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September 17, 2009

Director Michael McRaith, (IL) Chair
The Property and Casualty Insurance (C) Committee
Commissioner Kim Holland (OK) Chair
The Market Regulation and Consumer Affairs (D) Committee
National Association of Insurance Commissioners
444 N. Capitol Street, NW, Suite 701
Washington, DC 20001-1509

(Via Email – Pam Simpson, ***PSimpson@naic.org***)

RE: NAIC Hearing on Credit-Based Insurance Scores – September 23, 2009

Dear Director McRaith, Commissioner Holland,

FICO is pleased to respond to the following questions…..

1) Why is FICO not an "advisory organization"?

FICO is not an "advisory organization" as defined by the NAIC Model Property and Casualty Model Rating Law or as defined in state statutes.

NAIC Model
Property & Casualty Model Rating Law (File and Use Version)
Model 775
Section 2. Definitions
A. "Advisory organization" means any entity . . . which assists insurers in ratemaking related activities such as enumerated in Sections 10 and 11.

> Section 10: "consumer information system(s) which will provide and disseminate price and other relevant information on a readily available basis to purchasers of insurance".
>
> Section 11: "any service relating to statistical collection or the rates of any insurance subject to this Act".

Oklahoma Statute
Title 36, Chapter 1, Article 11B, Section 1140
Defining Advisory Organizations
A. "Advisory organization" means a corporation, an unincorporated association, a partnership or an individual, whether located inside or outside of this state, organized and licensed for the purpose of making rates, loss costs, rating plans, statistical collection, furnishing statistical data, policy forms and endorsements or rating systems.
B. The term "advisory organization" shall be synonymous with the terms "bureau", "statistical agent" and "rating organization".

Illinois Statutes
215 ILCS 5/123A-2
Definitions. As used in this Article, unless the context requires otherwise:
(a) "Advisory Organization" means every person, other than an insurance company who as its primary functions (i) compiles insurance statistics, or (ii) prepares insurance policies, bond forms, and underwriting rules, and (iii) furnishes that which it compiles and prepares to insurance companies who are its only members and subscribers.

FICO is certainly not "synonymous with the terms 'bureau', 'statistical agent' [or] rating organization'" as set forth in the Oklahoma statute. FICO does not make rates, loss costs, rating plans, and FICO does not furnish rates or rating manuals to the insurance industry, nor does FICO act in an advisory capacity with respect to ratemaking activities.

FICO does none of the activities prescribed by the Illinois statute: FICO does not compile insurance statistics, prepare insurance policies, bond forms, or underwriting rules; FICO does not collect and furnish loss or expense statistics to insurers or rating organizations; and FICO has no member insurers participating in our management or exclusive subscribers.

FICO does not come within the purview of the NAIC Model Act, as we do not assist insurers in providing and disseminating price or other information to purchasers of insurance; and we perform no services relating to statistical collection of information used to make insurance rates. FICO does not provide guidance regarding the specific business decisions and processes of insurance companies. Each insurance company determines how they will use credit-based insurance scores in their underwriting and/or pricing processes, based on their particular appetite for risk and the regulations of the states in which they do business.

FICO is a decision management software developer specializing in predictive modeling. We develop and maintain credit-based insurance score (CBIS) models that rank orders loss potential for homeowner and personal auto insurance applications and policies. Underwriters use FICO CBIS scores as an accurate and efficient tool in conjunction with other risk characteristics to make decisions in accordance with their underwriting programs. FICO is not involved in any of the underwriting or rating decisions made by insurance companies.

2) What factors are considered and are not considered by FICO Credit-Based Insurance Score models?

FICO Credit-Based Insurance Scores
Key information category impact (with minor exceptions driven by individual state statute or rule)

* Payment History (40% impact on a score)

While the majority of consumer credit reports historically show no late payments at all, payment history has proven to be predictive of more frequent or higher insurance losses and is one piece of information used in calculating a FICO CBIS score.

With minor exceptions required by some state laws, a FICO CBIS model considers payment information on many types of accounts, including credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. Also considered are public record reports such as bankruptcies, judgments, suits, liens, wage attachments and collection items.

Consideration is given to how late missed payments were, how much was owed, how recently they occurred and how many there are.

* Amounts Owed (30% impact on a score)

Owing a great deal of money on many accounts can indicate that a person is overextended, and this has been found to correlate with more frequent or higher insurance losses.

With minor exceptions as required by some state laws, a FICO CBIS model may consider the amount owed on all accounts and the amount owed on specific types of accounts, such as credit cards and installment loans. Also considered is how many accounts have balances, and how much of the total credit line is being used on credit cards and other "revolving credit" accounts,

Note that even if credit cards are paid off in full every month, a credit report may still show balances on those cards. The total balance on the last statement is generally the amount that will show in a credit report.

In some cases, having a very small balance without missing a payment shows that credit is being managed responsibly, and may be slightly better than no balance at all. On the other hand, closing unused credit accounts that show zero balances and that are in good standing will not generally raise a score.

* Length of Credit History (15% impact on a score)

In general, a longer credit history correlates with fewer and less severe insurance losses and results in a higher score. However, even people who have not been using credit long may get high scores, depending on what the rest of the credit report looks like.

With minor exceptions as required by some state laws, a FICO CBIS model can consider how long credit accounts have been established, viewing both the age of the oldest account and the average age of all accounts.

* New Credit (10% impact on score)

Research has shown that opening several credit accounts in a short period of time, increasing financial obligation — especially for people who do not have a long-established credit history – corresponds to higher or more frequent insurance losses. This is also true of multiple “inquiries” by consumers seeking credit.

FICO CBIS models distinguish between searching for many new credit accounts and "rate shopping", which is generally not associated with higher risk. This is handled by treating mortgage or auto loan inquiries that occur within a 30-day period as just a single inquiry.

With minor exceptions as required by some state laws, a FICO CBIS model may consider how many new accounts have been opened, how long it has been since new accounts were opened, and how many recent requests a consumer has made seeking credit. Note that while "inquiries" remain on your credit report for two years, FICO CBIS models only consider inquiries from the last 12 months.

* Types of Credit in Use (5% impact on score)

FICO CBIS models consider the mix of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. It is not necessary to have one of each, and it is not a good idea to open credit accounts not intended to be used. The credit mix usually won't be a key factor in determining a score but it may be more important if a credit report does not have a lot of other information on which to base a score.

NOTE: Factors not considered, tracked or otherwise available in the FICO Credit-Based Insurance Score models:

Ethnicity, religion, gender, familial status, national origin, age, marital status, salary, occupation, title, employer, and location.

Any interest rate being charged on any account, and any items reported as child/family support obligations or rental agreements.

FICO CBIS models do not consider – consumer disclosure inquiries a consumer has made for their own credit report, promotional inquiries made by lenders to make "pre-approved" credit offers, administrative or account inquires made by lenders to review your account with them, employer inquiries or insurance inquiries.

FICO CBIS models also do not consider any information not found in a consumer's credit report or any consumer credit information that is not proven to correlate to future insurance losses.

3) Are consumers' FICO Credit-Based Insurance Scores being impacted negatively during the current economic climate?

In spite of the current economic climate, recent analysis of FICO CBIS scoring models shows that average CBIS scores have remained virtually the same over time for the general population. This is especially noteworthy when the number of people who are delinquent in repaying creditors has grown in recent months.
We believe the overall stability of FICO CBIS scores may be caused by a greater number of consumers becoming even more credit conscious—making certain to pay all bills on time, paying down outstanding balances, and not seeking additional credit obligations.

While a small but growing number of consumers have experienced recent financial hardship, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. FICO CBIS models consider the interrelationship of all credit information in a consumer's credit report, including any negative information. Scores may change when lenders reduce credit limits, but FICO CBIS models assess a wide variety of data on credit reports, so the impact from a single factor like credit limit reductions will depend on what other data is on the credit report and the amount of line reduction taken by a lender.

Recent FICO analysis shows that while the number of credit limit reductions has increased over the past year, FICO credit risk scores have dropped minimally for some, not at all for others and some have even seen FICO credit risk score increases. While, in many cases, credit cardholders don't control their credit limits, they can control their account balances. Recent data shows that a notable number of consumers have reduced their revolving credit usage, helping to minimize any effect from lenders reducing their account limits.

Interestingly, while general population average scores have remained stable during the current economic downturn, the average FICO CBIS scores for the lowest scoring quadrant show a very slight increase in score. As noted previously, we suspect this can be attributed to many consumers' efforts to be more "credit conscious" at all levels of the scoring population.

While FICO CBIS scores have remained stable through a variety of movements in the economy over the past 16 years, our research will continue as the economic climate changes. FICO CBIS score stability is important in helping insurers make objective, consistent and accurate underwriting and pricing decisions.

4) Would the use of "non-traditional" credit data provide greater insight to future insurance loss relativities?

Efforts to identify and readily access "non-traditional" credit data to aid in insurance underwriting and pricing decisions have proven very difficult.

While credit reporting agencies continue to pursue access to such data as utility payments, rental/lease agreement payments and payday loan payments, those managing "non-traditional" credit relationships have apparently not yet fully bought into the value of sharing that data. Given very limited availability of the data for analysis, there has been only limited testing of its predictive value for the insurance industry. and utilization of this data has had very limited application, if any, in credit-based insurance scores.

Until a much larger segment of "non-traditional" credit providers agree to provide their consumer relationship data to the credit reporting agencies, or in other successfully aggregated data methods, the predictive value and the overall viability of such data with respect to consumer benefits and industry benefits cannot not be fully understood.

5) Would the use of a "standardized credit-based insurance scoring model" by the insurance industry benefit consumers?

Competition within the insurance industry is vital to consumers' interests. The competitive nature of the industry provides consumers with multiple and significantly varied products and services to meet their needs. Restricting an insurer's ability to utilize marketing, underwriting, pricing and book management tools in the way that helps that insurer make the best possible decisions, given their guiding market strategy, severely limits that competitive nature, also limiting the wide variety of product and service options available to consumers.

Disregarding or limiting the desire, focus and efforts of insurers and their analytic partners to constantly seek and uncover new sources of accurate and reliable data, enhanced data analysis techniques and expanding modeling technologies by forcing the use of a "standardized approach" would surely not benefit consumers. Consumers are best served when Insurance companies are able to make underwriting and pricing decisions based on the best available information supported by efficient and proven technologies.

A "standardized approach" would lead to less-informed, poorer decisions, severely limiting the competitive desire of the insurance industry that now serves consumer needs by offering greater affordability and availability of insurance in expanding markets. Should such a restriction be forced upon insurance companies, their desire and appetite to offer more affordable products and services to a wider range of consumers will be severely limited, as well. Such restrictions and limitations on the competitive nature of the industry could not possibly benefit insurance consumers.

FICO Credit-Based Insurance Scores were developed by the industry's leading predictive analytics company, utilizing modeling techniques and technology that have proven successful over past decades for the consumer credit, mortgage lending, retail credit, insurance and other industries

As FICO is an analytics, decision management firm and not a credit reporting agency, we've partnered over the years with the three major CRAs (Equifax, Experian and TransUnion), analyzing and pulling the best value from the consumer information datasets owned by those firms to build the best possible models for each industry.

It is that strength of analytics, data knowledge and modeling skills that allowed FICO to introduce credit-based insurance scores to the insurance industry in 1993 and to remain the leading provider of CBIS scores to the insurance industry today. While insurers have choices among predictive analytic and modeling firms, FICO is pleased to have offered the product strength, ongoing innovation and analysis, as well as the value and market support insurers demand to remain competitive and profitable while expanding their products, services to ever-growing numbers of consumers

Thank you for the opportunity to present this information. I look forward to responding to any additional questions from your Committees.

Sincerely,

Lamont D. Boyd

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