co	6.54	2,054
State Farm Mut Auto Ins Co	5.75	1,805
Allstate Ins Co	4.97	1,560
Progressive Cas Ins Co	4.88	1,531
National Ind Co	3.07	965
Employers Ins of Wausau	2.31	726
American Equity Ins Co	2.26	710
Zurich American Ins Co	2.26	709
Umialik Ins Co	2.05	644
Assurance Co of Amer	1.98	622
Lumbermens Mut Cas Co	1.87	588
Northern Ins Co of NY	1.82	572
St Paul Fire & Marine Ins Co	1.68	525
US Fidelity & Guaranty Co	1.59	499
Empire Fire & Marine Ins Co	1.53	480
Pacific Employers Ins Co	1.48	463
American Cas Co of Reading PA	1.47	462
Columbia Ins Co	1.47	460
Transcontinental Ins Co	1.46	460
<hr/>		
TOTAL FOR TOP 20 RANKED INSURERS	67.97	21,335
TOTAL FOR ALL 195 INSURERS WRITING THIS LINE	100.00	31,387

ANSWERS

to Your Questions About Insurance Bureau Scores

[1] WHAT IS AN INSURANCE BUREAU SCORE?

An Insurance Bureau Score is a snapshot of a consumer's insurance risk picture at a particular point in time based on credit report information. Insurers use Insurance Bureau Scores along with motor vehicle records, loss reports or application information to evaluate new and renewal auto and homeowner insurance policies. It helps them decide, "If we accept this applicant or renew this policy, will we likely be exposed to more losses than our collected premiums will allow us to handle?"

Insurance Bureau Scores are based solely on information in consumer credit reports. The scores are dynamic, changing as new information is added to a consumer's credit report. Insurers will typically ask for a current score when they receive a new application for insurance so they have the most recent information available.

[2] WHERE DO INSURANCE BUREAU SCORES COME FROM?

Insurance Bureau Scores are based on information from consumer credit reports that insurers get from the three major credit reporting agencies: Equifax, Experian (formerly known as TRW) and TransUnion. Information used in scoring includes:

- ▶ Outstanding debt
- ▶ Length of credit history
- ▶ Late payments, collections, bankruptcies
- ▶ New applications for credit
- ▶ Types of credit in use

[3] WHAT'S NOT INCLUDED IN AN INSURANCE BUREAU SCORE?

Insurance Bureau Scores do not use the following information:

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

[4] WHY DO INSURANCE COMPANIES USE INSURANCE BUREAU SCORES?

Insurance companies use scores to help them issue new and renewal insurance policies. Insurance Bureau Scores provide an objective, accurate and consistent tool that insurers use with other applicant information to better anticipate claims, while streamlining the decision process so they can issue policies more efficiently. By better anticipating claims, insurers can better control risk, enabling them to offer insurance coverage to more consumers at a fairer cost.

[5] HOW DO YOU KNOW IT WORKS?

Independent tests by insurance companies and a major consulting firm compared Insurance Bureau Scores against the claims history of policyholders. The tests demonstrated that the scores do predict the likelihood of claims.

[6] HOW CAN I FIND OUT MY SCORE?

While you can get copies of your credit reports from credit reporting agencies, only insurance companies can get Insurance Bureau Scores. However, your insurance company or its agent can tell you the main reasons behind your score.

Keep in mind that your score is one of many pieces of information an underwriter uses to review a policy. Factors like motor vehicle reports and application information also impact an insurer's decision. Also, remember that the score changes as new information is added to your credit report.

Your score will improve over time through a pattern of responsible credit use.

An Insurance Bureau Score is a snapshot of your insurance risk picture at a particular point in time based on credit report information.

Review your credit reports once a year and report any errors to the credit reporting agencies.

Insurance Bureau Scores provide underwriters an objective, accurate and consistent tool that, used with other underwriting information, helps them issue new and renewal insurance policies.

ANSWERS to Your Questions About Insurance Bureau Scores



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[7] HOW CAN I IMPROVE MY SCORE?

An Insurance Bureau Score is a snapshot of your insurance risk picture based on information in your credit report that reflects your credit payment patterns over time, with more emphasis on recent information. To improve a score, you should:

- ▶ Pay bills on time. Delinquent payments and collections can have a major negative impact on a score.
- ▶ Keep balances low on unsecured revolving debt like credit cards. High outstanding debt can affect a score.
- ▶ Apply for and open new credit accounts only as needed.

You can increase your score over time by using credit responsibly. It's also a good idea to periodically obtain a copy of your credit reports from the three major credit reporting agencies to check for any inaccuracies.

[8] WHAT IF I AM TURNED DOWN FOR INSURANCE?

If consumer credit information played a role in an insurer's decision to decline your insurance policy, the federal Fair Credit Reporting Act (FCRA) requires that the insurer tell you, and give you the name of the credit reporting agency that provided the information. In these situations, you are entitled by law to receive a free copy of your credit report to review, in order to help you understand how to better manage your credit or to challenge any errors that might appear on your report.

[9] WHAT IF THE INFORMATION IN MY CREDIT REPORT IS WRONG?

If you find errors in your credit report, you should report the errors to the credit reporting agency. By law, the credit reporting agency must investigate and respond to your request within 30 days. If you are in the process of applying for an insurance policy, you should immediately notify your insurance company about any incorrect information in your report. Small errors may have little or no effect on the score. If there are significant errors, the insurance company may choose to disregard the score and rely more on other underwriting information to make a decision on your application.

Make sure the information in your credit report is correct by reviewing your credit report from each credit reporting agency at least once a year. Call these numbers to order a copy (*a fee may be required*):

Equifax: 800 685 1111

TransUnion: 800 888 4213

Experian (formerly TRW): 888 397 3742

SCORING FACTS AND FALLACIES

F/I FALLACY: *With scoring, computers are making the underwriting decisions.*

FACT: Computers don't make underwriting decisions, people do. While a computer does calculate an Insurance Bureau Score, the score is only one of several pieces of information that underwriters use to help make a decision on new and renewal policies. Some insurance companies use scores to help them decide when to ask for more information from the applicant.

F/I FALLACY: *A poor score will haunt me forever.*

FACT: Just the opposite is true. An Insurance Bureau Score is a snapshot of your insurance risk picture at a particular point in time. Your score changes as new information is added to your credit reporting agency file. Over time, your score changes gradually as you change the way you handle your credit responsibilities. Because recent credit information is more predictive than older information, past credit problems will impact your score less as time passes. Insurance companies typically request a current score when you submit a new application so they have the most recent information available.

F/I FALLACY: *Insurance Bureau Scores are unfair to minorities.*

FACT: Insurance Bureau Scores do not consider ethnic group, religion, gender, marital status, nationality, age, income or address. Only credit-related information is included.

Insurance Bureau Scores have proven to be an accurate and consistent measure of insurance risk for all people who have some credit history. In other words, at a given score both non-minority and minority applicants present an equal level of insurance risk, or the likelihood of future insurance claims.

F/I FALLACY: *Scoring is an invasion of my privacy.*

FACT: Insurance companies have used consumer credit information to assist in their underwriting decisions since the FCRA was enacted in 1970. An Insurance Bureau Score is simply a number that provides an objective and consistent summary of that credit information. In fact, by using scores, some insurance companies don't need to ask for as much information on their application forms.

F/I FALLACY: *My Insurance Bureau Score will be hurt if I contact several insurance companies who each access my credit report.*

FACT: Insurance company requests or "inquiries" are not considered by Insurance Bureau Scores and will not affect your score.

MORRISON & FOERSTER LLP

7/29

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February 20, 2003

FEB 24 2003

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lfischer@mof.com

By Electronic Mail

The Honorable Bruce Weyhrauch, Chairman
State Affairs Committee
House of Representatives
Alaska State Capitol
Room 102
Juneau, AK 99801-1182

Re: Alaska House Bills 5 and 47

Dear Representative Weyhrauch:

I am a partner in the law firm of Morrison & Foerster LLP, and have been a partner in this firm since 1976. My specialty is financial services and consumer protection law. More importantly for purposes of this letter, I have worked extensively on privacy-related issues, including questions under the federal Fair Credit Reporting Act ("FCRA"), for more than 25 years. In fact, I am the author of the leading legal treatise on this subject, *The Law of Financial Privacy*.

If enacted, Alaska House Bills 5 and 47 would prohibit an insurer or underwriter from basing a standard, rate, or rating plan, in whole or in part, directly or indirectly, on a person's credit rating or credit score. House Bill 47 addresses automobile, homeowner's, and boat insurance, while House Bill 5 does not contain these references. For purposes of this letter, I assume that the reference to a person's credit rating or credit score in House Bills 5 and 47 would include a rating or score derived from information in a "consumer report," as that term is used in the FCRA. That is, I assume these bills would prohibit an insurer or underwriter from basing a standard, rate, or rating plan on a consumer's credit rating or credit score, when that rating or score is derived from information in a consumer report.

Several provisions in the FCRA clearly contemplate that insurance companies may use consumer reports (including credit scores) in connection with insurance

MORRISON & FOERSTER LLP

The Honorable Bruce Weyhrauch

February 20, 2003

Page Two

underwriting. In general, the FCRA provides that a person may obtain and use a consumer report for any "permissible purpose" provided for under the law. In particular, the FCRA states that a person may obtain and use a consumer report "in connection with the underwriting of insurance involving the consumer."¹ In addition to obtaining a consumer report in connection with insurance underwriting, the FCRA provides that an insurance company may obtain a consumer report in connection with insurance transactions that are not initiated by the consumer, so-called "prescreened" or "preapproved" transactions.² If a consumer report is used in connection with a prescreened transaction, the FCRA requires that a "firm offer of insurance" be provided to consumers who meet the criteria used to select consumers, along with certain disclosures.³

Based on my extensive knowledge and experience in this area, I have the following comments on the impact of the FCRA on House Bills 5 and 47, and, in particular, on efforts to restrict the use of consumer credit report information in insurance underwriting or rating decisions. The FCRA clearly contemplates that insurance companies may obtain consumer reports (including credit scores) in connection with the underwriting of insurance transactions. In fact, the Federal Trade Commission Commentary on the FCRA makes it clear that a person may obtain a consumer report in connection with the underwriting of insurance without the consumer's permission or even over the objection of the consumer.⁴ To the extent a state prohibits an insurer from obtaining or using a consumer report (including a credit score) in connection with the underwriting of insurance, the FCRA likely would preclude the enforcement of that state restriction.

More specifically, the FCRA, by its terms, generally prevails over inconsistent state laws, and directly preempts certain types of state laws.⁵ In particular, the FCRA clearly would preempt any state law that purports to prohibit the use of consumer report information to underwrite or select consumers for prescreened or preapproved offers of insurance, such as certain direct mail offers and telephone solicitations.⁶ Specifically, the FCRA provides that "[n]o requirement or prohibition may be imposed under the

¹ 15 U.S.C. §§ 1681b(a)(3)(C), 1681b(f).

² 15 U.S.C. § 1681b(c).

³ 15 U.S.C. §§ 1681b(c), 1681m(d).

⁴ 16 C.F.R. pt. 600, App., § 605--*General*, 2.

⁵ 15 U.S.C. § 1681t(a).

⁶ 15 U.S.C. §§ 1681t(b)(1)(A), 1681t(b)(1)(D).

MORRISON & FOERSTER LLP

The Honorable Bruce Weyhrauch
February 20, 2003
Page Three

laws of any State" with respect to prescreenings of consumer reports.⁷ In addition, it is quite likely that the FCRA also would preempt a state law that purports to prohibit the use of consumer report information for underwriting consumer insurance applications, as well as prescreened solicitations.

In this regard, it is implausible that Congress would have given insurance companies greater latitude in using credit history information to underwrite insurance for consumers who have *not* applied for insurance (*i.e.*, recipients of prescreened offers of insurance), than to underwrite insurance for consumers who have actually completed and submitted applications for such insurance, or who are currently insurance policyholders. The establishment of more restrictive rules on the use of credit history information for insurance applicants or existing policyholders than those permitted under the FCRA for prescreened insurance offers would have the anomalous effect of encouraging insurance companies to use credit history information to underwrite people who have never applied for insurance because those insurance companies might be precluded from using that same credit history information for insurance underwriting purposes after those same individuals submit applications for the same insurance. Congress could not possibly have intended such a result.

Therefore, the FCRA clearly would preempt any state law that purports to limit the use of consumer report information to make prescreened insurance offers, whether such offers are extended by mail or by telephone. Also, I believe that the FCRA would prevail over an attempt to preclude the use of consumer report information when making an underwriting or rating decision in connection with applications for new insurance coverage or renewals of existing insurance policies. Thus, the FCRA clearly would preempt House Bills 5 and 47 with respect to the use of credit information to make prescreened insurance offers, whether such offers are extended by mail or by telephone. Also, I believe that the FCRA would prevail over an attempt to use House Bills 5 and 47 to preclude the use of credit rating or scoring information to underwrite or rate insurance, including whether or not to issue a policy for insurance sold within the state.

Should you have any questions regarding the scope of the FCRA, or its preemptive effect on state law, I would be pleased to discuss them with you.

Sincerely yours,

⁷ 15 U.S.C. §§ 1681t(b)(1)(A), 1681t(b)(1)(D).

MORRISON & FOERSTER LLP

The Honorable Bruce Weyhrauch
February 20, 2003
Page Four

L. Richard Fischer
Morrison & Foerster LLP

Alaska State Legislature
House of Representatives

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Representative Harry Crawford
East Anchorage District 21

E-mail: Representative Harry Crawford@legis.state.ak.us

March 3, 2003

L. Richard Fischer
Morrison & Foerster, LLP
Via e-mail: lfischer@mofo.com

Re: Alaska House Bills 5 and 47

Dear Mr. Fisher:

Thank you for your e-mail letter of February 20, 2003, in which you give your legal opinion regarding proposed regulation of the use of credit scoring in Alaska. I have a few questions I hope you can answer.

1. You state several times that a "consumer report" includes credit scores, and you frequently use the term "consumer report" in a context where "credit score" is actually the appropriate term. On what authority do you base your conclusion that the term "credit report", as used in the Fair Credit Reporting Act, extends to and includes credit scores?
2. Can you explain why you think the FCRA, which first became effective in 1970, "clearly contemplated" that insurance companies would use credit scores, which were not developed until 25 years later? Is there legal authority for your position?
3. You state, "the FCRA clearly would preempt House Bills 5 and 47 with respect to the use of credit information" [my emphasis]. HB 5 and HB47 do not, however, attempt to limit the use of credit information; they only limit the use of credit scores derived from that information. Is it your position that the term "credit information" also includes credit scores? If so, on what authority do you base that conclusion?

L. Richard Fisher
March 3, 2003

Via e-mail
Page 2

4. On page 2 of your letter, you state: "In fact, the Federal Trade Commission Commentary on the FCRA makes it clear that a person may obtain a consumer report in connection with the underwriting of insurance"
 - a. Isn't it true that the commentary addresses consumer reports, not credit scores?
 - b. Isn't it also true that the commentary has no actual force of law?
5. Several states have passed legislation prohibiting or regulating the use of credit scores. Is your firm engaged in any litigation challenging such legislation? If so, who are your clients in that litigation?
6. Your letter to Alaska legislators appears unsolicited, although I note you are an attorney in a firm with more than 1,000 lawyers and whose legal practice, according to your website, encompasses every major area of commercial law, including insurance. At whose request did you write this letter?

Thank you for your time. I look forward to your response.

Sincerely,

Representative Harry T. Crawford, Jr.

HTC/cag

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March 25, 2003

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By Electronic Mail

The Honorable Harry Crawford
House of Representatives
Alaska State Capitol
Room 426
Juneau, AK 99801-1182

Re: Alaska House Bills 5 and 47

Dear Representative Crawford:

Thank you for your letter of March 4, 2003, in which you raised several questions about my letter of February 20, 2003, and Alaska House Bills 5 and 47, which would prohibit an insurer or underwriter from basing a standard, rate, or rating plan, in whole or in part, directly or indirectly, on a person's credit rating or credit score. I am pleased to respond to your questions. For ease of reference, I have included your questions below, in italics, followed by my responses.

You state several times that a "consumer report" includes credit scores, and you frequently use the term "consumer report" in a context where "credit score" is actually the appropriate term. On what authority do you base your conclusion that the term "credit report", as used in the Fair Credit Reporting Act, extends to and includes credit scores?

As I stated in my February 20 letter, I assume the reference to a person's credit rating or credit score in Alaska House Bills 5 and 47 includes a rating or score derived from information in a "consumer report" from a "consumer reporting agency," such as a credit bureau, as those terms are used in the federal Fair Credit Reporting Act ("FCRA"). That is, for purposes of my analysis of Alaska House Bills 5 and 47, I assume that a person's credit rating or credit score is based on information in a consumer report from a credit bureau.

MORRISON & FOERSTER LLP

The Honorable Harry Crawford
March 25, 2003
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The definition of "consumer report" in the FCRA is very broad. Consumer report means any communication of information by a consumer reporting agency "bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part" to establish a consumer's eligibility for credit, insurance and other specified purposes.¹

While it is possible that one could make an argument that a mere credit score is not itself a consumer report even if it is derived from information in a consumer report, such as a consumer's credit bureau file, since a score alone is less intrusive than a full credit bureau report, I believe that a credit score would be deemed by a court considering the issue to be a consumer report, when it is based on data which, itself, is a consumer report. It is implausible that a credit score, which is based on information in a consumer report, would not, itself, be deemed a consumer report. That is, because a credit score bears on a consumer's creditworthiness or similar credit factors, is based on consumer report data, and is used for credit and insurance eligibility decisions, I believe that a credit score is a consumer report.

This view is supported by a recent court decision that considered whether a credit score is a consumer report when that score is based on information obtained from a consumer's credit report. In *Scharpf v. AIG Marketing, Inc.*,² the district court evaluated whether an insurance company had a permissible purpose to obtain a consumer report in connection with the underwriting of insurance. In *Scharpf*, the insurance company obtained only a credit score from a consumer reporting agency, not a full consumer report.³ The court held that the company had a permissible purpose to obtain a consumer report under the circumstances of the case; more importantly, for purposes of this letter, the *Scharpf* decision stands for the proposition that a credit score is, itself, a consumer report, when it is derived from creditworthiness information in a consumer's credit report.⁴

In addition to the *Scharpf* decision, the Federal Trade Commission ("FTC") has addressed a similar issue. The FTC has, since 1970, been entrusted with enforcing the

¹ 15 U.S.C. § 1681a(d)(1).

² No. 3:00-CV-614(H), 2003 U.S. Dist. LEXIS 1482 (W.D. Ky. Jan. 30, 2003).

³ *Id.* at *3.

⁴ In addition to the *Scharpf* decision, at least one other court has assumed that a credit score is a consumer report under the FCRA. See *Kvalheim v. CheckFree Corp.*, No. 99-0135-RV-C, 2000 U.S. Dist. LEXIS 1959 (S.D. Ala. Feb. 18, 2000).

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FCRA, and has issued interpretations and orders regarding the scope of and the obligations imposed under the FCRA. With respect to FCRA interpretations, the FTC Commentary on the FCRA provides that "credit guides" that rate how well consumers pay their bills, are a series of consumer reports because they contain information used to establish a consumer's eligibility for credit.⁵ Although credit guides are not traditional consumer reports, they do rate how well consumers pay their bills and, thus, credit guides are viewed by the FTC as consumer reports. Because a credit score, like a credit guide, provides information about a consumer's creditworthiness, a credit score would be deemed a consumer report.

Can you explain why you think the FCRA, which first became effective in 1970, "clearly contemplated" that insurance companies would use credit scores, which were not developed until 25 years later? Is there legal authority for your position?

The statement in my letter that "the FCRA clearly contemplates that insurance companies may use consumer reports (including credit scores) in connection with insurance underwriting" was not intended to imply that insurance companies have been using credit scores since 1970. The statement was intended to point out that the FCRA recognizes that insurance companies have a permissible purpose to use consumer reports. In particular, since 1970, when the FCRA was enacted, it has expressly provided that consumer reporting agencies may furnish consumer reports to a person that intends to use the information in connection with the underwriting of insurance involving the consumer.⁶ The FCRA also has expressly provided since 1970 that if a person denies insurance for personal, family, or household purposes, based on information contained in a consumer report, the person must provide an "adverse action" notice to the consumer.⁷ Thus, since its enactment, the FCRA has clearly contemplated that insurance companies would be able to use consumer reports in connection with the underwriting of insurance.

As discussed above, since a credit score would be deemed a consumer report under the FCRA, I believe that the FCRA also contemplates that insurance companies may use any type of consumer report, including a credit score. The fact that insurance companies have not used credit scores since 1970 does not change the fact that insurers

⁵ See 16 C.F.R. pt. 600, app., § 603(d)4.B.

⁶ Pub. L. No. 90-321, Title VI, § 604(3)(C), as added Pub. L. No. 91-508, Title VI, § 601, 1970 U.S.C.C.A.N. 1301, 1319.

⁷ Pub. L. No. 90-321, Title VI, § 615(a), as added Pub. L. No. 91-508, Title VI, § 601, 1970 U.S.C.C.A.N. 1301, 1324.

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are permitted to obtain consumer reports (including credit scores) under the FCRA for use in connection with their underwriting activities.

You state, "the FCRA clearly would preempt House Bills 5 and 47 with respect to the use of credit information" [my emphasis]. HB 5 and HB 47 do not, however, attempt to limit the use of credit information; they only limit the use of credit scores derived from that information. Is it your position that the term "credit information" also includes credit scores? If so, on what authority do you base that conclusion?

I believe that the FCRA would preempt House Bills 5 and 47 with respect to the use of credit information, including credit scores that are derived from consumer report information, to make prescreened insurance offers. In particular, I believe that a limit on the use of credit scores constitutes a limit on the use of credit information because credit scores are derived from credit information contained in consumer reports. The use of the term "credit information" in the above quote reflects my view that the FCRA would preempt any state law that purports to prohibit the use of consumer report information, which would include credit scores derived from consumer report information, to underwrite consumers for prescreened or preapproved offers of insurance. Because credit scores are derived from and based on "credit information" contained in consumer reports, I believe limiting the use of credit scores would be preempted by the FCRA.

In addition, it is quite likely that the FCRA would preempt a state law that purports to prohibit the use of consumer report information for underwriting consumer insurance applications, as well as prescreened solicitations. In this regard, it is implausible that Congress would have given insurance companies greater latitude in using credit history information to underwrite insurance for consumers who have *not* applied for insurance (*i.e.*, recipients of prescreened offers of insurance), than to underwrite insurance for consumers who have actually completed and submitted applications for such insurance, or who are currently insurance policyholders. The establishment of more restrictive rules on the use of credit history information for insurance applicants or existing policyholders than those permitted under the FCRA for prescreened insurance offers would have the anomalous effect of encouraging insurance companies to use credit history information to underwrite people who have never applied for insurance, because those insurance companies might be precluded from using that same credit history information for insurance underwriting purposes after those same individuals submit applications for the same insurance. Congress could not possibly have intended such a result.

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On page 2 of your letter, you state: "In fact, the Federal Trade Commission Commentary on the FCRA makes it clear that a person may obtain a consumer report in connection with the underwriting of insurance"

*Isn't it true that the commentary addresses consumer reports, not credit scores?
Isn't it also true that the commentary has no actual force of law?*

The FTC Commentary does not expressly state that a "credit score" is a consumer report. However, for many years FTC staff have orally stated, in response to individual questions and in public statements, that a credit score is a consumer report if it is derived from information in a consumer report.⁸ Thus, I believe that the FTC would treat a credit score as a consumer report when that score is derived from information in a consumer report and used for eligibility purposes.

With regard to your question about whether the FTC Commentary has the force of law, the FTC has stated that its Commentary "does not have the force or effect of regulations or statutory provisions," but represents how the FTC will construe the FCRA in its enforcement and other activities.⁹ Courts have frequently referred to the FTC's Commentary in reviewing issues arising under the FCRA and often have deferred to the FTC's Commentary positions because the FTC has been entrusted to administer the FCRA.¹⁰ In addition, the fact that the FTC is entrusted with this enforcement responsibility, coupled with the fact that the FTC published its Commentary for public comment before adopting a final Commentary, would likely result in a court providing deference to the FTC views on matters addressed in the Commentary, particularly where the court finds the FTC's position to be persuasive.¹¹

Several states have passed legislation prohibiting or regulating the use of credit scores. Is your firm engaged in any litigation challenging such legislation? If so, who are your clients in that litigation?

The firm is not engaged in any litigation challenging state laws prohibiting or regulating the use of credit scores. Nevertheless, we have advised several insurance

⁸ If helpful, I would be happy to provide the name and telephone number of FTC staff who can confirm this view.

⁹ 16 C.F.R. pt. 600, app., intro.

¹⁰ See, for example, *Estiverne v. Sak's Fifth Avenue and JBS*, 9 F.3d 1171 (5th Cir. 1993). See also *Wilting v. Progressive County Mutual Insurance Co.*, 227 F.3d 474 (5th Cir. 2000).

¹¹ See *United States v. Mead Corp.*, 533 U.S. 218 (2001) (addressing deference due to agency interpretations and opinions).

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companies on the application of the FCRA to their operations. In addition, we have advised state legislators and state regulatory agencies about the federal FCRA and its impact on state laws, such as the use of credit scores.

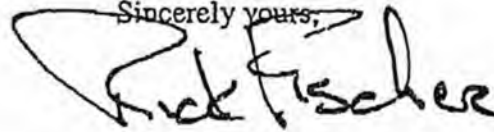
Your letter to Alaska legislators appears unsolicited, although I note you are an attorney in a firm with more than 1,000 lawyers and whose legal practice, according to your website, encompasses every major area of commercial law, including insurance. At whose request did you write this letter?

The letter was sent at the request of Progressive Casualty Insurance Company.

* * * * *

Should you have any additional questions about the FCRA, I would be pleased to discuss them with you.

Sincerely yours,



L. Richard Fischer
Morrison & Foerster LLP

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

CIVIL ACTION NO. 3:00-CV-614(H)

KATHLEEN SCHARPF

PLAINTIFF

V.

AIG MARKETING, INC., et al.

DEFENDANTS

MEMORANDUM OPINION

Plaintiff Kathleen Scharpf has filed a ten-count complaint alleging that, in obtaining her consumer report, Defendants AIG Marketing, Inc. ("AIG"), MBNA Insurance Agency ("MBNA"), and "Unknown Persons," violated the Fair Credit Reporting Act, 15 U.S.C. §1681 *et seq.*, invaded her privacy in violation of Kentucky common law, and engaged in an unlawful civil conspiracy.¹ The centerpiece to Plaintiff's FCRA allegations has been her contention that AIG lacked a "permissible purpose" to obtain her credit report. The cross motions for summary judgment focused on this issue. This Court limited the parties' discovery efforts to "the issue of the applicability to the defendants' conduct of the 'underwriting exception' to liability under the Act." While this may not be the only dispositive legal issue, for the reasons set forth below, Plaintiff's motion for summary judgment on this narrow issue is denied. Further discovery, however, could support the allegations contained in the complaint. Therefore, the Court will not

¹ Plaintiff has made eight claims related to the FCRA. Specifically, Count One alleges AIG negligently failed to comply with the FCRA's requirements. 15 U.S.C. § 1681o. Count Two alleges AIG willfully violated the FCRA. 15 U.S.C. § 1681n. Count Three alleges that AIG obtained her consumer report under false pretenses in violation of 15 U.S.C. § 1681q. Counts Four, Five, Six, Seven, and Nine allege that "Unknown Persons" who were "employees of AIG and/or MBNA" should be held personally liable for participating in the process by which her consumer report was obtained and used by AIG.

dismiss all of Plaintiff's underlying claims.

I.

The Court is presented with a narrow question related to the legality of what transpired during an August 1999 phone conversation between Plaintiff and AIG. The facts are best considered in two parts at this stage, looking briefly at the AIG-MBNA call transfer program, and then considering the phone conversation in issue.

This case arises out of a telemarketing relationship. AIG and MBNA are business partners and operate the MBNA Call Transfer Program.² In practice, according to Steven F. Wardzinski, president of the Sponsored Business Division of AIG, the Program operates as follows. While speaking by telephone to an MBNA representative about her credit card account, the MBNA account holder is typically asked if she would like to receive a "free, no obligation quote" for automobile insurance. If the consumer accepts the offer, she is immediately telephonically transferred to a waiting AIG representative who then requests information from the consumer, such as her name, address, type of vehicle, and social security number. Based on this information, the AIG representative, utilizing a computer program, calculates a quote. As part of this process, AIG's computer program automatically orders the credit score (which itself is based on information obtained from the consumer's credit report), and inputs this three-digit number into the program to determine the quote.

from whom?

²Except from argument in chambers, the Court does not have any account from AIG and MBNA concerning their relationship. This summary of the facts is therefore culled primarily from Plaintiff's statements of facts and the relevant depositions.

The relevant events begin on August 6, 1999, when Plaintiff spoke by telephone to MBNA, with whom she had a credit card, and consented to the transfer to an AIG representative. At the time, Plaintiff's current automobile insurance policy was about to expire and she decided to compare rates. During the brief conversation, the AIG representative asked Plaintiff a series of questions, including a request for her social security number. Whether or not Plaintiff provided this in response is a critical fact in dispute.³ Through some undetermined means, AIG nevertheless obtained access to her consumer report from Trans Union. As a result, AIG offered her an immediate rate quote. That rate quote was significantly higher than Plaintiff's current automobile insurance premium. So, Plaintiff stated she was not interested and terminated the conversation. Notwithstanding this rejection, AIG subsequently sent her a written application urging her to purchase the insurance at the offered rate.

Nearly one year later, while reviewing her credit report in July of 2000, Plaintiff noticed a record of AIG obtaining her consumer report on August 6, 1999. Plaintiff has now sued AIG and MBNA claiming that AIG's process of obtaining of her consumer report violated the FCRA, invaded her privacy, and was the product of an unlawful civil conspiracy.

³ At this stage, the Court finds this important fact is irrelevant in determining the narrow legal question at hand. Nevertheless, it may be important in future litigation in this case that Plaintiff asserts that, "being very protective of her privacy," she "never gave her social security number to the AIG[M] representative." (Scharpf. Depo., pg. 61-63). In contrast, Defendants argue that because, as a matter of fact according to Mr. Wardzinski, AIG has no other way of obtaining a consumer's Social Security number other than from a consumer, "Ms. Scharpf's memory appears to have betrayed her." Another possibility is that AIG gained access to the consumer credit report without aid of the social security number.

II.

This case poses a difficult and important issue of first impression. Namely, under the FCRA, can an insurance company obtain a consumer report, prior to the consumer's unequivocal application, in order to issue an insurance quote?⁴ This is an important issue because apparently a vast percentage of insurers may obtain consumer reports in a similar manner prior to receiving a specific application.

In 1970 Congress amended the Consumer Credit Protection Act, 15 U.S.C. § 1601 *et seq.*, by adding a number of provisions collectively known as the Fair Credit Reporting Act ("FCRA"). The FCRA provides the exclusive circumstances under which a credit reporting agency may furnish a credit report to another. *See* 15 U.S.C. § 1681b(a)(2). Insurance companies may be held liable under the FCRA because they must comply with the FCRA's terms in handling an insured's credit report. *St. Paul Guardian Ins. Co. v. Johnson*, 884 F.2d 881, 883 (5th Cir. 1989). As a result of congressional amendments in 1997, the FCRA now lists six limited "permissible purposes" for which a consumer reporting agency can provide a consumer report to third parties. *See* 15 U.S.C. § 1681b(a). The FCRA authorizes third parties, such as AIG, to obtain and use consumer reports only if they act in accordance with one of these permissible purposes. *See* 15 U.S.C. § 1681b(f)(1).⁵ Both sides agree that the singular "permissible purpose" applicable here is the provision that a third-party may obtain the consumer's report if it "intends to use the

⁴To date, only one federal court has considered this issue concluding in a remarkably brief opinion that such a scheme was permissible under the FCRA's text. *Wilting v. Progressive County Mutual Insur. Co.*, 227 F.3d 474 (5th Cir. 2000).

⁵Specifically, the FCRA states, "A person shall not use or obtain a consumer report for any purpose unless ... the consumer report is obtained for a purpose for which the consumer report is authorized to be furnished under this section." 15 U.S.C. § 1681b(f)(1).

information in connection with the underwriting of insurance involving the customer.” 15 U.S.C. § 1681b(a)(C). Plaintiff’s claim implicitly contains important questions of law and fact.

A.

Plaintiff first argues that, as a matter of law, the underwriting purpose is inapplicable here because she never “applied” for insurance. Because she never made an application for insurance, Plaintiff contends AIG had no right to access her credit report even if it was performing an underwriting function. The Court disagrees. Several basic principles of statutory construction compel this outcome. In addition, such a construction satisfies the balance Congress intended by enacting the FCRA.

As a starting point, to explore Plaintiff’s argument fairly, the Court’s analysis begins by examining that language. *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989). Tellingly, Section 1681b(a)(C)’s text does not contain an “application” requirement, certainly not an explicit one. To the contrary, the underwriting provision permits a consumer reporting agency to furnish a report to a company which *intends* to use the information *in connection with the underwriting* of insurance. 15 U.S.C. §1681b(a)(C). This statutory language does not limit the underwriting purpose to those occasions after someone has *applied* for insurance; nor, as Plaintiff would prefer, does it limit this purpose to obtaining a consumer report with the consumer’s knowledge. The three terms which Congress used to define this permissible purpose suggest that this conclusion is both correct and sensible within the FCRA’s overall scheme.

First, Congress did not restrict the scope of the permissible distribution of a report to companies like AIG who can prove they will use a consumer report for underwriting. Rather,

consumer credit companies are permitted to furnish the reports where a third party, such as AIG, demonstrates an *intent* to use the report for the authorized purpose. *See, e.g., Yang v. Government Employees Insur. Co.*, 146 F.3d 1320, 1325 (11th Cir. 1998) (noting that there are three potential types of use that might exist under this section: ultimate use, expectation of use, and the purpose for compiling the report, and concluding that only one of those purposes is necessary to meet a "permissible purpose" provision); *Korotki v. Attorney Servs. Corp.*, 931 F. Supp. 1269, 1276 (D. Md. 1996) ("[S]o long as a user has reason to believe that a permissible purpose exists, that user may obtain a consumer report without violating the FCRA"). Second, Webster's Dictionary defines "connection" as "an association or relationship; logical ordering of words or ideas." Webster's II New Riverside Dictionary 300 (1994). Thus, both the practical and strict definitional applications suggest that a consumer reporting agency may provide a consumer report without evidence that a consumer has made an application. Consequently, it is counterintuitive to suggest that the recipient would need an application before using the information which the consumer credit agency had legally provided.

Third, while Congress did not define the word "underwriting," the Federal Trade Commission ("FTC"), as the agency authorized with administering the FCRA, 15 U.S.C. §1681s(a), has provided a definition. That definition states, "An insurer may obtain a consumer report to decide whether or not to issue a policy to the consumer, the amount and terms of the coverage, the duration of the policy, the rates or fees charged, or whether or not to renew or cancel a policy, because these are all 'underwriting' decisions." FTC Commentary on the Fair Credit Reporting Act, 16 C.F.R. pt. 600, App.; *see also Wilting*, 227 F.3d at 476 (adopting the FTC's definition). Similarly, in defining "consumer report," the FCRA states that information on

an individual may be obtained “for the purpose of serving as a factor in establishing the consumer’s *eligibility* for” insurance. 15 U.S.C. §1681a(d)(1). None of these definitions suggest that an application is the pre-condition to this permissible purpose. Rather, the terms intimate an insurer may examine a consumer’s credit report to assess the risks that person poses.

Another cardinal principle of statutory construction supports this interpretation. *Duncan v. Walker*, 533 U.S. 167 (2001). That principle says that “a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.” *Id.*; see *United States v. Menasche*, 348 U.S. 528, 538-539 (1955). Plaintiff argues repeatedly that “the term ‘application’ and derivations thereof are used more than a dozen times in the FCRA.” Pl.’s Mot. Summ. J. at 16. Plaintiff specifically relies on the FCRA’s use of “applicant” in the permissible purpose pertaining to a consumer’s application “for a license or other benefit granted by a governmental instrumentality.” *Id.* at 17-18; 15 U.S.C. § 1681b(a)(3)(D).⁶ Were this Court to adopt Plaintiff’s construction of the statute and infer that the term “application” is a prerequisite to triggering every “permissible purpose,” simply because it appears in the text of one permissible purpose, the express use of the term “applicant” in § 1681b(a)(3)(D) “would be rendered insignificant, if not wholly superfluous.” *TRW, Inc. v. Andrews*, 534 U.S. 19, 31 (2001). This court is “reluctant to treat statutory terms as surplusage in any setting,” and declines to do so here. *Id.*

⁶In its entirety, §1681b(a)(3) states that a person may obtain a consumer report if he “intends to use the information in connection with a determination of the consumer’s eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant’s financial responsibility or status.”

The principle that a statute should be read and construed as a whole is also germane here. *United States v. American Trucking Ass'ns, Inc.*, 310 U.S. 534, 542-43 (1940). That is, in the context of the overall statutory scheme, § 1681b(a)(C) is better read *not* as restricting this permissible purpose to instances where a consumer has submitted a written application, but instead as setting up a safeguard to ensure that a user of a consumer report is operating with a permissible purpose, *when it lacks the consumer's express permission*. This is an important distinction. Though neither party focuses on it, the underwriting permissible purpose is itself not an unlimited source of power. In FCRA's permissible purpose section, Congress began its enunciation of the six permissible purposes by noting their scope was "[s]ubject to subsection (c) of this section." 15 U.S.C. § 1681b(a).⁷ Subsection (c), in turn, imposes limitations on cases where the consumer does not initiate the transaction.⁸ That section of the FCRA states:

⁷ The entire text of the introduction states, "In general—Subject to subsection (c) of this section, any consumer reporting agency may furnish a consumer report under the following circumstances and no other." 15 U.S.C. § 1681b(a).

⁸ Those limitations are as follows:

- (c) Furnishing reports in connection with credit or insurance transactions that are not initiated by the consumer.
 - (1) In general. A consumer reporting agency may furnish a consumer report relating to any consumer pursuant to subparagraph (A) or (C) of subsection (a)(3) in connection with any credit or insurance transaction that is not initiated by the consumer only if--
 - (A) the consumer authorizes the agency to provide such report to such person; or
 - (B) (i) the transaction consists of a firm offer of credit or insurance;
 - (ii) the consumer reporting agency has complied with subsection (e); and
 - (iii) there is not in effect an election by the consumer, made in accordance with subsection (e), to have the consumer's name and address excluded from lists of names provided by the agency pursuant to this paragraph.
 - (2) Limits on information received under paragraph (1)(b). A person may receive pursuant to paragraph (1)(B) only--
 - (A) the name and address of a consumer;
 - (B) an identifier that is not unique to the consumer and that is used by the person solely for the purpose of verifying the identity of the consumer; and
 - (C) other information pertaining to a consumer that does not identify the relationship or experience of the consumer with respect to a particular creditor or other entity.

A consumer reporting agency may furnish a consumer report relating to any consumer pursuant to [the underwriting permissible purpose set forth in] this section in connection with any credit or insurance transaction that is not initiated by the consumer only if—(A) the consumer authorizes the agency to provide such report to such person; or (B)(I) *the transaction consists of a firm offer of credit or insurance* [and the consumer has not elected to be excluded from identified lists].

15 U.S.C. § 1681b(c)(1).

(3) Information regarding inquiries. Except as provided in section 609(a)(5) [15 USCS § 1681g(a)(5)], a consumer reporting agency shall not furnish to any person a record of inquiries in connection with a credit or insurance transaction that is not initiated by a consumer.

15 U.S.C. § 1681b(c).

The FCRA elsewhere defines "firm offer of credit or insurance," to be "any offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer report on the consumer, to meet the specific criteria used to select the consumer for the offer." 15 U.S.C. § 1681a(l).⁹ Thus, the FCRA seems to contemplate that a company may obtain a consumer report without the consumer's application or knowledge, if it provides a firm offer in connection with one of the permissible purposes. For purposes of this analysis the Court must assume that AIG through its agent MBNA initiated the transaction.¹⁰ According to Wardzinski, the quote provided by AIG over the phone was binding on AIG for sixty days and was available if the Plaintiff completed the written application for the insurance. (Wardzinski Dep. at 34, 54, 61-64, 88). In this way, then, Plaintiff's experience was no different from the unhappy

⁹ In its entirety, the definition of "firm offer of credit or insurance" provides as follows:

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

- (1) The consumer being determined, based on information in the consumer's application for the credit or insurance, to meet specific criteria bearing on credit worthiness or insurability, as applicable, that are established--
 - (A) before selection of the consumer for the offer; and
 - (B) for the purpose of determining whether to extend credit or insurance pursuant to the offer.
- (2) Verification.
 - (A) that the consumer continues to meet the specific criteria used to select the consumer for the offer, by using information in a consumer report on the consumer, information in the consumer's application for the credit or insurance, or other information bearing on the credit worthiness or insurability of the consumer; or
 - (B) of the information in the consumer's application for the credit or insurance, to determine that the consumer meets the specific criteria bearing on credit worthiness or insurability.
- (3) The consumer furnishing any collateral that is a requirement for the extension of the credit or insurance that was--
 - (A) established before selection of the consumer for the offer of credit or insurance; and
 - (B) disclosed to the consumer in the offer of credit or insurance.

15 U.S.C. § 1681a(1)

¹⁰ AIG disputes this conclusion and argues that Plaintiff initiated the transaction by agreeing to the call

consumer who discovers a credit card company legally obtained her credit history without her authorization in order to make her a credit card offer, subject to the approval of her application.

See Baker v. American Express, 2002 U.S. Dist. LEXIS 10005, *6-*7 (W.D. Ky. 2002).

Nevertheless, by making the firm offer, AIG has complied with the protections established in the FCRA.

This more complete and logical reading of §1681b(a)(C) shows that it restricts an insurer's access to a consumer's credit report, by requiring a legitimate underwriting use, *and* by requiring either the consumer's express permission *or* the making of a firm offer. This interpretation eminently comports with what Congress intended for the FCRA. In enacting the FCRA, Congress made four findings, three of which are particularly relevant to the question of law Plaintiff poses.

Those pertinent findings state:

(2) An elaborate mechanism has been developed for investigating and evaluating the credit worthiness, credit standing, credit capacity, character, and general reputation of consumers.

(3) Consumer reporting agencies have assumed a vital role in assembling and evaluating consumer credit and other information on consumers.

(4) There is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy.

15 U.S.C. § 1681(a).

In effect, the FCRA created a fair mechanism through which creditors and insurers could obtain a consumer's report in order to make an offer and evaluate creditworthiness. Conversely, it also established procedures to ensure accuracy and to protect consumer privacy. The FCRA strikes a balance between these two competing ends.

transfer.

Evidence of this give and take is prevalent throughout the FCRA. When preparing a report, a consumer reporting agency must follow "*reasonable* procedures to assure *maximum possible accuracy*." 15 U.S.C. 1681e(c) (emphasis added). The stated aim is therefore perfection in protecting the consumer, but the burden on the credit reporting agency is only to act reasonably. Similarly, it is *presumed* that a consumer's *privacy will not be violated* in the context of a firm offer for a permissible purpose, unless that consumer personally seeks to have her name removed from a consumer reporting agency's list. 15 U.S.C. § 1681b(c). Moreover, if a plaintiff seeks to bring a state law defamation, invasion of privacy, or negligence reporting claim against a consumer reporting agency, she can succeed only upon overcoming the highest standard of malice. 15 U.S.C. § 1681h(e). Last, only *after* a creditor or insurer takes action against a consumer's interest, is that consumer informed of her right to see their credit report or know that it was used against her. 15 U.S.C. § 1681a(k). Taken together these provisions illustrate that 15 U.S.C. § 1681b(a)(C), even absent the "application" requirement Plaintiff asks this Court to impute, is consistent with Congress's clear desire to allow some carefully proscribed investigation into a consumer's credit history, even without his knowledge or consent.

B.

Turning once again to the facts in this case, Plaintiff contends that she did not make an "application." Despite Plaintiff's assumption to the contrary, this fact is disputed. Even assuming the Court did agree with Plaintiff on her legal argument, a reasonable person could conclude, based on the evidence presently before the Court, that AIG did overcome this implicit "application" requirement. This disputed fact makes the grant of summary judgment improper.

According to her deposition, Plaintiff agreed to the phone transfer and then provided some

detailed information, like that one would provide on a written application. Among those pieces of information were her name, address, the make and model of her car, specific information about her driving history, and her desired policy coverage. (Scharpf Dep. at 69-72, 95-96). Plaintiff has since stated that she was aware the quote the insurer provided her was subject, in the same way her written application would be, to “the background checks [of her] the driving record, to verify the appropriate rates that they gave [her].” (*Id.* at 37, 39, 43). Thus, the only major distinction between what Plaintiff would term “an application” and what a reasonable person could term an “application” appears to be an unequivocal statement to her that, by providing this information, she was applying for insurance.

This very factual scenario highlights another failing of Plaintiff’s legal argument. As a practical matter, Plaintiff’s argument is not workable in this context. Defendants are legally bound not to obtain the Plaintiff’s credit report unless they use it “in connection with the underwriting of insurance.” Both parties agree that the Defendants were involved in underwriting; Plaintiff’s claim is only that the FTC and Congress simply did not intend for this provision to kick in until a consumer made an “application.” But determining when the application process formally begins would either have this Court add an extra requirement for all insurance companies, or would inject the Court into every phone call to determine whether the consumer believed she had made an application. Neither of these outcomes is either appropriate or necessary in this context. Although the FCRA as it stands is not perfect, it does contain a reasonable number of protections which, when enforced, strike the proper balance between protecting business and consumer rights. Despite Plaintiff’s well-formulated arguments, the Court simply cannot reach her conclusions. Therefore, the Court concludes that neither the specific statutory language nor the FCRA’s broad

purposes require an application for insurance in order to justify access to a credit report.

III.

In the process of arguing the interpretation of the FCRA, the parties raise two important issues which the Court believes deserve a direct response. Those issues are noted at this time with the hope that it might focus the parties in the future course of their litigation.

A.

First, after careful consideration, the Court has declined to give substantial deferential weight to the assorted pieces of non-binding Federal Trade Commission ("FTC") interpretations. Several important factors that led to this conclusion.¹¹

¹¹Plaintiff has argued at length that this Court is bound by certain FTC commentary and definitions. However, Plaintiff has not explained why, in accordance with basic principles of administrative law, the FTC's definitions, sample notices, and informal opinions are binding, persuasive, or what level of deference is proper under these circumstances. After analyzing the law in this respect, the Court for the reasons explained herein, concludes it is not bound to adopt the conclusions in these different pieces of information.

Plaintiff argues this Court should look to is an Informal Staff Opinion Letter. *See* FTC Informal Staff Opinion Letter, David Medine (Feb.11, 1998). That letter states that where a consumer asks a car dealer questions about prices and financing, "The customer may simply be comparison shopping. In such a situation, the dealer must obtain written permission from the consumer before obtaining a consumer report." *Id.* The scope of the inquiry in that case, however, dealt with *a different section of the act*. Specifically, the FTC was asked whether, *consistent with § 1681b(a)(3)(F)'s permissible purpose*, an auto dealership could obtain a consumer report on an individual who visits a showroom and thus "in connection with a business transaction that is initiated by the customer."¹² In interpreting that provision, the FTC advised that the customer did not trigger the permissible purpose until she was *knowingly* initiating a transaction, as opposed to asking general questions about prices. As a legal matter, the FTC opinion letter specifically clarified when a consumer "initiated" a transaction, not when "underwriting" began. For this reason, the Court is reluctant to hold that an informal agency opinion relating to the sale of cars and the "business transaction" permissible purpose should also control the underwriting of insurance and its unique permissible purpose. Our case involves an altogether different situation and a different statutory provision. Had Congress intended the same set of rules for these two situations, it would not have carved out two separate exceptions written at different levels of generality.

¹² In its entirety, §1681b(a)(3)(F) states that a person may obtain a consumer report if he "otherwise has a legitimate business need for the information in connection with a business transaction that is initiated by the consumer."

Plaintiff also points to the FTC's example of what type of notice a credit reporting agency should give to a user of a consumer report. Importantly, the FTC provided its sample notice in response to Congress's directive in 15 U.S.C. § 1681e(d), requiring that a consumer reporting agency provide to any company "(A) who regularly and in the ordinary course of business furnishes information to the agency with respect to any consumer; or (B) to whom a consumer report is provided by the [credit reporting] agency; a notice of [the receiving company's] responsibilities under this subchapter." The FCRA further notes that, after the FTC prescribes the content of that notice, "a consumer reporting agency shall be in compliance with this subsection if it provides a notice ... that is *substantially similar* to the FTC prescription." 15 U.S.C. § 1681e(d)(2) (emphasis added). The FTC draft notice states that "users must have a permissible purpose" and paraphrases the underwriting permissible purpose as follows: "For the underwriting of insurance as a result of an *application* from a consumer." 16 C.F.R. § 601 App. C (emphasis added). To be sure, one could say that the FTC sample notice implies that only an application can trigger a permissible purpose.

Under the FCRA, the FTC is the agency empowered to enforce the Act. 15 U.S.C. § 1681s(a). Plaintiff does not go so far, however, to argue that the FTC's sample notice is entitled to the level of deference set forth in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (in appropriate circumstances, agency determination is binding unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to statute). Based upon the circumstances through which this draft notice was published, the Court agrees.

If the FTC's draft notice had been adopted in a rulemaking or other formal proceeding, *Chevron* deference would be appropriate. Instead, the FTC itself clearly states, "[t]he Commentary

does not have the force or effect of regulations or statutory provisions.” C.F.R. Pt. 600 A, Introduction ¶ 1. Recent Supreme Court cases emphasize that such agency statements do not deserve broad *Chevron* deference. See *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Christensen v. Harris County*, 529 U.S. 576 (2000). In *Christensen* the Supreme Court held that “interpretations such as those in opinion letters -- like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law -- do not warrant *Chevron*-style deference.” 529 U.S. at 587. “Instead,” the Court continued, “interpretations contained in formats such as opinion letters are ‘entitled to respect’ . . . but only to the extent that those interpretations have the ‘power to persuade.’” *Id.*; see also *Navarro v. Pfizer Corp.*, 261 F.3d 90 (1st Cir. 2001); *Catskill Mts. Chapter of Trout Unlimited, Inc. v. City of New York*, 273 F.3d 481 (2nd Cir. 2001); *AFGE, Local 2119 v. Rumsfeld*, 262 F.3d 649 (7th Cir. 2001); *Nat’l Org. of Veterans’ Advocates, Inc. v. Sec’y of Veterans Affairs*, 260 F.3d 1365 (Fed. Cir. 2001).

However, as *Mead* and *Christensen* make clear, courts do not face a choice between *Chevron* deference and no deference at all. Administrative decisions not subject to *Chevron* deference may be entitled to a lesser degree of deference; the agency position should be followed to the extent persuasive. See *Mead* 533 U.S. at 228; (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)). For the reasons that follow, however, the Court does not find the FTC’s position to be persuasive.¹³ Most importantly, although the agency uses the term “application,” there is *no*

¹³ As the Supreme Court recently noted in *Mead*, 533 U.S. 218, Justice Jackson’s enunciation of the *Skidmore* test is as follows,

“The weight [accorded to an administrative] judgment in a particular case will depend upon the

evidence that the FTC gave its use of this term any special consideration or was moved to use that term for any particular reason. In fact, as this Court has already noted, the FTC's definition of underwriting makes absolutely no mention of an "application" requirements needed to trigger that process; the FTC itself therefore, on this question, takes inconsistent positions.¹⁴ Rather, the fact that a consumer reporting agency will not violate this act if it issues its own notice "substantially similar" to the FTC's draft notice suggests the "application" requirement is hardly equivocal.

thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."

Skidmore, 323 U.S. at 140.

¹⁴ The FTC's definition of "underwriting" states, "An insurer may obtain a consumer report to decide whether or not to issue a policy to the consumer, the amount and terms of the coverage, the duration of the policy, the rates or fees charged, or whether or not to renew or cancel a policy, because these are all "underwriting" decisions." FTC Commentary on the Fair Credit Reporting Act, 16 C.F.R. pt. 600, App.; *see also Wilting*, 227 F.3d at 476 (adopting the FTC's definition).

See 15 U.S.C. § 1681e(d)(2).¹⁵ The FTC opinion letter and commentary, therefore, while deserving consideration, are neither binding nor persuasive. The Court does not believe that the FTC sample notice should decide this case.

B.

¹⁵ Importantly, the Court briefly notes that, even applying a full *Chevron* analysis, Plaintiff would probably fail on this point. The Supreme Court has established a two-step process for reviewing an agency's interpretation of a statute that it administers. *Chevron*, 467 U.S. 837 (1984). "First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Jewish Hosp., Inc. v. Sec'y of Health & Human Servs.*, 19 F.3d 270, 273 (6th Cir. 1994) The Supreme Court has explained that "the judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *Chevron*, 467 U.S. at 843 n.9.

Applying step one of *Chevron*, the Court is persuaded that the statute in this case is clear; Congress did not intend to prevent using a consumer report for the purposes of underwriting *only after* a customer had made a formal application. Rather, as discussed throughout this opinion, the FCRA is a notice statute. There are instances where a company may obtain a consumer's credit report without their permission or advance knowledge, so long as that company subsequently *notifies* the consumer of its usage. The words used as well as the different parts of the statute when considered together demonstrate this clarity.

A second remaining question concerns Plaintiff's rights in the event of an "adverse action." The statute defines adverse action to include any act against a consumer, such as offering a higher rate or refusing to offer any insurance, that is made in reliance on their credit report. 15 U.S.C. § 1681a(k)(1)(B)(I).¹⁶ Clearly, such an action has occurred here. Defendants acknowledge access to the credit report or its results; they also used the report to take an adverse action. In such an event, Defendants must follow several procedures that include notifying the Plaintiff of her right to look at her credit report. 15 U.S.C. § 1681m(a). The Defendants did not do this. They say such action was not required because the "adverse action" requirement only applies to cases where the plaintiff is obtaining a quote on insurance, *existing or applied for*. 15 U.S.C. § 1681a(k)(1)(B)(I). In other words, Defendants say: (1) they can access her insurance without her permission because the permissible purpose exception does not require an application, but (2) they may treat her "adversely" as to her auto insurance without any notice to her, because she had not

¹⁶The pertinent portions of 15 U.S.C. § 1681a(k) state:

(k) Adverse action.

(1) Actions included. The term "adverse action"--

(A) has the same meaning as in section 701(d)(6) of the Equal Credit Opportunity Act [15 USCS § 1691(d)(6)]; and

(B) means--

(I) a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance;

(ii) a denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee;

(iii) a denial or cancellation of, an increase in any charge for, or any other adverse or unfavorable change in the terms of, any license or benefit described in section 604(a)(3)(D) [15 USCS § 1681b(a)(3)(D)]; and

(iv) an action taken or determination that is--

(I) made in connection with an application that was made by, or a transaction that was initiated by, any consumer, or in connection with a review of an account under section 604(a)(3)(F)(ii) [15 USCS § 1681b(a)(3)(F)(ii)]; and

(II) adverse to the interests of the consumer.

yet applied. In effect, they argue that the “adverse action” provision and the “permissible purpose” section of the FCRA do not fit perfectly together; one can access a report with a permissible purpose but is not subject to the adverse action requirements. Plaintiff highlights this incongruity to argue that Defendants can “have it both ways.”

Admittedly, the scope of the “adverse action” provision is not presently and may never be directly at issue. However, both Plaintiff and Defendants used the “adverse action” provision to make their respective statutory arguments. Therefore, this discussion both supports and lends proper context to the Court’s conclusions in Section II of this Memorandum. To accept Defendants’ argument one must admit to a vast loophole in the statute which establishes a process quite contrary to the FCRA’s essential purposes. The only logical recourse is to conclude that the language in § 1681 a(k)(1)(B)(I) does not precondition an insurance company’s adverse action duties on the making of a formal written application. In fact, the Court finds ample support for this conclusion at this stage.

The legislative history of this section suggests that Defendants are wrong – the adverse action section is to be read broadly, “It is the Committee’s intent that, whenever a consumer report is obtained for a permissible purpose under Section 604(a), any action taken based on that report that is adverse to the interests of the consumer triggers the adverse action notice requirements under section 615.” H.R. Rep.No. 103-486 at 26 (1994); *see also* H.R. Rep. No. 102-692 at 21 (1992), and S. Rep. No. 103-209, at 8 (1993). Similarly, although not binding, the FTC has taken a similar position in an informal opinion letter addressing a related question. *See* FTC Informal Staff Opinion Letter, Hanna A. Stires (Mar. 1, 2000) (adopting the aforementioned legislative history and concluding that “[i]n sum, the legislative history indicates that the term ‘adverse

action' should be read broadly in to include *any action taken whenever a credit report is obtained for a permissible purpose* that is 'adverse to the interests of the consumer'"). At this time, the Court also reads the statute in the same way.

IV.

Having concluded that Defendant AIG had a permissible purpose when it obtained Plaintiff's consumer credit report, the Court now considers, in light of Defendant's cross-motion for summary judgment on all counts, each claim made in Plaintiff's complaint. In reaching these conclusions, this Court's February 1, 2001 Order limiting the parties' discovery is particularly determinative. Up to this point, all discovery has focused on facts pertinent to AIG's compliance with the FCRA and its underwriting processes. Genuine issues of material fact remain and subsequent discovery will be necessary.

As to Counts I and II, the Court is finding that AIG did have a permissible purpose in obtaining Plaintiff's credit report, does not decide whether AIG negligently or willfully violated the FCRA's requirements. Many of AIG's actions were highly suspect, including its treatment of customers unwilling to provide their social security numbers¹⁷ and the apparent adverse action that probably occurred. Plaintiff has generally plead violations of 15 U.S.C. §1681o and 15 U.S.C. § 1681n though it does not appear to press the "adverse action" aspect of these sections. Whether Plaintiff wants to pursue those other potential violations, whether she must amend her

¹⁷ Discovery this far has shown that AIG does not appear to be entirely honest with its customers in collecting information. According to the AIG caller instructions, if an AIG representative is asked by the consumer why a social security number is necessary, the AIG representative is instructed to state that the customer files are all indexed by social security number. In truth, however, Donald Procopio, senior vice president of AIG, testified at his deposition that AIG requests the consumer's social security number in order to facilitate obtaining the consumer's credit report. (Procopio Depo. at 57.) Consistent with this finding, Wardzinski further stated at his deposition that AIG indexes its files according to customer ID numbers that bear no relationship to a customer's SSN. (Wardzinski Depo. at 150.)

complaint to do so and whether any other defenses would bar such claims are issues which remain unresolved. Therefore, the Court will retain Counts I and II of the Plaintiff's complaint at least for the present time.

In Count III, Plaintiff alleges that AIG obtained and used her report under false pretenses in violation of the FCRA, 15 U.S.C. § 1681q. It is well-established that if a person obtains and uses a consumer report pursuant to a valid permissible purpose authorized by the FCRA, 15 U.S.C. § 1681b, it cannot be liable under a false pretenses theory. See *Duncan v. Handmaker*, 149 F.3d 424, 429 (6th Cir. 1998); *Zamora v. Valley Fed. Sav. & Loan Ass'n*, 811 F.2d 1368, 1370 (10th Cir. 1987). Because the Court concludes AIG had a permissible purpose for obtaining the Plaintiff's credit report, Count III is dismissed.

At this stage, the Court also must deny Defendant's motion to dismiss Count VIII, Plaintiff's state law invasion of privacy claim. Although it is true this Court held in *McAnly v. Middleton & Reutlinger*, 77 F. Supp. 2d 810, 815 (W.D. Ky. 1999), that a state law privacy claim cannot be based on a lawful disclosure under the FCRA, that case involved a claim in which the disclosure was concomitantly found to be lawful. The Court has not yet made its final determination on that point in this case. Rather it has more narrowly concluded that AIG had a permissible purpose to obtain the report; whether or not the rest of its actions – in particular how it went about obtaining Plaintiff's social security number – were permissible the Court is not prepared to say.

The Court denies Defendants' motion to dismiss Count X, Plaintiff's allegation that AIG and MBNA's conduct constituted an unlawful civil conspiracy. Under Kentucky law, a civil conspiracy is a "corrupt or unlawful combination or agreement between two or more persons to do

by concerted action an unlawful act, or to do a lawful act by unlawful means." *McDonald v. Goodman*, 239 S.W.2d 97, 100 (Ky. 1951). AIG has admitted that it had a contractual relationship with MBNA and there is some question as to how or where AIG obtained the Plaintiff's social security number. The facts thus far create the possibility that subsequent discovery might reveal that AIG had a permissible purpose when it obtained Plaintiff's consumer report, but that it nevertheless obtained that report through an unlawful means.

Finally, Plaintiff at this stage has yet to identify any "Unknown Persons" who, as employees of AIG and MBNA, should be held personally liable for their actions. Therefore, Counts IV, V, VI, VII, and IX are also dismissed.

The Court will enter an order consistent with this Memorandum Opinion.

JOHN G. HEYBURN II
CHIEF JUDGE, U.S. DISTRICT COURT

cc: Counsel of Record

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

CIVIL ACTION NO. 3:00-CV-614(H)

KATHLEEN SCHARPF

PLAINTIFF

V.

AIG MARKETING, INC., et al.

DEFENDANTS

ORDER

The Court has considered the parties cross motions for summary judgment. Being otherwise sufficiently advised,

IT IS HEREBY ORDERED that Plaintiff's Motion for Summary Judgment as to liability on the grounds that AIG lacked a "permissible purpose" when it obtained her credit report, is DENIED. Counts I and II are retained pending resolution of other issues, including those discussed in the Memorandum Opinion.

IT IS FURTHER ORDERED that Defendants' motions for summary judgment are SUSTAINED IN PART and Count III is DISMISSED WITH PREJUDICE and Counts IV, V, VI, VII and IX are DISMISSED WITHOUT PREJUDICE.

IT IS FURTHER ORDERED that Defendants' motion for summary judgment is DENIED as to Counts VIII and X.

This ____ day of January, 2003.

JOHN G. HEYBURN II
CHIEF JUDGE, U.S. DISTRICT COURT

cc: Counsel of Record

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March 28, 2003

Representative Bruce Weyhrauch
Chairman, House State Affairs Committee
State Capitol, Room 102
Juneau, AK 99801-1182

Re: House Bill 47
House Bill 5

Dear Representative Weyhrauch:

I am writing to you on behalf of State Farm regarding House Bill 47 and House Bill 5. I understand there is going to be a time limit for individual testimony, so I thought it might be helpful to provide some additional background information. To that end, I am enclosing herewith a copy of a March 5, 2002, letter I sent to Senator Stevens of the Senate Labor and Commerce Committee relating to the credit scoring legislation pending before that Committee last year. I am also enclosing herewith a copy of a work draft we reached agreement on last year with the sponsor of Senate Bill 320. Finally, I am enclosing herewith a copy of a brochure that explains State Farm's underwriting model.

I appreciate the opportunity the Committee gave to me to testify earlier this year. I was asked a number of questions during that hearing about studies that might show the effect of the use of underwriting scores based on credit by various insurers. There are a number of studies that are in existence. These include a recent review of various studies by the American Academy of Actuaries and most recently a study done by the University of Texas. I have enclosed copies of both of these documents for your review, as well as the very thorough study done by James E. Monaghan. I am sure you are also aware of the study done by the Alaska Division of Insurance as well as the Washington Division of Insurance.

The study by the University of Texas was based on 175,647 separate auto policies, which were transferred to Choicepoint. Choicepoint then provided credit scores for this sample of policies. This study found "there is less than a 1 in 10,000 chance that the relationship observed between credit score and relative loss ratio could be due to chance alone." The charts contained in this report vividly demonstrate the relationship between credit score and loss.

Senator Dave Donley
March 28, 2003
Page 2

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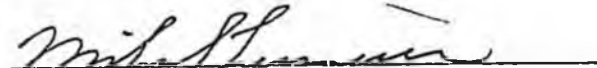
You are probably also aware that the issue of credit based insurance scoring has been before the National Association of Insurance Commissioners. We understand the NAIC recently asked to American Academy of Actuaries to review the recent studies mentioned above.

We continue to believe this tool to be a very valuable one and urge the Committee to allow its use. Should there be any further information we can provide to you, please let us know.

Sincerely,

LESSMEIER & WINTERS

By:


Michael L. Lessmeier

MLL/caf

Rep Weyhrauch-01-MLLwpd.wpd

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Documents 1 to 3 of 3

1. hrs 0431-0010c-0207.htm

Abstract: 431:10C-207 Discriminatory practices prohibited. No insurer shall base any standard or rating plan, in whole or in part, directly or indirectly, upon a person's race, creed, ethnic extraction, age, sex, length of driving experience, credit bureau rating, marital status, or physical handicap. [L. 1987, c 347, pt of §2]

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size 841 bytes

2. HRS 0435- ANNOTATIONS

Abstract: HRS 0435- ANNOTATIONS Cross References For present provisions, see chapter 431, article 10B. INSURANCE LAW REVISION CORRESPONDING SECTION REFERENCE TABLE 1987) HRS section HRS section 1985 Replacement Acts 347, 348, 349 1986 Supplement 1987 Session Laws 294-1 431:10C-102 294-2 431:10C-103 294-3 43

http://www.capitol.hawaii.gov/hrscurrent/vol09_ch0431-0435e/hrs435/hrs_0435-anno.htm
size 27414 bytes

3. TITLE 24

Abstract: TITLE 24. INSURANCE Chapter 431 Insurance Code 431A Readability of Insurance Contracts-Repealed 431D Insurance Company Insolvency-Repealed 431F Hawaii Life and Disability Insurance Guaranty Association Act—Repealed 431H Insurance Information Protection Act-Repealed 431J Captive Insurance Companies-R

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To: House State Affairs Committee, 1-907-465-2273
Representative Bruce Weyhrauch

From: Philip H. Mink, President
The Insurance Center, an Alaskan Corporation

RE: Public Hearing for HB 47 and HB 5
Insurance Discrimination by Credit Scoring

Thank you for allowing an open discussion on Credit Scoring. I have over 30 years of company underwriting, wholesale and Insurance Agent ownership experience. The last 21 years has been in Alaska, providing specialty products for the more difficult lines of business. I think a thumbnail presentation of the history behind Credit Scoring is important.

The Venice merchants sending ships through the Mediterranean Sea to open trade with the Far East began the concept during the middle ages. They would ban together a fleet to make the venture and distribute the profit between participants, including those that lost ships or cargo in the venture. Participants had to provide adequate crews, sea worthy vessels and trained captains.

Credit Scoring was carried through out Europe during the Renaissance. The Lloyds coffee house was a meeting place where financial interests met with merchants and underwriters to finance business ventures into the new world. They spread the exposure of loss among several participants, insuring no one financier would suffer catastrophic failure.

Today, Insurance consumers benefit from Credit Scoring. Insurance consumers that have good credit ratings get better insurance rates. They are more financially able to respond to maintenance and unforeseen events.

Eliminating insurance underwriting Credit Scoring is likened to attorneys being barred from discovery before trial or a banker not being able to review a credit report for a loan consideration. Insurance rates and premiums could level out, but only towards highest end of the spectrum, affecting all consumers adversely.

Please let the American Free Enterprise system work. Further regulation will only stifle insurance markets in a State that is already market poor.

Thank your for your time.

Subject: House Bills 5 & 47

Date: Wed, 26 Mar 2003 23:31:07 -0900

From: Ron Sexton <rkssoldotna@gci.net>

To: Ginny Austerman <Ginny_Austerman@Legis.state.ak.us>

March 26, 2003

House Bills 5 & 47

Dear Fellow Alaskans:

I am opposed to any type of credit scoring for any insurance purposes. I have been told, by an agent, that he only gets objections on credit scoring from people with poor credit. That is definitely not my case! There are legal, personal and character issues involved.

The insurance companies, for a home owners policy, don't ask if you smoke, drink or do drugs. They don't ask for urine and blood samples. I was told that credit scoring is a "tool" that the insurance industry uses to write "better business". Well, the above questions could be "tools" for writing "better business" too and in the case of life insurance are used. These types of questions and verifications would show possible risk factors. I would do the above if asked but I will not give my SSN out to anyone that doesn't have a tax related need for it.

At the present time, I am required to give a lost history report. I have no problem with that. The insurance company can do a drivers report. They can do a personal interview and a inspection of my property that I want insured. If they want to check out other public sources of information they can go to the courthouse and check out small claims, civil and criminal records. They could even check the Permanent Fund records for claims against people who fail to meet their obligations. I think this is more then enough information for any company to do an evaluation.

Asking me to give my SSN, which is my private number for income tax purposes only, is an violation of my privacy and the law and in my opinion a conspiracy of the insurance industry to get access to information that has been collected by a third party with or without my knowledge. The fact that I must give my permission for them to use my number demonstrates that it is a private number and it should stay that way.

I urge you to pass a bill that will eliminate the need for credit scoring and thereby the need for a Social Security Number, for any type of insurance, whether for personal or business needs.

Sincerely,

Ron Sexton
Owner
Trinity Enterprises dba Trinity Greenhouse
P.O. Box 882
Soldotna, AK 99669
WK 907-262-9242
HM 907-262-4177

Subject: HB47 Important!

Date: Wed, 05 Feb 2003 11:41:32 -0900

From: Ron Sexton <rksoldotna@gci.net>

To: Representative_Bruce_Weyhrauch@legis.state.ak.us

To whom it may concern,

I need to express my concern about the insurance industry having the need to collect credit information, in order to price their insurance policies to potential customers. They do not ask for lost history reports from people who are shopping for new insurance coverage. They just seem interested in credit information and the red flags that information will bring up.

The discrimination that is taking place because of this policy is outrageous. I think this policy is two fold. First, people who have insurance will be forced to stay with coverage they have in order to keep insurance enforce without having to give up their personal information to shop around. Second, if you do allow a credit check, to find some reason to put people into a higher rating. If this were not so, why don't they ask for lost history reports? If you don't have any insurance history, isn't that in and of itself possible reason to increase the rate, until a track record is established.

In order to get a quote on coverage, they want your social security number to run the check. The Social Security Administration states "Prevent identity theft - protect your Social Security number", form #SSA-7005-SM-SI (10-2002). We have become so loose with giving this number out that we now face identity theft in our society in a big way.

I for one have never participated in any credit card offer. So what do you think my credit report would show? Some people have said to me how do you rent cars or get advanced room reservations. Just let me say "there is more than one way to skin a cat". My wife and I have no problem in living life without credit cards. The requirement of needing the social security number, for any other purpose than what it is mandated for, is use and abuse of our personal freedom.

I ask you this, how many times has an insurance agent been on your property to evaluate their risk in insuring your property? They do it sight unseen. I have lived in Alaska for 28 years and 26 of those years on the same property. I have never had an insurance agent on my property. They now want to use our credit information to see just what risk we are to them, while they sit in their office and drink coffee.

I encourage the passage of this bill. I would also recommend it include business insurance for the same reasons. My business property has had only one insurance representative on site in the 27 years of coverage. They are the current underwriters and have offer the best price and coverage and service over any other company we have had. They did not ask for any credit review!

Let us stand united on preserving our personal identity and freedoms. It is time to say enough, on information gathering.

Sincerely Submitted,

Ron Sexton



Alaska State Legislature Representative Harry Crawford Senator Kim Elton

www.akdemocrats.org

FOR IMMEDIATE RELEASE • February 9, 2002

CONTACT: Rep. Crawford (907) 465-3438

Sen. Elton (907) 465-4947

Actualities: (907) 465-5001

Elton, Crawford Bills Prohibit Discrimination in Insurance Rates **Bills ban use of credit score to rate auto and home insurance.**

JUNEAU – Sen. Kim Elton (D-Juneau) and Rep. Harry Crawford (D-Anchorage) introduced bills to prohibit the use of credit scores in underwriting and rate setting for home and auto insurance.

The insurance industry began using credit scores in underwriting and rate-setting in Alaska in 1993. The industry claims there is a strong correlation between a consumer's credit score and the likelihood that the consumer will file a claim, but they won't explain why the correlation may exist. Credit scores are generated by third-party organizations that run a consumer's credit history through a secret formula. The credit score and the method of its generation are unavailable to both consumers and insurance regulators. This leaves insurance regulators without the knowledge they need to fulfill their statutory obligation to protect Alaska's consumers from discrimination.

"Credit scoring is bad business in Alaska," said Elton. "Why should an Alaskan who doesn't believe in buying on time, but who has a good driving record pay higher car insurance premiums? Why should a woman who divorces a bum but has a good driving record pay a lot more for car insurance? Why should a couple who is approved for a home mortgage not be approved for the insurance coverage necessary to purchase the house?"

"Self-employed workers, recent divorcees, and members of minority and religious groups can be denied insurance if a credit bureau scores them low," said Crawford. "Discrimination in any form is objectionable, but when it works economic hardships on groups and individuals without explanation, we have to put a stop to it."

Crawford also noted that many older Alaskans prefer to pay cash, saying, "Our seniors aren't an insurance risk simply because they don't choose to borrow. How can you defend a rate-setting method that says they are?"

Credit scoring has been a topic of debate across the nation, and research in other jurisdictions has shown clear evidence that the method is discriminatory. One report, done by the Maryland division of insurance, showed that credit scoring resulted in low-income families paying up to twice as much for insurance premiums, regardless of claim history.



Tuesday, January 29, 2002, 12:00 a.m. Pacific

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Kreidler's weak case to limit 'credit scoring'

Insurance Commissioner Mike Kreidler proposes to restrict the use of "credit scoring" by insurance companies. He has made an interesting argument but has not proved his case.

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It was in the early 1990s that insurance companies found a correlation between people's use of credit and their claims on auto and homeowners' policies. Progressive Insurance, a California company, assigned policyholders to 18 credit scores — a formula that considers whether a person is a recent bankrupt, late in payments, has opened an unusual number of credit lines, etc. The group with the worst score had claims about two-and-a-half times greater than the group with the best score.

Allstate also found a strong correlation with credit and claims.

Are they saying they can predict car accidents by looking at how people manage their credit cards? Yes. They say it and are doing it. The question is, should it be restricted?

Commissioner Kreidler thinks no one should be denied coverage on account of a poor credit score, and that it should affect rates no more than 20 percent. Why? Because he has seen a number of cases that he thought unfair. One person went bankrupt because of a medical crisis. Another, an immigrant from a culture without bank cards, didn't have credit.

Medical crises may be insured against. People who move here are presumed to learn our ways.

If car insurers were proposing for the first time to use the driving record, there would be hard-luck stories too: the story of the undeserved ticket; the story of the accident that was the other guy's fault. And on the use of age and gender, countless parents have thought, "My son is not one of these hot-rod drivers. So he's 16. Should it cost *that much*?"

If the state were to mandate only a 20-percent extra premium for 16-year-old boys, whose premium would have to be raised to pay the claims? That is the problem with the 20-percent cap Kreidler proposes: For every nickel it saves A, it will penalize B.

Kreidler worries that a high rate will cause the poor to drop their coverage. But, according to the companies, prudence is not related to income. Some of the poor benefit under the credit scoring and some don't.

The other thing that disturbs Kreidler about credit scoring is that no one can say why it works. Ask the insurers to explain why men have more car accidents than women. They don't know. Their interest is in the fact. So, too, with credit. It is a fact that people with poor credit are poor risks for wrecked cars.

If our insurance commissioner would ask the companies to ignore their discovery, he needs a stronger case than this.

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Subject: USATODAY.com - Bad credit boosts insurance costs

Date: Tue, 04 Mar 2003 10:22:07 -0900

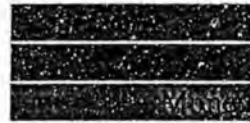
From: Jay Hardenbrook <Jay_Hardenbrook@legis.state.ak.us>

To: Ginny_Austerman@legis.state.ak.us

Just a little something extra to add to the packet. I tried to send it to you yesterday, but wasn't sure if you got it with all of the email problems.

Thanks,
Jay

<http://www.usatoday.com/money/perfi/general/2002-03-12-insurance.htm>



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03/11/2002 - Updated 11:20 PM ET

Bad credit boosts insurance costs

By Thomas A. Fogarty, USA TODAY

Credit trouble doesn't just make it hard to get a loan. For many, it's increasing the cost of insurance.

Two dozen state legislatures are looking at curbing the growing practice of using a customer's credit history to predict insurance claims. Nearly every auto insurer in the USA has started to assign a score to a customer's credit history. Practices vary, but the score is used in deciding to issue a policy, to renew it, or to price it. Credit scoring is becoming the norm for home insurers, too. The Washington legislature this month became the first to significantly restrict credit scoring for insurance.

Political backlash is building because of cases like that of Larry Jackson and his wife, Elizabeth Alexander, of Kirkland, Wash. Last fall, their auto insurer raised their rates 40%. The bump followed six years of accident-free coverage and timely premium payments. But the insurer decided to factor credit scores into pricing decisions; that brought up a bankruptcy filing from seven years ago.

"My wife and I are careful drivers, and our credit has not been an issue for a number of years," says Jackson, 45, a mining engineer.

Not in dispute is the ability of credit scores to predict broadly the

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likelihood of future claims by a certain type of customer.

Credit scores work in insurance calculations, says Lamont Boyd of credit-scoring firm Fair Isaac, because "the vast majority of people tend to do things in a certain way." Thus, he says, those who manage their credit well also tend to leave home early enough that they don't have to drive recklessly to get to work on time.

Joe Annoti, spokesman for the National Association of Independent Insurers, says banning the use of credit scores by insurers could increase rates for good credit risks because insurers could no longer distinguish good risks from bad.

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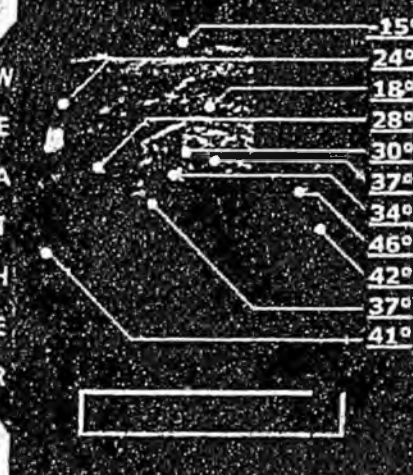
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viewpoint *Michael Moceris*

Web posted Monday, February 24, 2003

Credit scoring powerful tool for predicting risky behavior

By Devery Prince
For the Journal

Centuries ago, anyone with a new idea that went against popular belief was shunned by society or its leaders. It didn't matter if they could prove their idea; the fact that it went against the beliefs of the day made it detestable to those who wanted to maintain the status quo. A well-known example is Galileo, who was sentenced to prison for writing that the earth is not the center of the universe.

Today, some members of the state legislature appear ready to eliminate insurance companies' ability to use credit information for insurance scoring simply because they don't understand it. The fact is numerous studies have proven that using certain information contained in credit reports is an accurate predictor of insurance losses.

Two of the largest statistical consulting companies, Tillinghast-Towers, Perrin and Fair, Isaac have both published studies showing a statistically significant correlation between credit scores and insurance losses. Studies such as these employ statistical analysis methods similar to those used by universities, scholars, laboratories, businesses and a host of other groups for their research.

If you discredit the studies proving the accuracy of the use of credit scoring, then millions of other studies must be invalidated because they all depend on similar mathematical models to determine

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relationships between factors. Opponents of the use of credit have yet to produce a single study that suggests that credit history is no a valid predictor of insurance losses.

Instead of looking at the compiled data and research on millions of insurance customers, the critics endlessly repeat statements that have no credible evidence or studies to back them up. The volume evidence compiled by insurance and independent research companies overwhelms the anecdotal reports being fed to the unknowing public by those opposed to credit scoring.

The bottom line is that the insurance industry wants to be able to use the tools that will allow customers to pay premiums that accurately reflect their risk of loss. Just like factors such as age, marital status, gender, driving record, miles driven and car type, a insurance score based on credit has proven to be very accurate in predicting the likelihood of insurance losses. If these weren't valid predictors, the insurance industry wouldn't use them.

Credit is, as proven by studies and industry data, the single most powerful predictor of future loss and aids the industry in fairly and accurately pricing insurance for consumers.

Banning the use of credit will take away the ability of insurance companies to identify responsible customers who should be rewarded with lower premiums. Instead, those responsible customers will have to pay higher premiums to subsidize those who are more likely to incur a loss.

Is it fair to use unproven accusations against the use of credit simply because someone doesn't understand it or because it is new? The unfortunate victims of this campaign will be those whose good insurance scores show that they are less likely to incur losses, and yet will be forced to pay more because this accurate factor cannot be considered.

Make no mistake: Someone will pay for the costs. The difference is that some legislators want one group to subsidize another group in the form of higher premiums, and insurance companies just want to reward those who are less likely to incur losses.

Devery Prince is the principal of Anchorage-based Devery Prince Agency, which provides insurance to individuals and businesses across Alaska. He can be reached at 907-279-9000.

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Anchorage Daily News - Published Feb. 10, 03 3/29
Credit scoring is a useful tool for insurance companies; don't ban it

As an Alaska insurance agent, I am very concerned about proposed legislation that would ban the use of credit for setting insurance rates. Those who question credit's validity need only to look at the numerous studies that prove its accuracy in identifying people who should receive discounts because they will have fewer losses.

Your editorial of Jan. 26 brings up some valid points on the use of credit for insurance scoring, such as medical catastrophes. These issues can be addressed with some reasonable limitations. However, the philosophy of "I don't like it or understand it, so let's ban it" ignores the irrefutable fact that it is accurate and helps to promote healthy competition in the insurance industry, something Alaska desperately needs.

Let's not allow the government to pass another law to restrict business, especially a law that will prevent insurance companies from identifying people who should be rewarded for responsible behavior. If any of these bills pass, those who will suffer will be consumers and small-business owners like me.

-- Devery Prince

Anchorage

Credit scoring rewards consumers who will incur fewer losses

As an insurance agent who takes pride in providing my customers with outstanding service and fair rates, I was disappointed by your editorial (Credit scoring: either reform or abolish this insurance shortcut," Jan. 26) endorsing legislation banning the use of credit to set insurance rates.

The reason credit is a predictor of risk is not "magic." Numerous scientifically designed studies and data from the industry have proven the connection between a person's credit history and the number of losses they will incur. The way a person cares for their finances can reflect the way they maintain their homes, and taking financial risks can mirror risky behavior in activities such as driving. Why would the industry use it if it wasn't accurate?

Credit scoring will allow an insurance company to reward consumers who will have fewer losses with lower rates. If we have found an accurate predictor so we can offer those discounts to the majority of our customers, why should it be taken away by the Legislature? That seems highly unfair to those people who are responsible and deserve good insurance rates. People with responsible behavior should not have to subsidize the insurance rates of those who are irresponsible.

-- Stan Tebow

Palmer

Begich is a candidate for change after nine years of stagnation

It's refreshing to see Mark Begich is running for mayor. I was afraid he'd sit this race out and let the two other candidates go to battle.

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OPINIONS

COMPASS: Points of view from the community

By RICHARD L. LOWELLEllen Goodman
comment

(Published: February 24, 2003)

Insurance crisis demands attention

As a veteran insurance broker with 26 years of experience in Alaska, I am alarmed by the never-before-seen insurance crisis in our state with regard to the large number of personal-lines companies ceasing to do business in Alaska. My fear is that, if this trend continues, the effects will be disastrous for consumers, our businesses and, ultimately, our economy. That is why it is imperative that we examine what the Legislature is proposing very closely while there is still time to make corrections.

As evidenced by three bills in the Legislature, a recent concern is the use of credit scoring to obtain a proper insurance rate. While all of us know of isolated circumstances where credit scoring may have had a negative impact on an individual consumer, the hard reality is that if the Legislature does not allow insurance companies to use some sort of credit scoring as a tool in conjunction with other guidelines, they will cease doing business in Alaska. This will reduce even further the number of insurance companies operating here.

The benefit to consumers of the use of credit is that those who will have fewer losses can be more easily identified and rewarded with discounts. Credit is another predictive factor such as age, marital status, gender and type of car. Good drivers should not be made to unfairly subsidize poor drivers.

I believe that a compromise is needed between the insurance companies and the Alaska Division of Insurance. It is critical to ensure that both consumers and insurance companies are being protected and treated fairly. The past few years have been extremely difficult within the tumultuous insurance industry. Alaska has lost many national companies representing home and auto including Kemper, Fireman's Fund, AAA, United Pacific, Deerbrook, InsurQuest, Colonial, Windsor, Atlanta Casualty, Industrial Indemnity, Alaska Insurance Co. and Continental. In particular, the loss of two major home and auto companies, Fireman's Fund and Kemper, were especially difficult for the market. Fortunately, many of these customers went with Safeco, a company that uses credit scoring in addition to its other underwriting guidelines.

Another major concern is the hastiness of this legislation at a time when a new director of insurance is being selected. Ideally, the new director should

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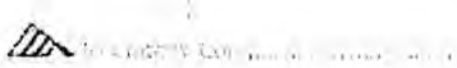
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be given time to get situated into the new position and work toward a compromise between the insurance companies and the Legislature.

The proposed bills to ban the use of credit scoring are very shortsighted. We need healthy insurance competition in Alaska. Banning the use of credit scoring will serve only to drive more companies from our state as well as take away a valuable, proven tool to set rates fairly. The Legislature should withhold any action until the new director of insurance achieves a compromise that benefits everyone.

Richard L. Lowell is an independent insurance broker with Ribelin Lowell and Co. in Anchorage.



Subject: Anchorage Daily News | Opinion

Date: Tue, 28 Jan 2003 08:01:46 -0900

From: Jay Hardenbrook <Jay_Hardenbrook@legis.state.ak.us>

To: Ginny_Austerman@legis.state.ak.us

Just a little something extra to add to the bill packet on HB 5.

Thanks,
Jay

<http://www.adn.com/opinion/story/2522259p-2574956c.html>








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OPINIONS

Opinion

Credit scoring

Can we reform or abolish this insurance shortcut

(Published: January 26, 2003)

Insurance companies love the practice of credit scoring because it's cheap and easy. By some magic known only to actuarial wizards, a person's credit records can be converted into a number that companies find useful to decide whether to insure a person or how much to charge him. No need to spend a lot of time tracking down motor vehicle files, checking property records or evaluating other information that directly bears on what kind of risk the applicant poses.

And if there is no logical connection between a person's credit history and the odds she will make auto or home insurance claims? No problem. It's magic, but it works.

Except that it doesn't always.

Some people with good driving records get socked with big rate increases because of what's in their credit file. Some people with good credit but bad driving records get lower rates they don't deserve.

Some people have less than perfect credit records for reasons beyond their control. They may have suffered a medical catastrophe. A recent divorce may have scrambled their finances. An angry ex-spouse may be withholding child support payments.

And the whole exercise of credit scoring is premised on the assumption that

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what is in a person's credit file is accurate. Many an Alaskan can testify to the contrary.

Credit scoring has drawn plenty of criticism, even from inside the insurance industry. The National Association of Professional Allstate Agents has condemned it on multiple grounds. The methodology is secret, with no oversight by state insurance commissioners. Credit scores can change frequently, calling their reliability into question. Noting the impact it has on minorities, the poor, senior citizens and others who don't use much credit, the group calls credit scoring "a new method of redlining."

Anchorage state Sen. John Cowdery, R-Lower Hillside, is leading the charge to ban credit scoring in Alaska. Hardly an advocate of big government, he knows first hand from his daughter's experience how credit scoring can punish someone with a clean driving record. He's joined by colleagues from both ends of the spectrum: conservative Republican Fred Dyson of Eagle River and Democrats Kim Elton of Juneau and Gretchen Guess and Johnny Ellis of Anchorage.

At minimum, some reforms are essential. Exclusive reliance on credit scores should be banned. Customers must have a way to make sure their credit records are accurate and get refunds if errors cause them to be overcharged for insurance. Those with little credit history should not be penalized for it. State insurance regulators must be able to scrutinize the mystery formulas so they can judge how appropriate the process is.

By the time insurance companies comply with reasonable conditions like these, credit scoring may no longer be such a cheap and easy way to decide coverage and set rates. If insurance companies aren't willing to mend the practice of credit scoring, though, the Legislature should end it altogether.



Credit scoring issue may drive into Legislature

RECORD: Opponents charge discrimination while insurance companies call it a valuable tool.

By Cathy Brown
The Associated Press

(Published: January 14, 2003)

Juneau -- When state Sen. John Cowdery's daughter's insurance rates skyrocketed after she got a new truck last year, he was outraged.

He said his daughter had a clean driving record but the insurance company jacked up her premiums because of her credit score.

As chairman of the Senate Transportation Committee last year, Cowdery was in a position to do something about it. He introduced legislation to ban the use of credit scoring in setting insurance rates.

The bill did not make it through the Legislature last year, but Cowdery, R-Anchorage, is introducing the measure again. He's co-sponsoring it with Sen. Kim Elton, D-Juneau.

Reps. Harry Crawford, D-Anchorage, and Mike Chenault, R-Nikiski, are introducing similar bills in the House. The legislative session starts Jan. 21.

The lawmakers say the practice unfairly discriminates against people who may be good insurance risks, despite not having great credit scores.

The insurance industry argues, however, that there is a statistical correlation between bad credit scores and higher insurance risks and that not using the scores would penalize people who are a lower risk.

After Cowdery's daughter's case prompted him to investigate credit scoring, Cowdery said, he began hearing from other people whose rates had risen because of the practice.

"People came out of the woodwork talking about this," Cowdery said.

The use of credit scoring has become increasingly common in the insurance industry and about two dozen states considered limiting it last year, Elton said. Washington state passed a law restricting the practice.

Elton said credit scoring can unfairly discriminate against people who may have poor credit for reasons unrelated to the home they own or their driving habits.

Minorities, rural residents, senior citizens, and groups that for religious reasons do not believe in using credit are especially at risk, Elton said.

"For example, in rural Alaska where you have seasonal employment, you often deal with a grocery store kind of off the cuff, and you get carried until employment happens the next season," Elton said. Also at risk are people overwhelmed by high medical bills, he said.

Nicole Mahrt, a spokeswoman for American Insurance Association, defended the practice. Insurance companies do still use traditional factors, such as driving history and age, to set rates, but they've found credit history is also useful.

"It statistically is very effective in predicting losses," she said. "So essentially it helps people that are a better risk not subsidize those that are higher risks."

Insurance companies can account for factors that would unfairly brand someone a bad risk, such as those who never buy on credit, and look for other information in setting their rates, Mahrt said.

Also, the people who develop the models for insurance companies are trying to find a way to pull medical bills out of the formula so a serious illness does not unfairly push up auto and homeowners insurance rates, Mahrt said.

Different insurance companies give more weight to some credit factors than others, so consumers can shop around if they do not like the rates they are quoted, she added.

Elton said while there may be a statistical correlation between credit risk and insurance claims, in practice using credit scores can lead to bizarre outcomes.

An insurance agent relayed an anecdote about a person convicted of DWI paying less for insurance than a person with a bad credit score, though both drove identical vehicles, Elton said.

Elton said he believes the legislation has a good chance of passing this year because supporters began educating their colleagues about it last year.