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Details:

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WISCONSIN STATE LEGISLATURE ...
PUBLIC HEARING - COMMITTEE RECORDS

2007-08

(session year)

Assembly

(Assembly, Senate or Joint)

Committee on ... Insurance
(AC-In)

COMMITTEE NOTICES ...

- Committee Reports ... **CR**
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INFORMATION COLLECTED BY COMMITTEE FOR AND AGAINST PROPOSAL

- Appointments ... **Appt**
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  - (**ab** = Assembly Bill) (**ar** = Assembly Resolution) (**ajr** = Assembly Joint Resolution)
  - (**sb** = Senate Bill) (**sr** = Senate Resolution) (**sjr** = Senate Joint Resolution)
- Miscellaneous ... **Misc**

* Contents organized for archiving by: Mike Barman (LRB) (Aug/2010)

AB 387 Folder

Thursday, November 29, 2007
11:00 AM
328 Northwest
State Capitol

Use of Credit Scores by Insurance Industry

Invited speakers will discuss the use of credit scores by the insurance industry:

- Sean Dilweg, Commissioner of Insurance for the State of Wisconsin
- Dave Snyder, Vice President and Assistant General Counsel for the American Insurance Association (AIA)
- Sally McCarty, former Commissioner of Insurance for the State of Indiana
- Lamont Boyd, Insurance Market Director, Global Scoring Solutions, Fair Isaac Corporation
- Lynn Knauf, Director of Personal Lines, Property Casualty Insurers Association of America (PCI)

Info. Hearing


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Jim Doyle, Governor
Sean Dilweg, Commissioner

Wisconsin.gov

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Use of Credit Information in Auto and Homeowners Policies
Testimony of Commissioner Sean Dilweg
Assembly Insurance Committee Informational Hearing
November 29, 2007

AB 387 Folder

Thank you Chairman Lasee and members of the Assembly Insurance Committee for the invitation to speak to the Committee for information on the regulation of the use of consumer credit information in auto and homeowner's insurance.

The use of credit information in underwriting and rating is not prohibited by state statute. However, the use of credit information has come under increasing scrutiny by consumer groups; state legislators and the federal government. Of greatest concern is the potential that low-income persons or minorities will become disproportionally negatively affected.

In 1997, OCI issued a bulletin to Property and Casualty Insurance Companies that provided OCI's position regarding the use of credit information in underwriting. Since 1997, OCI's position has been that Insurers may use credit information as one of the criteria they consider when underwriting personal lines insurance. However, insurers are not permitted to use credit information, through the use of credit reports or credit 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.

Additionally, OCI's bulletin encouraged insurers to implement certain procedures to avoid noncompliance with Wisconsin's unfair marketing practices statutes including:

- Written underwriting criteria on how credit information affects the underwriting decision.
- Disclose to the applicant/insured the specific items on the credit report which resulted in the underwriting decision.
- Processes that take into consideration disclosures from applicants and insureds about any inaccuracies contained on the credit report.
- Guidelines relating to the timeliness and applicability to the risk being insured of the credit information it utilizes.
- The insurer, if it uses credit information only in certain circumstances, may not do so on an unfairly discriminatory basis.

The circumstances must substantially relate to the topic of credit history as an underwriting criteria.

- Disclose on the insurance application that the insurer may/will gather credit information and list the circumstances when a credit report will be ordered

Since 2002, the number of OCI complaints related to the use of credit information totals 148. OCI averages 8000 complaints annually. OCI received 5 complaints in 2002; 34 complaints in 2003; 20 complaints in 2004; 14 complaints in 2005; and 25 complaints in 2006. For 2007, OCI has received 49 complaints, 34 of them against one company that began using credit information as a rating factor for the first time this year in its homeowners line of business for both new business and renewals.

Almost all insurers doing business in Wisconsin now use credit information in some fashion. Insurers began by actually reviewing credit reports or asking questions on the application. Over time changes in technology made it easier for insurers to combine data throughout the company into integrated databases, making it easier to conduct research to develop credit-based insurance scores. Insurance scores may contain different data elements than are used by financial institutions in determining credit

Insurers use credit-based insurance scores that are developed in the same manner as credit scores generally. To construct a model, score developers obtain a sample of insurance policies for which losses are known. They start with the credit information available about customers and the known losses for them during a period of time. They use various statistical and other techniques to develop a model that predicts losses based on the credit information that was available. Insurers select the type of information that they wish to use such as performance on credit obligations, number of new accounts, use of credit, length of credit history and types of credit used.

Some insurers use credit in underwriting, some in rating and pricing, and some use it for both underwriting and rating. Insurers use the information along with other criteria to select applicants, to rate applicants, and to renew or nonrenew customers. In underwriting, insurers use certain characteristics of a consumer to assign the person to a pool based on the consumer's apparent risk of loss. The pool into which the consumer is placed sets the base premium rate for a policy. In rating, the insurer uses risk characteristics, including the insurance score, to adjust the base premium up or down to determine the actual amount the consumer will be charged. Given the now widespread use of credit information insurers tell me that they are adversely selected against if they do not apply credit information in the underwriting process.

A review of regulation in other states shows that 10 states regulate the use of credit information similarly, although not identically, as Wisconsin does, where a person's credit information cannot be the sole determining factor in underwriting. Many of these states also apply the same criteria to premium rating by insurers. Six states apply their credit rules to rating only, including Michigan and Hawaii, which prohibit the use of credit information in rating actions entirely.

Most recently, the State of Massachusetts has banned the use of credit information in automobile underwriting and rating for one year as the state reforms its auto insurance regulation to a market driven system. Other states require insurers file their measurement tools or actuarial formulas with the state regulatory agency and also require insurers to notify consumers when credit information is used or if a negative action has occurred because of information obtained from a person's credit information. Two states and the District of Columbia do not regulate the use of credit at all.

Eighteen states regulate the use of credit information using a regulatory model developed by the National Association of Insurance Legislators (NCOIL). Generally, the NCOIL model prohibits insurers from using income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the consumer as a factor in calculating an insurance score.

The NCOIL model does not allow insurers to deny, cancel, nonrenew a policy, or base rates of personal insurance solely on the basis of credit information. Under the model an insurance score must not use credit information that is older than 36 months and must be periodically recalculated. Also, insurers may not consider the absence of credit as a factor in calculating an insurance score. Insurers are not permitted under the model from using certain types of credit inquiries or medical related collection accounts as a negative factor in calculating insurance scores.

The NCOIL model also requires insurers to consider any inaccurate items in credit reports that are brought to their attention. Insurers are also required to disclose to the consumer if they use credit information and the result of any adverse actions that are caused by the use of credit information. The model also requires insurers to file their scoring models with the appropriate regulatory agency.

Insurers tell regulators that they rely on studies which indicate that a correlation exists between an individual's credit or insurance score and claims experience. This correlation is said to help improve accuracy in predicting risk. While these studies point to a correlation, they do not indicate causation; they cannot state definitively that bad credit history will increase claims experience.

The studies also do not appear to adequately address the possibility of an adverse impact on low-income and minority populations due to the use of credit or insurance scores. A February 2004 report issued by the Maryland Insurance Administration (MIA) could not conclusively determine whether the use of credit scoring has an adverse impact on low-income or minority populations largely because insurers do not collect information on an applicant's race or income. A 2004 study by the Missouri Department of Insurance claimed that low income households and minorities are adversely affected by insurance scoring. However, the department's study methodology was called into question leaving some uncertainty behind the results.

This year, in July, the Federal Trade Commission (FTC) found that auto insurers' use of insurance credit scores did lead to more accurate underwriting of auto insurance policies in that there is a correlation between insurance scores and the likelihood of filing an insurance claim. The FTC report stated that credit scores cannot easily be used as a proxy for race and ethnic origin. In other words, credit scoring predicted risk for members of minority groups in much the same way that it predicted risk for members of non-minority groups.

One month later, the Federal Reserve also released a study of the use of credit scoring saying that credit scores were predictive of credit risk and were not proxies or substitutes for race ethnicity or gender.

Insurers will tell you that more people benefit from the use of credit information than those who are negatively affected. This argument led voters in Oregon to reject Oregon Ballot Initiative 42 that would have banned insurers' use of insurance scores in rating and underwriting. A study at the time indicated that 58 percent of auto policyholders and 53 percent of homeowners policyholders paid lower premiums due to the use of credit information by their insurer. Auto insurance policyholders with a favorable credit score paid as much as 48 percent less than they would have paid without the insurer's use of credit information, with an average saving of $115, and homeowners paid an average of $60 less.

What is clear is that there needs to be much more information and education that consumers need in order to make sound decisions regarding the use of credit information in their insurance policies. OCI is ready to assist lawmakers and the public in providing as much information as necessary. OCI will take an active role in working with the insurance industry, consumers, and policy makers in furthering this discussion.

Wisconsin has a strong and competitive property and casualty insurance market, where auto and homeowner's rates consistently rank as the lowest in the nation and where hundreds of insurers are competing for policyholders. I wish to thank the committee for holding this hearing and would be happy to answer any questions that you have.

Bulletins to Insurers

Date: June 16, 1997

To: Property and Casualty Insurance Companies

From: Josephine W. Musser, Commissioner of Insurance

Subject: The Use of Credit Reports In Underwriting Personal Auto and Homeowner's Policies

In recent years, personal lines insurers have begun using credit history information to select and sometimes nonrenew homeowner's and automobile insurance consumers. This bulletin is the result of this office's review of the use of credit information in the personal lines underwriting process in Wisconsin and provides our position regarding the use of credit information in underwriting personal lines property and casualty business.

Insurers may use credit information as one of the criteria they consider when underwriting personal lines insurance. However, it is the position of this office that insurers should not use credit information, whether they use credit reports or credit 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.

Additionally, in order to avoid potential violations of s. 628.34, Wis. Stat., when using credit information in personal lines underwriting, insurers should consider implementing at least the following procedures:

1. The insurer should have written underwriting criteria on how credit information affects the underwriting decision. The criteria needs to include quantifiable underwriting standards. For example, an underwriting criteria explaining that "a few late payments may indicate a credit problem" would be too subjective.

2. When the insurer uses credit information, it should disclose to the applicant/insured the items on the credit report which resulted in the underwriting decision.

3. The insurer should consider any information received from the applicant/insured about any inaccuracy contained on his or her credit report and make a determination as to whether it should rely upon the credit report in question in making its underwriting decision. The insurer should not wait more than 30 days for the credit bureau to make a determination whether it will correct inaccurate or incomplete items contained on a credit report.

4. The insurer should consider and establish guidelines relating to the timeliness and applicability to the risk being insured of the credit information it utilizes.

5. The insurer, if it uses credit information only in certain circumstances, may not do so on an unfairly discriminatory basis. The circumstances must substantially relate to the topic of credit history as an underwriting criteria.

6. The insurer should disclose on its insurance application that it may/will gather credit information and list the circumstances when a credit report will be ordered.

Any questions on the above may be referred to Phil Kress (608-266-0430) or Susan Ezalarab (608-266-8885) of my staff.

Thank you.

Updated: June 16, 1997


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Nov 29, 2007
Info. Hearing
Speakers

DAVID F. SNYDER

David F. Snyder is Vice President and Assistant General Counsel for the American Insurance Association (AIA), specializing in international trade, insurance regulatory issues, transportation insurance and legal reform. His responsibilities include drafting legislation and regulations, testifying, managing litigation, working with other interested public and private sector parties and communicating with the media.

Mr. Snyder joined AIA in 1987 after working for Nationwide Insurance, managing its government affairs in its largest premium volume state. He left AIA in 1990 to work for State Farm Insurance Company and later returned to AIA. Prior to these positions, he served the Commonwealth of Pennsylvania as General Counsel of the Commerce Department, Deputy Attorney General in Torts Litigation and Legislative Liaison for the Insurance Department. Earlier, he worked in the U.S. Department of Transportation and the U.S. Fire Administration. These positions included trial and appellate litigation, in-house legal counsel and government affairs responsibilities.

Mr. Snyder graduated Magna Cum Laude from Dickinson College in Pennsylvania and graduated from the George Washington University Law School in Washington, D.C. He is licensed to practice in the District of Columbia, Pennsylvania and Virginia and several federal courts. He is also a Chartered Property and Casualty Underwriter (CPCU).

David participated as the sole U.S. insurance industry expert in a U.S. Government sponsored meeting on insurance in Iraq held in Amman, Jordan in June, 2004. He also represented U.S. insurers in a national conference on highway safety in Moscow, Russia and was one of two foreign experts in discussions in Israel and Gaza between the Israelis and Palestinians on auto insurance issues in 2000. He has regularly represented U.S. insurers in trilateral discussions in Canada, Mexico and the U.S. involving the implementation of transportation aspects of the North American Free Trade Agreement and in international trade, natural catastrophe and terrorism insurance meetings in Geneva and Paris in connection with his representation of non-life insurers as part of the US delegation to the Insurance and Private Pensions Committee of the OECD. He has also made presentations in 2005 and 2006 in regulatory dialogues in Beijing with high level representatives of the Chinese and US regulators and industry. In May 2007, he was a presenter for the third time at the GATS and Financial Services Seminar sponsored by the British Institute of International and Comparative Law.

He has testified before numerous international, federal and state legislative and administrative bodies, including the National Transportation Safety Board, and has addressed audiences on auto insurance, transportation, financial services regulation and international issues. He has appeared on ABC, CBS, CNN, NBC and FOX networks and has been quoted in the Detroit News, Smart Money, New York Times, Wall Street Journal and Washington Post.

Mr. Snyder has served as Mayor and Vice Mayor of the City of Falls Church, Virginia, having been elected to four terms on the City Council, most recently on May 2, 2006. In July 2004, he was elected Chairman of the Northern Virginia Transportation Authority and served for two years. He is now serving for the second time, as chairman of the Northern Virginia Transportation Commission and is the Virginia co-chairman of the Metropolitan Washington Air Quality Committee.

David chaired the group that coordinated the transportation and evacuation components of the Regional Emergency Coordination Plan first approved by the Metropolitan Washington Council of Governments on September 11, 2002 in response to the terrorist attacks against the Pentagon and World Trade Center. He has participated in other terrorism and incident response programs and continues to serve on the Washington Metro Region's Emergency Preparedness Council.

He is an active Emergency Medical Technician with a Washington, D.C. area rescue squad, having more than 30 years experience in fire, rescue, and emergency medical services. Mr. Snyder is also fortunate to be married to a journalist with two wonderful children.

CREDIT SCORING - A REGULATED PRACTICE THAT BENEFITS CONSUMERS

November 29, 2007

Madison, Wisconsin

David F. Snyder
Vice President & Assistant General Counsel
American Insurance Association
1130 Connecticut Ave., NW
Washington, DC 20036
dsnyder@aiadc.org

AB 387
Folder

- The Wisconsin personal lines market, including the regulated use of credit scoring, is, by every general measure, strong and beneficial for consumers.
- Wisconsin ranks 50^{th} in combined average premium, 45^{th} in average insurance expenditure and 50^{th} when premiums are compared to income.
- Wisconsin's residual market for automobile insurance is virtually nonexistent.

- Federal Fair Credit Reporting Act (FCRA) permits insurer use of credit information, subject to other regulatory provisions in the FCRA.
- State insurance rating and anti-discrimination laws apply to insurer use of credit information.

- Insurers have long used, without controversy, financial information including credit standing to assess and price for risk in commercial insurance.
- One government report found that there is a correlation between the financial health of motor carriers and the safety of their over the road operations.

- Starting in the mid 1990's, insurers began using credit information in personal lines of insurance.
- The greater precision in risk assessment as a result of credit scoring has led to more availability of insurance and declining residual market populations.
- The use of credit scoring allows insurers to price more accurately with many more pricing levels, resulting in more individual pricing, and adding increased accuracy to the older risk classifications such as territory.

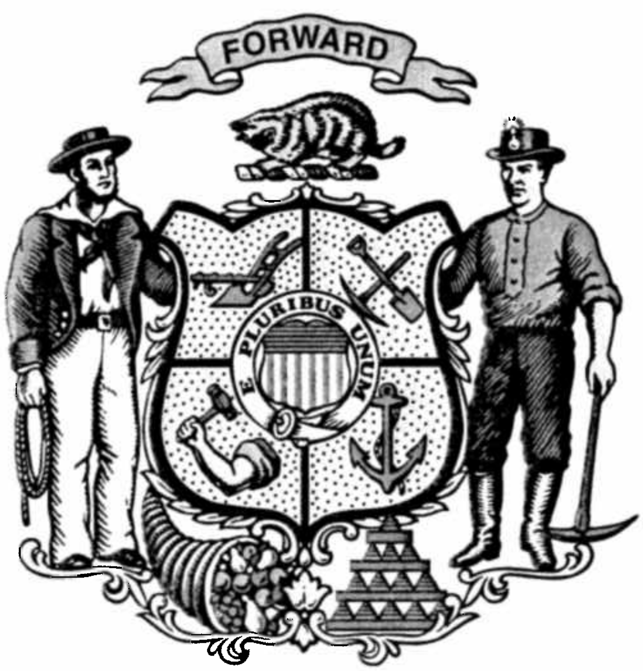
- The vast majority of states allow credit scoring, with few exceptions.
- When used for rating or underwriting, credit scoring is subject to the same legal standards and review by regulators as any other factor, including the "excessive, inadequate, or unfairly discriminatory" standard in state and federal anti-discrimination laws.
- Some states have provided additional targeted regulation including Wisconsin's Bulletin 6-16-97,referencing Section 628.34 Wis. Stats.

- State studies have all found a strong correlation between credit scores and risk of loss.

- The Federal Trade Commission and the Federal Reserve Board were directed by Congress to study the benefits of credit scoring by lenders and insurers and any effects on demographic groups. Both reports were released earlier this year.
- The Federal Trade Commission found:
  - Strong correlation between risk and credit scores.
  - Market benefits such as more people finding coverage.
  - Without credit scoring, a majority (59%) would see higher rates.
  - Little proxy effects for demographic groups.
- The Federal Reserve Board made similar findings in its report.

CONCLUSION

- Credit scoring has benefited consumers through improved risk measurement and pricing and greater availability of insurance.
- The state already has the necessary regulatory authority to assure the appropriate use of credit scoring.
- The personal lines market in Wisconsin, including regulated credit scoring, compares very favorably with every other state, so no drastic correction is needed or would be beneficial for the public.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Biography: Sally McCarty

Sally McCarty's insurance background began in Indiana's HMO market where she spent nearly ten years working in consumer relations, marketing, and provider relations. In 1994 she was recruited by then Governor Evan Bayh to be the Deputy Commissioner for Health Issues for the Indiana Department of Insurance. She became the Department's Chief Deputy Commissioner in August of 1996 and the late Governor Frank O'Bannon appointed McCarty to be Indiana's Insurance Commissioner in June of 1997. Her seven-year tenure in that position was the longest continuous term as insurance commissioner in Indiana history.

While a commissioner, McCarty's National Association of Insurance Commissioners (NAIC) activities focused on consumer and health insurance issues. Her committee work included membership on the NAIC/Consumer Liaison Committee, including one year each as Vice-Chair and Chair. She also chaired the Consumer Participation Board of Trustees and the Special Committee on Health Insurance. McCarty played a major role in the initiation of the NAIC's Consumer Information Source and served on the Executive Committee for five years. She represented the NAIC on the Board of Directors of the Utilization Review Accreditation Commission (URAC) for two years.

As Indiana's insurance commissioner, McCarty filled a statutory role on the Board of Directors of the Indiana Comprehensive Health Insurance Association, the state's health insurance high-risk pool. In that role, she became familiar with the problems faced by individuals and families affected by bleeding disorders. Since leaving the insurance commissioner's post in July of 2004, McCarty has worked with the Indiana Hemophilia and Thrombosis Treatment Center and Hemophilia of Indiana to help resolve reimbursement issues, educate consumers and insurers, and, most recently, to develop and initiate a dental insurance program for Indiana's bleeding disorders community. She serves on the National Hemophilia Foundation's (NHF) Policy Committee and has been invited to conduct workshops on the rights of insurance consumers at the NHF's annual meetings and at NHF chapters throughout the country. Currently, she is representing NHF as a 2007 NAIC Funded Consumer Representative.

Testimony of Sally McCarty
Madison, Wisconsin
November 29, 2007

Mr. Chairman and members of the committee, thank you for the opportunity to testify today concerning Assembly Bill 387.

Indiana passed a modified version of the NCOIL Model Credit Scoring law during my tenure as Commissioner. I hope that the insight gained through my involvement with that process, and through my review of more recent research, will be helpful as you consider this proposal.

After reviewing the findings and criticisms related to the use of credit scoring in personal lines insurance underwriting, I will ask you to consider one question: "Does this make sense?"

Insurer Claims:

1) Insurance scoring is predictive of the likelihood a consumer will have claims and will use benefits to a greater degree.

2) If insurers are able to price more accurately premiums will remain stable and lower -- for some.

3) People who manage their finances well are likely to manage their risks well and that's why credit scoring works.

Whether or not credit scoring is a good predictor of risk, the system has serious flaws. Those flaws include claims that the practice of using credit scoring to underwrite personal lines policies:

1) Is arbitrary and inherently unfair;

2) Has a disproportionate impact on consumers in poor and minority communities and appears to be a proxy for race and income;

3) Undermines the basic insurance mechanism and public policy goals for insurance

4) Reduces the availability of insurance; and, most important

5) Penalizes consumers for life events that may have nothing to do with their financial responsibility ethic, e.g.:

- Medical catastrophes or routine inordinate costs, e.g. clotting factor coinsurance.
- Aversion to credit (depression-era consumers).
- Periods of unemployment or other short term need to rely on credit

5) No one has been able to explain the nexus between financial stability (as defined by the scoring algorithm) and propensity to submit claims. The score has nothing to do with paying premiums on a timely basis, as many believe it does.

Studies

There have been a number of studies examining the use of credit scoring, the better known of these were conducted by the Texas and Missouri Departments of Insurance and, more recently, the FTC.

The Texas and Missouri studies found:

- A strong relationship between insurance scores and race and income.
- Evidence that an insurance score was a good predictor of risk

FTC Study, published in July of 2007:

Found that credit scoring is a good predictor of insurance risk but, upon closer examination, found that this was true in the aggregate but not for individuals.

While the average number of claims per year in the lowest score decile of collision coverage, for example, was more than twice that in the highest decile, **there were still only 12 claims per hundred cars per year of coverage for the lowest score decile.** So, the vast majority of customers in even the riskiest decile would not file a claim in a given year. .

Thus, at best, 88% of those in the low score/high premium group would not even submit a claim yet they are paying higher premiums because of a credit score.

As with other risk variables, credit-based insurance scores are able to separate consumers into groups with different average risk, but cannot predict the claims of individual consumers.

Criticisms of FTC Study (by a coalition of consumer groups):

- No analysis of the impact of scoring on availability and affordability of insurance products and on how consumers actually fare under credit scoring.
- Repeated spurious – as described above -- correlation between insurance scores and claims. Ignored evidence that insurance scoring is a proxy for some other factor actually related to claims.
- Failure to analyze the insurer's claim that there is a correlation between managing finances and managing risk
- 20% of population is unscorable due to little or no credit history.
- Disproportionately low income or minorities
- No critical analysis of scoring models – not even a cursory examination. Most factors have nothing to do with whether a consumer pays bills on time.

- No examination of alternatives to insurance scoring that is predictive of claims but not based on consumer credit information.

HOW DOES IT WORK?

While a supposed correlation between credit scores and insurance risk is recognized, NO ONE has been able to explain why that is true.

The FTC report examined some possible explanations:

1) "There is ongoing research reflected in the behavioral economics literature that tends to show that people who engage in risky behavior in an area of their lives are often willing to take on more risk in other areas, as well.

Researchers have studied attitudes toward risk, as well as behavior, in financial settings and driving, as well as a range of other areas including smoking, occupational choice, and migration. One recent article argues that existing research shows that physiological and psychological factors affect how much risk individuals are willing to take in their financial, driving, and other behavior.

Many of the psychological studies surveyed in that article analyze the Relationship between psychological factors and risk-taking in a single aspect of life. "

2) "A circumstance that could explain the relationship between Credit-based insurance scores and risk under automobile insurance policies is differences in the resources that consumers put into maintaining their cars. Consumers with lower scores may not be willing or able to spend as much money to maintain their cars. This may, in turn, make the cars more dangerous to operate and lead to more or larger claims.

What is "fair"?

- An insurer can produce some kind of data showing a statistical relationship between credit scores and insurance losses.
- Credit scores use information that may or may not have anything to do with how one manages his finances. Such, as WHICH credit card is used. HOW purchases are financed and whether or not one uses credit at all.
- The choice of financial factors is subjective and may have nothing to do with financial responsibility.
- One person's score varies from credit bureau to credit bureau.
- Consumers' financial management skill is being evaluated based on information provided by the mortgage credit industry. (Note the irony.)
- No hits" and "Thin files" -- considered neutral." Illogical – why not "above average" or not at all?

If one does not want to consider "fairness" then one must ask the operative question:

Does it Make Sense?

1) All studies and proponents are able to identify a connection between low credit scores and insurance claims, although that connection is shaky when it considered on an individual basis.
2) There are claims in some states that more than half of the insureds are paying lower rates than they would be paying without credit scoring. If this is true and more than half of a company's insureds are paying lower rates, than a disproportionate share of the premium is being shifted to lose least able to pay.

This flies in the face of the basic principles of insurance.

3) The very people least able to absorb a rate increase, those experiencing high medical expenses, divorce, layoffs, etc. are being penalized with higher rates – even though they many have never filed a claim.

4) Indiana law requires insurers to review credit scores every 3 years (annually upon request of the insured.) Insurers are planning to approach the legislature to have the 3-year requirement deleted. Why would insurers want to remove a review of a tool that they claim is so valuable?

5) NO ONE can explain or prove why the correlation exists. This is the most compelling reason of all to prohibit the practice. All the major studies found the possibility that the score could – intentionally or unintentionally be functioning as a proxy for race and income.

   In the absence of any plausible explanation for the seeming correlation, doesn't it make sense to discontinue the practice rather than continue a practice that is harming people who can least afford to be harmed?

6) Credit scoring is a win-win for the insurers and, at best, at win-lose for the insureds and a lose-lose for many insureds.

Given the considerations outlined above, it would be difficult to conclude that the use of credit scoring in rating personal lines policies is neither fair, nor does it make sense. Short of evidence to the contrary, it appears to be a practice that, at best, is anti-consumer and, at worst, singles out the most vulnerable of consumers for higher rates or outright rejection and thus becomes a factor in a pattern of consumer abuses.


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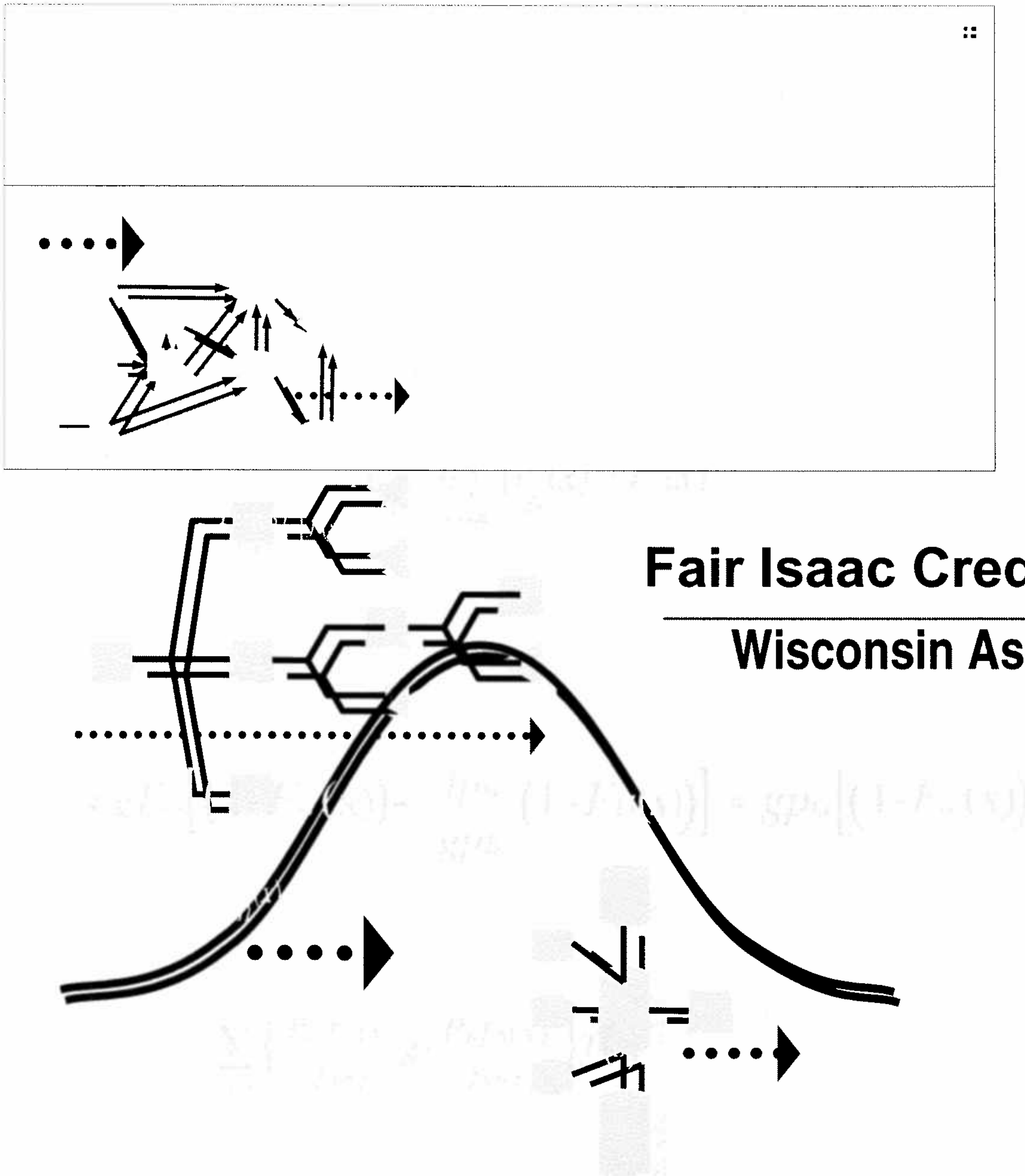
Lamont D. Boyd, CPCU, AIM
Insurance Market Director, Global Scoring Solutions
Fair Isaac Corporation

Lamont Boyd is responsible for client and partnership opportunities that make use of Fair Isaac's credit-based insurance scoring and property risk scoring products and services. Working with more than 300 insurance clients throughout the US and Canada and speaking regularly to industry and consumer groups, Mr. Boyd is recognized as one of the industry's leading experts in predictive scoring technology. Prior to joining Fair Isaac in 1993, he served 19 years in underwriting and sales management with a major property and casualty insurer. He received his CPCU designation in 1990 and is member of the Society's Information Technology, Personal Lines and Underwriting Sections. He is a CPCU National Leader as a member of the Underwriting Section Committee and is former Chair of the Information Technology Section Committee.

Fair Isaac Corporation (NYSE:FIC) makes decisions smarter. The company's solutions and technologies for Enterprise Decision Management give businesses the power to automate more processes, and apply more intelligence to every customer interaction. Through increasing the precision, consistency and agility of their decisions, Fair Isaac clients worldwide increase sales, build customer value, cut fraud losses, manage credit risk, reduce operational costs, meet changing compliance demands and enter new markets more profitably. Founded in 1956, Fair Isaac powers hundreds of billions of decisions a year in financial services, insurance, telecommunications, retail, consumer-branded goods, healthcare and the public sector. Fair Isaac also helps millions of individuals manage their credit health through the www.myfico.com website. Visit Fair Isaac online at www.fairisaac.com.



FairIsaac

Fair Isaac Credit-Based Insurance Scores

Wisconsin Assembly, Committee on Insurance

Informational Hearing

November 2007

AB 387
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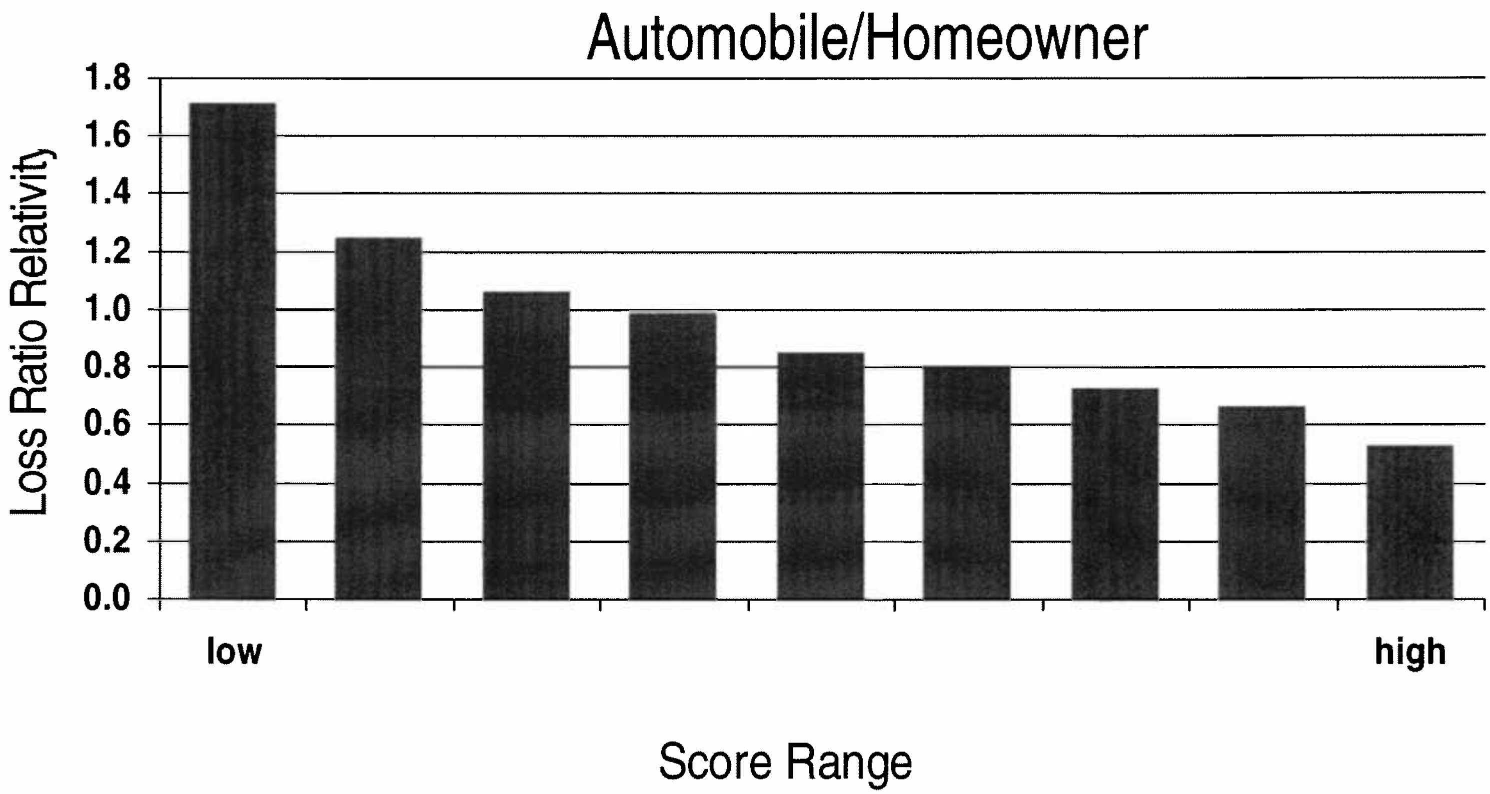
You touch Fair Isaac technology when you…

Credit-Based Insurance Scores

FairIsaac

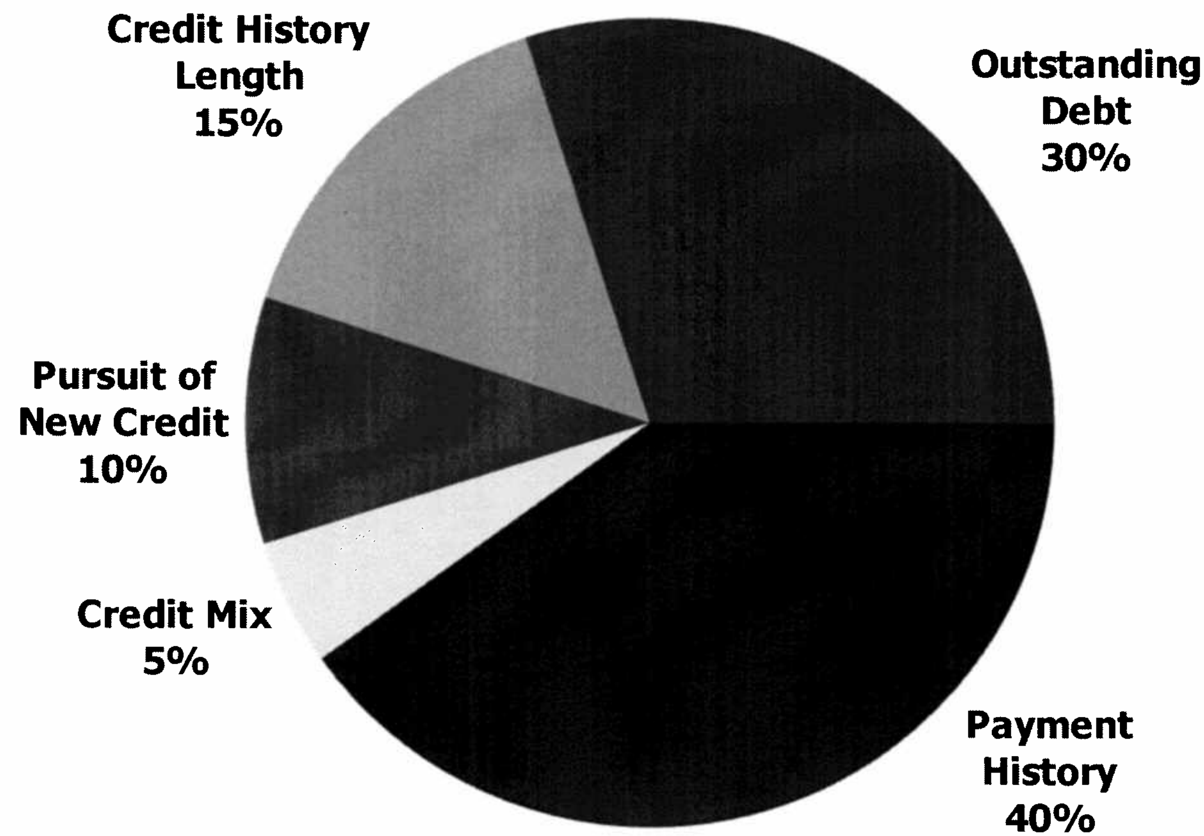
- Introduced CBIS in 1993
- Consumer Benefits
  - Relationship between how people manage their credit and how they manage their risk is significant
  - Majority of consumers manage their credit well and *benefit* from the use of insurance scoring

CBIS: rank order example



Fair Isaac Credit-Based Insurance Score

Five general areas of predictive information



Types of inquiries

- CBIS scores only consider consumer-initiated inquiries posted in the last 12 months
- CBIS scores do not consider the following inquiries:
  - Promotional inquiries
  - Account review inquiries
  - Consumer disclosure inquiries
  - Insurance inquiries
  - Employment inquiries

Information <u>not</u> considered by Fair Isaac Credit-Based Insurance Scores

FairIsaac

- Race, color, national origin
- Religion
- Gender
- Marital status
- Age
- Income, occupation or employment history
- Location of residence
- Any interest rate being charged
- Child/family support obligations or rental agreements
- Certain types of inquiries
- Whether or not a consumer is participating in credit counseling of any kind
- Any information that is not proven to be predictive of future performance
- Any information not found in the credit report

For a better insurance score…

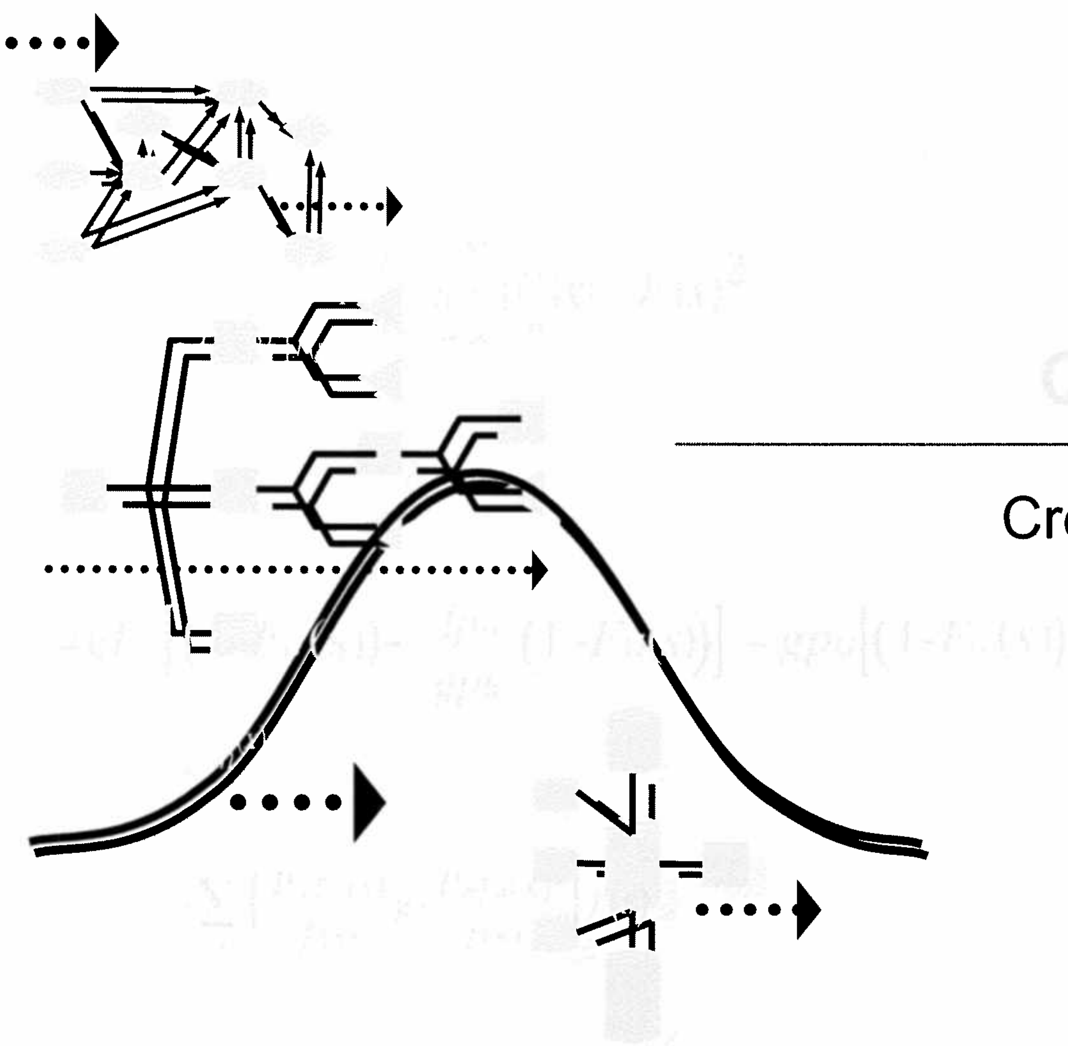
FairIsaac

- Remember, insurance scores reflect payment patterns over time with more emphasis on recent information
- Pay bills, taxes, fines and fees consistently as agreed. Catch up missed payments and stay current
- Keep balances low on credit cards and other revolving credit
- Apply for and open new credit accounts only as needed

For more information

FairIsaac

- Education to help consumers understand and change habits to influence credit-based insurance scores is available at www.insurancescore.com
- Under the 2003 Fair and Accurate Credit Transactions Act (FACT Act), consumers can access each credit report annually via www.annualcreditreport.com
- Review adverse action notices, including reasons provided, against credit report data for accuracy and understanding



Questions & Answers

Credit-Based Insurance Scores

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Fair Isaac
Credit-Based Insurance Scores

PRIMARY POINTS

1. **Most consumers benefit from the use of insurance scores –**
   According to insurers, up to 75 percent of their policyholders pay lower premiums because of the insurers' use of credit-based insurance scoring within their underwriting process. In addition, consumers benefit because the use of scoring enables insurers to make more accurate, objective, consistent and timely underwriting and pricing decisions.

   This occurs because most consumers manage their credit obligations well and have good scores. Insurance scoring helps identify those consumers who present lower risk of loss so insurers can offer them lower insurance premiums. This helps to make insurance coverage more available and affordable to the majority of consumers.

2. **Correlation between credit behavior and insurance risk has been proven –**
   Separate studies by the Texas Department of Insurance (TDI), the University of Texas, Tillinghast Towers-Perrin, EPIC Consultants and others have proven that credit-based history correlates with the risk of insurance loss. The recent TDI study showed that: *(source: III PowerPoint presentation, January 2005)*
   - The average loss per vehicle for people with the worst insurance scores is double that of people with the best credit-based insurance scores for this group.
   - Homeowners insurance loss ratios for people with the worst insurance scores are triple that of people with the best scores for this group.
   - Drivers with the best credit history are involved in about 40 percent fewer accidents than those with the worst credit history for this group.

3. **It's common sense that credit habits relate to insurance risk –**
   In general, people with good credit habits demonstrate careful behavior overall. This crosses over into their driving habits, care of their automobiles, and care taken in the maintenance and safety of their homes.

4. **For insurers the issue is risk, not race –**
   Insurance scoring does not discriminate racially or by income, as the recent study by the Texas Department of Insurance confirmed. Insurance scoring is a color-blind, objective process. Only credit-related information proven to have a connection with insurance losses is used to determine an insurance score.

5. **Fair Isaac credit-based insurance scores are fair to consumers –**
Our insurance scores are uncompromisingly fair. They evaluate only credit-related information from consumer credit reports. They do not consider the person's income, age, marital status, gender, race, ethnic group, religion, nationality or location. People who are in identical situations would be charged exactly the same amount for auto or homeowners insurance, irrespective of differences in race, ethnicity or levels of income, under a rating plan that permits the use of credit-based insurance scores in underwriting.

ADDITIONAL POINTS

6. **Use of insurance scoring helps stabilize and open the marketplace for consumers –**
The use of insurance scores keeps the insurance marketplace competitive, resulting in the availability of lower prices, better service, and more choices for consumers. Underwriters gain opportunities to identify and write insurance for people who in the past they may have declined because of incomplete knowledge or information. Also, a good credit history can offset negative underwriting factors such as a poor driving record, thereby enabling someone to get insurance who might otherwise have been denied or charged more.

7. **Insurance scores are different from credit-risk scores –**
While both types of scores use information from consumer credit files, they predict very different outcomes. Credit-risk scores such as FICO® scores are built to predict the likelihood of delinquency or non-payment of credit obligations. Insurance scores, by contrast, are built to predict whether a consumer is likely to result in more (or less) insurance losses than the average consumer.

8. **Use of insurance scoring frees insurers to focus on exceptional cases –**
Insurers use insurance scoring to help make routine underwriting and pricing decisions. This frees underwriters to spend more time helping applicants who have unusual situations or needs.

9. **Fair Isaac is committed to helping consumers obtain credit and insurance coverage fairly and affordably –**
We have established web sites and educational programs to help consumers become better informed about credit-risk and insurance scores. These programs explain the credit behaviors that will help consumers improve their scores. Each score based on credit bureau data is accompanied by up to four (4) score reason codes to help consumers identify where they may have lost points, again providing insight into how credit behaviors are impacting scores, approval potential and pricing. We encourage our clients to use scores responsibly, and welcome opportunities to address these issues with credit grantors, insurance companies, regulatory and legislative bodies, consumer advocates, consumers and the media.

Q&A

1. **Do minority and low-income groups have worse insurance scores than other groups?**
According to the study by the Texas Department of Insurance, a higher percentage of adults in low-income groups and certain minority groups (African-American and Hispanic) have somewhat lower scores compared with the rest of the adult population. However, the study also showed that each group studied receives the full range of insurance scores.

2. **Do these scores discriminate by race?**
Emphatically not. The TDI study in fact proved that such claims are false. Each group studied received the full range of insurance scores, which is possible only if insurance scoring is a color-blind, objective process. Only credit-related information proven to have a connection with insurance losses is used to determine a score. For Fair Isaac and insurers, the issue has always been one of risk, not race.

3. **Does the score negatively affect one group more than another?**
No, because consumers in every group pose a wide range of insurance risk. U.S. law requires businesses to avoid deliberate bias against minority and low- income groups. Through the use of insurance scoring, only individual consumers who represent potentially higher risk pay higher premiums, regardless of their race or income. Significantly, consumers with poor credit-based insurance scores can improve their scores by improving their credit habits. . Use of insurance scoring helps to lower insurance premiums for most consumers, which makes insurance coverage more available and affordable.

4. **How are credit-based insurance scores different from FICO® credit risk scores?**
Fair Isaac's insurance scores are developed based on auto and property insurance policy data and information in consumer credit bureau files. These scores are designed to predict the risk of auto or homeowner insurance loss. The newest versions of our insurance scores are available at the three major credit bureaus under the following names:
    - InScore® at Equifax
    - Fair Isaac Insurance Risk Score (formerly ASSIST) at TransUnion
    - Experian/Fair Isaac Insurance Score at Experian (available via ChoicePoint)

    FICO credit risk scores are developed based on information in consumer credit files only, and they are designed to predict the likelihood that a consumer will pay debts and financial obligations as agreed. FICO scores are available at the three major credit bureaus under the following names:
    - BEACON® score at Equifax
    - FICO® Risk Score, Classic at Trans Union
    - Experian/Fair Isaac Score at Experian

5. **How can consumers get their Fair Isaac insurance score?**
Insurance scores are not available to consumers because of business challenges that exist uniquely in insurance underwriting. For example, in addition to using insurance scores, insurers typically consider a wide variety of consumer information such as motor vehicle reports and loss histories. To be most useful to consumers, disclosure of

insurance scores should also include other relevant consumer information used by insurers. That way, consumers gain the best understanding of the insurer's decision and how they can positively influence the underlying information in the future. Today much of that additional consumer information isn't available to Fair Isaac so we wouldn't be able to pass it along to consumers.

Insurance companies using Fair Isaac insurance scores do receive up to four score reason codes with every score. These score reason codes identify the factors on the consumer's credit report that prevented the consumer from receiving the most possible points. Consumers who believe these reason codes misrepresent their credit history can examine their credit reports, as noted in the insurer's adverse action notice, or for free at each credit bureau once annually under the terms of the 2003 Fair and Accurate Credit Transactions Act, and can request investigation of any information that they find to be inaccurate or incomplete.

Consumers can learn more about insurance scores at Fair Isaac's website www.insurancescore.com, and can access information about their FICO credit scores via another Fair Isaac website, www.myFICO.com. In addition, consumers can find educational tips to help improve their credit management. By improving their credit management and raising their scores, consumers will find greater access and availability to credit.

6. What are insurance scores?

Insurance scores are snapshots of consumers' insurance risk based on information in their credit report that reflects their credit-payment patterns over time, with more emphasis on recent information. An insurance score is the result of an objective, statistical analysis of credit report information identifying the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial patterns.

7. How do insurance scores work?

Insurance scores rank consumers by their expected loss potential and claim frequency. As a group, people scoring in lower ranges statistically demonstrate risk of generating higher and more frequent losses than people whose scores fall in higher ranges. Underwriters can use this knowledge to take actions based on their guidelines for acceptable levels of risk.

Insurance scores consider many aspects of the individual's credit management history, including but not limited to:

- payment history
- presence of any major financial blemishes (bankruptcy, liens, foreclosures, etc.)
- number of open accounts

Overall credit patterns determine the insurance score. Isolated events seldom influence a customer's score enough to contribute to an adverse underwriting decision.

8. How can people raise their insurance scores?

People can raise their insurance scores over time by using credit responsibly, and paying their bills, taxes, fees and fines on time. Fair Isaac's consumer web site www.insurancescore.com explains how the insurance score is calculated and how it can be improved. Similarly, our consumer web site www.myfico.com has abundant information, tools and services to help people improve their credit management.

Improving credit habits will improve scores, and will ultimately improve the access and affordability of credit and insurance products for the average consumer.

9. **Does getting a high insurance score mean I'll also have a high FICO credit-risk score?**
   Usually that is true, although it is possible for people can have good insurance scores but low credit-risk scores. This is because insurance companies and banks use separate kinds of credit-based systems to evaluate the risk presented by prospective customers. Insurance scores are derived from a unique mathematical formula applied to specific financial behaviors in order to predict the likelihood of an insurance loss.

   People can have low insurance scores without ever having filed a claim. That's because insurance scores are applicable to customer groups. Consider that some teenage drivers will never have an accident. As a group, however, teenage drivers experience many accidents. Similarly, as a group, customers with low insurance scores tend to have more losses than those with high scores.

10. **How reliable are insurance scores? How widely are they used?**
    The data at credit bureaus is one of the most accurate sets of consumer data available to insurers. Based on studies, the error rate in credit reports is considerably lower than the error rate found in motor vehicle records.

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Bio for Lynn Knauf, CPCU

Lynn Knauf is a Director of Personal Lines for the Property Casualty Insurers Association of America (PCI), a national property casualty trade association. Ms. Knauf monitors insurance-related legislation and regulation to determine its impact on PCI Member Companies. Her core responsibilities include issues related to credit-based insurance scoring, and catastrophe exposure issues. Ms. Knauf has more than 20 years experience in the property casualty industry. Prior to joining the trade association she worked for a national property casualty writer.

PCI is comprised of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write $154 billion in annual premium, or 38 percent of the nation's property/casualty insurance. Member companies write 47.1 percent of the U.S. automobile insurance market, 37 percent of the homeowners market, 31.1 percent of the commercial property and liability market, and 38.8 percent of the private workers' compensation market.

PCI Property Casualty Insurers Association of America
Shaping the Future of American Insurance

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Statement of Property Casualty Insurers Association of America On Credit-Based Insurance Scoring Before the Assembly Committee on Insurance

November 29, 2007

My name is Lynn Knauf and I am a Director of Personal Lines for the Property Casualty Insurers Association of America (PCI). PCI is a national property casualty trade association comprised of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write $195 billion in annual premium, or nearly 40 percent of the nation's property/casualty insurance. PCI members insure two-thirds of the personal lines market in Wisconsin. I appreciate the opportunity to be here today to speak on this very important topic.

Not all insurers choose to use credit information in their underwriting or rating practices, but PCI believes that insurers should maintain the right to do so. The federal Fair Credit Reporting Act authorized insurers to begin receiving credit information nearly 30 years ago. However, over the past 10 years, the use of credit information in insurance has grown rapidly. Insurance scoring (alternately referred to as "credit scoring" or "credit-based insurance scoring") is an objective and accurate method for assessing the likelihood of insurance losses. Experience has shown that policyholders with positive credit information are less likely to incur insurance losses, and credit-based insurance scores are one of the most accurate ways for insurers to differentiate between lower and higher insurance risks. Insurers that consider credit information in their underwriting and pricing decisions do so for only one reason – insurance scoring allows them to rate and price business with a greater degree of accuracy and certainty. The majority of consumers realize discounts due to their favorable credit histories, and all consumers benefit when good underwriting and rating tools make it possible for more companies to compete in the marketplace.

Although information on credit-based insurance scoring is readily available through insurers, insurance organizations, and the Office of Insurance Commissioner, there are still a lot of questions and even misconceptions about its role in personal lines underwriting and rating. Hopefully, my comments today will address some of the most common questions and lay to rest certain misconceptions about credit-based insurance scoring.

1. Credit-based insurance scoring does not discriminate against low income or minority consumers.

   It is important to understand how insurers use credit information and to note that there are significant differences between the credit scores used by lenders and the credit-based insurance scores used by many insurers. Although both are derived from information found on credit reports, the information is measured differently. Insurers use credit information in developing insurance scores to predict the likelihood of future insurance loss. Credit-based insurance scores provide an objective measurement of how one manages risk of credit. Lending institutions, on the other hand, use credit scores to determine the availability, amount and price of credit products offered to the consumer. Lending institutions use credit to determine the likelihood of repayment. The most significant difference between insurers and lending institutions then is that insurers never consider income. Insurers measure "how," not "how much."

   In addition to income level, one's address, ethnicity, religion, gender, familial status, nationality, age and marital status are also not considered within a credit score calculation. Further, there is no reliable evidence that points to insurance scoring resulting in higher insurance rates for any specific class of individual. Low credit scores do not correlate to a specific territory or class of individuals. On the contrary, both high and low scores are found across all income levels and territories.

2. Credit-based insurance scoring is used because it is highly predictive of insurance risk.

   There is a proven statistical relationship between credit-based insurance scores and insurance losses. A study of 150,000 policyholders released in March 2003 by the University of Texas found a "significant relationship" between a policyholder's insurance score and incurred losses. The Texas researchers also determined that credit scoring yielded new information regarding predicted loss experience not contained in traditional underwriting variables.

   Also in 2003, the largest and most comprehensive study ever undertaken on the connection between credit history and insurance risk was completed by EPIC Actuaries, LLC on behalf of the property/casualty insurance industry's four national trade associations. EPIC researchers reviewed a sample of nearly 2.7 million automobile policies and found that, after fully accounting for all overlap and relationship with other risk factors - such as age/gender, territory, model year, driving record and coverage limit - insurance scores are significantly related to loss propensity and that a consumer's credit-based insurance score is unquestionably correlated to that consumer's propensity for auto insurance loss for *each* automobile insurance coverage (such as liability, collision, and comprehensive). Results of the EPIC study are consistent across the country, from state to state and region to region.

More recently, the Federal Trade Commission completed its study on the effects of credit-based insurance scoring in automobile insurance. The study found a strong correlation between insurance risk and credit risk.

3. Credit-based insurance scoring is one of many factors used in underwriting and rating decisions.

   Insurers differ as to if, and to what extent, they will consider credit information. However, all insurance companies continue to consider traditional underwriting and rating factors as well. For example, driving record, prior insurance losses and type of vehicle are still considered in automobile insurance decisions. Type of construction, property condition, and prior loss history are still considered in homeowners insurance decisions.

   The Wisconsin Commissioner of Insurance does not permit companies to use credit-based insurance scoring as the sole factor in a decision to cancel, nonrenew, or deny coverage. However, even in the absence of such regulatory directive, PCI does *not* support the use of credit-based insurance scoring as the sole basis for a policy denial, nonrenewal or cancellation.

4. Insurers do not use credit-based insurance scores simply to charge higher rates or eliminate business.

   Insurance is a very competitive business; any company that would actively seek to unjustifiably raise rates wouldn't stay in business very long. Credit-based insurance scores are a highly predictive tool that adds another level of objectivity to the underwriting process and accuracy to the rating process. They allow insurers to accept business with a higher degree of certainty, and to charge an appropriate rate for the risk. This means that credit-based insurance scores allow companies to be more competitive. In turn, the use of credit-based insurance scoring has helped many companies to write more business – not less; to enter new markets; and to commit more capital to existing markets.

5. The majority of policyholders will benefit from the use of credit-based insurance scores.

   While some consumers may fear that credit-based insurance scoring will somehow hurt them, the majority of consumers actually have good credit-based insurance scores and will pay less than they would if credit information were not used.

Our member companies have reported to us that a majority of their customers enjoyed rate decreases after the implementation of credit-based insurance scoring, and/or that rates overall were lower than they would otherwise be without the use of credit information. The FTC study cited earlier found that 55 percent of consumers would see higher rates overall if credit–based insurance scoring was not used. And an annual study completed by the Arkansas Insurance Commissioner has consistently found that far more consumers see rate decreases than increases as a result of credit-based insurance scoring.[1]

6. The use of credit-based insurance scores is highly regulated by both state and federal law – even in the absence of a specific insurance statute pertaining to credit-based insurance scoring.

   The federal Fair Credit Reporting Act, enacted in 1970, gave insurers the right to consider credit information. The Act ensures that, if an insurer takes an adverse action as a result of credit information or a credit-based insurance score, the applicant or policyholder will receive notification and information on how to request a copy of their credit report, and how to dispute information believed to be incorrect. The federal Equal Credit Opportunity Act, which ensures that all consumers are given an equal chance to obtain credit, prohibits specific factors from being included in a credit report and credit-based insurance score. Consequently, income level, one's address, ethnicity, religion, gender, familial status, nationality, age and marital status are NOT considered within a credit-based insurance score calculation. Wisconsin provides specific guidance under an OIC Bulletin issued in 1997 (making Wisconsin one of the first states to issue a specific directive on the issue.) The Insurance Commissioner is also able to regulate insurer practices through market conduct surveys, filing laws and filing approval processes, cancellation and termination laws and unfair trade practice laws.

7. Credit-based insurance scores are accurate overall, despite some complaints of inaccurate data on credit reports.

   Credit reports contain very few errors that would adversely affect a credit-based insurance score. Further, inaccurate credit information would be of no use to insurers (or any financial or lending institution), and strong correlation between credit and insurance risk would not consistently hold true if the vast majority of credit report data was not accurate. It is in

[1] In 2006, for private passenger automobile coverages 90.2 percent of consumers either received a discount for credit or it had no effect on their premium. For homeowners coverages 90.8 percent of consumers either received a discount for credit or it had no effect on their premium.

everyone's interest to ensure that credit reports are accurate: consumers, insurers and credit bureaus alike. Credit reporting agencies want to provide a product that stands up to competitive scrutiny, and the consumer wants convenient and timely access to credit.

Of course errors do occur. If a consumer identifies incorrect information in his or her credit report, he/she has the right to have the credit-reporting company correct or remove that information. Insurance companies, in turn, will reevaluate and recalculate premiums when notified that an error has been identified and corrected by the credit-reporting bureau.

8. Insurance company notices provide the consumer with useful information on the use of credit-based information.

   Federal law requires insurers (and other users of credit information) to provide notice to the consumer when credit information "adversely" affects the rate. Many insurers have interpreted the law to require such notices where anything but the best rate available is offered – even if the use of credit resulted in an overall premium reduction or better rate than previously offered. Wisconsin regulatory directive also requires insurers that consider credit information to disclose that fact to consumers. Unfortunately, the end result of these notices is that some consumers may have concerns that their rates will rise, or that their coverage is in jeopardy. However, the notices are intended to assure that the consumer is informed and also understands the procedure for disputing any incorrect information in their credit report.

Finally, while credit-based insurance scoring is an objective tool, companies do recognize that personal circumstances may sometimes warrant exceptions. Most companies have developed business practices to address situations where an extraordinary life circumstance has resulted in a temporary negative effect on credit report information.

Again, I appreciate the opportunity to be here today, and I would be happy to answer any questions from the Committee.

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