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MARKET REGULATION AND CONSUMER AFFAIRS (D) COMMITTEE
THE USE OF CREDIT-BASED INSURANCE SCORES
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Director Michael McRaith (IL): This meeting follows on our April 30, 2009, hearing in Washington, D.C. The April 30 hearing included various opinions on a variety of perspectives. We heard first from the credit scoring agencies, actuaries, industry representatives as well as consumer representatives. It is fair to say that there wasn't a lot of agreement, but there was thoughtful testimony provided, some of which was helpful. There is a summary that is attached to the agenda today. The transcript of the 30 is being edited still, but the materials that we invited to be submitted are available on the NAIC website. If you were unable to attend you can listen to the audio version and view the materials. I encourage you to visit the website.

Today's hearing is also being recorded and will be available in transcript form at some point after the hearing. We are pleased to receive today comments from Commissioner Ario (PA) and from NCOIL about what NCOIL intends to do with its model act, and a discussion about next steps.

Commissioner Kim Holland (OK): Thank you, I wasn't in DC, but I did listen to the audio tapes. I am hoping that this is a productive meeting as well to get to some solution/direction for our organization to take on how we view credit scoring and additionally, if there is a public policy imperative that directs our future discussion with respect to credit elements and then insurance score. I found the testimony compelling on both parts as I've said before, I thought the industry presented clear evidence that credit elements are a viable part of an insurance score and that it is predictive. But, then again, I thought the consumer advocates made an important case that if indeed disparate impact occurs and a protected population is adversely affected, disproportionally, that is something that we should all be concerned about. We have two different sides of the same coin and we need to find a middle ground to ensure that indeed we can have appropriate pricing for risk and at the same time ensure that our consumers, particularly those that might be most disadvantaged can afford to buy the coverage that they need. So, I again, appreciate all of those that participated.

Joel Ario: Thank you Director McRaith and Commissioner Holland. I plan to discuss two things in just ten minutes or so. One, talk about the dynamics that I think set up the controversy on credit scoring here at the NAIC. I do appreciate the consumer voices who say that we need to have an NAIC model, but that is easier said than done. I think the membership is still deeply split on the issue of credit scoring, so it is one of those issues on which we have a very difficult time in coming to consensus. I will talk about that briefly and then talk about potential middle ground that maybe would garner more support. Although, having looked at this issue over the last 15 years, I would not have a problem with a ban or a moratorium if we could figure out how to do it in an effective manner. Again, I don't think the positions are close enough to be likely to turn into an NAIC position.

What are the underlying dynamics of the issue? There are really two from my perspective. One is on the actuarial side of the equation. I think the correlation is there, however, there is a lot of dispute about it. The fundamental fact is that there is a correlation between somebody's credit score or their insurance score and losses in the property and casualty lines. Some insurers have been very enthusiastic in embracing that correlation and using it from the start. Other carriers were more reticent about it, but in the end, almost everyone uses it today and one of the reasons that they use it is they look at their book of business and say "If I don't have credit scoring in there and so far as it actually works to predict loses, then I'm going to be selected against compared to the carriers that use it." So everyone does use it and the correlation is there and there is a whole set of arguments that I understand is that isn't as intuitive as other correlations and so forth. But I think that the fact that it is there from an actuarial perspective does mean that a lot of people on our side of the table say that it is reasonable and fair to use it in the marketplace. No state has found that the actuarial correlation isn't there. If the actuaries found that it wasn't there, the actuaries would simply prohibit its use. The fundamental requirement of the rate and form process is that it will be there. That is the starting point which leads into a set of implications from the carriers that allows for the writing of more business because it is a tool that can calibrate risk and so forth. That is the side of it that gets a number of people in the regulator community to say that it passes the minimal threshold that it should be allowed in the marketplace.

Then we get to the second factor, which causes a number of us, including me, a lot of concern, which is that it also has disproportionate impact. It doesn't fall on all populations equally, and really no factor would fall completely equally, but this particular one falls particularly disproportionately on certain minority groups, low income groups, the kind of constituencies

that we, as regulators, are most worried about in terms of affordability and availability of insurance. I think that those facts are out there. I do think that the industry argument that as long as we are willfully ignorant of that disproportionate impact and don't intend to discriminate and I wouldn't allege that anybody is intentionally discriminating here; I think they are willfully ignorant of the disproportionate impact. I think that argument is not good and I was disappointed at the hearing that that was essentially the industry position. We don't know and we don't want to know about those disproportionate impacts. That kind of prospective from the industry will continue to have people on the regulator side of the table deeply concerned about the issue and if, in fact, some of the predictions are made about the current economy, that will translate into some real affordability and maybe even availability issues, particularly for people in urban environments and so forth. If that turns out to be true and we have some real crisis in either the auto or homeowner market, around that issue, I think that you are going to see a very serious ramp-up on scrutiny of credit scoring and more attempts to do things about it. I think that it would be better to get ahead of that curve if we could. What could we do about it? Again, the ban or the moratorium is on the table. The political challenge of that is that it would take legislative action in most or all of our states to get that done. If you look around the country, at the end of the day, Maryland is the only state that has engaged in a direct debate on this issue in the legislature. The legislature has chosen to ban credit scoring. There are other places where it is banned, like California where it was done under Proposition 103 before it was even an issue and in Hawaii, going way back before it was really an issue. So it has happened some other places, but not in an engagement where both sides are arguing the pros and cons. I think it is still a difficult issue to do. I also think that there is a practical issue. If in fact, as most factors would, most people come out better than worse on any individual factors, is probably true of credit scoring as well, if you unwind the system. That results in the majority of people getting increased rates in favor of the people who are being discriminated against on credit scoring. That presents its own practical challenges for a lot of us as well.

What are potential middle grounds? There are two areas that could be looked at. One is standardizing the models. One thing that has always struck me as odd is the industry argument that this is predictive, it is the best predictive variable that we have out there, but we all do it completely differently and there is no chance of standardizing it. Those two things cannot be true put side-by-side. If it is in fact predictive, and again, I said that the actuaries have convinced me that it is, then there is a core of variables there that are the predictive variables and it doesn't have to be used completely differently by all carriers.

There are two reasons why I think it is fruitful to look into that area. One is that there have been cases like the Allstate case in the courts and in various other states, such as Washington and Montana, if you look inside the models there are probably some of the factors used within an insurance score model that have more of a disproportionate impact to them than others. Then you could end up saying that certain parts of the credit scoring model, for instance, factors that have to do with what kinds of credit cards you have, seem to correlate more with people who might be a little more up-scale, having the kinds of cards that benefit from that factor and other people not having those. There may be other factors like that and we could eliminate certain factors and take out some of the disproportionate impact that way.

The other problem that we have all faced with credit scoring is that people can't understand it. The models are very complicated and inter-active, and probably the person who I had the most engaged conversation with was somebody who was totally frustrated because they didn't get the very top score. This person thinks they should always have the top of every category, and their insurer could not explain to them how they could improve their credit score. Making the models easier to understand for the consumer, I know this isn't necessarily the favorite position of the actuaries, but making it easier for the consumers to understand would be helpful too. The whole question of can we standardize the models more than we have, and take out some disproportionate impact to make them easier to understand. I think there could be fruitful benefit to looking at that area. The banks have done that to some degree and the models are more standardized as I understand it on that side.

The second issue is renewal. Most carriers have learned that if you use credit scoring as aggressively at renewal as you do on new business, particularly on people who have no losses, no claims, that is going to generate consumer complaints. So the industry has, to some degree already self-policed in this area to tame-down the use of credit scoring on renewal, especially the people who have no losses, because it taps into all of the areas that frustrate people about credit scoring. For instance, in both states that I have worked in, Oregon and Pennsylvania, we basically prohibit credit scoring at renewal to penalize people. Once you say we are going to prohibit it across the board at renewal, this gets to the difficulty of trying to do these middle-range solutions. You say that we don't want to absolutely prohibit it because if somebody has an improved credit history, they ought to be able to take advantage of that with their current carrier. Otherwise, people would be forced to move back into the new business model in order to take advantage of any gains. Then you say you can discount it and use it to the advantage of the consumer. Of course, the actuary knows that whatever is a discount to one person has an indirect penalizing feature on other people. But it is more indirect. In the states of Pennsylvania and Oregon you cannot use credit scoring at renewal to increase somebody's rates, but you can use it to their advantage in terms of rating. I think that could be looked at as an area as well. I think that there may be less fervent opposition from the industry on the renewal side.

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Those are the two areas that I promote. I am interested to hear the NCOIL model discussed today. I do think it illustrates another problem with credit scoring though to say that we have to have variables that are uniform and fair to everyone. But now, we have a broadening exception where on a case-by-case basis we are going to do it differently. This does raise the challenge where the regulator basically says that they want you to use these things very consistently and make sure you are fair to everyone, except where you should make an exception. That is a hard thing to make work as well. With that I conclude.

Candice Thorston (NCOIL): I will just lay out the NCOIL model, how the legislators arrived at it and where we are today. In 2001, a legislator brought the issue to NCOIL. He was a future president, but at the time he was the chair of the Property and Casualty Committee, He brought it forward because he did not like it, and he wanted NCOIL to consider opposing it, banning it. After nearly two years of discussions, included extended committee discussions, special meetings, a general session, consideration of two model laws, a lengthy hearing in which NCOIL ensured that consumers were able to participate and made sure that there was no obstacle to them attending, they passed the model act regarding use of credit information and personal insurance.

I should say that the hearing that immediately preceded the adoption of it was lengthy and thorough. The legislators went line-by-line through the model and made changes as they saw appropriate. The purpose of it is that it tries to protect consumers. The legislators understood that there is opportunity for abuse, and that insurers should not have free-reign with consumer's credit information. But it also recognized that for states that wanted to allow credit scoring, the model would help promote a competitive market that helps all of us. Its main over-riding principle is that insurance companies have to use information besides credit. That can't be the only thing that they use. Then it sets forth a number of consumer protections, which were outlined in a letter that NCOIL sent to your Committees just prior to the April 30 hearing. Without going through every single one, it states that it discourages insurers from considering the absence of credit or a thin credit file because that relates to certain demographics. Young people who don't have credit, minorities, low-income people who use credit differently, senior citizens who don't have credit, which is probably a very wise decision right now. It also states that credit inquiries that a consumer didn't initiate can't count. So, when credit card companies, like over the last few years, mine your credit reports trying to decide whether you should get a low or no interest credit offer, that doesn't count against the consumer because that isn't the consumer's fault. It really tries to reward sound financial behavior. It states that inquiries related to the auto lending industry or the mortgage lending industry only count once within the 30-day period. Because often, insurance and credit scores count negatively if you have too many hits on your credit report. Obviously, if you are shopping around for a mortgage, and you go to four lenders in three months looking for the best rate, that is a good decision and that is not something that should count against folks. It also states that insurers have to use new information. You can't take an adverse action unless you use an insurance score that is calculated within ninety days, and yet, unless you use a credit report issued within ninety days, it states that if you are a consumer and you dispute something in your credit report and you notify your insurance company, that insurance company has to go and re-underwrite and re-rate you. If the company finds that you have over paid, the insurance company has to return the amount of overpayment. It gives disclosures up front, disclosures are always important, but at the time NCOIL adopted the model, consumers were far less aware of the credit information related in any way to their insurance buying behavior. The model says up front that the insurance company has to notify you that your credit is going to count. It also prevents insurance from considering things that relate to medical collection accounts, which are obviously are their own issue.

In 2005, NCOIL adopted a drafting note regarding extraordinary life circumstances. There were, at the time, six or seven states with the NCOIL model which included provisions like this in their laws. The purpose is to recognize that there are things in life that happen, that are not people's fault and they shouldn't be penalized for them, and insurance companies should understand. The drafting note is fairly straight forward—it states that a state may want to authorize or require an insurance company to grant an extraordinary life-exception (basically a credit pass) for people who make a written request saying that they have an extraordinary event and they want insurance relief for it. It states that the consumer has to prove that the event actually occurred. The insurance company doesn't have to grant an exception for the same event more than once. That drafting note, the legislators feel, certainly addresses what is going on today. But because of the unique nature of what is going on, the fact that the crisis affects every person in this room in some fashion, that it is complex and has a lot of variables, the legislators feel that any good model law that really is appropriate to states has to be dynamic and has to respond to what is going on.

In our summer meeting in July, they are going to look at an amendment you have before you, that would take the extraordinary life circumstance language out of a drafting note and make it part of a model. It says that an insurance company shall give an exception to someone who asks for one because of an extraordinary event. It spells out instead of just stating generally that some kind of extraordinary life circumstance that the insurer may deem an extraordinary circumstance. It says that you have to consider a catastrophic event, such as one declared by the state or federal government. That relates to hurricane Ike, to Katrina, to hail storms in the Midwest, serious illness or injury or illness or injury that occurs to an

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immediate family member, death of a spouse, child or parent, divorce or involuntary interruption of legally owed alimony or support payments. If you are a spouse, ex-spouse, and your situation makes it difficult, following a divorce, for you to support yourself, this also relates to child-support payments that you may no longer be getting because your ex-spouse is a victim of the economic crisis. This has a wide-reach: identity theft, temporary loss of employment for a period of three months or more if it results from involuntary termination. This covers the autoworkers that have been laid workers, the GM and Chrysler dealerships; military deployment overseas and there is a catch-all category for insurance companies to consider extraordinary events they deem appropriate.

I should say that when you try to craft language that appropriately encompasses people who are real victims, who are not suffering as a result of their poor financial decisions, but are victims. It is extraordinarily difficult to do that without letting irresponsible people through the same door. The extraordinary events that are listed do touch people who are victims, but to try to craft out and give time frames, for instance, when the economic crisis really hit in this country, when your credit deteriorated, when you actually play that out, it is very difficult to do something that really works.

The amendment states that the insurance company has to give an exception, but it may require that the consumer prove that the extraordinary event happened. It may require that the event had a direct impact. It says that an insurance company may require that the consumer asks for the pass within sixty days of the renewal or the request for coverage. It says that an insurance company doesn't have to require that the request is made in writing. For instance, if you go to your insurance agent and talk about how bad your situation is, it is possible that the agent can go to the insurance company and ask for help. It also gives a time frame so the consumer isn't left hanging trying to figure out whether they have been approved or not. The insurance company has thirty days to get back to the consumer with a "yes" or "no" answer as to whether they have been given a credit pass. It also has to disclose that this option exists.

The legislators feel that this will certainly help people and that it will more specifically address people in what is going on now and it represents a real opportunity for them to respond. They will be looking at this July 12, 2009, at the NCOIL Property and Casualty Committee meeting.

Questions for Commissioner Ario or Ms. Thorson or Comments from Regulators:

Director McRaith: Did NCOIL consider or discuss in the day-long hearing when developing the model, was there any discussion about potential disproportionate impact? Was that not a topic on that day?

Ms. Thorson: It was discussed, but the legislators felt that the policy that they put forward was for states that want to authorize or allow credit scoring. It is really the state's decision as far as how to address the disproportionate impact.

Director McRaith: The extraordinary circumstances language that you mentioned, so hypothetically, if someone were to suffer through the financial and other trauma of a hurricane, loses a job, has to file personal bankruptcy, that event will linger and have an impact on credit for years to come. On what point is the exception lifted.

Ms. Thorson: That is a decision that the insurance company would work out with the consumer. But also, many insurance companies don't use credit for renewal, as Commissioner Ario mentioned. So if you give a credit pass when you are initiating the policy, it would not necessarily linger for other things. It would linger for your credit score in the lending industry, but it wouldn't necessarily linger for your insurance policy.

Director McRaith: So the extraordinary circumstances provision would apply only at initial underwriting?

Ms. Thorson: No, it would apply for renewal as well. If you are partially into your policy and you develop this problem, at any time you can go to your insurance company.

Director McRaith: So it would only then have an actual value to consumer in a state where the company actually uses credit scores on renewal?

Ms. Thorson: It would have an initial impact. If you are going to apply for an insurance policy for instance and you realize that you've had this issue that you have had a bankruptcy related to it you could certainly point that out to your insurer that this event happened and please understand that this credit report credit experience is not necessarily your fault. The exception could be granted if the insurance company uses credit information at an up-front request for coverage the exception could be granted then. Then if the insurance company doesn't use the credit for renewal, I would think that your credit wouldn't wind up counting from the very beginning.

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George Bradner (CT): Most companies in most states use credit when they write new business. So that score is used to price that risk. So if nothing is done at renewal, that price that was established at the new business writing will continue to go forward, unless the insured request a new score be generated because it is going to benefit them.

Director McRaith: How many states have adopted NCOIL model?

Ms. Thorson: Twenty-six.

Director McRaith: So in the other states, Maryland and California is another, how many states don't have any regulation at all on the use of credit scores? Do we know that?

Ms. Thorson: I don't know

Commissioner Ario: Most states have something.

Director McRaith: How many states have, I think Illinois is one that has adopted the extraordinary circumstances provision.

Ms. Thorson: Yes it is. I should mention that when NCOIL first adopted the model law, there were two legislators that really drove it and one was a legislator from Illinois.

Director McRaith: Yes, that was before my time.

Mary Miller (OH): One of my concerns of a standardized model would be that right now when someone is not happy with the impact on their insurance premium based on their credit, they are able to shop other carriers where they might find, where their model uses things a little bit differently, that they could get a better rate. I would be concerned about eliminating that.

Commissioner Ario: That is a valid concern—whatever we do with credit scoring unless we allow its free use or ban it, any of these intermediate solutions are going to have pluses and minuses and I think that is a fair minus to the standardization proposal.

Commissioner Holland: I have a couple of questions for industry, Dave Snyder (American Insurance Association—AIA) or Neil Alldredge (National Association of Mutual Insurance Companies—NAMIC), if either one of you would be willing, since you gave testimony, to respond to a couple of questions, maybe both. One of the things that is still unclear to me is the extent to which an adverse impact on pricing in terms of premium, the extent to which that actually applies. The testimony that I heard was consistently that the vast majority of people have no impact to their premium, that there is some portion that has a positive impact to their premium and then there is some small portion that actually has a negative impact. Understanding, and if I grant you the predictability of credit elements in your insurance scoring and the validity of that, I'm still not clear that it necessitates a pricing differential at the premium level if there is indeed only a small group of people. If we consider the fact that insurance is a pooling of risk, it strikes me that it doesn't seem to be a huge pricing differential to spread the risk and exposure of a few over the vast majority to avoid concerns of a disproportionate share of people at the lower incomes being adversely affected. Particularly in states like Oklahoma where I have twenty-five percent uninsured and I have a very robust insurance market. It is not lack of competition, we can write anything that is out there. My guess is that those individuals are increasingly challenged affording coverage, especially in these down times. So if that is the case, even a small adjustment in premium could put them over the edge which causes me a great public policy concern. So I would like clarity on what is the percentage of population overall that is likely to have an adverse premium impact, and in terms of if you can, if you look at just average pricing what kind of cost that is?

Neil Alldredge: Let's start with looking at some of the studies that you have. You might find some of the answer there. The Arkansas study is the one that we cite most often because it is the most straight-forward and simple. It seems to be repetitive in its finding. We have had it three years now. It shows a lot of individuals in the middle with a neutral score, several that receive a decrease in their premium and then 10-15% have an increase. It is interesting though that if you look at some of the other studies, I think one of the reasons that you see a justification for that is that the risk for those individuals in the low score categories of loss isn't just small. It is a substantial increase in the potential for loss. One of the original studies that was done by Mike Miller (Actuarial Consultant, EPIC Consulting, LLC) indicated that people in the lowest score categories have frequency and severity that is three to four times that of people in the higher score categories. I think that not only is the risk of loss greater, it is substantially greater. I think that it is a fair question of what happens to those individuals. Do they leave the market because somehow the score forces them out, and then what does that cause, an increase, for instance, in uninsured motorist rates? Most of the studies and market places indicate that scores make insurance more available to more people. It may be more expensive to people in the low score categories, but by and large, we don't see residual market mechanisms

increasing. There are other questions that go along with uninsured issue as well, such as what role does compulsory auto insurance play in that? Those kind of questions are also part of the answer too, I don't think that you can just be about scoring and that there is an increase, therefore, there is a direct correlation with an increase in people who are uninsured. We just don't see it. It is a fair question on what happens to those individuals if people are displaced?

Dave Snyder (AIA): Let me add to what Mr. Alldredge said. There was some testimony from an actuary from an insurance company that said that about 90% of their policy holders either pay less or were unaffected as result of their going to credit scoring. That is in your summary. In addition, we included in written materials included for that hearing, an example from a major national company about the percentages of people that would see increases and what those increases would be. For example, drivers 60 years or older, about 80% of them would see an increase if you ban credit scoring and the increase would be 8-10% for them. There is significant data regarding the cost shifting that would occur with subsidies being paid by better risks for worse risks. So I think by eliminating a factor like this does significant damage to risk-based pricing.

Secondly, it is not just distributing the premium. This factor being both effective and efficient has allowed the insurers to move to a system that replaced the old "pass-fail system". It allowed them to move to a system where they could pretty much write anyone who comes in because you have the certainty that you now have a measurement tool that will allow you to accurately assess their risk. That in turn, as companies have testified in public hearings in the state, has allowed them to write more policyholders. That capital and that competition in turn, has a beneficial overall effect in terms of holding down prices to the point that the competitive market can possibly drive them down to. So, it is important that it distributes the cost of insurance based upon the risk, but that in turn has had an overall beneficial impact of availability in the personal lines of insurance that I think is reflected by a very competitive good market that has generated very low complaint levels to spite the fact that there is an adverse action process that is deliberately created to bring forth any complaints if they are actually there. With regard to overall costs, and we are not insensitive to the cost of insurance. Others have made the policy judgment that people have to buy automobile insurance. Some could argue that it is not fair to low income people, but that decision has been made in a lot of states. That wasn't the decision that we particularly supported, but that said, it is there. We believe that rather than artificially creating subsidies which do mask things that are going on in terms of risk, that a better approach is to look at the mandatory coverage and are they too high. There is a lot of pressure around the country to increase mandatory financial responsibility. What effect does that have? That directly prices people out of the market. What is the level of mandatory insurance? What are the underlying costs? Are there fraud problems, a drunk-driving problem? These are all of the kinds of things that we think the more fruitful area of cooperation is that effects and positively effects everyone rather than creating internal subsidies and potentially reversing a very positive process in personal lines that has led to very extensive competition. A lot of companies in the market are providing their capital and more accurate risk assessment.

Commissioner James Donelon (LA): I have long recognized or thought that I knew that there was a redistribution of wealth going on here. I would like you, if you have the data, and let me add here that I have been one of those guilty of advocating for higher mandatory limits. You just gave me a perspective on that, which I had not previously considered. Can you quantify with any of the studies that you are aware of, what this redistribution of premium burden for those over sixty or those with better credit would experience if we outlawed it in Louisiana.

Mr. Snyder: Yes, just by way of example, the premium increases for drivers over sixty if you eliminated credit or are in the 10-11% range in the homeowner's area, for example, the average increase would be 16-17-20% in some cases. That data is available by state. That gives you some example of what you would be imposing on better risks if you ban or put a moratorium on the use of credit.

Director McRaith: I have a follow-up question on that, and I know Joel, you do too. I have heard this number that 90% of the insured population benefits or sees a positive result from the use of an insurance score on their rates, is that right?

Mr. Alldredge: That is the finding from the Arkansas study – 89-90% has been what they found.

Director McRaith: Improvement from what? What is the baseline? Is it some sort of a base rate, right?

Mr. Alldredge: That's correct

Director McRaith: Does the average insurance/credit score somehow reflected in the development of the base rate?

Mr. Alldredge: It was used as one of the factors that established the base rate.

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Director McRaith: That affects the value of the argument that only 10% of the population is disproportionally or negatively effected by the use of an insurance score when you are factoring in the average, however, it is factored in, to the development of the base rate.

Commissioner Ario: This issue continues to be elusive to me of whether the argument on credit scoring is that it is totally distributive so that the aggregate rate need of the companies is the same with or without credit scoring or whether the testimony is that somehow credit scoring increases or decreases the overall rates. I think it is distributive, but then I listen to the arguments then it is somehow suggested that it actually helps more than it hurts. I think that at the end of the day it is purely distributive so that it is a wash overall. It may be distributive at 60% have marginal benefit and only 40% lose—but they lose more. The question is can you give a simple "yes" or "no" that at the end of the day it is a net even thing for how much people pay for their insurance. Is that true or not true?

Mr. Snyder: Yes, it is distributive, but it is not an arbitrary economic distribution, it is distributive according to risk. As companies have testified, that the availability of this tool has allowed them to write more customers in all areas of the given state, both rural and urban than they would otherwise be willing and able to do because they have a risk assessment factor that has proven to be extremely useful and additive. In addition because they are able to do that, they are also now able to have a rate instead of the old approach, which was preferred standard non-standard if you were in the residual market has allowed them to pretty much write every customer because they can now customize the rate accordingly.

Commissioner Ario: It would be then true that there may be two winners for every loser, but that is only because the loser pays twice what the winners gain. You may add new people, but that doesn't change the basic proposition.

Mr. Snyder: The proposition is does this tool accurately predict risk. If it does, then it is something that should be presumed to be used in the market subject to your tests in your states of excessive, inadequate, and unfairly discriminatory.

Commissioner Ario: I assumed you are saying "yes". It doesn't reduce/increase people's insurance, it just distributes it differently.

Mr. Snyder: It measures risk and therefore, more fairly and accurately produces a product which is all about risk. I think that is inherent in all of the state laws, and secondly, because it is a cost effective tool that has added significantly to risk assessment, that has, we believe and companies have testified in public hearings, that is has had overall market benefits in terms of allowing them to bring their capital to the market in order to compete and to offer customers more accurate rates than the old three-tier approach.

Superintendent Morris Chavez (NM): As the chair of the Consumer Liaison Committee, I want to stress that there are some grave concerns on the Committee. This is the voice of the consumer here at the NAIC. There are concerns with the use of credit scoring as an underwriting tool. The Committee had a meeting yesterday, with testimony provided, but I would be remiss on behalf of the Committee, if I failed to inform you there are more questions that we want answered.

Second, on a personal note, as a Commissioner and as a person of color, I have issues with this. Does this disproportionally affect people of color? I grew up poor and I've made decisions to help my family with money and missed a mortgage or credit card payment. That has probably adversely affected my credit score. Does that make me more high-risk driver? I don't believe so. I know it isn't just your credit score that goes into that—it is an insurance score. For my personal experience I think that we aren't looking closely enough as to what affect does it have? We had a company come in recently and talk to us about how this works? I understand credit scoring, so how does an insurance score work? They went through the data, it was quite confusing. I really don't understand how you came to that model. I asked the company how can I turn to a consumer and explain to them when I, as the Commissioner, don't understand it, how can I explain it to a consumer? I think it disproportionally affects the people of color in the state of New Mexico. One of the actuaries made the comment "we have empirical data that shows it right here." He had stacks and stacks of paper, but I can't take that to a consumer if I don't even understand that. My point is, I call out to the industry, do what is right, make it easy, make me understand and explain to me how it doesn't affect people of color, or poor people. We know in America that poor people don't really have a voice, they can't lobby, they don't vote. I would like to call on industry to explain to me, make it simple and show me how it does not disproportionally affect people of color.

Commissioner Sharon Clark (KY): As the former Director of Consumer Protection of the Department I would like to ask the industry two things. I have been told that lack of credit means a bad credit history. In the Commonwealth of Kentucky we have many seniors who have paid off their homes, they do not have credit cards, they are debt-free they pay cash for things, so I have the feeling that they are being negatively impacted.

Then the other issue that recently came to my attention, and I would like verification. If you have individuals who have credit cards and pay those credit cards off each month, I am told that they have a lower credit scoring than if you carry a significant balance on your credit card. If that is the case, it will be very difficult to explain that to consumers/legislatures when this issue comes before the session next year. Are those accurate assumptions?

Mr. Snyder: The NCOIL model addresses the no available credit information and requires that they be treated neutrally. I think that one is addressed well in the model. We will certainly be willing to work with you to make sure that it is something that is understandable and applicable the way that you need it.

Commissioner Ario: Can I ask clarification—the NCOIL model allows a number of different ways to do that and they include ways that would not give people credit for being good credit worthy in the sense that they have no credit problems simply because they don't have the credit history, right. It isn't neutral in the sense that they benefit from it, it is neutral in the sense that it can be discriminatory against them as against other people.

Mr. Snyder: Yes. To add to that I would expand to say it is one of the areas where I think the market place has evolved though. Most companies would tell you that thin files, particularly folks that are older, perform better as a group than those that are younger with thin files. That is one of the areas where the industry is a little more precise in its usage of that information than it was four, five or six years ago. Most companies today would tell you that individuals that have thin file that is above a certain age perform much better than those that are younger.

Commissioner Ario: Then you would agree that the NCOIL model would allow them to treat those two groups exactly the same?

Mr. Alldredge: It would allow them to, whether or not they are is the question.

Commissioner Clark: The second part of that question is that the case if people pay off their credit cards each month and try to do the right thing that they are penalized as opposed to holding that balance.

Mr. Alldredge: That is one of those areas where the models are different and I think the answer is that typically is "it depends" on what factors are in the model and how companies use the information. I can't tell you either way—I think it varies from model to model.

Commissioner Clark: Please forward me the answer to that, if someone has an answer?

Director McRaith: Can you answer that question, briefly…

Eric Ellman (Consumer Data Industry Association): We are the trade association that represents consumer reporting agencies. One of our member companies is Choice Point which has been acquired by Lexis Nexis I don't have any of that type of data—I will take that question back to my company and submit that answer in writing to Eric Nordman (NAIC) in the next few days.

Birny Birnbaum (Center for Economic Justice—CEJ): I have reviewed a number of actual credit scoring models and many of the models have factors that include the ratio of debt to the credit limits. I have never seen a scoring model in which the consumer wasn't penalized for having high debt to credit limits. The answer to your question is that there isn't any model out there where a consumer is penalized for paying off their credit cards. Having said that, the way the debt to limit ratio works is how much your balance is at the end of the end of the month. Even if you pay it off, you have a balance of $5,000 and your limit is $6,000 that is the way that it is reported, even if you pay it off. Particular situation you said, people who carry big things on an on-going basis are not going to benefit compared to consumers who pay off their bills.

Kevin Bumell (Trans Union LLC): Regarding the question of paying off your credit cards or keeping a balance, our scores look at the totality of the credit report, the utilization is certain a factor. What we see is that people who are more highly utilized, meaning that their balance, as relates to credit limits, if that is high is usually considered a more risky behavior than somebody who keeps it well around 30% or less. As far as somebody paying off their credit cards vs. carrying a balance, it does not benefit them to carry a balance and keep rolling it over and over.

Commissioner Mike Kreidler (WA): What about the individual that is debt-free, no credit cards, no credit history.

Mr. Bumell: They are considered to be a neutral score and will not harm or hurt them.

Commissioner Kreidler: Mr. Alldredge just testified that seniors that have no credit generally have a much better credit profile than younger people who have no credit history. But it is absolutely clear under the NCOIL model that the seniors can be treated exactly like the young people, so they do not get credit in the model for having good loss predictive value. Correct?

Mr. Bumell: I believe that is correct. But when we talk about seniors, they generally have a lower losses than the younger folks with the same no hit or thin file.

Commissioner Ario: I'm trying to make a point that when you say they get a neutral score that is an adverse thing for them on how they should fit into the spectrum. You are right companies don't have to do it, but if they do it neutrally or lump everyone together, then it has an adverse affect on the seniors.

Mr. Alldredge: I would remind everyone that the insurance score is one piece of the whole underwriting puzzle, so it is only one factor.

Joel Laucher (CA): On that last comment that you just made, I think that we need a little more discussion on the NCOIL on the component that says you can't take an adverse action based solely on the credit score component. I think that is major item to discuss. When there are ten underwriting components that a company considers, any single one of them can end up causing the adverse action, including credit score, because it can be the only one out of line.

A question for the industry, which is impacted negatively? We are hearing the positive, is the burden of the 90% falling on some of the population, what is the range of the negative impact and who is that burden falling on?

Mr. Snyder: The negative is falling on the worst-risk policyholders. Because the use of credit is a way to predict risk and the likelihood of filing a claim. The economic effects fall on those who are the worst risks under cost-based pricing. The issue of potential discrimination is that the state rating laws all have the standard excessive, inadequate, unfairly, discriminatorily. You have the tools to look the models and risk classification systems, and determine that insurance companies are not engaged in any overt discrimination. There is a concept of desperate impact in the law. Whether it applies here is an open question, but assume it does. The law has been very narrowly crafted so far. The law basically says that you can show a statistical impact on various groups but that is only the beginning of the inquiry. Because the business at that point has the ability to show that there is a legitimate business purpose—in this case risk-assessment. Then the burden shifts back to the other side to demonstrate that there is another tool out there equally effective, in this case risk-assessment, that doesn't have the impacts that that does. That is the law that we all live under.

Mr. Laucher: I wasn't saying it was unfairly discriminatory or had a impact. I was asking where is the burden falling, whether fair or not, who are the 10% that are paying more and what is the range of the surcharges they are paying.

Mr. Snyder: Are you asking about the demographics of the 10%?

Mr. Laucher: Right, somebody has got to be paying more.

Mr. Snyder: We will provide information for you—the burden is falling on higher-risk policyholders.

Mr. Alldredge: I think the answer is that group looks like the country. One thing about scores is that they are predictive within racial groups. You just can't say that one segment of people have low scores. It is predicted in all groups. If you look at the group that is having the increase, there are all groups.

Mr. Laucher: I'm not disputing, I just want to mention 60 year olds aren't in that group, somewhere this is falling, and I'd like to hear the negative side. What you said is not right either. You said every group has some people in that 10% that are paying a lot more for the other 90% true ratio. But every sophisticated study that has been done shows that there are more people of low-income and minority groups in those cells. It does disproportionate impact. It doesn't have equal distribution. It doesn't prove it is wrong, but there is clear evidence of disproportionate impact for certain minority and low-income groups, correct?

Mr. Alldredge: I think clear evidence part may be overstating it some, but I do think that all races, colors, ages, in those groups. Then it is a matter of the mathematical analysis of the studies.

Bob Wake (ME): In saying that 80% of seniors aren't in this group, doesn't say that seniors benefit, because 20% are in the surcharged group and 10% of everybody else is, that means that seniors as a class are adversely impacted. I've heard varying figures, but consistently, 10% are in tiers that are adversely affected. You also need to consider people that are in a standard

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tier due to credit scoring who would be in a preferred tier in other models, so it isn't just the 10%. I know a consumer who was bumped from preferred-tier to standard-tier because he responded to an ad that stated "open this account, try it out and we will give you a free $25 savings bond for three transactions, it will be no cost to you". It turned out to be a couple of hundred dollars in insurance premium to this consumer because the extra account adversely affects his sterling credit score. That isn't the people that we are most concerned about, and disparate impact raises some policy concerns. We need to make a decision as a society if there is a situation where factors beyond a persons control are predictors of risk, whether we want to allow that or whether we want to share the burden more equitably. We think of race and poverty in those situations. That is a public policy debate, those subsidies, if they are subsidies aren't necessarily bad, but there is the issue is it a good predictor. I have heard some figures being thrown around 90% benefit means only 10% are harmed. I've also 10% harmed, 70% aren't affected, 20% benefited a little. That seems closer to the truth, but you find it is somewhat of a blunt instrument. Looking at this 10% how many of them would be classified as high-risk with a more sophisticated underwriting tool and how much is efficiency. I'm hearing from the companies this is a good underwriting tool, but I'm hearing between the lines is this is a good underwriting tool because it is a pretty good predictor of risk and a really cheap underwriting tool for what it does. That is something that we need to think about the policy implications of, does this competition help protect us? Some of the issues are non-issues because companies are not going to disregard senior thin files vs. young adult thin files. Companies can capture that data, they are going to do it, and it is in their interest as well.

Commissioner Marcie Morrison (CO): It appears that to the industry there seems to be confusion or misunderstanding of what your toolbox really does or does not do. I have personally asked the companies to look at the algorithm that puts together this toolbox, and evidently that is not something that is shared easily. We will be having some public hearings in our state and maybe the folks with the toolbox will come forth and give more information. It is something that is written back to the consumer each time we go through this process. The insurer will explain that your premium has increased and due to many factors. It is only fair if the consumer is having an increase in their premium then the factors should be clearly delineated, and not refer them to their credit company or their own financial status. If you want the consumer to feel that the industry is playing fair, and then list the factors that make the difference of getting a $150-200 premium increase when the consumer hasn't done anything. I would appreciate if you would delineate what those factors are, that would be helpful.

Commissioner Jay Bradford (AR): What concerns me is the fact that people who are in a lower economic status, due to no fault of their own, they have lower deductibles and don't have the means to absorb loses so they use their insurance. That is what they purchase it for. People of lower economic status are higher risk because they can't self-insure themselves, they have loans on their vehicles and they have to fix them. I come from the producer side, and people who have higher incomes have fewer claims because they have higher deductibles and their brokers tell them they shouldn't submit the claim if it is $400-700. But if someone is working at minimum wage he has to.

Commissioner Holland: I know there are a number of elements that are utilized in developing an insurance score and that credit elements for the purposes of inclusion in an insurance score are or may be different than the ones applied in obtaining a loan. To what extent do the specific credit elements weigh in the development in the score overall as a predictor. Are the credit elements viewed as more predictive of risk than actual losses or other elements that are collected and utilized in the developing the overall score. I'm looking for context in terms of the credit elements application and the overall score and its impact on ultimately premium costs.

Mr. Snyder: Hopefully, one of the modelers can answer that. I want to respond to Commissioner Bradford's question. The fact is that credit in the studies, both governmental and private, indicates that it is a predictive factor not just on collision and comprehensive and liability claims as well. That isn't something that you can pay off. It is for all auto coverage in the Epic Actuarial Study of more than two million records to be one of the top three predictive factors. It is not just that, it also measures overall exposure of risk.

Mr. Ellman: The data presented by Trans Union and Choice Point, Lexis Nexis and FICO as well indicated an extraordinary level of insurance score stability over the last eight quarters or so. This is difference in the lack of stability of credit scores. There is a significant difference between a credit score and an insurance score. Something is happening in the insurance world that maintains an insurance score stability.

Mr. Bumell: Our insurance scores are developed specifically from the credit report. They are all credit variables in our scores. That is what is returned to insurers. If they use that in their overall model with other factors that is their proprietary algorithm. Our scores only take information from the credit report itself.

Commissioner Holland: So that would be an industry question, then, Dave? Every company is using a variety of different elements including that insurance score. Can you give me an indication as to the degree it is impacting the overall insurance score, relative to the others.

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Mr. Snyder: Yes, we can bring in individual companies and work with you to understand that.

Commissioner Holland: In many respects it is rather an intractable situation because most people don't want to pay for someone else's risk. I appreciate the fact that we have to get to pricing and actually realistically, is reflective of an individual's risk. The challenge, however, is the extent as we have discussed is that credit that is not directly related to a claim different than risk affects a premium. I think our ability to really grapple with that question is at the heart of this discussion.

Mr. Birnbaum: Here are our recommendations for the next steps for the next group. I will start with today's *Star Tribune* newspaper. "Hard times make credit score key." The paper acknowledges what is obvious that millions of consumer's scores have dropped. You have to watch for vicious cycle, bad credit history, harder to recover. The falling credit scores are a reflection of the times. Plummeting home values, record foreclosures, the overall recession. At the same time lenders are applying stricter standards to borrowers including requiring higher credit scores. We are in a crisis. This is not a debate about a correlation; there are millions of consumers whose credit scores are being affected due to job loss. As I said in the consumer liaison meeting yesterday and my comments I handed you today, I included a recent actual credit scoring model filed with the state. You can see the factors that go in the model. You have an actual model, and then you have actual information about record increases and numbers of foreclosures, record increases in delinquencies, the number of delinquencies, bankruptcies. We know all of these negative activities have increased; we know that banks have reduced credit limits and raised rates. We know that for large number of consumers the balance to limits ratio has gone up. We know that the objective measures in the credit scoring models have worsened for millions of consumers.

Commissioner Holland: So in terms of that, companies are arguing that they don't use that information at renewal. If there is a dramatic change in the foreclosure, etc. a negative impact is not going to impact pricing at renewal, do you agree or not?

Mr. Birnbaum: We've heard testimony that some companies do not use credit scoring at renewal. Does that protect consumers? No. If a consumer had a bankruptcy two years ago because abusive subprime lending, they are still dealing with the impact two years later. The fact that the company isn't using credit score renewal doesn't benefit or help that consumer. The second part is that the claim somehow in some states can only use credit scoring to benefit a consumer. We know that it is a zero sum game and in order to provide a discount for somebody you have to give a surcharge to somebody else. So if you are only going to give "benefits" you have to raise the base rate for everyone in order to give discounts to a few. It is an impossible concept to give benefits because of the credit scoring. The other issue is we don't know whether the companies do or do not use at renewal. The example that I gave you was a company that uses it as a rating factor every six months. In my comments, I demonstrated that we have a true economic and financial crisis and this is a real change over time. Foreclosures have gone from 1.3 million to over 3.5 million in a two year period. Trans Union reported mortgage delinquency rates in 2001 of 1.4%. In the first quarter of 2009 it was 5.2%—3.7 times the 2001. In some states, Nevada and Florida, the mortgage delinquency was 11.6 and 11%. There is tremendous despair among the states, and that is the same with credit scores. Even if they stayed the same, and I don't think that is true. There is still a huge part of the population whose credit scores are deteriorating, while there may be some parts where they are improving for some reason. The answer to Commissioner Ario's question—who is paying for this?—is people who have gone into foreclosure, because they got a mortgage that was unsustainable because of an adjustable rate, people who have gone into bankruptcy because of medical bills, people who have thin files because the credit reports don't have any information on if you have paid your utility bills or rent on time. Those are the people who are getting hammered on this. This is a real public policy issue. The scoring model that I provided was developed from experience from 2001 to 2004. We are now in a period where the underlying economic experiences are much different. We would expect claims to go up, but claims have gone down. The lesson is, a foreclosure today doesn't mean the same thing in a credit scoring model that it did five years ago. If it did we would see a huge spike in claims. Based on this information that you are getting today is essentially unverifiable, self-serving information from the industry. I submit to you that if you look at the economic circumstances and look at the models you will see that it has to be that the credit scores are deteriorating. We recommend that:

- The NAIC develop a model set of procedures for states to implement a moratorium on an administrative basis.
- The NAIC work to develop a template for uniform data collection on applications and policies.
- Engage with NCOIL on the life exceptions to its extraordinary circumstances model.

Director McRaith: We will not discuss suggestions for next steps due to the time restrictions. Are there other ideas that another regulator has to put on the table for conversation at a later date?

Commissioner Ario: I agree with engaging with NCOIL

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Commissioner Holland: I am persuaded by lack of data in our own populations, as well as overall implications of scoring good and bad. I think we need to discuss drilling down on some of the issues that are important.

Superintendent Chavez: Who is the central repository for information that we get letters from companies, Eric?

Commissioner McRaith: Yes, Eric would be a good contact point.

Commissioner Morrison: How would you like the state hearings to fold into NAIC?

Director McRaith: Florida held a hearing and the testimony and information has been submitted as part of the NAIC hearing on April 30. I think that we need to have collective access to that information. I think that we should continue to coordinate that through Mr. Nordman and Tim Mullen at NAIC.

As the regulator community, do we envision ourselves as having any responsibility to deal with this issue going forward, and if so, what would that responsibility be? That is what I'm looking at for next steps.

Steve Parton (FL): I think that we should take a look at the laws and model laws that we have out there. I have trouble with the word "solely". Take a look at the classification of "neutral" when you have a thin file. We have heard several discussions on this.

Commissioner Holland: I would be interested in states that have adopted NCOIL models, the extent to which industry views their competitive position at this point, whether the adoption of NCOIL has changed penetration rates, the ability to price product in a competitive way. That would be informative.

Mr. Laucher: I think that we should take action in using the unfair discrimination components of our laws to say given the current status of the financial markets, the states believe that these components should not be the basis for an adverse action whether individually, or a component of a credit or insurance score and prohibit using those on renewals, new business.

Ms. Miller: I think we should look at what the changes in the residual markets have been would be an interesting component.

George Bradner (CT): Connecticut would be interested in the wording "solely" vs. determining, and if those records were public and able to be able to look at those. Look into that difference. Obtain copies of NCOIL transcripts.

Director McRaith: If interested parties have recommended next steps, please provide those to Mr. Nordman or Mr. Mullen at the NAIC.

We will have a conference call in which the public can participate and will provide ample notice of call for that call.
If you have suggestions on next steps, please provide those to Mr. Nordman or Mr. Mullen by June 30, 2009.
Thank you

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