

SB

13

Alaska State Legislature

Senator John Cowdery
Chair, Rules & Transportation



Senator Kim Elton
Minority Whip

MEMORANDUM

April 2, 2003

To: Senator Ralph Seekins, Chair
Senate Judiciary Committee

From: Senator John Cowdery *lc*
Senator Kim Elton *KE*

Re: Hearing Request

We respectfully request a hearing on Senate Bill 13, prohibiting discrimination in insurance rates based on credit rating or credit scoring.

We appreciate the hours you devoted to this issue in the Labor & Commerce committee. The attached sponsor statement lays out many of the problems with the practice of credit scoring. We have also attached several letters and news articles, as well as the recent Alaska Division of Insurance study.

We look forward to taking this matter up at the committee's earliest convenience.

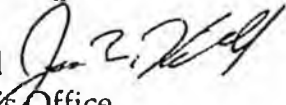


SENATOR KIM ELTON

MEMORANDUM

May 5, 2003

To: Legislative Legal Services

From: Jesse Kiehl 
Sen. Elton's Office

This memo refers to my previous memo of May 2 regarding SB 13.

Upon conferring with staff to the joint sponsor, Sen. Cowdery, I have two revisions to that request.

1. The 36-month time limit for consumers to notify an insurer that credit information (on which underwriting or rating decisions were based) has been corrected should be shortened to 12 months.
2. Please amend the CS so the models, credit factors, and scoring formulae or algorithms used for underwriting, tiering, and rating filed with the division may be protected as a trade secret. Add a requirement that the division make available to the public a description of the factors involved in the models (&c) and their approximate weighting.

As promised, I have also attached draft language for the provisions requiring insurers to assist consumers with the error correction process.

The chair of the Senate Judiciary Committee has noticed a hearing on SB 13 tomorrow morning (5/6/03) at 8:00 a.m. I would like to have the C.S. available then. Please accept my apologies for the short notice on these changes. I appreciate your assistance.

Amend CSHB 47 (STA)

Page 4, line 7, insert the following new section. Relabel the existing sections (b) - (g) accordingly.

Dispute Resolution

(b) An insurer that uses credit information in underwriting or rating shall establish a dispute resolution process that meets the minimum standards of this subsection.

- (1) If the insured notifies the insurer that credit information used in underwriting or rating or for calculating an insurance score is inaccurate, the insurer shall attempt to verify the accuracy of the information by obtaining credit information from all credit reporting agencies. If there is a discrepancy between the credit information obtained from the credit reporting agencies, the insurer may not use the credit information until the discrepancies are corrected. If there is no discrepancy among the credit information obtained from the credit reporting agencies, but the consumer maintains that the credit information is incorrect, the consumer may provide the insurer with documentation demonstrating that the credit information obtained from the credit reporting agency is incorrect. When the consumer provides documentation, the insurer may not use the disputed credit information until the credit information is determined to be correct under the FCRA dispute resolution process.
- (2) The insurer shall establish a process, as required by AS 21.39.090, to respond to questions related to the application of the insured's rating plan.

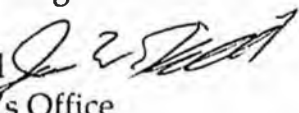


SENATOR KIM ELTON

MEMORANDUM

May 2, 2003

To: Legislative Legal Services

From: Jesse Kiehl 
Sen. Elton's Office

Please prepare a work draft of a committee substitute for SB 13, the bill Senators Cowdery and Elton jointly sponsor on credit scoring in insurance.

The CS will constitute a major rewrite of the bill. It should accomplish the following:

- Narrow the scope to address personal lines of insurance, including boats, ATV's, motorcycles, mobile homes, renter's coverage, inland marine, &c.
- Allow an insurer to use credit information for underwriting, tiering, and/or rate setting only with the consent of the consumer, and specify that an insurer or producer may not take an adverse action against a consumer who withholds his or her consent.
- Prohibit insurers from using credit information to make an underwriting, tiering, or rating decision without considering "other substantive factors."
- Allow insurers to use credit information only for underwriting, tiering, and/or rating new business. It should make explicit that an insurer may not use credit information at renewal.
- Provide that a consumer forced by divorce or death of a spouse or partner to seek new insurance does not constitute new business and credit information may not be used.
- Prohibit insurers from using the following types of credit information, either independently or as part of a credit score:
 1. Information disputed under FCRA
 2. Number or type of credit inquiries
 3. Type of credit card
 4. Absence of credit card
 5. Personal Finance Company account(s)
 6. Absence of credit history
 7. Too little information to calculate a score
 8. Initial purchase of a home or vehicle (including boats, ATV's, &c)
 9. Total available credit

10. Medical collections

11. Age at which credit was first established

- Prohibit insurers from using a credit score that uses income, age, sex, address, zip code, census block, ethnicity, religion, marital status, or nationality as a factor.
- Prohibit insurers from using a credit score or credit information based on a consumer credit report that is more than seven months old.
- Prohibit insurers from using a credit score derived from an insurance model to determine eligibility for a payment plan. This provision should not ban use of a traditional lending credit score, the intent of which is to evaluate creditworthiness, in determining payment plan eligibility.
- Require insurers to file the models, credit factors, and scoring formulae or algorithms used for underwriting, tiering, and rating with the division. No new provision should allow a third party or vendor to file on the insurer's behalf. No new provision should be made to render this information confidential or classify it as a trade secret.
- Require insurers to file the data used to develop those models, factors, formulae, and algorithms with the division. No new provision should allow a third party or vendor to file on the insurer's behalf. This data may be kept confidential by the department and protected as a trade secret.
- Require an insurer that takes an adverse action in underwriting, rating, or tiering based on credit data to:
 1. Give notice of adverse action under the Fair Credit Reporting Act (FCRA).
 2. Notify the consumer of his/her right to a free copy of the consumer's credit report.
 3. Inform the consumer of his/her rights to correct errors in a credit report under FCRA.
 4. Assist the consumer with the error correction process. I will forward draft language for this requirement to you as soon as I receive it from the Division of Insurance.
 5. Provide information on how a consumer can improve his or her credit score.
 6. Inform the consumer of all factors in the consumer's credit history that hurt his/her score. The division should approve the wording of this information in advance.
- Require insurers to refund the difference in premium due to use of credit information in underwriting, tiering, and/or rating if incorrect credit information was used and the consumer has his/her credit report corrected under FCRA and notifies the insurer. Fairness would seem to dictate a 36-month time limit for the consumer to find such errors.
- Define adverse action. The definition on page three of CSHB 5(STA), 23-LS0021\I would do nicely, although I believe the inclusion of the word "or" on line 16 is a typographical error.

- State that nothing in this act requires an insurer to use credit information for any purpose.

The Division of Insurance asks that these restrictions be made clear in both chapter 36 and 39 of title 21, as appropriate, to aid them in enforcement.

I understand how little time is left in the session, and appreciate your assistance.

Alaska State Legislature

Senator John Cowdery
Chair, Rules & Transportation



Senator Kim Elton
Minority Whip

SB 13 - Prohibiting Credit Scoring in Insurance Sponsor Statement

SB 13 prohibits insurance companies in Alaska from using credit scores in underwriting or rate setting for car or home insurance. Credit scores are derived by running credit histories through a secret formula that is not available to insurance regulators or consumers. Alaska home and auto insurers commonly base decisions on whether to offer a policy on credit scores. If insurance is offered, premiums are then based on the secret score and not on driving record or claim history. The worse the credit score, the higher the premium.

State insurance regulators and other organizations have scrutinized the use of credit scores since the insurance industry adopted the methodology in the 1980s. Research in other jurisdictions clearly demonstrates credit scoring is discriminatory, and an investigation by the Alaska Division of Insurance concluded, "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." In keeping with its statutory mandate (AS.21.36.120) to protect the Alaska consumer against unfair discrimination, the division recommended curbing the practice to protect the public.

Some Alaskans have poor credit for reasons beyond their control—those who went through a divorce; seasonal workers; those who had serious medical emergencies; or those with unforeseen problems in their businesses or careers. There are many Alaskans without credit histories at all: rural Alaskans in a cash economy; members of religious groups that forbid the use of credit (neither a borrower nor a lender be); and many older Alaskans who distrust credit and instead pay cash. Is it fair to deny insurance to a 30-year-old woman with a clean driving record simply because a divorce changed her credit status? Is it fair to raise the premiums of a 67-year-old man with a clean driving record whose medical bills affected his credit history?

For that matter, credit scores reflect much more than your debt and payment history. Just having credit checked too often can result in a worse credit score. Losing health insurance, seeking credit counseling, paying debt early, using a debit card, or having a

Nordstrom's card all are known to hurt a person's credit score, and therefore increase the cost of insurance.

Lack of information is another fundamental problem with credit scoring. Neither consumers nor state regulators have access to scores or how information is manipulated to create those scores. The insurance industry is unwilling or unable to articulate how or why, thus we cannot know with certainty whether discriminatory factors are used in determining the scores. There is simply no explanation for how the 'black box' can be effective in light of a recent study showing tremendous inaccuracies in the credit reports used to calculate scores.

Hawaii has completely banned the use of credit scoring in both rate setting and underwriting. Maryland and Washington have sharply restricted it. The Hawaii law was implemented in 1987, and Hawaiians enjoy lower premiums than Alaskans.

CS FOR SENATE BILL NO. 13()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:

Referred:

Sponsor(s): SENATORS ELTON AND COWDERY, Ellis, Dyson, Guess, French, Lincoln

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to using credit history or insurance scoring for insurance purposes;**
2 **and 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.** It is the purpose of this Act to regulate the use of credit information for
7 personal insurance so that consumers are provided with certain protections with respect to the
8 use of credit information. This Act is not intended to apply to commercial insurance
9 transactions.

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

11 **Sec. 21.36.460. Uses of and restrictions on credit history or insurance**
12 **scoring applicable to personal insurance.** (a) If an insurer writing personal
13 insurance uses credit information in underwriting or rating a consumer, the insurer
14 shall disclose, either on the insurance application or, at the time the insurance

1 application is taken, that the insurer will obtain credit information in connection with
2 the application. The disclosure required under this subsection shall be in writing or in
3 the same medium as the application for insurance. Use of the following statement
4 constitutes compliance with this subsection: "In connection with this application for
5 insurance, we will review your credit report or obtain or use a credit-based insurance
6 score based on the information contained in your credit report. We may use this
7 information to decide whether to insure you or how much to charge." If an insurer
8 uses a third party to calculate the applicant's insurance score, the disclosure required
9 under this subsection must also contain language similar to: "We may use a third-
10 party in connection with the development of your insurance score."

11 (b) An insurer that takes adverse action involving personal insurance against a
12 consumer based in whole or in part on credit history or insurance score shall provide
13 the consumer the opportunity to request reconsideration of the adverse action and
14 provide written notice to the applicant or named insured. The notice must

15 (1) clearly and specifically state the significant factors of the credit
16 history or insurance score that resulted in the adverse action, in a manner that allows
17 the consumer to identify the basis for the adverse action;

18 (2) inform the consumer that the consumer is entitled to

19 (A) request reconsideration of the adverse action; and

20 (B) a free copy of the consumer's report under 15 U.S.C. 1681
21 et seq. (Fair Credit Reporting Act);

22 (3) inform the consumer that the consumer has the right to correct
23 errors in the credit report;

24 (4) advise the consumer on ways to improve the consumer's insurance
25 score; and

26 (5) provide information to assist the consumer with the error correction
27 process.

28 (c) An insurer may use credit history to cancel, deny, underwrite, or rate
29 personal insurance only in combination with other substantive underwriting factors.
30 For the purposes of this subsection,

31 (1) refusal to offer personal insurance coverage to a consumer

1 constitutes denial of personal insurance; and

2 (2) an offer of placement with an affiliate insurer does not constitute
3 denial of coverage.

4 (d) An insurer may not

5 (1) fail to renew or, at renewal, again underwrite or rate a personal
6 insurance policy based in whole or in part on a consumer's credit history or insurance
7 score;

8 (2) cancel, deny, underwrite, or rate personal insurance coverage based
9 in whole or in part on

10 (A) the absence of credit history or the inability to determine
11 the consumer's credit history if the insurer has received accurate and complete
12 information from the consumer;

13 (B) credit inquiries not initiated by the consumer;

14 (C) credit inquiries relating to insurance coverage, if identified
15 on a consumer's credit report;

16 (D) credit inquiries by the consumer for the consumer's own
17 credit information;

18 (E) multiple lender inquiries, if coded on the consumer's credit
19 report as being for automobile, boat, recreation vehicle, or home mortgage
20 loans, unless all inquiries under that code within a 30-day period are counted
21 as one;

22 (F) credit history or an insurance score based on collection
23 accounts identified with a medical industry code;

24 (G) the consumer's use of a particular type of credit card,
25 charge card, or debit card or the absence of a credit card;

26 (H) the consumer's total available line of credit; however, the
27 consumer's ratio of debt to total available line of credit may be considered;

28 (I) the consumer's obtaining an automobile or home loan within
29 the previous 12 months;

30 (J) the presence or absence of personal finance company
31 accounts; or

1 (K) the age at which credit is established;

2 (3) use the credit history of the consumer when the consumer provides
3 a written notice to the insurer affirming that the credit history results from the actions
4 of a joint account owner who is or was a spouse of the consumer;

5 (4) use an insurance score that is calculated using the income, age, sex,
6 address, zip code, census block, ethnic group, religion, marital status, or nationality of
7 the consumer as a factor;

8 (5) use credit history to determine an insurance score if the history is
9 obtained more than 60 days before the policy is issued;

10 (6) use an insurance score derived from an insurance scoring model to
11 determine eligibility for an insurance payment plan; this paragraph does not prohibit
12 the use of credit history to evaluate the ability of the consumer to make payments.

13 (e) If incorrect credit history is used to underwrite or rate personal insurance
14 coverage and a consumer is charged higher premiums or offered less favorable policy
15 terms due to the disputed credit history, the insurer shall reissue or rerate the policy
16 retroactive to the effective date of the current policy term and the policy, as reissued or
17 ratered, shall provide premiums and policy terms the consumer would have been
18 eligible for if accurate credit history had been used to underwrite or rate the policy. If
19 an insurer determines that the insured has overpaid a premium, the insurer shall refund
20 to the insured the amount of overpayment calculated back to the last 12 months of
21 coverage or the actual policy period, whichever period is shorter. This subsection
22 applies only if the consumer discovers the incorrect credit history within 12 months
23 after the policy is issued, resolves the dispute as described under (f) of this section or
24 under the process in 15 U.S.C. 1681 et seq. (Fair Credit Reporting Act), and notifies
25 the insurer in writing that the dispute has been resolved.

26 (f) If the use of disputed credit history results in denial or cancellation of
27 personal insurance coverage, an insurer shall reunderwrite the coverage without the
28 use of credit information as a factor. This subsection applies only if, within 10 days
29 following denial or cancellation, the consumer provides a reconsideration certification
30 to the insurer that sets forth any items of the credit history that are disputed and that
31 indicates that the consumer has initiated the dispute resolution process in 15 U.S.C.

1 1681 (Fair Credit Reporting Act) by requesting a copy of the consumer's credit report.
2 An insurer's reconsideration certification form

3 (1) is subject to filing and approval by the director under
4 AS 21.42.120; and

5 (2) shall be provided by an insurer to the consumer at the time of
6 denial or cancellation.

7 (g) This section does not require an insurer to use credit history for any
8 purpose.

9 (h) In this section,

10 (1) "adverse action" has the meaning given in 15 U.S.C. 1681 et seq.
11 (Fair Credit Reporting Act) and includes

12 (A) cancellation, denial, or failure to renew personal insurance
13 coverage;

14 (B) charging a higher insurance premium for personal
15 insurance than would have been offered if the credit history or insurance score
16 had been more favorable, whether the charge is by

17 (i) application of a rating rule;

18 (ii) assignment to a rating tier that does not have the
19 lowest available rates; or

20 (iii) placement with an affiliate company that does not
21 offer the lowest rates available to the consumer within the affiliate
22 group of insurance companies; or

23 (C) any reduction or adverse or unfavorable change in the
24 terms of coverage or amount of personal insurance due to a consumer's credit
25 history or insurance score; a reduction or adverse or unfavorable change in the
26 terms of coverage occurs when

27 (i) coverage provided to the consumer is not as broad in
28 scope as coverage requested by the consumer but available to other
29 insureds of the insurer or any affiliate; or

30 (ii) the consumer is not eligible for benefits that are
31 available through affiliate insurers;

- 1 (2) "affiliate" has the meaning given in AS 21.22.200;
- 2 (3) "consumer" means an individual policyholder or applicant for
3 insurance;
- 4 (4) "consumer report" has the meaning given in 15 U.S.C. 1681 et seq.
5 (Fair Credit Reporting Act);
- 6 (5) "credit history" means written, oral, or other communication of
7 information by a consumer reporting agency bearing on a consumer's
8 creditworthiness, credit standing, or credit capacity that is used or expected to be used,
9 or collected in whole or in part, for the purpose of serving as a factor in determining
10 personal insurance premiums or eligibility for coverage;
- 11 (6) "insurance score" means a number or rating that is derived from an
12 algorithm, computer application, model, or other process that is based in whole or in
13 part on credit history;
- 14 (7) "personal insurance" means
- 15 (A) private passenger automobile or motorcycle coverage;
- 16 (B) homeowner coverage, including mobile homeowner's,
17 manufactured homeowner's, condominium owner's, and renter's coverage;
- 18 (C) dwelling property coverage;
- 19 (D) earthquake coverage for a residence or personal property;
- 20 (E) personal liability and theft coverage;
- 21 (F) personal property inland marine coverage;
- 22 (G) personal boat, watercraft, snowmobile, and recreational
23 vehicle coverage; and
- 24 (H) umbrella insurance coverage.

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

26 **Sec. 21.39.035. Required filing of insurance scoring models; personal**
27 **insurance.** (a) Credit history may not be used to determine personal insurance rates,
28 premiums, or to make underwriting decisions unless the insurance scoring models are
29 filed with the director. Insurance scoring models include all attributes and factors
30 used in the calculation of an insurance score, statistical validation, documentation,
31 appropriate loss information, and any other relevant factors.

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

(1) is confidential, shall be considered a trade secret, and is not subject to public inspection under AS 21.06.060;

(2) may be released or otherwise shared as provided in AS 21.06.060; and

(3) shall be filed by the insurer and may not be filed by a third party or vendor.

(c) An insurer shall comply with AS 21.36.460 when using credit history to calculate a personal insurance score or determine personal insurance premiums or rates.

(d) Notwithstanding (b) of this section, the director shall make available to the public a general description of the insurance scoring models filed under (a) of this section. A general description of insurance scoring models may not disclose any trade secrets contained in the models.

(e) In this section,

(1) "credit history" 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. AS 21.36.460(g) and (h), added by sec. 2 of this Act, and AS 21.39.035(a), (b), (d), and (e), added by sec. 3 of this Act take effect June 1, 2003.

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: SB 13
 (S) Publish Date: 5/2/03

Revision Date/Time (Note if correction): _____ Dept. Affected: DCED
 Title Insurance Discrimination by BRU Insurance (116)
Credit Rating Component Insurance Operations
 Sponsor Senators Cowdery & Elton
 Requester Senate Labor & Commerce 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 ratings 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: Linda S. Hall, Director Phone 907.269.7900
 Division: Division of Insurance Date/Time 4/8/03 8:25 AM
 Approved by: Edgar Blatchford, Commissioner Date 4/8/2003
 Agency: Department of Community & Economic Development

Several Organizations oppose the use of insurance credit scoring:

John Bryant, Agent Champion, is Terminated

John Bryant was an agent for a very large insurer. He treated his clients the way they deserve to be treated and even went to bat for them in the game of "insurance credit scoring". He was terminated for his efforts

The Center for Economic Justice

"David "Birny" Birnbaum, of the Center for Economic Justice, recently said, "There has been no comprehensive **independent** [emphasis added] study of a link between credit problems and car accidents. The industry is accepting 'statistics' from the company that provides that information and programs!" ^L

The National Association of Professional Allstate Agents

The National Association of Professional Allstate Agents (NAPAA) has studied the issue of "credit scoring," or "insurance scoring," and because Allstate was one of the earliest users of credit scoring algorithms to underwrite and rate insurance policies, Allstate insurance agents have the most experience dealing with this system and its adverse effect on our customers. Our conclusions based on this unique experience are:

- o It is a secret methodology, not subject to examination by Insurance Commissioners, which affects the premium and/or acceptance of insurance applicants and existing customers.
- o Credit scoring appeared when insurance companies were denied the ability to overtly Redline geographical areas and certain minority groups.
- o Credit scoring is a new method of Redlining meant to replace the old method.
- o Particularly affected are minorities, low-income groups, senior citizens and others who rarely, or never, make use of credit. Other affected people are those who have had divorces, the death of a spouse, large medical bills or even those who check their own credit regularly to be sure the information is accurate.
- o The insurance/credit score is a moving target - Today one may have a "score" of 4, next month a score of 2. The consumer just has to hope they get lucky when they apply, because they are stuck with whatever the score happens to be at that time, with no possibility of improvement, for the life of the policy.
- o Credit scoring allows a company to take rate increases at their sole discretion by merely adjusting their never examined and secret algorithm by changing the weighting of certain values.

Credit scoring for insurance is not socially acceptable. It violates the values Americans hold dear. The American way is to be judged on those things that are directly relevant to the

subject: Tickets, accidents, vehicle usage etc. for auto insurance and condition of premises, past losses and upkeep etc. for property insurance. Credit scoring for insurance purposes is Redlining. NAPAA strongly opposes Redlining, thus we have no choice but to oppose credit scoring.

United Farmers Agents Association

"Our industry struggles with a bad reputation already. The misuse of credit scoring will further erode consumer confidence. It's time for the industry to step up and commission an independent study of the relationship between credit and future losses. It's time for the industry to force the release of the rating factors in the FICO programs. Its time to change the rules so consumers can get specific answers about their scores."

The National Association of State Farm Agents, Inc.

Resolution Sept 28, 2001

The National Association of State Farm Agents, inc. (NASFA) hereby resolves that we are opposed to any insurance company using credit scoring for the purpose of Property & Casualty underwriting and rating. We further support legislation to prohibit credit scoring for the purpose of Property & Casualty underwriting and rating. We believe this form of underwriting is profiling clients who would otherwise be eligible for Property & Casualty business.

The Coalition of Exclusive Agent Associations

Credit Scoring POSITION STATEMENT Adopted March 11,2002

"In the absence of full and good faith disclosure to the consumer and appropriate state insurance officials of all weighting factors and the respective percentage(s) or importance of their weighting, the CEAA opposes the use and consideration of credit status and/or credit scoring in any manner in connection with the acceptance, rejection, renewal or determination of insurance coverage or with respect to the determination of insurance rates and/or rate increases. It is the position of CEAA that credit information, written or otherwise, should not be given any consideration as a basis for determining the acceptance, rejection or renewal of insurance coverage or insurance rates."

National Auto Agents Alliance

"The National Auto Agents Alliance recently issued a statement that credit scoring is "unreliable, inaccurate, and so against public interest as to endanger the insurance industry to the wrath of the public... The NAAA feels that credit scoring may even suggest a level of redlining that segments insureds into "haves and have-nots."

National Association of Insurance Commissioners

"In a White Paper issued recently by the NAIC, which now wants this credit scoring practice monitored, it was suggested that insurers not be allowed to deny policies based solely on credit reports. It also recommends that the industry develop objective, verifiable guidelines for ordering credit reports"

This information is from the following website.
www.geocities.com/insurance_credit_scoring

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1/17/03

DON'T BASE INSURANCE RATES ON ...

Credit ratings

A GAIN THIS year, the Legislature will have the chance to end the insurance industry's controversial use of credit ratings to determine how much auto and home insurance will cost Alaskans.

A measure introduced by Sens. John Cowdery, R-Anchorage, and Kim Elton, D-Juneau, would bar the use of credit scoring to set premiums.

Critics of credit scoring say it opens the door to financial and even racial discrimination. Its proponents say it is a fair and accurate assessment of potential losses.

The practice is under fire in more than two dozen states. Similar legislation was introduced last year in the Alaska Legislature, but died in the Senate Labor and Commerce Committee as time ran out in the session and questions remained about exactly what the bill should contain.

Credit scoring is how many insurers nowadays calculate in whole or in part, the amount of your insurance premiums. They obtain personal information from credit bureaus, including debt amount, collections, bankruptcies, payment history, amount and types of credit. They feed it into a computer model and you receive a score. A good score means lower rates. A bad score can mean you pay more.

Insurers say the use of credit histories and scoring is necessary because it allows them to identify drivers who will cost the company the most in losses. They say studies — which themselves have stirred questions — have shown that people who keep their financial house in order are better risks.

Opponents of credit scoring say it reared its head after insurance companies some years ago were barred from "redlining" certain geographical areas and minorities. Additionally, they say the practice zeros in on the elderly, the young, people with little credit, renters and others, even those with errors in their credit history. Purchasing a home, for instance, can affect your credit rating, and the insurance you will have to buy for the home.

Testimony introduced last year before the state Senate Transportation Committee illustrates the point.

A woman with a clean driving record and who already had insurance — but who rented her home — received a \$452 increase on her six-month insurance bill because of her credit score. At the same time, a man with with good credit who was buying his home qualified as a preferred customer — even though his driving record included a DWI with an accident.

It would seem to us that driving records or a history of losses should count toward calculating insurance premiums, not a person's credit history or a score generated from information that may be flawed, from a system immune from public scrutiny.

Cowdery and Elton are on the right track in pursuing this legislation. Hopefully it will fare better than it did last year.

OUR VIEW

Credit scoring

*Either reform or abolish
this insurance shortcut*

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 that 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.

*The whole exercise
of credit scoring is
premised on the
assumption that
what is in a person's
credit file is
accurate. Many an
Alaskan can testify
to the contrary.*

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 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.

ADN 1/27/2003

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.

*The methodology is
secret, with no
oversight by state
insurance
commissioners.
Credit scores can
change frequently,
calling their
reliability into
question.*



TOUCH-SCREEN VOTING

What do you think?

Last week's question:

Sens. John Cowdery, a Republican, and Kim Elton, a Democrat, have pre-filed a bill to prohibit "credit scoring," the insurance industry practice of setting rates based on a customer's credit history. Should the cost of someone's insurance be based on credit history?

YES	NO	UNSURE
34	259	5
11%	87%	2%

Number of respondents: 298

Comments:

A person with a perfectly clean driving record and who may have lost a business or employment causing creditors to take legal action to collect a debt should not be penalized by paying higher car insurance rates.

Does owning a small business make you a bad driver? Do medical bills you can't pay make you a bad driver? Does an acrimonious divorce make you a bad driver? Does cutting up your credit cards or paying cash for your car make you a bad driver? All those things give you a bad credit score. Credit scoring has to go.

If the insurance companies insist on basing my insurance on my credit report, then I can make them an offer. For each year I complete as a safe driver with no claims against my policy, the insurance company should reimburse me the moneys I have awarded them for that year.

A person should be allowed to buy insurance at a reasonable price regardless of their credit history.

This week's question:

A citizens group, BEARS Inc., is proposing a center where garbage bears would be placed in an attempt to rehabilitate them. The center also would be a place to view bears and educate people

Juneau hospitality shines

By JIM POWELL

nk you to the hundreds people and businesses at participated in last l's site selection visit by c Winter Game's Inter-Committee.

turday morning, with ng crowds at the airport, d in the fog as the com- jet circled overhead. As icked and it became . no planes were going t looked as if the care- ared visit was in jeop-

d, Juneau's welcoming e met Saturday night ed the entire program. 10... the committee nt... eau and once :tic Winter Game's sup- rned out at the airport, st, the hockey rink, the nd at the high school. l was the International

and other skiers and snowboard- ers waving signs and chanting "Juneau 2006." Inside the lodge, an impressive presentation by local experts was given about our ski facilities and capabilities for the ski, snowboard and snowshoe events. The games would take place in early March and records show Eaglecrest has never failed to have a large snow pack then. Our large volunteer and family oriented ski area was highlight-



ed. During the warm in- formal recep- tion that followed there were lots of one- on-one con- versations between committee members and the skiing public.

Then on to Douglas, where two Douglas Fire Department trucks escorted us to the hockey rink. The... ..

Alaskan Native Elder Agnes Ballinger. The lunch was capped off with a short DVD produced by the Juneau Convention and Visitors Bureau, Mad Dog Graphx, Damon Struebner, and others.

The high school complex, where the 2,000-plus student athletes would be housed, was the final venue. The committee entered the gym to welcome signs and cheers by the JDHS cheerleaders. The dance team performed its light show. A very impressive selling point was our renovated high school. Our ability to house, feed, and have a safe place for athletes to meet is one of our bid's strongest components.

Concerning the weather, the committee was very responsive to Juneau's proposals for contingency plans for back-up ferry

far as I can see. It insults me and it violates my civil rights," said Boisean Michael Howard, whose insurance agent told him a month ago that his homeowner's policy would be canceled because his credit score had plummeted. Now, he said, he has a new homeowner's insurance policy, and the coverage that used to cost him \$265 a year is up to \$725 a year.

and more common in recent years to use credit history to help determine homeowner's and auto insurance premiums. They contend that records of collections, tax liens, bankruptcies and civil court judgments are as helpful in figuring insurance rates as a person's driving record, and those predictions help keep rates down.

Opponents contend credit scores are unfair, hurt people arbitrarily and lead to people going without insurance.

-- Wayne Hoffman

▪ [Senate Bill 1408](#)

"They've got too many tools to rip off the public whenever they want," he said.

Credit scores come from a person's credit history. A person who pays bills on time and has little revolving credit, for example, might have a good credit score, while a person who is months behind on bills and has burgeoning credit card debt might have a bad credit score.

Insurance companies say bad credit scores tend to correlate to future claims the company will have to pay.

Boise insurance agent Bob Ricketts said the practice is neither fair nor logical. It is legal in Idaho, though.

"If you have a person with a DUI and they have good credit, they will be accepted in a preferred-rate class now," said Ricketts, chairman of the Independent Insurance Agents of Idaho.

Coeur d'Alene Sen. John Goedde is the group's president. He's proposing legislation that would restrict the use of credit scores by insurance companies when figuring automobile and homeowner's insurance. About half of the state legislatures across the

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country are looking at similar legislation.

Goedde, a freshman Republican, said he's heard of homeowner's insurance rates shooting up 300 percent, and said the biggest losers are the elderly, the very young and members of minority groups. His legislation, Senate Bill 1408, would restrict insurance companies from using credit scores as the primary reason for denying insurance or jacking up a customer's insurance rates.

The measure will have a hearing today.

Another insurance agent, Republican Rep. Bill Deal of Nampa, said it would be OK to use credit scores for new customers. But he calls the trend of the past 10 years -- using credit scores to judge existing customers -- "very inequitable and morally wrong."

Boise insurance agent Eric Jeglum said he opposes the proposed legislation. He said studies have proved "without a doubt" that credit scores are a reliable predictor of future insurance claims. The worse the credit score, the more claims are likely, he said. And the better the credit score, the fewer the claims, in general.

If that tool were not available to insurance companies, he said, rates would climb 20 percent for people who are now categorized as having good credit.

"Credit scoring allows us to accurately indicate what the rates should be," Jeglum said.

He equates it to what happens when insurance companies figure the premium for teen drivers. Not all of them are unreliable behind the wheel, but insurance companies assign a higher premium to them because young drivers, as a group, tend to be a higher risk than older drivers with more experience.

Max Marshall of Boise doesn't buy it. He had to file bankruptcy for health reasons, and now he says he can't insure his home for anything less than \$325 a year.

"I don't understand why my credit rating would affect home insurance," Marshall said. "I don't think it's fair. It seems to be discrimination.

"Now, not only do we have the health bills, everything is going to cost more for something

that is beyond our control."

"We've been anecdotalized to death on this," said Michael Harrold of the National Association of Independent Insurers, whose group favors the use of credit scoring. There's always going to be someone who appears to be an exception to the pattern when it comes to credit scores. But the bottom line, said Harrold, the association's Northwest regional manager, is, "You're not hearing from the 50 to 60 to 70 percent of policyholders who are getting a discount" because of good credit scores.

"Really, insurance is about predicting future loss. It's not always about what you've done in the past. (Credit scores) are a phenomenally predictive tool," he said.

As the number of delinquent accounts, tax liens, bankruptcies and civil court judgments increase, so do insurance companies' losses, according to Harrold's data from the credit-scoring company Fair, Isaac.

"I don't see why it's pro-consumer to prohibit the use of a mechanism to allow people to pay the most fair insurance rate," Harrold said.

Ralph Buchanan, president of the United Farmers Agents Association, said the reason is simple: It's wrong.

"The old way of rating auto insurance, I could go out and get a five-year history of tickets and accidents for you. That for years and years has told me whether you're a good driver or bad," Buchanan said.

But the American Insurance Association contends people are paying a fairer rate for insurance now that credit scores are available to guide insurers.

Restricting the use of credit scores would result in less competition among companies and require the good customers to subsidize the bad, association members say.

Two-thirds of customers have good credit, and they will see their rates go up to pay the claims of the one-third with bad credit, said Bill Gausewitz, AIA's assistant vice president for state affairs.

For Howard, that's little comfort.

"Tripling your homeowner's rate because of your credit rating assumes quite a lot," he said. "It's nothing short of stealing."

To offer story ideas or comments, contact reporter Wayne Hoffman at whoffman@idahostatesman.com or 377-6416.

Insurers get an earful from senators
Panel: Industry's use of credit history is wrong

By Wayne Hoffman
The Idaho Statesman

A Senate committee chastised the insurance industry Thursday for its use of people's credit history in figuring insurance premiums and voted 7-2 to restrict the practice.

8 RS + 1 D

Senators on the Commerce and Human Resources Committee said the use of credit scores to set rates and sometimes to deny insurance coverage is arbitrary, mysterious and flat wrong.

Senate Bill 1408, now on its way to the full Senate, would restrict the use of credit scores so that they cannot be the primary basis for an insurance company's decision to change rates or drop automobile or homeowner's insurance coverage.

Some insurance trade associations contend the credit scores have proven to be excellent indicators of potential insurance claims, and they're used to keep rates down.

Others contend the practice discriminates and that there's nothing to prove the scores really reflect much of anything.

Half of the states in the country are considering legislation restricting in some fashion the use of credit scores.

"For me to try to explain to my customers why this is taking place ... it's confusing," said Boise insurance agent Bob Ricketts of the Independent Insurance Agents of Idaho, who is against the practice.

He said he has plenty of proof to show that clients who have a history of claims were renewed with double-digit reductions in premiums while some clients with no insurance claims are showing double-digit increases in premiums.

Sen. Brent Hill, R-Rexburg, found the insurance industry's explanations so nebulous and frustrating that he grilled insurance agent Jennifer Oldenburg for her support of credit scores.

Oldenburg said credit scores have been helpful in selling insurance at competitive prices.

"It's not the only thing that's used" to determine premiums, Oldenburg said.

But Hill said he had yet to hear a good reason for where credit scores come from and how they are applied. He expressed dismay that Oldenburg can't counsel people on how to get their credit back in good standing.

"I'm not surprised you don't know. Your customer doesn't either," Hill said.

Oldenburg said insurance companies have the right to pick the best mechanisms for figuring insurance rates.

"That's right. They have that right -- at the present time," Hill retorted.

American Insurance Association lobbyist Phil Barber acknowledged the insurance industry "has done a very poor job in informing agents and informing me and the public in general" about credit scoring.

But he said lawmakers should avoid passing Senate Bill 1408 in haste when a compromise could be reached.

Barber said the industry would be willing to accept a restriction that says insurance companies can't use the scores as the sole reason to cancel or jack up rates.

But senators voted 7-2 against that proposal, saying it would leave consumers in no better a position than they're in now. Insurance companies will merely make credit scores the majority reason for the decision and throw in a miniscule second factor to comply with the law, they said.

To offer story ideas or comments, contact reporter Wayne Hoffman at whoffman@idahostatesman.com or 377-6416.

National Association of Professional Allstate Agents

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Commissioner Mike Kreidler
Washington Department of Insurance
Insurance Building/14th & Water
Capitol Campus
P.O. Box 40255
Olympia, WA 98504-0255

October 15, 2001

Dear Commissioner Kreidler,

The National Association of Professional Allstate Agents (NAPAA) has studied the issue of "credit scoring," or "insurance scoring," and because Allstate was one of the earliest users of credit scoring algorithms to underwrite and rate insurance policies, Allstate insurance agents have the most experience dealing with this system and its adverse effect on our customers. Our conclusions based on this unique experience are:

- It is a secret methodology, not subject to examination by Insurance Commissioners, which affects the premium and/or acceptance of insurance applicants and existing customers.
- Credit scoring appeared when insurance companies were denied the ability to overtly Redline geographical areas and certain minority groups.
- Credit scoring is a new method of Redlining meant to replace the old method.
- Particularly affected are minorities, low-income groups, senior citizens and others who rarely, or never, make use of credit. Other affected people are those who have had divorcees, the death of a spouse, large medical bills or even those who check their own credit regularly to be sure the information is accurate.
- The insurance/credit score is a moving target - Today one may have a "score" of 4, next month a score of 2. The consumer just has to hope they get lucky when they apply, because they are stuck with whatever the score happens to be at that time, with no possibility of improvement, for the life of the policy.
- Credit scoring allows a company to take rate increases at their sole discretion by merely adjusting their never examined and secret algorithm by changing the weighting of certain values.

Credit scoring for insurance is not socially acceptable. It violates the values Americans hold dear. The American way is to be judged on those things that are directly relevant to the subject: Tickets, accidents, vehicle usage etc. for auto insurance and condition of premises, past losses and upkeep etc. for property insurance. Credit scoring for insurance purposes is Redlining. NAPAA strongly opposes Redlining, thus we have no choice but to oppose credit scoring.

Insurance commissioners, in various states, are conducting hearings to better understand how the use of credit impacts the insurance consumer. Captive Allstate agents wish to participate and contribute at these meetings since they are closest to the consumer and see firsthand how implementation of credit directly affects the customer. However, they have been discouraged to do so under threat of retaliation by Allstate. If an agent's presence at these hearings were made mandatory, we would make every effort to assure the presence of a NAPAA representative.

Sincerely,

Janice Mathison
Executive Director

National Association of Professional Allstate Agents

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Washington Department of Insurance
Commissioner Mike Kreidler
Insurance Building/ 14th & Water
Capitol Campus
P.O. Box 40255
Olympia, WA 98504-0255

- Carol Sureau
- Gigi
- Lisa Smego
- Bill D.

October 22, 2001

Dear Commissioner Kreidler,

In a previous letter to you from our association (copy attached), we informed you of NAPAA's position on Credit Scoring. In that letter, we explained that captive insurance agents who may desire to participate and contribute at hearings regarding Credit Scoring and Redlining have been prevented from doing so by threats of retaliation by their companies.

Agents have more knowledge of the effects of this practice on their clients than any other segment involved in the process. Yet, contrary to the public good, insurance companies exert every effort to prevent such knowledge from being made public.

On October 12, 2001, NAPAA informed the Allstate insurance agents in the state of Washington of the public hearings to be held on Credit Scoring. We encouraged them and their clients to attend one of the meetings. Allstate reacted swiftly to our bulletin. In a letter dated October 15, 2001, Field Vice President A. Darryl Page warned Allstate agents against participating in those hearings. We have attached a copy of his letter.

It is clearly not in the best interests of the citizens of Washington state, efforts of your office to regulate insurers, or those of legislators representing their constituents for a private company to deny access to the information possessed by insurance agents; valuable and insightful information.

We urge you to find a way that would allow agents to participate, to testify at public hearings, in legislative committee hearings and other government venues without fear of retaliation by their associated companies. Otherwise, how can our system of government function as it was intended?

NAPAA stands ready to assist in any effort you may make to ensure that your department and the citizens of Washington hear the truth.

Sincerely,

Janice Mathison
Executive Director

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April 18, 2002

Honorable Kim Elton
Senator,
Alaska State Senate

Juneau, AK 99811

Re: Credit History and Credit Scoring in Insurance

Dear Senator Elton

I read in the paper yesterday that you have proposed legislation to prohibit the use of credit history and credit scoring in the State of Alaska for underwriting and selection of personal automobile insurance and homeowners insurance. I support your efforts to do so and would like to offer some observations that may be of interest.

By way of background, I am a retired state employee (as of 3/31/97), having worked at the Alaska Division of Insurance for more than 27 years as its Chief of Market Surveillance. I was responsible for rate review, form review and market conduct examinations. I also spent considerable time working with legislators and staff on a variety of insurance issues. Currently I continue to reside in Juneau and operate a small consulting firm that provides market conduct examination services for state insurance departments. I have no Alaska contracts. States currently using my services include Delaware, New Mexico and North Dakota. For these states I establish examination processes, develop state specific handbooks on how to perform such examinations, train examiners, supervise and conduct examinations. My views do not reflect those of the states for whom I provide services, they are my own.

In 1995 when credit history was first being used by insurers in personal automobile insurance, The National Association of Insurance Commissioners appointed a working group to look into the issue and ultimately develop a white paper as a guide for states considering what to do about the issue. I chaired the initial working group but after several meetings asked Maryland to assume the chair since I was somewhat over-committed at the time. I continued to remain active with the working group. I can recall one meeting in Northbrook Illinois that was of particular interest. We had about a dozen

regulators from a number of states meet with an insurer to gain an understanding why they felt the credit history should be an underwriting consideration. Our group was comprised of a good cross section of expertise including actuaries, economists, and examiners.

The company data presented suggested that there was a considerable correlation between the propensity for loss and credit history. There were several problems for which we could not elicit satisfactory answers and essentially these remain unchanged today. They are:

1. The data was based on the Company's customer database and since that had spent considerable time, effort and money to develop the system, they did not want another company to copy their data and use it as their own. They felt that such action, which is fairly commonplace, would place them at a competitive disadvantage. We were not able to look at the underlying data or supporting calculations. The data would appear to be more supportive of rate differentials rather than selection differentials.
2. In our attempts to understand how poor credit could tie into increased likelihood of loss only one person made an analytical observation that made some sense. He said that the intended form of credit scoring was in a sense a quantification of responsibility. It would appear that poor credit history is a reflection of responsibility and attitude that according to the presenters carried over into how a person drives an automobile or does things that might reduce an insurers exposure to loss. This tie was not demonstrated, it was theorized.
3. The insurer at that point had not developed the process to the point that duplication for factors already considered in other underwriting considerations could be avoided.
4. Fiscal emergencies were not factored out of the process. Someone with a longstanding good credit history who has an expensive medical emergency that temporarily revises the persons payment history would not receive special consideration even though the underlying attitude to paying on their commitments was unchanged. A similar issue arises in a depressed economy when layoffs occur. Being unable to continue to meet obligations is not the same as being unwilling to meet them and credit scoring does not make the distinction.

Many insurers these days are trying to outsource functions or parts of functions to independent vendors. They do this in part because it is difficult for the regulator to achieve a comprehensive view of the company's operations. They also do it for perceived gains from savings on expenses. The savings often come from reduced management oversight of the outsourced function.

During the past few years, I have been involved in the examination of eight major auto and homeowners insurers, six of those directly and the other two as a supervisor. Some do not use credit history, some do not use credit scoring. Some use credit only for placement in a rating tier. Some use credit only on new business. I believe that the

system as I have seen it is inherently flawed and are unfairly discriminatory. Insurance is by its nature discriminatory and that is not unreasonable. Unfair discrimination is quite another story. Some examples of why I think Credit History and Credit Scoring is unfair are:

1. If credit history and credit scoring is intended to reflect responsibility then it is unfair because that connection has not been established and no efficient method has been established to identify exceptions.
2. Most insurers use credit scoring only at the initial underwriting and that is to determine into which rating tier the person should be written. That is unfair since attitudes can change, credit history can change, and no opportunity is provided to assure that the selection criteria and measurement has remained unchanged. If a person's score improves is he/she locked into the tier that resulted from the initial review? This might arguably be a conflict with the federal Fair Credit Reporting Act that contains a limit on how long the information in a credit report can be used.
3. The fact that scoring information is secret is unfair. If the information developed on a person and how it is used is secret, how is anyone to know that it has been properly used? It makes the Insurance Director's job to oversee a fair insurance marketplace very difficult if not impossible to achieve.
4. The nature of the scoring is that a large transaction such as the purchase of a house has a negative influence on the credit score thus presenting the buyer with problems when he/she attempts to insure the house. It's a sort of "Catch 22" kind of effect which comes up frequently in complaints. A contact with other state insurance departments concerning their complaints on credit history and credit scoring might prove enlightening.

At this juncture, my own preference is for an outright ban on the use of credit history and credit scoring for personal lines automobile insurance and homeowners insurance. If the legislature wishes to proceed with some form of limitation, I would urge caution because that would tend to give a flawed program sanction. Better not to act or to assure that the Director of Insurance has adequate rulemaking authority to provide for protection of the public. I would also urge caution about the structure of a ban because there are insurance lines of business where credit history review is appropriate, for example some of the commercial financial products and possibly fidelity and surety products.

I am sorry that my late awareness of this as a legislative issue in Alaska and my somewhat bizarre travel schedule prevents me from providing more direct input. I will be on travel status for the next three weeks but can be reached at my cell phone (907) 321-4084.

Very truly yours,



Donald P. Koch, CIE
President

**Testimony of Birny Birnbaum
Before the Alaska Senate Labor and Commerce Committee**

Insurance Credit Scoring and SB 13

April 22, 2003

Thank you for the opportunity to offer testimony in support of a prohibition against insurers' use credit scoring for underwriting, rating and conditioning payment plan eligibility for personal lines insurance. In addition to this testimony, I have previously submitted:

- A report I recently submitted to the Ohio Civil Rights Commission, which concludes that insurers' use of credit scoring very likely has a disproportionate impact on poor and minority communities;
- Tables from the *2000 Statistical Abstract of the United States*, which show a vivid correlation between income and the credit characteristics most heavily weighted in insurance credit scoring models.
- Comments on the problems with the National Conference of Insurance Legislators model law on credit scoring;
- Preliminary comments on a recent study by the Bureau of Business Research at the University of Texas.
- Comments submitted to the House State Affairs Committee on 3/29/03
- Comments submitted to the Senate Labor and Commerce Committee on 4/8/03

I have previously laid out my arguments why it is reasonable and necessary to prohibit insurers' use of consumer credit information for personal lines insurance underwriting, rating and payment plan eligibility – the practice is inherently unfair, discriminates against certain classes of consumers, undermines the insurance mechanism, undermines regulatory oversight of rates and violates actuarial principles for risk classification.

I wanted to use my time today to respond to some of the industry arguments on credit scoring and the comments of Mr. Niehaus of Progressive, in particular. On April 8, Mr. Niehaus offered a number of assertions regarding credit scoring.

First, he said that a ban on credit scoring would force Progressive to raise rates for two-thirds of their policyholders. This is, of course, not true. A ban on credit scoring will simply prevent insurers from using this unfair classification tool. Insurers choose the rates they charge, subject to review by the insurance commissioner.

Also, since when did we determine whether a practice was fair based on how many people benefited from the practice? In America, the minority is supposed to be protected against unfair practices by the majority.

However, you should know that several years ago in Arizona, after the Arizona Senate had passed a bill to prohibit credit scoring, Progressive and an industry trade association sent letters to their policyholders threatening rate increases if the credit scoring ban was enacted. And after credit scoring was banned for homeowners insurance and severely restricted for auto insurance in Maryland, insurers sent notices with renewal policies implying that the state legislature had forced the insurers to increase rates.

The bottom line is that the legislation to prohibit insurers from using credit scoring should also contain a provision to include a notice to consumers upon policy issuance or renewal along the lines of:

Your legislature has banned the use of your personal credit information by insurers to determine if you are eligible for coverage and how much you will pay. No insurer is required to raise rates or charge you more as a result of this law.

Second, Mr. Niehaus argues that good drivers will subsidize bad drivers if the use of credit is prohibited. The Texas study showed that for the consumers with the worst credit scores, there were 12 claims out of a hundred policies and for the best credit scores there were 9 claims out of a hundred policies. So the shift of about one claim per hundred evens out the frequency of claims among all groups. The bottom line is that most consumers don't file claims in a given year and the movement of one claim from one group of consumers to another can change that group from being "good" drivers to "bad" drivers.

Third, Mr. Niehaus argued that a ban on credit scoring would create an unlevel playing field where direct writers would have an advantage. This is not correct. The FCRA allows all insurers to use credit to get mailing lists of consumers. But once a solicitation is sent, the insurer is subject to the insurance laws of the state. All sorts of insurers use credit for direct mail insurance solicitation – Allstate, State Farm, Progressive, GEICO and many others – with and without agents. This argument has no merit.

Fourth, Mr. Niehaus failed to identify Maryland as a state that banned the use of credit scoring in recent years –for homeowners. And Maryland severely restricted the use of credit. Although insurance industry lobbyists have been successful at fighting good credit scoring legislation in many states, there are a number of states today where either the state senate or the state house has passed a law banning the use of credit.

Fifth, Mr. Niehaus argued that a ban on credit would damage an Alaskan market that is already in bad shape. He said that Alaska was 47th out of 51 states and the DC in profitability and that insurers had lost money in three of the last four years. Since these are the years that insurers have used credit scoring, it appears that credit scoring is the factor damaging the market! Again, the bottom line is that a ban on credit scoring will not "damage the market." It will simply make the underwriting and rating of insurance policies fairer because that underwriting and rating will be based on factors that consumers understand and that provide consumers with an economic incentive to prevent losses.

Sixth, Mr. Niehaus suggested that the legislature look at the NCOIL model as an alternative. The NCOIL model was developed as a compromise between some agents groups and the insurance industry. In exchange for supporting credit scoring, the agents got a liability shield for carrying out credit scoring practices on behalf of insurers. The NCOIL model provides very few consumer protections. Rather, it simply endorses the practices of most insurers.

Attached please find a description of the Progressive scoring model, which was presented at a hearing last year in Michigan. It should be noted that Progressive's credit scoring practices are among the most consumer friendly in the industry – the least bad among many bad practices. So when you are looking at Progressive, remember that other insurers' practices are much worse.

But even looking at the relatively simple Progressive model, here are the nine factors:

1. Months you have managed credit
2. Age at which you first established credit
3. Number of times a payment was past due more than 30 days
4. Number of loans and accounts with a satisfactory current payment record
5. Number of credit card accounts currently past due more than 30 days
6. Percent of available credit limit currently being used on revolving accounts
7. Percent of available credit limit currently being used on all open accounts
8. Months since your most recent auto loan was made
9. Credit inquiries you initiated in the past 25 months

Note how little these factors have to do with how well a consumer manages his or her credit. Items 1 and 2 are directly related to a consumer's age, not how they manage credit. Item 3 makes no distinction between a consumer who had a difficult time years ago – perhaps because of unemployment or a medical catastrophe – and one having trouble today. Item 5 is strongly correlated to income, as shown in the Statistical Abstract charts I provided earlier. How does the timing of your auto loan relate to how you manage credit?

And this is among the most consumer friendly of any insurer's scoring models! It should be clear that even if there is a statistical relationship between any of these factors and expected loss, the factors are pulling in people who manage credit well in addition to people who do not manage credit very well.

Finally, today, I would like to discuss the Texas study. The industry has argued that the Texas study cements their assertion that credit is correlated to risk of loss. That is not the case. There has never been much dispute that insurers can produce numbers showing that credit scores are correlated to expected losses. The question has always been, is this correlation due to credit itself or is it due to some other factor that credit is correlated to? In 1996, the NAIC credit scoring working group dismissed the simple loss ratio analysis – credit scores versus loss ratio – as insufficient to demonstrate a true correlation between credit and risk of loss. Rather, the NAIC group called for a multi-variate analysis – an analysis that takes into account all the other underwriting and rating factors used by insurers – to determine what credit's unique contribution to risk of loss might be. The NAIC wanted to know if credit was correlated with some other factor – something already used by insurers but mispriced or something prohibited.

The Texas study regarding correlation relies upon the same loss ratio methodology rejected by the NAIC in 1996. As such, the study offers nothing new on the correlation controversy.

However, the study also showed that the average and median credit scores for the standard market were substantially higher than the scores for the non standard market insurers. Since the scores were taken from policies issues in the beginning of 1998 – specifically chosen because the insurers were not using credit at the time – we would expect a random distribution of credit scores between the two groups. In other words, because the scores were taken before insurers were using credit, we expect the average credit scores in the two markets to be the same. But they weren't – not by a long shot. This means that insurers were already using some underwriting factor or factors to distinguish risk of consumers that is correlated to credit. *The Texas study showed that credit is duplicating some other factor or factors that insurers are already using!*

Since the best evidence to date shows that credit is a surrogate for other factors, we have further information to support a ban on insurers' use of credit scoring.

Personal insurance credit inquiry for John Doe

PROGRESSIVE®

Page 1 of 2

With your permission, Progressive reviews selected information from your credit history when you request a quote for insurance. Your rate is based on many factors: the car you drive, where you live, the amount and type of coverage you select, your driving and claims history, and your payment and credit history.

	You	Average
Experience you have with managing credit		
Months you have managed credit	48 Months	96 Months
Age at which you first established credit	16	21
Number of times a payment was past due more than 30 days	4	1
Current payment status of installment loans and revolving accounts		
Number of loans and accounts with a satisfactory current payment record	2	5
Number of credit card accounts currently past due more than 30 days	0	0
Use of available credit		
Percent of available credit limit currently being used on revolving accounts	88%	35%
Percent of available credit limit currently being used on all open accounts	70%	56%
Months since your most recent auto loan was made	12 Months	4 Months
Credit inquiries you initiated in the past 25 months	5	4
Insurance Credit Score	116	100

Your payment and credit history information was obtained from Experian. More detailed information can only be obtained by you by calling Experian at 1-888-397-3742. You may order a copy of your credit report free of charge.

Definitions

Installment loans have fixed terms with regular payments, such as a car loan, home loan, student loan, or personal loan. Revolving accounts have varying payments depending on the balance of the account. This includes all major credit cards and cards from department stores.

Personal insurance credit inquiry for John Doe

How your insurance credit score is determined

A lower score is better, as it indicates that you have carefully and consistently managed credit over many years. Consumers who use credit responsibly are statistically less likely to be involved in auto accidents and may be eligible for lower rates. To determine your insurance credit score, we subtract points for items that are better than average and add points for items that are worse than average.

Every consumer starts with the same number of points 100

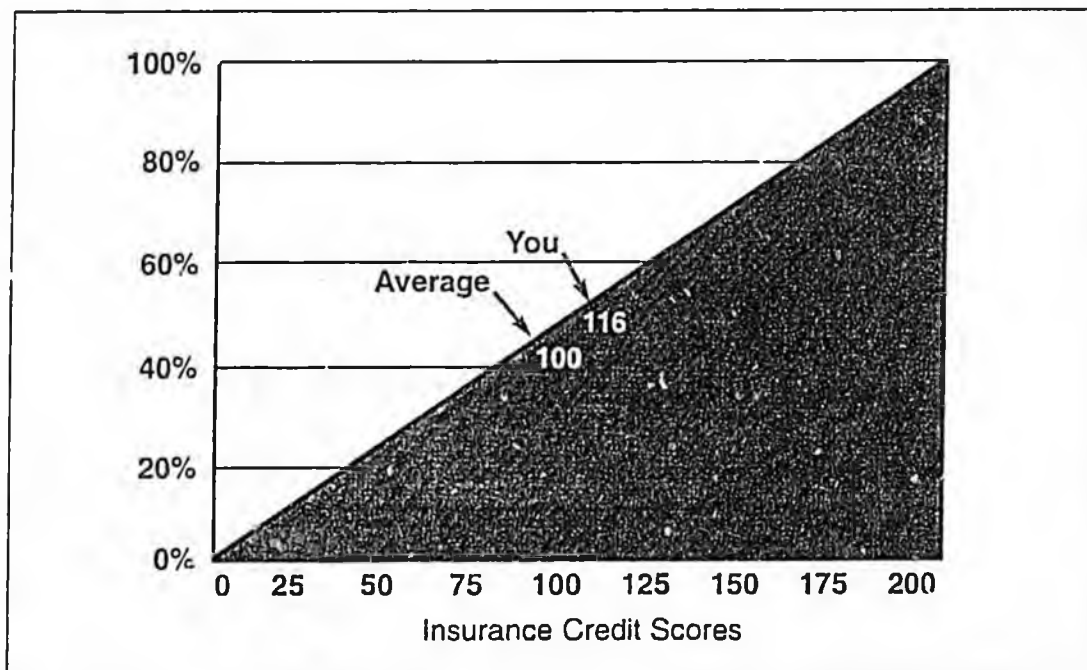
Items better than average:

First established credit at age 16	-10	
12 months since last auto loan was made	<u>-7</u>	
Total of all better than average items		-17

Items worse than average:

Managed credit for 48 months	18	
2 loans and accounts that are current	8	
88% of available credit in use	4	
5 credit inquiries in the past 25 months	<u>3</u>	
Total of all worse than average items		<u>33</u>

Your insurance credit score = **116**



Consumers who received a quote from Progressive in the past 6 months had an average insurance credit score of 100.

Your insurance credit score is 116 and is lower than 44% of consumers who received a quote from Progressive in the past 6 months, but is higher than the average.

So, what's in the Score?

Scoring model vendors refuse to divulge the methodology of these studies, the underlying data for independent verification, or the details of the study results. They claim these models are a "trade secret" and 'fear' that disclosure would lead to outside infringement.

What we do know is:

Information used in scoring models:

Outstanding Debt
Length of Credit History
New Application for Credit
Types of Credit in Use
Late payments
Collections
Bankruptcies
Inquiries

Information NOT used in scoring models:

Ethnic Group
Religion
Gender
Familial Status
Handicap
Age
Marital Status
Address
Nationality
Income -????.

And they use the following to determine the score:

Number of delinquencies.

The number of months since the most recent delinquency.

The number of trade lines open.

The number of adverse public record items (bankruptcies, judgments, liens, and foreclosures).

The number of months since the most recent public record item.

Trade account balances.

Ratio of the trade account balance to the credit limit available on the account.

Number of inquiries.

How this score is calculated and the actual score is unknown to the consumer. ***Update** - the credit bureaus are now offering your insurance credit score - at a price. (If anyone uses this service, please let email if you understand it anymore than before you obtained the score - Thanks!). Incidentally, because the methodology is given to **no one**, credit scoring models are completely **unverified for accuracy, uninvestigated for legality, and unregulated by regulators**. The scoring model vendors believe that if the consumer had access to the score and methodology of the score that:

1. consumers will not understand the score and;
2. if consumers did have the score, they may change their behavior and skew the results.

So this means the industry does not want us to change our behavior and become better drivers? No, because again, these scores are not being determined using driving records but whether or not you are likely to file a claim for an incident. **The industry is more concerned with their bottom line than they are for your safety.**

Credit reports can be manipulated, (Rapid ReScoring), and as long as the consumer is unaware as to how he/she is scored, the numbers will correlate. Obviously, the industry has found the use of insurance credit scoring to be extremely profitable as they fight mightily to keep it unrestricted, this leads me to believe there may be underlying reasons. (See my theories here.)

It may seem to make some sense that a person with a poor insurance credit score might be more likely to need compensation for an accident but that is only until you learn the type of individuals who have characteristics that score poorly in an insurance scoring model. A few of these include:

- Small business owners.
- Home-based business owners.
- Consumers who pay off their mortgages and/or auto loans early.
- Consumers who shop around for mortgage and/or auto loans for more than two weeks.
- Consumers with little or no credit histories, referred to as a "thin credit file".
- Consumers who do not believe in using credit.
- Consumers who seek credit counseling.

Does this appear to indicate financial irresponsibility to you?

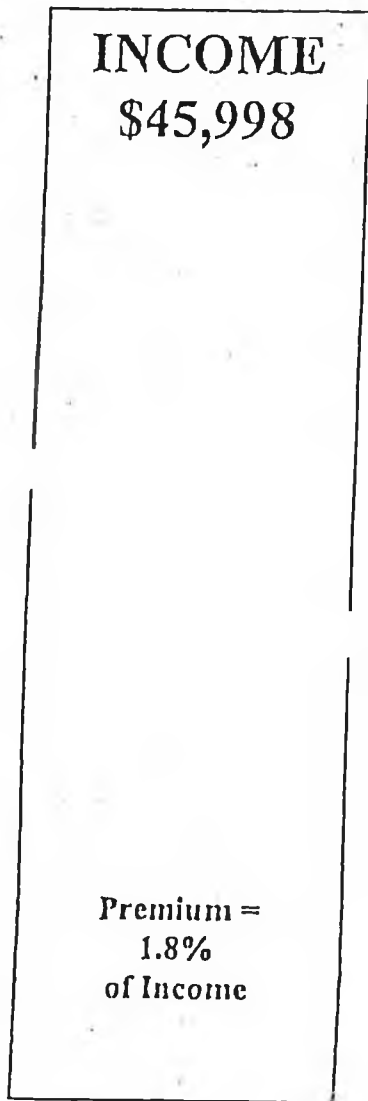
Then you have to consider the victims, the individuals who have poor insurance credit scores through no fault of the own:

- Victims of identity theft. (The fastest growing crime in America.)
- Victims of terrorist attacks.
- Employees who lose their health coverage.
- Consumers who experience a death in the family.
- Consumers who divorce.
- Consumers who experience catastrophic illnesses within the family.
- Consumers who file medical bankruptcies.
- Lower income Americans are more likely, in many cases, to have credit files that score poorly. (thin files). They are also less likely to have the disposable income necessary to settle an accident without the insurance company.

**This information is from the following website.
www.geocities.com/insurance_credit_scoring**

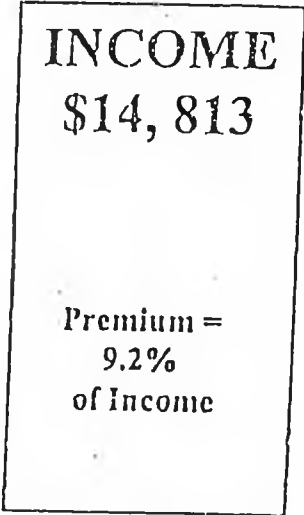
Comparison of Premium by Household Income

Maryland Division of Insurance



Premium
\$972

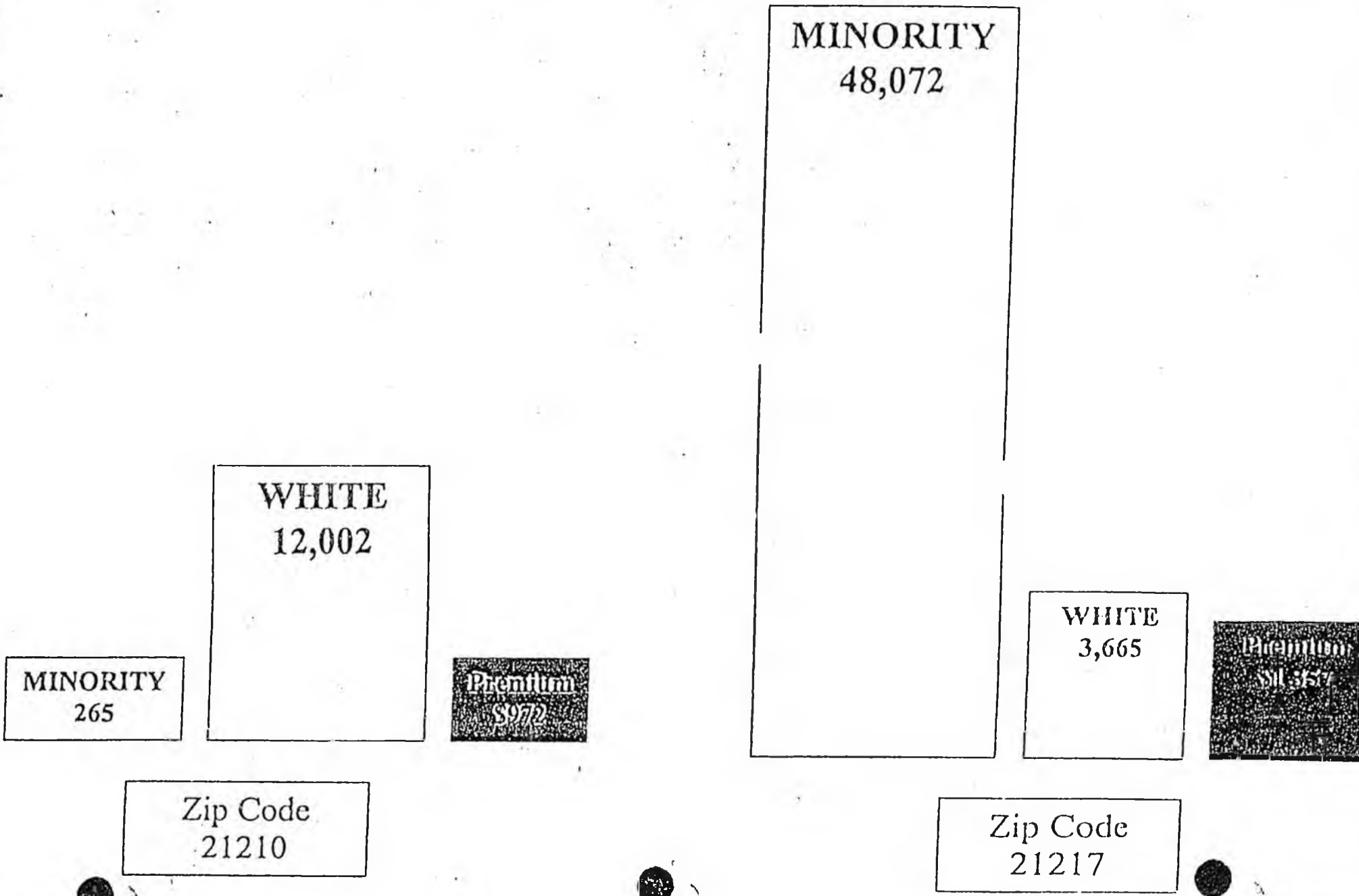
Zip Code
21210



Premium
\$1,357

Zip Code
21217

Comparison of Premium by Population Composition



STATE OF ALASKA

FRANK H. MURKOWSKI,
GOVERNOR

DEPARTMENT OF LAW
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March 5, 2003

The Honorable John Cowdery
Alaska State Senate
State Capitol, Room 101
Juneau, AK 99801-1182

Re: SB 13 Preemption

Dear Senator Cowdery:

Deputy Attorney General Nordstrand asked that I respond to a question regarding SB 13, an Act that would prohibit the use of credit scoring in insurance rating. Apparently it has been suggested that SB 13 would be preempted by the Fair Credit Reporting Act (FCRA). Although such an argument may be made, for the reasons that follow I do not believe that a preemption argument would prevail.

It is true that FCRA permits insurers to use an individual's credit history in underwriting. But such permissive use does not mean that the FCRA preempts the state's regulatory authority over the business of insurance. Any preemption analysis with respect to a state's authority to regulate insurance should start with the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*

In the McCarran-Ferguson Act Congress expressly left the regulation of insurance to the states. Indeed, the Act establishes what amounts to "reverse preemption" in favor of state regulation of insurance. First, Congress declared that it is in the public interest that the business of insurance continue to be regulated by the states. 15 U.S.C. § 1011. Next, Congress stated: "The business of insurance, and every person engaged therein shall be subject to the laws of the several States which relate to the regulation and taxation of such business." 15 U.S.C. § 1012 (a). Finally, Congress said:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of

insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.

15 U.S.C. § 1012 (b).

Thus, any preemption analysis regarding state regulation of insurance starts with the premise that state laws are not preempted.

The FCRA itself makes it clear that Congress did not intend to preempt state regulation of insurance. 15 U.S.C. § 1681t (a) states:

Except as provided in subsections (b) and (c) of this section, this subchapter does not annul, alter, or exempt any person from complying with the laws of any State with respect to the collection, distribution, or use of any information on consumers, except to the extent that those laws are inconsistent with any provision of this subchapter, and then only to the extent of the inconsistency.

Subsections (b) and (c) do refer to insurance, however section 1681t (d) (2) (C) provides that those subsections "do not apply to any provision of State law...that gives greater protection to consumers than is provided under this subchapter."¹

Thus, the FCRA's provisions relating to insurance do not apply to any provision of state law that is intended to give consumers greater protection than is provided under the FCRA. Assuming that SB 13 is intended to provide greater consumer protections, it should survive a preemption challenge based on the FCRA's own terms.

Next, even if sections 1681t (a) and (d) did not on their face exempt SB 13 from FCRA preemption, SB 13 would only be found to be preempted to the extent of any inconsistency with the FCRA. Although at first look, SB 13's prohibition on the use of credit scoring seems inconsistent with the FCRA statement that insurers may use consumer credit information for underwriting, a proper analysis of the question is not as simple as that. The United States Supreme Court has held that where it is possible to comply with a state law without triggering a federal enforcement action under the federal law in question, the state law is not inconsistent with the federal law. *Jones v. Rath Packing Co.*, 430 U.S. 519, 540 (1977). The Court also found that an inconsistency analysis must consider whether the state law "stands as an obstacle to the ...purposes and objectives of the Congress." *Id.* at 540-41. SB 13 presents neither problem.


¹ Subsections (b) and (c) also do not apply to any state law enacted after January 1, 2004 when the FCRA is due to sunset. 1681t (d) (2) (A).

The FCRA provides that insurers *may* use consumer credit information for underwriting, not that they *must* do so. Therefore, compliance with a state law that prohibits the use of consumer credit information in underwriting or rating does not trigger any federal enforcement action under the FCRA. Thus, SB 13 is not inconsistent with the FCRA on that basis. Nor would SB 13 be an obstacle to the objectives of Congress in enacting the FCRA. The fundamental purpose of the FCRA was the protection of the consumer. If SB 13 merely adds additional consumer protection, it does not stand as an obstacle to fulfillment of that congressional intent. *See Credit Data of Arizona Inc. v. State of Arizona*, 602 F. 2d 195, 197-98 (9th Cir. 1979) (FCRA permits credit reporting agencies to charge reasonable fees for disclosure but does not require imposition of such fees – State law prohibiting such fees was not preempted).

In sum, because (1) the McCarran-Ferguson Act establishes reverse preemption in favor of State regulation of insurance, (2) the FCRA on its face does not abrogate State law if such law provides greater consumer protection than the FCRA, and (3) SB 13 is not, in any event, inconsistent with the FCRA, I believe that SB 13 would not be preempted by the FCRA.

Sincerely,

GREGG D. RENKES
ATTORNEY GENERAL

By: 
Nathaniel B. Atwood
Assistant Attorney General

NBA:jem

cc: Scott Nordstrand
Deputy Attorney General

Linda S. Hall
Director, Division of Insurance

Use of Credit Reports and Credit Scoring By the Insurance Industry (March 2003)

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
Alabama	In early August 2002, the Department of Insurance issued a consumer alert entitled "Credit Scoring: How Does It Affect You?" The alert, which can be accessed at www.aldoi.org/currentrelease.asp?Headline=282 , suggested the department would promulgate a regulation in this area in 2002, but no action has been taken.	The Alabama Department of Insurance has developed a comprehensive draft regulation that will be vetted and considered during a public hearing in May 2003.
Alaska	Several bills were proposed during the 2002 legislative session, including two which would have prevented an insurer or underwriter from "bas[ing] a standard, rate, or rating plan, in whole or in part, directly or indirectly, upon a person's credit rating or credit scoring." While several hearings were held on these and related proposals, nothing was adopted in 2002. The legislature is likely to again consider the issue in 2003, and the Alaska Division of Insurance is expected to conduct an investigation in the interim.	The Alaska Insurance Division issued a report entitled "Insurance Credit Scoring in Alaska" in February 2003, and legislation will be considered this year. The department report can be accessed at: www.dced.state.ak.us/insurance/pub/FINAL_credit_score_report.pdf . Two legislative proposals to ban the use of credit information by the insurance industry are expected to receive a committee hearing before the end of March.
Arizona	In 2002, HB 2386 was adopted by the House and Senate and signed into law on May 22, 2002. The new law, which is now effective, does the following: <ul style="list-style-type: none"> • Defines "adverse underwriting decision" and requires the written disclosure of certain information when such an action is taken. Among other provisions, the disclosure must include the specific reasons for the adverse underwriting decision. • Establishes rules concerning the correction or deletion of certain kinds of "personal information." • Grants consumers the right to request that an insurer reconsider an underwriting decision in certain instances. 	
Arkansas	Among other provisions, Arkansas Code Ann. §23-56-317 provides that: <ul style="list-style-type: none"> • No insurer shall refuse to issue or renew coverage or limit the amount of coverage on a risk based solely upon the insurer's knowledge of the insured's or applicant's consumer report (as defined), unless: <ol style="list-style-type: none"> (1) the report can be shown to identify characteristics that substantially increase the risk of loss at or after policy issuance or renewal; and (2) the insurer or its agent sends a notice of cancellation, refusal to renew, or declination to the insured or applicant which contains a statement which advises that the cancellation, non-renewal, or declination is based on information contained in a consumer report. • If the insurer relies solely upon a credit scoring system or model in reaching its underwriting decision, the insurer must: <ol style="list-style-type: none"> (1) file the credit scoring system with the commissioner; and (2) provide the applicant or insured with a clear, concise explanation of the factors taken into consideration in reaching its decision. • If used for rating, the guidelines on the use of consumer reports or consumer report scoring system or model must be filed with the commissioner. • No insurer may condition the issuance of an insurance policy upon the fact that an applicant or insured does not possess a credit card. 	On March 24, the Arkansas Senate adopted Senate Bill 846, which is nearly identical to the NCOIL model law. The bill was adopted in the Senate without a single dissenting vote.
California	California has no express prohibition against an insurer using credit information. However, Proposition 103 (enacted in 1988) does not authorize the use of credit information as an "optional" auto rating factor. Prop 103 requires that auto insurance rates must be determined by the following factors in decreasing order of importance: (1) The insured's driving safety record; (2) The number of miles driven annually; and (3) The number of years of driving experience. In addition to these three factors, Prop 103 also authorizes the Commissioner, by regulation, to adopt optional factors that have a substantial relationship to the risk of loss. The Commissioner has not adopted credit information as an optional rating factor. Thus, this information cannot be used in determining auto insurance rates.	

Provided by:

AK Independent Insurance Agents & Brokers Assn

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
Colorado	<p>This aspect of Prop J3 only applies to auto insurance, and since there is no express prohibition on the use of credit information, it can be used in other lines such as homeowners insurance. However, the California Department has taken an increasingly hostile attitude to the use of credit information, and some companies have reported the Department has rejected rate filings in part because of how credit information was used.</p> <p>Pursuant to C.R.S. 12-14.3-103(c)(III) and Division of Insurance Bulletin 11-00, insurers using credit scores or credit reports in the underwriting or rating process are to disclose this fact. Specifically, the consumer must receive written notification, or notification in the same medium as the application for insurance, that a credit report may be requested in connection with his/her application for insurance, and that credit scoring information may be used to determine either the consumer's eligibility for insurance or the premium to be charged.</p> <p>Regulation 5-1-16 became effective July 1, 2002. A copy of the new regulation can be accessed at http://www.dora.state.co.us/insurance/regs/5-1-16.pdf. Among other provisions, the regulation:</p> <ul style="list-style-type: none"> • Prohibits the use of credit history or insurance scoring as the sole basis for refusing to insure applicants, canceling or non-renewing existing insureds, rating policies, placing consumers in tiers, or reducing coverage. • Requires insurers to establish and comply with objective and verifiable guidelines. • Prohibits an insurer from treating credit inquiries not initiated by the consumer and collections accounts that are identified with a medical industry code as negative factors. • Requires that consumers over 65 with no credit history and consumers whose credit information is adversely impacted by a dissolution of marriage or by the credit information of a former spouse be treated as though they had a neutral credit history or insurance score. • Requires an insurer to use a consumer's current credit information whenever credit information is used in the underwriting or rating process. • Requires insurers to disclose certain information about its use of credit information upon the request of the insurance department. • Mandates the disclosure of certain information to consumers concerning the use of consumer reports or insurance scores. • Reaffirms the FCRA obligations that insurers face. • Provides for a policyholder appeal and error correction process. 	<p>House Bill 1273 has been adopted unanimously by both chambers of the Colorado General Assembly. The bill requires insurers to disclose to applicants or policyholders that credit information will be used for underwriting or rating and allows consumers to receive an explanation of the "significant characteristics of the credit information that impact the policyholder's insurance score."</p>
Connecticut	<p>The rules in place in Connecticut come in the form of guidelines issued by the Insurance Department – Guidelines for the Examination of Financial History Measurement Programs for Personal Risk Insurance Underwriting and Rating Plans (March 2, 2001). According to the state, the guidelines are supported by authority granted under Chapters 701 & 705. Among other provisions, the guidelines require the following:</p> <ol style="list-style-type: none"> (1) Such programs that are used to underwrite or rate risks must be filed with the Department. Among other things, the filing must identify the characteristics used in the program from which a measurement is derived. (2) Such programs may be used only for new business and must not penalize an insured for no credit history. (3) Documentation must be submitted to demonstrate the correlation between the measurement program and the expected risk of loss. (4) Financial History Measurement Programs may not use the following characteristics – number of credit inquiries, a consumer's total available line of credit, disputed credit information, and other characteristics. (5) Company rules must provide that a policy may not be declined, canceled, or non-renewed solely due to an adverse credit score or measurement. (6) There are a series of requirements that are initiated in the event of an adverse action. An adverse action includes the consumer who is denied coverage, charged a higher rate, assigned to a higher tier or higher priced company within an insurer group, not given a reduced discount, etc. (7) Companies are required to report after a program has been in place for two years, and they must also comply with department requests for a set of test examples reflecting various financial history characteristics. 	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
Delaware	<p>The guidelines can be downloaded at http://www.state.ct.us/cld/letterfh.pdf.</p> <p>Both chambers of the Delaware General Assembly adopted resolutions that address the industry's use of credit information during the 2002 legislative session. The resolutions, House Resolution 85 and Senate Concurrent Resolution 35, were passed by their respective chambers just prior to the legislature's adjournment – and the two resolutions are very similar. They both call on the Department of Insurance to promptly promulgate regulations in this area, and the Senate version asks the department to report its recommendations to the General Assembly by January 15, 2003. The resolutions also note that the "Delaware Insurance Commissioner has required that insurers and credit score vendors using credit scoring models meet with the members of the Commissioner's office to fully explain the manner in which such models are being used in either or both the underwriting or rating of insurance policies."</p>	<p>In late 2002, the Delaware Insurance Department released its draft of Proposed Regulation 87, which would regulate insurer use of credit information. The department conducted a series of public hearings across the state in January and received numerous comments on the proposal, but nothing has been finalized to date. Another public hearing has been scheduled for April 22, 2003. More information about the proposed regulation can be accessed at www.state.de.us/inscom/CreditScore.htm.</p>
Florida	<p>Florida's insurance code has a number of general consumer protection provisions that provided the Florida Department with the authority to promulgate a regulation in this area.</p> <p>The regulation (4-125.004, 1996) provides that any insurer that requests or utilizes credit reports in the review of personal lines auto or homeowners insurance applications shall maintain and adhere to written procedures established by the insurer. These procedures must specify the following, among other items:</p> <ul style="list-style-type: none"> (1) the circumstances under which credit reports will or may be requested and the reports will or may be used in underwriting decisions; (2) that the insurer shall notify the applicant in writing prior to such request that a credit report will or may be requested (if the notification is given on the application, it must be initiated by the applicant); and (3) that any applicant affected by an adverse underwriting decision shall be advised of the means by which the applicant can obtain a copy of the credit report. <p>Any insurer that requests or utilizes credit reports in the consideration of personal lines auto or homeowners applications must maintain evidence of its compliance with these written procedures, and this evidence must be available for examination by the Dept. When an insurer under this rule denies an application based on info from a credit report, the insurer must indicate the means by which an applicant may obtain a copy of their credit report and by which the applicant may identify the specific items in the report which resulted in the denial.</p>	<p>Florida Insurance Commissioner Tom Gallagher established a task force in 2001 to examine the use of credit data and scoring models in the insurance industry. This task force has issued a detailed report, which can be accessed at: www.doi.state.fl.us/consumers/crtf/CRTF_Final_Report.pdf.</p>
Georgia	<p>The issue is addressed by Regulation 120-2-65 (1997), which can be accessed online at www.ganet.org/rules/index.cgi?base=120/2/65. The use of credit is prohibited under the regulations for private passenger auto insurance. However, the regulations contain an exception to the general prohibition which allows use of credit in underwriting if the use of credit is actuarially supported or relevant to the risk.</p> <p>There is no explicit requirement that insurers receive the department's approval prior to implementing underwriting guidelines which contain provisions for credit histories. However, a company using such guidelines without specific approval could be subject to penalties if the department determines that the use of credit is not actuarially supported or relevant to the risk.</p> <p>During 2002, Commissioner Oxendine announced he would support legislation to prohibit the use of credit scoring in auto insurance underwriting – see www.inscomm.state.ga.us/ANNOUNCEMENTS/020802.pdf. The commissioner's announcement followed two days of hearings in late 2001. Hearing transcripts and other information can be found at www.inscomm.state.ga.us/CONSUMER/CreditScoringHearings.asp.</p>	<p>On March 24, the Georgia House of Representatives adopted House Bill 215, which is effectively to the NCOIL model with several minor revisions. The bill, which would go into effect July 1, passed the House with only four opposition votes.</p>
Hawaii	<p>State law essentially prohibits the use of credit information in the underwriting of auto insurance. Specifically, §431:10C-207 provides: "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."</p> <p>As described in the April 3, 2002 edition of the <i>Honolulu Advertiser</i>, seven auto insurers recently agreed to pay more than \$115,000 in fines for illegally using criteria (including credit histories) barred under state law. The announcement followed a department investigation that began in August 2001. The companies fined represent nearly 2/3 of the auto market, and the fines ranged from \$5,500 to \$40,000. Fines against four</p>	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
Idaho	<p>additional companies are still pending resolution, and the department has suggested that it might seek fines for each policy violation if insurers dispute the initial fines.</p> <p>Senate Bill 1408 (2002) was adopted overwhelmingly by the Idaho Legislature and took effect on January 1, 2003. The new law adds the following section to Idaho code.</p> <p>41-1843 INSURANCE RATES AND CREDIT RATING.</p> <p>(1) No insurer regulated pursuant to this title shall charge a higher premium than would otherwise be charged, or cancel, nonrenew or decline to issue a property or casualty policy or coverage based primarily upon an individual's credit rating or credit history.</p> <p>(2) As used in this section, "based primarily" means that the weight given by the insurer to an individual's credit rating or credit history exceeds the weight given by the insurer to all other criteria considered in making the decision to charge a higher premium or to cancel, nonrenew or decline to issue an insurance policy.</p> <p>(3) This section shall apply only to [P&C] insurance, as defined in chapter 5, title 41, Idaho Code, to be used primarily for personal, family or household purposes.</p> <p>The use of the phrase "based primarily" has been a source of controversy and concern, and many in the industry feel the term is subjective and likely to result in unnecessary litigation. The department of insurance has initiated its rulemaking process and is working on developing its rules on implementation of the new law.</p>	
Illinois	<p>Illinois passed a law during the 2001 session – PA 92-480 (HB 2419). Under the law, a company may not refuse to issue or renew a policy of insurance solely on the basis of a credit report for the lines of insurance covered. In addition, if a credit report is used in conjunction with other criteria to refuse to issue or renew a policy of insurance, the insurer shall provide the applicant or policyholder with a notice of the underwriting action taken. For purposes of that provision, compliance with the notification requirements of the FCRA shall constitute compliance with the state requirement.</p> <p>In late February, the Insurance Department released the results from its survey on insurer use of credit information, and those findings can be found online at www.state.il.us/ins/General/insurers_credit_report.pdf. The department has also developed an informational piece for consumers that can be accessed at www.state.il.us/ins/General/how_insurers_use_credit.htm.</p>	<p>On March 19, the Illinois House unanimously approved House Bill 1640, which is nearly identical to the NCOIL model law. It is now under consideration in the Senate.</p>
Indiana	<p>The only mention of the use of credit information in underwriting in the Indiana Code today is in IC 27-1-22-25, which deals only with private passenger automobile insurance. It states that an insurer may not charge a higher rate for a private passenger automobile policy to an individual who has filed for bankruptcy.</p> <p>Please note the law only states that an insurer may not charge a higher rate. It is silent about an insurer rejecting a potential insured based on a bankruptcy. Other than the bankruptcy language, the Indiana code and Indiana Department of Insurance rules are silent on the use of credit information.</p>	<p>Bulletin 111 (see http://www.ai.org/idoi/bulletin111.pdf) was issued July 1, 2002.</p>
Iowa	<p>The Iowa Insurance Division recently adopted a rule (191—20.12, effective July 1, 2001) that addresses the use of credit history in underwriting and making of rates for personal and homeowners policies. Among other provisions, the rule, which applies to personal lines insurance, requires the following:</p> <ul style="list-style-type: none"> • An insurer must disclose at the time an application is taken that it may or will gather credit information, and an insurer must notify a consumer when an adverse action is taken, following the requirements of the FCRA §624(b). • An insurer is also prohibited from canceling a policy, refusing to renew a policy, or rejecting an application based solely on information contained in a credit report or credit scores, and an insurer may not take these same actions based on information it knows is inaccurate or incomplete. • An insurer is also required to have specific, written criteria on how credit information is utilized in underwriting and tier placement. The commissioner may also require an insurer to file (1) the characteristics or factors from a credit report that are used as credit criteria or used in determining a credit score; (2) in the case of credit scoring, the algorithm, computer program, model, or other process 	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<p>that is used in determining a credit score (along with the underlying support, including statistical validation, for the development of the algorithm, computer program, model, or other process that is used in determining a credit score); and (3) any underwriting guidelines relating to the use of the credit criteria or credit scores, along with appropriate supporting material for the use of the guidelines.</p> <ul style="list-style-type: none"> • At the request of the commissioner, an interested party (such as an scoring modeler) shall file or discuss under confidentiality protection with the commissioner the algorithm, computer program, model, or other process that is used in determining a credit score (along with the underlying support, including statistical validation, for the development of the algorithm, computer program, model, or other process that is used in determining a credit score). • Filings made by insurers or interested parties shall be considered confidential records and are protected as trade secrets in accordance with state law. 	
Kansas	<p>With only one dissenting vote, Senate Concurrent Resolution 1623 was adopted by the Kansas Legislature in 2002. The resolution authorized the creation of a private and public sector task force to study "the desirability of regulation of insurance scoring practices for the benefit of Kansas consumers" and to report back to the legislature before the start of the 2003 session.</p>	<p>A substitute version of Senate Bill 144 has been approved by the Kansas Senate. The initial proposal was developed and recommended by the insurance commissioner, and the revised version – which is very similar to the NCOIL model law – was drafted following hearings on the issues. The bill also includes the following provisions:</p> <ul style="list-style-type: none"> • Its provisions also apply to "individually underwritten policies of farm owners." • When an insurer reexamines an insured's credit report or score at the request of that consumer at annual renewal, the insurer may not increase insurance rates because of the current report or score. • Insurers taking adverse actions against consumers "shall provide a procedure whereby a consumer may review an adverse action based on credit information", and insurers and their agents are provided with immunity from any action arising from information provided through this process.
Kentucky	<p>KRS 304.20-040 and KRS 304.20-042, adopted in 1998 and revised in 2000, say insurers cannot decline, refuse to renew, or cancel auto or property and casualty insurance covering personal risks based solely on credit history or lack of credit.</p> <p>HB 564 was introduced in 2002 but not adopted. Under the proposal, "no insurer may base any rates, in whole or in part, upon the use of an insurance risk score unless the method for calculating the insurance risk score is filed in support of a rate filing with the commissioner and the commissioner determines the insurance risk score has a substantial relationship to the risk of loss."</p>	
Louisiana	<p>The insurance code's unfair trade practices provisions address this issue. Specifically, §22:1214(7)(l) states that the following acts are swept within unfair trade practices acts of the state:</p> <p>"With regard to automobile liability insurance, terminating or modifying coverage, or refusing to issue or refusing to renew any policy solely because the applicant or insured filed for bankruptcy. This Subparagraph shall not apply where the refusal to continue to insure is based upon nonpayment of premium."</p> <p>The Louisiana Department of Insurance held a public hearing on the industry's use of credit information on May 1, 2002, and a department report on the issue was expected to be released. The Department was also considering developing a new regulation or issuing a bulletin on the issue by the end of the year.</p>	<p>Legislative action is expected in Louisiana once the legislature convenes in late March.</p>
Maine	<p>The Maine Department of Professional & Financial Regulation has posted "P&C Tier Placement Guidelines" on its website, and these can be viewed at http://www.state.me.us/pfr/ins/tier.htm. The guidelines say the following about using credit reports in the auto insurance context:</p>	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<p>May be used in conjunction with other underwriting criteria in determining tier placement. Company should be prepared to substantiate the relationship to insurance risk and provide notification information to insureds as required under the Fair Credit Reporting Act, Title 10 MRSA, Chapter 210, §1311-1329. Company, or a vendor on the company's behalf, should file all factors that are considered including any scoring algorithm.</p> <p>The guidelines say the following about using credit reports in the auto context:</p> <p>"May not be used as sole underwriting criteria or as the reason for rejecting a risk. Company must prove the relationship to insurance risk and provide notification information to insureds as required under Fair Credit Reporting Act. Do not allow 'black box' scoring. Company needs to file all factors that are considered and the scoring algorithm. For more details, please see article in the October 1997 Bureau Newsletter."</p>	
Maryland	<p>HB 521/Chapter 580 was adopted overwhelmingly by both chambers of the General Assembly in the closing minutes of the 2002 session and signed into law. A summary of the law follows:</p> <ul style="list-style-type: none"> • In the homeowners context, an insurer may not "refuse to underwrite, cancel, or refuse to renew a risk based, in whole or in part, on the credit history of an applicant or insured; rate a risk based, in whole or in part, on the credit history of an applicant or insured in any manner . . . ; or require a particular payment plan based, in whole or in part, on the credit history of the insured or applicant." • In the auto context, an insurer may not "refuse to underwrite, cancel, refuse to renew, or increase the renewal premium based, in whole or in part, on the credit history of an insured or applicant; or require a particular payment plan based, in whole or in part, on the credit history of the insured or applicant." • An insurer may use the credit history of an applicant to rate a new auto policy, but there are restrictions. The insurer may not use "a factor on the credit history of the applicant that occurred more than 5 years prior to the issuance of the new policy" and must advise the applicant that his/her credit history is used. At the request of the applicant, the insurer must also "provide a premium quotation that separately identifies the portion of the premium attributable to the applicant's credit history." • In the rating of a new auto policy, insurers may not use the absence of credit history (or the inability to determine the applicant's credit history) or the number of credit inquiries on a person's history. • Every two years or at the request of the insured, auto insurers must review the credit history of an insured who was adversely impacted by the use of credit history at the initial rating and make the appropriate premium adjustments. Insurers must disclose these review options to applicants at the time of issuance of the policy. • "With respect to private passenger motor vehicle insurance, an insurer that rates a new policy based, in whole or in part, on the credit history of the applicant may, if actuarially justified, provide a discount of up to 40% or impose a surcharge of up to 40%." • The MD Insurance Commissioner is also directed to conduct a study on whether the use of credit scoring has "an adverse impact on any demographic group defined by race or socio-economic status." These and other findings are required to be submitted to the General Assembly by January 1, 2004. <p>The Maryland Insurance Division issued a bulletin (Bulletin 02-14) that is intended assist insurers with their compliance obligations under the new law. The July 2002 bulletin, which is essentially a section-by-section Q&A, can be downloaded at www.mdinsurance.state.md.us/documents/BulletinP&C02-14.pdf. The department shortly thereafter issued a supplementary bulletin (Bulletin 02-16), which can be downloaded at www.mdinsurance.state.md.us/documents/BulletinP&C02-16.pdf.</p>	
Massachusetts	<p>Legislation on this subject is expected at some point in the future. In addition, Julianne Bowler, the commissioner of insurance, addressed the use of credit information in a April 8, 2002 interview that appeared in BestWire. She said: "Credit scoring is prohibited in Massachusetts, in all lines of business. It's tied into our fair trade practices act. All the insurance companies have that information on the checklists when they submit for rate or form approval so they know up front they can't use it."</p>	

State	Existing Rules and Previous Action	Relevant Legislative or Regulatory Activity
Michigan	<p>The Michigan Office of Financial and Insurance Services held a series of six public hearings on the use of credit information between June 4 and July 18, 2002, and the Commissioner issued a report on his findings in December 2002. The issuance of the report was followed in February by the development of a new bulletin – Bulletin No. 2003-01-INS – concerning the use of credit information. For copies of the testimony provided at the hearings, a copy of the Commissioner's report, and other information, see www.michigan.gov/cis/0,1607,7-154-10555_12902_15784--00,html.</p> <p>In July 2002, then-State Attorney General and current Governor Jennifer Granholm issued a Consumer Alert entitled "Home and Auto Insurance – Get the Credit You Deserve!" That alert can be found at www.ag.state.mi.us/cn/alerts/c_alerts/consumer_alert67.htm. The then-Attorney General also issued a press release related to the consumer alert in which she was quoted as saying: "Though not illegal, the practice of 'insurance credit scoring' should certainly give every consumer pause, especially in light of the fact that Consumer Reports has found that 70 percent of credit reports have an error and 29 percent have a major error. How fair is it to penalize consumers for a score that could very well be erroneous?" See www.ag.state.mi.us/press_release/pr10332.htm. She has also stated that she would support efforts to ban credit scoring, something she called "a terrible practice."</p>	<p>On February 14, 2003, outgoing Commissioner Frank Fitzgerald issued Order No. 03-005-M and Bulletin No. 2003-01-INS, which require insurers using credit information to take certain compliance actions. The key requirements are outlined below:</p> <ul style="list-style-type: none"> • Companies must file the specific credit classification factors used to calculate insurance scores and any credit-related formulas used to apply discounts with the department by July 1, 2003, and they must also file an actuarial certification justifying the discount levels and tiers being used. [The bulletin also makes clear that rating materials filed with the agency are accessible to inspection by the public.] • Insurers using insurance scoring discounts must recalculate and then apply an insured's score at least once annually, and carriers must recalculate these scores and apply the appropriate discounts whenever a person successfully disputes information contained in one's credit history. • Insurers using credit scoring must inform auto and homeowners policyholders and applicants that credit information is used and disclose the tier in which the person is placed. <p>The report issued by the department in December also included several recommendations for legislative action. Although no formal legislative action has taken place to date, the House Insurance and Financial Services Committee has established a subcommittee to study the issue.</p>
Minnesota	<p>Minn. Stat. §72A.499, subdivision 1, addresses insurer obligations when adverse underwriting decisions are made. These provisions are listed below:</p> <p>"Subdivision 1. Notice and information. (a) In the event of an adverse underwriting decision, the insurer or insurance agent responsible for the decision shall provide in writing to the applicant, policyholder, or individual proposed for coverage:</p> <p>(1) the specific reason or reasons for the adverse underwriting decision, a summary of the person's rights under sections 72A.497 and 72A.498, and that upon request the person may receive the specific items of personal information that support those reasons and the specific sources of the information; or</p> <p>(2) the specific reason or reasons for the adverse underwriting decision, the specific items of personal and privileged information that support those reasons, the names and addresses of the sources that supplied the specific items of information specified, and a summary of the rights established under sections 72A.497 and 72A.498.</p> <p>(b) In addition to the requirements of paragraph (a), if the adverse underwriting decision is either solely or partially based upon a report of creditworthiness, credit standing, or credit capacity that an insurer receives from a consumer reporting agency, the insurer or insurance agent responsible for the decision shall provide in writing the primary reason or reasons for the credit score or other credit based information used by the insurer in the insurer's adverse underwriting decision."</p> <p>The MN Department of Commerce's viewpoint on the relevant issues can be found in a consumer tip sheet that has been posted at www.commerce.state.mn.us/pages/ConsumerTips/ConTip-CreditScore.htm.</p>	<p>SF2363, which is now in effect, unanimously passed the Minnesota Legislature and was signed into law in 2002. In summary, the law provides the following:</p> <p>(a) An insurer may not reject, cancel or non-renew an auto or homeowners policy in whole or in part on the basis of credit information without consideration of other underwriting factors.</p> <p>(b) If credit information or scoring is used in underwriting the insurer must disclose that credit information will be obtained and used as part of the insurance underwriting process.</p> <p>(c) Insurance inquiries and non-consumer initiated inquiries may not be used as part of the scoring process.</p> <p>(d) If a credit information or score relating to a consumer is adversely impacted or cannot be generated because of the lack of a credit history, the insurer must exclude the use of credit as a factor in underwriting.</p> <p>(e) Insurers must provide reasonable credit exemptions based upon prior credit histories for persons whose credit information is unduly influenced by extraordinary life events, such as a catastrophic injury or the death of a spouse.</p> <p>(f) A scoring methodology may not be used by an insurer if the methodology incorporates the gender, race, nationality, or religion of an insured or applicant.</p> <p>(g) Insurers who employ a credit scoring or insurance scoring system in underwriting must have on file with the commissioner</p>

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
		(1) the Insurer's scoring methodology, and (2) information that supports the Insurer's use of a credit score or insurance score. Information provided by an insurer to the commissioner under these provisions is trade secret information.
Mississippi Missouri	<p>The Missouri Department of Insurance recently posted an FAQ on industry use of credit information to its website, and this can be found online at www.insurance.state.mo.us/consumer/faq/creditScoring.htm.</p> <p>Missouri Governor Bob Holden called for credit-related legislation in early 2002 and made the issue part of his legislative package. A substitute compromise bill – House Bill 1502 – was ultimately adopted in place of the two proposals originally put forth. Among other provisions, the law does the following:</p> <ul style="list-style-type: none"> • Prohibits insurers from taking adverse actions against consumers based on a credit report or insurance credit score without consideration of another noncredit related underwriting factor. • Requires that insurers disclose at time of application or on the application itself that credit reports or insurance scores are utilized. • Prohibits an insurer from taking an adverse action based on information in a credit report that is the subject of a written dispute until such dispute has reached a final determination in accordance with the FCRA. • Imposes certain disclosure requirements on insurers that take adverse actions based on a credit report or insurance score and provides those subject to an adverse action with the ability to request a reevaluation. • Permits insurers to obtain a current credit report or insurance score at the time of renewal underwriting, but prohibit adverse actions based on scores or credit reports that are more than three years old. • Prohibits the number of consumer insurance inquiries from being utilized as a negative factor in scoring formulas. • Prevents entities that create, compile, or provide insurance scores from selling or otherwise providing certain types of information – including the estimated expiration date of insurance policies – in certain instances. See §12. <p>The law applies to all contracts entered into on or after July 1, 2003.</p>	
Montana	<p>There is a statute and bulletin in place. Among other provisions, state law (see §33-18-210(11)) provides that:</p> <p>"An insurer writing automobile or homeowner insurance may not refuse to insure, refuse to continue to insure, charge higher rates, or limit the scope or amount of coverage or benefits available to an individual based solely on the insurer's knowledge of the individual's credit history unless (i) the insurer possesses substantial documentation that credit history is significantly correlated with the types of risks insured or to be insured; (ii) the insurer sends written communication to the individual disclosing that the insurance coverage was declined, not renewed, or limited in scope or amount of coverage or benefits because of credit information relating to the applicant or the insured; and (iii) upon subsequent request of the individual, mailed within 10 days of receipt of the denial, nonrenewal, or limitation, the insurer provides the individual with a copy of the credit report at issue or the name and address of a third party from whom the individual may obtain a copy of the credit report, within 10 days of receipt of the request."</p> <p>The department issued an "advisory bulletin" on September 7, 2001, that addresses Montana law concerning adverse actions. See http://www.state.mt.us/sao/Other/csmemorandum.htm.</p>	Two separate bills are moving through the Montana Legislature. The first, Senate Bill 349, is based on the NCOIL model law and was adopted 47-3 by the Senate on February 28. The second, House Bill 184, is supported by the insurance commissioner and was approved 87-11 by the House on February 12.
Nebraska	There is no written law, regulation, bulletin, or other provision in place regulating/restricting use of information in underwriting. The Department's "public position" is that credit history cannot be used as sole underwriting criterion – but consumer complaints have not been very successful.	The unicameral legislature is currently considering LB 487, and the proposal passed the Banking, Commerce, and Insurance Committee on February 26. The bill is nearly identical to the NCOIL model law.

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<p>However, the 2001 Legislature passed LB 444, which instituted two relatively simple disclosure requirements that apply to private passenger auto insurance. The applicable section of the law states:</p> <p>"On and after July 1, 2002, no private passenger automobile liability policy shall be delivered, issued for delivery, or renewed with respect to any motor vehicle licensed in this state unless accompanied by a disclosure showing . . . if any credit-based rating was used to determine the rate charged."</p> <p>As described by the department, this disclosure requirement covers only those situations where an individual insurer has two or more rate levels available to a policyholder and credit scoring or some other use of credit history is a factor used in determining which rate applies. In these situations, the insurer must make a clear affirmative statement to the policyholder that it has used credit history or credit scoring as a factor in determining the rate being charged. Please note that it will not suffice to merely include a blanket statement that credit scoring might have affected the rate – the disclosure should be an affirmative statement made only when credit scoring or credit history is used by the individual insurer in its pricing calculations.</p>	
Nevada	<p>In 2002, the Nevada Division of Insurance convened a meeting with a group of industry representatives, consumer advocates, and credit agencies to discuss the use of credit scores in setting insurance rates. The division is concerned about whether the practice unfairly discriminates against certain segments of the population, and they are investigating the issue.</p>	
New Hampshire	<p>On March 4, 2002, New Hampshire adopted a new regulation in this area (INS 3300), which is effective September 1. A copy of the new regulation can be accessed online at http://www.state.nh.us/insurance/Regs/ins3300adopted%203-4-02.pdf. A summary of the regulation follows:</p> <ul style="list-style-type: none"> • The regulation applies to auto and homeowners insurers that use insurance scores (as that term is defined) for underwriting and rating purposes. Insurers must develop written standards for the use of such scores, and these scores may not be based on race, sex, religion, national origin, place of residence, blindness, physical disabilities, or other articulated factors. • Insurers must submit their underwriting models and rates with the department "for approval." The characteristics, factors, and criteria associated used in the underwriting or rating must be filed. In addition, insurers must also separately submit their insurance scoring models, and such models must be approved prior to their use. As part of this latter filing, insurers must include statistical validation supporting the use of insurance scores in the rating process. • Insurers that use an insurance score at the time of original application must provide a notice of this fact to the consumer, and a similar notice must be provided if such scores are used upon renewal. The notice must be provided by the same method that the application is submitted. • The regulation defines "adverse action" and sets out a set of rules for when such actions are taken by an insurer. In these instances, insurers must notify the consumer, provide the contact information of the consumer reporting agency that furnished the information to the insurer, and provide notice of the consumer's rights. If requested, insurers must also provide consumers with the two primary reasons why the consumer was assigned the insurance score. 	
New Jersey		
New Mexico	<p>A March 4, 2002 Insurance Chronicle story reported on Superintendent Serna and the insurance division's position on the use of credit information, and the article suggested the division has some concerns with the correlation between risk and credit history and the impact of using credit histories in New Mexico. Bulletin No. 2002-001, located at http://www.nmipc.state.nm.us/insbul22001.pdf, also states that all insurers using credit scoring in any phase of their underwriting or ratemaking process must submit all portions of their programs related to credit scoring to the Insurance Division.</p>	<p>The Superintendent established a task force in 2002 to examine the issue, conduct public hearings, and develop policy recommendations. The task force provided its recommendations to the Superintendent in late 2002, but no new regulations have yet been promulgated as a result of the group's actions. Superintendent Serna remains concerned about the implications that the use of credit scoring may have on minorities, and he has asked the University of New Mexico to conduct a study of the issue (expected to be completed by the Summer of 2003).</p> <p>Two bills to ban the use of credit information by the insurance industry were introduced in 2003, but both failed to pass before the close of the legislative session.</p>

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
New York	The NY Department has some in-house guidelines regarding the use of credit information. It is an Informal Department opinion, which also covers the use of credit information for moving consumers among tiers in multi-tier plans. It is allowable to use credit history as one of the underwriting criteria, but not the sole criteria.	
North Carolina		Legislation in this area could be introduced and considered during the 2003 session.
North Dakota	<p>A story in the February 24, 2002 edition of the <u>Argus Leader</u> reported that "Commissioner Jim Poolman . . . wants to find out how widespread the practice of credit scoring is and what problems it might be creating." The article reported that the commissioner was particularly interested on the impact on farmers who suffer periodic financial problems, people with no credit history, and individuals who use cash for purchases.</p> <p>Commissioner Poolman scheduled a public hearing to "solicit opinions on the use of credit information in pricing and underwriting of insurance." The hearing, held on April 2, 2002, was attended by numerous legislators and several company representatives. The Commissioner and the legislature are now expected to consider whether regulation or legislation is needed.</p>	The North Dakota House and Senate both overwhelmingly passed House Bill 1260, which is nearly identical to the NCOIL model law. The most recent action on the bill, the Senate's passage, took place on March 24, 2003.
Ohio	<p>House Bill 519 was introduced in February 2002, which would:</p> <ul style="list-style-type: none"> • Prohibit an insurer from refusing to "write or renew motor vehicle insurance solely on the basis of an applicant's or insured's credit score or credit report." • Prohibit an insurer from considering "a credit score or credit report in underwriting motor vehicle insurance unless the credit score was determined or the credit report issued within the prior year." • Require that insurers annually obtain new credit scores and credit reports for each of its motor vehicle insurance insureds and utilize that information in determining its insureds' premiums. ["If spouses are covered under the same policy of motor vehicle insurance, an insurer shall obtain credit scores or credit reports on both spouses, and the better credit score or credit report shall be used in determining the premium for the policy."]] • Require that insurers notify an applicant in writing prior to the issuance of a policy if credit information is considered to determine rates. • Prohibit an insurer from increasing an applicant's or insured's premium as a result of a request for information on the insurer's use of credit scores and credit reports." • Require that a person's lack of credit history be treated as a neutral factor. • Compel the Department of Insurance to study and issue a report on the use of credit information by the insurance industry. 	
Oklahoma	<p>In a June 30, 2000 bulletin, Commissioner Fisher informed the industry that the OK Board for P&C Rates had recently established guidelines to be used "for credit reports/scores in underwriting and rate determinations for insurance in the State of Oklahoma.</p> <p>The Commissioner also made clear that "agents and consumers [should] not bear the expense of obtaining credit reports/scores." He also expressed concern with the liability exposure for agents when companies use a consumer's credit information, and he urged companies to "limit the information that goes to the agent as to eliminate any sort of liability the agent might incur."</p> <p>The Commissioner also said: "If you choose to apply credit reports/scores to your current book of business, please allow an additional 90 days notice to the standard renewal offer. This should give consumers time to verify the accuracy of their information."</p> <p>The formal procedures address these issues in greater detail, and some of the key provisions summarized below:</p> <ul style="list-style-type: none"> • Insurers are required to notify insureds of "any adverse action taken as a result of the insured's credit history or credit score, which includes an increase in premium due to a change in tier or company placement." 	In late February, the Oklahoma House passed House Bill 1751 by a vote of 99-1, and the proposal has been forwarded to the Senate for its consideration. The proposal is very similar to the model law that was adopted by NCOIL in November 2002.

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<ul style="list-style-type: none"> • Insurers are prohibited from refusing to "insure, cancel, or nonrenew based solely on an insured's credit history or credit score." • Insurers are prohibited from penalizing an insured for having no credit history. • The procedures contain a correction of premiums provisions that requires a refund of back to the last 12 months of coverage. • An insurer is required to have "specific written criteria on how credit information affects underwriting and rate determinations," and certain information must be filed with the Board if requested. <p>The Oklahoma Department of Insurance website also discusses the rules in place in Oklahoma – http://www.oid.state.ok.us/AskCarrollFisher/110101CreditRatesAuto.htm.</p> <p>In September 2001, the Oklahoma Board for P&C Rates revised its earlier guidelines, and in November 2001, the Insurance Commissioner issued Bulletin No. PC 2001-07 detailing the new rules. The new bulletin can be downloaded online at http://www.oid.state.ok.us/080301P&CRevised/112601P&CBulletinPC2001-07.pdf. The revised rules loosen the "rechecking" requirements and provide insurers with an alternative for satisfying the filing requirements.</p>	
Oregon	<p>The Oregon Insurance Division adopted a rule addressing insurer use of credit information in December 2002, and the new regulations are to take effect beginning June 1, 2003. The rules primarily impose new requirements concerning the disclosures that must be made to consumers in the event that credit information is to be used and after an adverse action is taken. A copy of the new rule can be accessed at www.cbs.state.or.us/external/ins/docs/rules/recent_adopt/125-2002_rule.pdf.</p> <p>Joel Arlo, Oregon's Insurance Administrator, is also Co-Chairman of the NAIC's Credit Scoring Working Group – along with Washington State Commissioner Mike Kreidler</p>	Several bills have been introduced during the 2003 legislative session, but none has been the subject of any formal committee consideration or vote.
Pennsylvania	Senate Bill 1456 (2002) was introduced late during that legislative session. The proposal says that an insurer "shall not deny, cancel or refuse to renew personal insurance due in whole or in part to an insured's credit history." However, the bill permits the use of credit histories in combination "with other objective criteria," but the maximum premium differential based on credit history shall be no more than 20%.	
Rhode Island	<p>Under Rhode Island law (§§6-13.1-20 – 6-13.1-23): A credit report in connection with a consumer's application for credit, employment, or insurance cannot be requested unless a consumer is first informed that a credit report may be requested in connection with such application. Whenever credit or insurance for personal, family, or household purposes involving a consumer is denied or the charge for such credit or insurance is increased either wholly or partly because of information contained in a credit report from a credit bureau, the user of the credit report shall advise the consumer against whom such adverse action has been taken and supply the name and address of the credit bureau making the report. Any consumer who requests disclosure of his or her credit file from a credit bureau shall be entitled to have mailed to the consumer a copy of the information in the files of the credit bureau that pertains to the consumer at the time of the consumer's request for disclosure within four working days of such request. The credit bureau may impose a reasonable charge for said report. The law provides for a disputed credit report resolution, setting time limits during which the credit bureau must reinvestigate the current status of the information provided and allow the consumer to file brief statements setting forth the nature of the dispute. Whenever a statement of dispute is filed, any subsequent consumer report containing the information in question must clearly note that it is disputed by the consumer. Following any deletion or correction of information which is found to be inaccurate, the credit bureau must furnish a copy of the corrected credit report to the consumer at no charge and at the request of the consumer, furnish a copy of the corrected report to any persons specifically designated by the consumer.</p> <p>The legislature recently adopted HB 8027, which becomes effective at the start of 2003, and the proposal has become effective without the governor's signature. The legislative intent section of the new law states that "[s]tudies of the issue have revealed a strong body of evidence which clearly and convincingly shows that a credit score is a strong predictor of future loss," but it also says that "a series of safeguards" and "reasonable requirements" are necessary.</p>	Senate Bill 137 and House Bill 5362 have been introduced in the Rhode Island General Assembly, and both bills would incorporate Sections 5(H) and 11 of the NCOIL model law to the reform statute adopted in 2002.

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<p>In addition to other provisions, the new law only permits an insurer to use insurance scoring for rating and underwriting of homeowners' or auto insurance if:</p> <ul style="list-style-type: none"> • The insurer "demonstrates the predictive nature of their insurance score to the insurance division." • If requested by an existing customer, an insurer must "obtain an updated insurance score for the consumer." If the score has improved, the insurer must provide whatever rating decrease is appropriate, but the insurer's ability to increase rates based solely on the revised score is limited. • An insurer "shall not decline insurance for a new customer based solely on an insurance score, or absence of insurance score" – and an insurer shall not cancel, nonrenew, or increase rates based solely on the worsening of a consumer's score except under limited circumstances. <p>The new law also provides a definition for "insurance score" and mandates that "agents shall be held harmless by insurers for all acts, efforts and disclosures in obtaining an insurance score on the insurer's behalf." Again, the law takes effect January 1, 2003.</p>	
South Carolina	<p>SC Code §38-73-740 (Act 181 of 1993) provides: "All information, including investigative and credit reports used in determining the classification or premium rates of any person applying for automobile insurance, must be kept on file by the insurer for at least 3 years from the date the application was made. Upon request of the applicant, the applicant, the contents of the file must be made available for inspection by the applicant and copies of the documents must be furnished [to] the applicant if he pays for the cost of reproducing copies."</p> <p>Bulletin 98-2 (issued 8/1998) included the following Q&A:</p> <p>(9) Can any insurer utilize credit reports or credit scores in determining the rate level tier within which to place an applicant or renewing insured? Yes. State law <i>currently</i> recognizes the use of credit reports and credit scores in the premium calculation process within §38-73-740. However, if a credit report or credit score is utilized to determine a risk's classification or premium rate, then the credit report or credit score must be retained by the insurer for 3 years from the date the application and, upon request and upon the payment of reasonable copying costs, must be provided to the applicant or renewing insured by the insurer or, through the insurer, by the 3rd party scoring vendor. It is important to note that §38-73-740 imposes a requirement upon insurers not upon 3rd party scoring vendors.</p> <p>[. . .] If an insurer places an insured in a higher than the lowest rate level tier available for that underwriting insurer or available within the group of which that underwriting insurer is a member as a result of a credit report or credit score and if the credit report or credit score is detailed as the §38-77-126 disclosure reason for the higher rate level tier, then the insured must be given notice of the credit report's or the credit score's availability pursuant to §38-73-740.</p> <p>In 2002, the legislature adjourned without any bill being adopted, but the Department of Insurance addressed the issue by issuing Bulletin Number 2002-04 on May 24, 2002. That bulletin, which is effective on January 1, 2003, can be accessed at http://www.state.sc.us/dol/Bulletin2002-04.pdf.</p>	
South Dakota	<p>A department hearing on the issue was held March 26, 2002. Almost two dozen companies and the relevant trade associations were in attendance, and it is expected the debate will lead to some form of action in the coming months. A second meeting on the issue was held in mid-May 2002. The department is weighing its options at this point, and it is expected that they will either develop and issue a regulation or prepare a legislative proposal for 2003. The department is thought to have the authority to issue a regulation or bulletin in this area, so the first option is perhaps the more likely scenario.</p>	
Tennessee	<p>The Tennessee Insurance Department's Review Requirements Checklist states that credit scoring plans must be filed with the department for certain lines of insurance. For personal auto, farm, dwelling fire, and homeowners insurance, the checklist states that (1) justification for using credit scoring must be provided; (2) the credit scoring system cannot be the sole basis for determining rates/tiers; (3) the credit scoring program must specify the credit reporting company(ies) used, the characteristics used, the points assigned to the various credit characteristics, and the formula used to obtain the final point, and (4) the point ranges for</p>	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	determining the applicable rates/tiers must be filed. The checklist can be accessed at http://www.state.in.us/commerce/fspmkt.pdf .	
Texas	Texas does not have a law that regulates the use of credit information for underwriting purposes. However, the Texas Insurance Code does prohibit discriminatory practices.	<p>Numerous bills addressing the issue have been introduced, but little formal action has taken place as of this date.</p> <p>In addition, a study released from the Bureau of Business Research at the University of Texas found a "statistically significant" relationship between a person's credit history and tendency to incur losses on an auto insurance policy. The study was commissioned by Lt. Governor William Ralliff in June 2002 to examine the relationship between credit scores and incurred losses. The study determined, in general, that "lower credit scores were associated with larger incurred losses." The study can be found at: www.utexas.edu/depts/bbr/bhr_creditstudy.pdf.</p>
Utah	During the 2002 session, the legislature passed and the governor signed HB110. The new law, which applies only to "motor vehicle related insurance," prohibits the use of "credit information" in most instances. However, credit information is expressly permitted if used to (1) "determine[e] initial underwriting" "if risk related factors other than credit information are considered" and (2) provide insureds with "a reduction in rates" or "any other discount similar to [a] reduction of rates . . ."	
Vermont		
Virginia	<p>On June 17, 2002, Commissioner Gross issued Administrative Letter 2002-6, which requires scoring models to be filed with the Bureau of Insurance. Specifically, the letter states the following:</p> <p>"It has recently come to the attention of the State Corporation Commission Bureau of Insurance that it is possible to change the mathematical components/formulae of a credit scoring model used for calculating rate levels, thereby changing the final rate charged to an insured. Section 38.2-1906 of the Code of Virginia requires that all rates and supplementary rate information be filed prior to their use.</p> <p>Effective immediately, any insurer that intends to use credit scoring models in rating or tiering must file the models prior to their use. Insurers currently using credit scoring models in rating or tiering must file their models no later than September 1, 2002.</p> <p>The models will be considered part of the rate filing and will be open to public inspection according to § 38.2-1907."</p>	<p>Senate Bill 1284 (Chapter 553) was signed into law by Governor Warner on March 24. The new law is similar to the NCOIL model law and other state statutes, and some of the elements of the proposal are highlighted below:</p> <ul style="list-style-type: none"> • The bill applies to motor vehicle insurance and policies written to insure owner-occupied buildings or the personal property of a tenant's residential property risk. • The proposal includes initial notification, adverse action, and re-check, and error correction requirements similar to those in the NCOIL model law. • The bill prohibits the use of the following factors for underwriting, tier placement, or rating purposes – information identified as disputed by the consumer reporting agency, insurance or non-consumer initiated inquiries, collection accounts with a medical industry code, certain lender inquiries made within 30 days on one another, and a person's total available line of credit. • "An insurer may, upon request, provide reasonable exceptions for an individual whose credit information is directly and adversely impacted by a catastrophic event, as determined by the insurer, including, but not limited to, catastrophic illness or injury or the death of a spouse or member of the same household. The insurer may require reasonable documentation of the event prior to granting an exception." • These provisions would apply to all new policies not later than January 1, 2004, and to all renewal policies not later than April 1, 2004.
Washington	<p>House Bill 2544 (2002) was enacted last year, and some of the statute's major provisions are outlined below.</p> <ul style="list-style-type: none"> • Insurers taking adverse actions (as defined under the act) "based in whole or in part on credit history or 	

State	Existing Rules and Previous Action	Recent Legislative or Regulatory Activity
	<p>Insurance score shall provide written notice" to those affected. Such notice "must state the significant factors ... that resulted in the adverse action."</p> <ul style="list-style-type: none"> • Insurers are prohibited from canceling or nonrenewing personal insurance based in whole or in part on credit history or insurance score. • Insurers "may use credit history to deny personal insurance coverage only in combination with other substantive underwriting factors." • Insurers are prohibited from denying personal insurance or setting rates based on one's absence of credit history, the number of credit inquiries, and a series of other factors (based in part on guidelines developed last year in Connecticut). • Insurers must file insurance scoring models with the commissioner, and this information will be kept confidential. • The commissioner is required to prepare a report on the use of credit history for the legislature. <p>On September 6, the Office of the Insurance Commissioner (OIC) issued its rules related to enforcement of the new law. A copy of these rules, which contain a Q&A, can be found online at www.insurance.wa.gov/tableofcontents/newrules/2001-11103.pdf.</p>	
West Virginia	<p>West Virginia's statutes provide that no insurer may decline to issue or terminate a policy of insurance if the declination is based solely on adverse credit reports or scores. The citations are §33-6B-3 (j) (1990) for auto insurance and 33-17A-6(h) (1990) for property insurance.</p> <p>The Insurance Commission released Informational Letter No. 142 in July 2002. The letter permits the use of credit-related information, lifts the moratorium that had been in place, and outlines the rules that must be followed when credit information is utilized. See www.state.wv.us/insurance/info%20142.htm.</p>	
Wisconsin	<p>In June 1997, the Office of the Commissioner of Insurance (OCI) issued a bulletin entitled "The Use of Credit Reports in Underwriting Personal Auto and Homeowner's Policies." This bulletin can be viewed online at http://oci.wi.gov/bulletin/61697bul.htm.</p> <p>The bulletin says "insurers should not use credit information, whether they use credit reports or scoring mechanisms, as the sole reason to refuse an application, cancel a new insurance policy in its first 60 days of coverage, or nonrenew an existing policy." The bulletin also suggests that insurers could face violations of the unfair marketing practices statute if they do not implement the following procedures:</p> <ol style="list-style-type: none"> (1) Develop written criteria (including quantifiable underwriting standards) on how credit information affects the underwriting decision. (2) Disclose to applicants and insureds the items which resulted in the underwriting decision. (3) Consider information from applicants and insureds concerning the accuracy of a credit report. (4) Disclose to consumers that it may/will gather credit information and outline the circumstances when a credit report will be used. [The bulletin cites other procedures also.] <p>In 2001, the OCI surveyed auto and homeowner's insurers in the state to determine how they utilize credit information in the underwriting and rating process. The results from this inquiry can be found online at http://oci.wi.gov/creduse.pdf.</p>	
Wyoming		<p>Senate File 81 (2003) has been approved by both the Wyoming Legislature and was signed into law on March 3. The new law provides the insurance commissioner with rulemaking authority to issue regulations concerning the use of credit scoring in the underwriting of personal lines insurance policies. The law requires that the regulations prohibit the use of credit information as the sole basis to underwrite and require that consumers receive an initial disclosure that credit information will be used.</p>

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.chomes.com/chome/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.

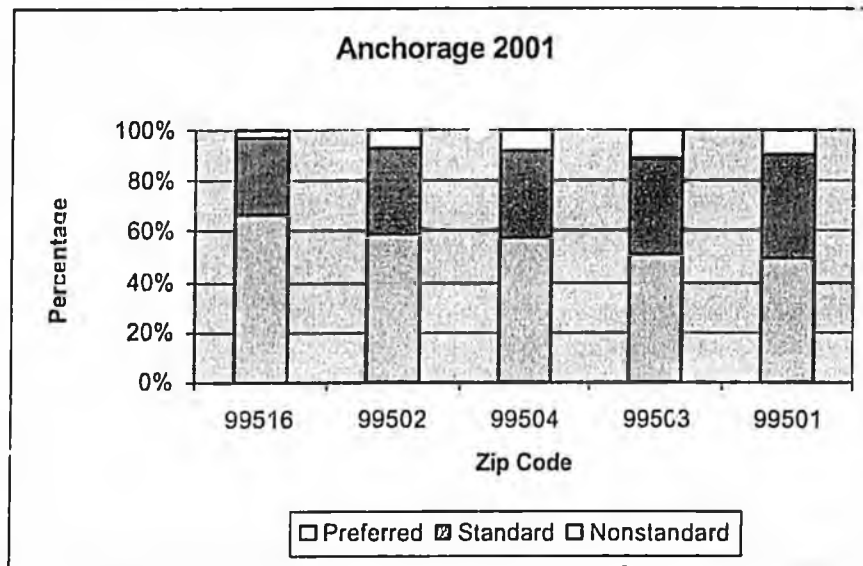
- Zip code Group A consists of zip codes 99501, 99509, 99510, 99511, 99512, 99513, 99514, 99520, 99521, 99522, 99523 and 99524.
- Zip code Group B consists of zip codes 99502, 99507, 99515 and 99518.
- Zip code Group C consists of zip codes 99503 and 99508.

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.

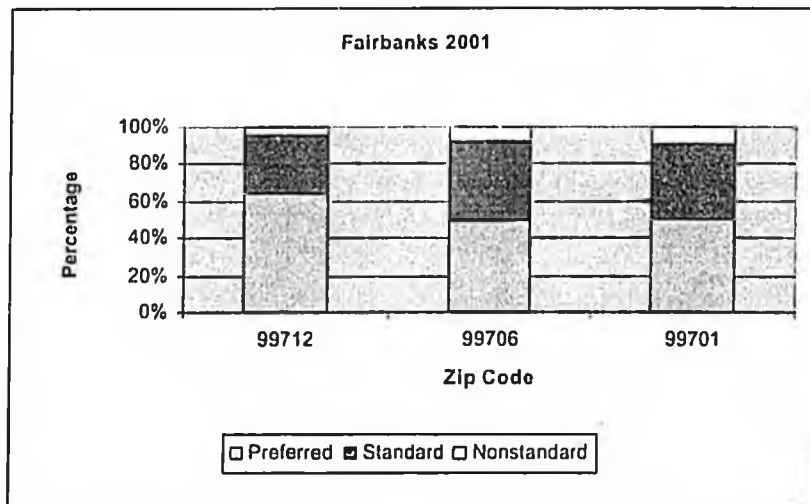
- Zip code Group D consists of zip codes 99706, 99707, 99708, 99709 and 99710.
- Zip code Group E consists of zip codes 99701 and 99711.

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

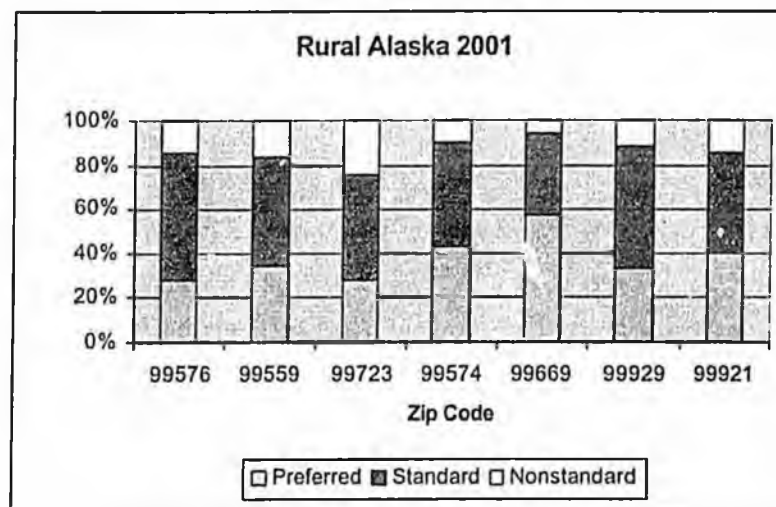
Table III contains data from rural Alaska. The policyholder distributions for rural Alaska are represented by some of the larger communities in various locations around the state: Dillingham (99576), Bethel (99559), Barrow(99723), Cordova (99574), Soldotna (99669), Wrangell (99929) and Craig (99921).

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%
99774	\$72,711	84%	20%	55%	24%
99669	\$57,981	94%	48%	39%	13%
99925	\$51,879	80%	12%	70%	18%
99927	\$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.

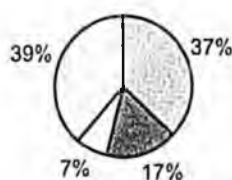
Of the companies using insurance credit scoring, 86% use a third-party vendor to provide their model. The companies are almost evenly split between the use of Choicepoint (53%) and Fair, Issac & Company, Inc. (47%). Many of the companies were either unaware of the details of the model used by their vendor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

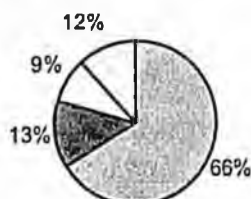


□ Underwriting □ Rating □ Both □ Neither

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.*

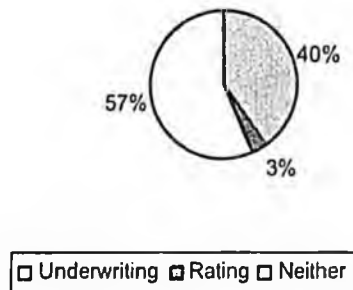
When corrected information is received, 10 of the insurers will apply the corrected information to all affected policies, 6 will apply the corrected information to the current policy only and 8 will only apply the corrected information if it results in lower rates for the

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

Homeowners Insurance

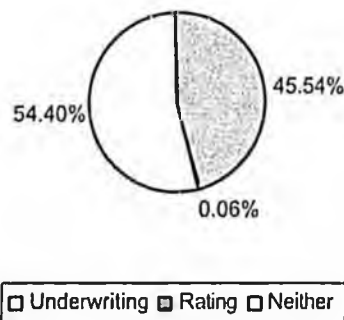
Of the 30 active homeowners insurers who responded to the survey, 13 (48%) use credit history. Credit history is used by 12 companies for underwriting and by 1 company for rating.

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	3	Yes	31	No
Rating	2	Yes	29	No
Solicitation	0	Yes	35	No
Company placement	4	Yes	22	No

Homeowners			
Underwriting	<u>4</u>	Yes	<u>10</u> No
Rating	<u>0</u>	Yes	<u>13</u> No
Solicitation	<u>0</u>	Yes	<u>14</u> No
Company placement	<u>2</u>	Yes	<u>11</u> 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?

a) **Auto**
21 Yes 14 No

a) **Homeowners**
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?

a) **Auto**
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

a) **Homeowners**
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

Frank H. Murkowski, Governor

Alaska Department of Community
and Economic Development

Division of Insurance

P.O. Box 110805, Juneau, AK 99811-0805

Telephone: (907) 465-2515 • Fax: (907) 465-3422 • Text Telephone: (907) 465-5437

Email: Insurance@dced.state.ak.us • Website: www.dced.state.ak.us/insurance/

May 7, 2003

The Honorable Con Bunde
Chair, Senate Labor & Commerce
Room 506
State Capitol
Juneau, AK 99801-1182

The Honorable Ralph Seekins
Chair, Senate Judiciary
Room 125
State Capitol
Juneau, AK 99801-1182

RE: SB 13 – Using Credit History or Credit Scoring For Insurance Purposes

Dear Senators Bunde and Seekins:

During the May 1, 2003, Senate Labor & Commerce hearing on SB 13, the Division of Insurance was asked to provide additional historical information on rate changes for personal auto and homeowners business as well as for the overall profitability of these markets in Alaska.

This information is included on the attached exhibits. Four insurers were selected to be representative of the personal auto and homeowners rate changes. These insurers were selected because they generally have the largest market shares in each of these lines. For personal auto, the four insurers have approximately 55% of the market. For homeowners, the selected insurers have approximately 75% of the market.

If you have any additional questions, please let me know.

Sincerely,



Linda S. Hall
Director

SUMMARY OF PERSONAL AUTO RATE CHANGES IN ALASKA

<u>Company</u>	<u>Effective Date</u>	<u>Change</u>
<i>Allstate Insurance Company</i>	11/25/1996	0.10%
	3/8/1999	0.00%
	8/24/2000	8.00%
	2/4/2002	8.30%
	2/24/2003	5.40%
<i>Progressive Insurance Companies</i>	11/7/1995	-0.70%
	9/1/1996	2.50%
	9/25/1998*	0.50%
	6/17/1999	-1.00%
	11/30/1999	6.50%
	8/8/2000	7.00%
	4/22/2002	4.80%
	8/30/2002	6.00%
<i>State Farm Mutual Automobile Insurance Company</i>	7/1/1996	4.90%
	9/15/1997	-2.40%
	9/15/1998	-9.40%
	5/15/2000	1.40%
	8/1/2001	5.90%
	1/1/2003	18.20%
<i>United Services Automobile Association</i>	9/30/1996	-9.00%
	1/1/1998	-9.00%
	6/30/1999	14.10%
	7/15/2001	11.50%
	03/08/02*	0.00%
	12/7/2002	14.80%

*These changes include the initial use of credit scoring.

SUMMARY OF HOMEOWNERS RATE CHANGES IN ALASKA

<u>Company</u>	<u>Effective Date</u>	<u>Change</u>
<i>Allstate Insurance Company</i>	1/22/1996	1.8%
	5/18/1998	9.4%
	5/22/2000	2.4%
	1/21/2002	15.0%
	7/22/2002	6.2%
<i>SAFECO Insurance Company of America</i>	10/1/1998	5.4%
	10/21/1999	3.6%
	7/6/2000	3.0%
	8/30/2001	3.0%
	3/5/2003	10.0%
<i>State Farm Fire & Casualty Company</i>	11/15/1995	1.8%
	8/1/1997	6.6%
	1/1/1999	-2.9%
	4/15/2000	-0.6%
	6/15/2001	-6.4%
	6/15/2002	12.3%
<i>United Services Automobile Association</i>	3/1/1997	-5.9%
	2/1/2002	15.0%
	4/1/2003*	0.2%

*This change includes the initial use of credit scoring

INSURANCE PROFITABILITY IN ALASKA

Private Passenger Auto

Year	Return on Net Worth	
	Alaska	Countrywide
1993	13.7%	14.2%
1994	15.4%	11.4%
1995	8.2%	11.6%
1996	20.8%	12.1%
1997	17.3%	12.4%
1998	-5.7%	10.1%
1999	6.2%	7.7%
2000	-0.5%	2.2%
2001	-6.0%	2.0%

Homeowners

Year	Return on Net Worth	
	Alaska	Countrywide
1993	16.3%	2.5%
1994	15.7%	-1.7%
1995	8.5%	3.4%
1996	-27.9%	-4.2%
1997	12.4%	12.4%
1998	20.0%	5.4%
1999	10.6%	5.4%
2000	6.3%	3.8%
2001	13.1%	-7.2%

These figures are taken from the **Report on Profitability by Line by State In 2001** prepared by the National Association of Insurance Commissioners. See the accompanying *Disclaimers* for caveats and limitations on the uses of these data.

DISCLAIMERS

NAIC Report on Profitability By Line By State

The NAIC *Report on Profitability By Line By State* has been appreciated for many years because it provides a consistent view of the underwriting and investment experiences of the property/casualty insurance industry for each line of insurance in each state. Because it has been produced for many years, it allows changes in results to be viewed over time. It is prepared by an objective source, the NAIC, and is carefully viewed for accuracy and reasonableness. However, the report's limitations should be clearly understood. The report contains some caveats regarding the data used in the report, the procedures used to compile the data and the validity of that data for various uses. These caveats are contained in the introductory and explanatory material in the first section of the report. Selected caveats are shown or summarized below:

"The report cannot and should not be used to determine whether current rates are adequate to cover future costs." (page 1)

"To the extent possible, the data from the annual statement utilized in the report are adjusted to approximate figures on a generally accepted accounting principles (GAAP) basis.the GAAP adjustments made for the profitability report are imperfect approximations." (page 1)

"It is necessary to emphasize that because of inherent data limitations and the need to apply a 'one size fits all' methodology, the profitability report provides only approximations of actual profits earned by line and by state. Some components of profit in a particular state and line could differ significantly from the results shown in the report." (page 2)

"Unrealized capital gains and losses generally are not included in net income under generally accepted accounting principles and, accordingly, are not included as investment gain in this report." (page 3)

"Federal taxes are estimated..." (page 4)

The data for all companies in all states are aggregated prior to allocation of that data by line by state. Data which the companies do not allocate by state and which the report allocates by state from countrywide aggregates for all companies combined includes: net worth, investment gain, federal taxes, general expenses, unallocated loss adjustment expenses, other acquisition expenses and the effects of consolidation of affiliated insurers. (Summary of portions of pages 1-27)

Some general qualifications shown on page 5 of the report are as follows:

"The development of this report is dependent on the accuracy of the information contained in the annual statements filed by insurers. Although the data used to calculate the statistics contained in this report were extracted from annual statements filed with the NAIC, the NAIC does not guarantee their accuracy."

"While the NAIC exercises a great deal of care in capturing data from annual statements and producing this report, as with any statistical project of this magnitude, errors can occur. Consequently, the NAIC makes no representations or warranties with respect to the accuracy of the data and statistics in this report."

If you have any questions regarding this report, please contact Thomas E. Kindred, Jr. at the NAIC at (816) 783-8225. Additional copies of this report can be obtained from the NAIC Insurance Products & Services Division at (816) 783-8300.

SB 13 – Credit Scoring Bill Analysis for Judiciary CS

- The bill regulates the use of credit information for personal insurance. It does not apply to commercial insurance.
- Credit scoring is allowed for all aspects of writing new business: underwriting, rate setting, and the decision whether to insure at all.
- An insurer must notify the customer that credit will be used. A sample notice is provided so insurance companies can be certain of compliance with the law.
- An insurer may not use credit information when it's time to re-up a policy—either to nonrenew or in the underwriting/rate setting process that determines how much a consumer pays.
- Credit cannot stand alone. An insurer must also use other substantive factors in making decisions. These could include any or all of the traditional categories for assessing risk (*e.g.*: accident history, tickets, homeowner's claims, etc.)
- Some credit scoring models create a disincentive to good financial management, duplicate categories used elsewhere in assessing risk (like age), or look at factors that may be a proxy for race or income. The bill says certain factors can't be considered when an insurer looks at credit, including:
 - Age, marital status, race, religion, zip code
 - Medical collections
 - Lack of credit
 - Particular type of credit card (*e.g.*: Nordstrom, American Express)
 - Total available line of credit
 - Age at which credit is established
 - Comparison shopping for insurance or home, auto, or boat loans
- When use of credit hurts a consumer in the insurance process, the insurer must provide a clear and specific notice of adverse action explaining the elements that hurt the consumer's score and notifying the consumer of his/her rights.
- The bill outlines a dispute resolution process that protects consumers with errors on their credit reports, and makes it less likely they'll become uninsured motorists.
- Insurance scoring models and the data behind them must be filed with the Division of Insurance for approval. These are protected as trade secrets.
- The Division of Insurance will provide the public with education and a general description of how the models work.

Subject: CS bullet points

Date: Sun, 11 May 2003 12:34:37 -0800

From: Jesse Kiehl <jesse_kiehl@legis.state.ak.us>

To: Brian Hove <Brian_Hove@legis.state.ak.us>

Brian,

The attached bullets contain the highlights of the CS.

One thing that's not in there: in L&C Sen. Seekins asked about models that rate someone who recently purchased a home or car as a higher risk than someone who hasn't purchased a home or auto in several years. That nonsensical element is addressed in the CS, but for brevity's sake I left it out of the bullets.

For fairness' sake, I'll let you know up front that there are two major beefs the industry's lobbyists will have with this:


1) They want to use credit at renewal time. We offered to meet them halfway and let them use it for a certain number of renewals or years, but they won't go there.

2) They want to be able to look at type of credit card (store cards like Nordy's, Sears are bad, so is AMEX). Neither sponsor will budge on that.

I checked with Linda Hall, Director of the Division of Insurance. She would like us to reach agreement with the industry, but she will say the division is ok with the CS as written.

If you want me to take you through it in detail or answer questions, I'd be happy to. Annette will present it for the sponsors on Monday, and we'll all be there for questions/sparring.

- Jesse

 SB 13 Talking Points Judiciary CS.doc	Name: SB 13 Talking Points Judiciary CS.doc Type: WINWORD File (application/msword) Encoding: base64 Download Status: Not downloaded with message
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