

PUBLIC HEARING: USE OF CREDIT IN INSURANCE

Saturday, May 30, 2009
10:00 am – 12:30 pm
Iowa State Capitol Building, RM 116

Agenda

- I. Opening of Hearing
 - a. Introduction of Consumer Advocate / Presenter
- II. Presentation: Credit Scores Use in Insurance in Iowa
Ramona Lee, Iowa Insurance Division
- III. Consumer Testimony and Comment
- IV. Insurance Industry Testimony
 - a. Questions and Comments from Consumers and
Consumer Advocate
- V. Closing of Hearing
 - a. Announce opportunity to submit written testimony to
supplement public statement

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance

May 30, 2009 (10:00 am – 12:30 pm)

The public hearing on the use of credit in insurance commenced at 10:00 am at the Iowa State Capitol Building, room 116 on Saturday May 30, 2009. Iowa Insurance Division representatives present included Angel Robinson, Consumer Advocate, Ramona Lee, Actuarial Administrator, and Tom O'Meara, of the Market Regulation Bureau. Additionally present were six consumers, one representative from the Iowa Independent Insurance Agents, and eleven representatives of the insurance industry.

I. Opening of Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with the introduction of herself and Ramona Lee, Actuarial Administrator as members of the Iowa Insurance Division staff. Ms. Robinson informed those present that the purpose of the public hearing was to provide consumers with an opportunity to hear about the topic from experts and to provide a venue for consumers to express their opinions and thoughts on the subject. Consumers were asked to sign in if they were willing to do so. Ms. Robinson presented the agenda of and introduced the presentation by Ms. Lee about how insurance scoring in Iowa.

II. Presentation by Ramona Lee, Actuarial Administrator: Credit Scores use in Iowa (PowerPoint presentation attached).

Ms. Lee explained the purpose of her presentation is to explain how insurance scoring is currently used in Iowa today. Ms. Lee explained her job at the Iowa Insurance Division is to review rates used by property/casualty insurers authorized to do business in Iowa. A review of rates requires assuring that the proposed premiums charged are fair and reasonable for the coverage provided. Iowa's current law has been in effect since 2004. Ms. Lee then explained insurance scores and defined them. Insurance score is defined as a number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or part on credit information for the purposes of predicting the future insurance loss exposure of consumers. Insurance scores are used in personal insurance and regulated by the Fair Credit Reporting Act and Iowa Code sections 515.103, 515.4, 515.5, and 515.24. Ms. Lee then explained that

insurance scores are used in underwriting to determine if an insurance company will give you a policy and if so, which affiliated company would have your policy. For rating, an insurance score could be added to premium totals with other factors. When calculating an insurance score the factors of income, gender, address, zip code, ethnic group, religion, marital status, race, and nationality are not permitted to be used for calculating insurance scoring.

Insurance scores are considered to be a trade secret, but rate filings (the calculations of how your rate is determined) are available for public viewing. Ms. Lee explained that adverse action notifications must be sent to consumers. The adverse notifications must state the reasons behind the adverse action. Ms. Lee also explained that credit information cannot be the sole basis to deny, cancel, refuse to renew, or base renewal rates upon. It was also explained that insurers must notify consumers that credit information will be reviewed. Restrictions are additionally placed on the use of incomplete or incorrect credit information and the age of credit information. Ms. Lee explained that some credit inquiries may not be used. These inquiries included inquiries: for the consumer's own information, not initiated by the consumer, related to insurance, medical collections, and multiple inquiries for home and automobile lending within the last month. Ms. Lee shared that insurers must treat consumers with an absence of credit (or where there is an inability to calculate an insurance score) as neutral in rating a policy. Ms. Lee concluded by explaining that there are other factors besides insurance scores used to determine premium.

- III. Summary of testimony from consumers: (There were six consumers present. Only four consumers volunteered to submit testimony. The testimony summaries are provided in the order given.)

Martha Reineke (written statement attached):

Ms. Reineke disagrees with the practice of insurance scoring. Ms. Reineke was notified that she had an "unfavorable number of open or revolving accounts", "recent delinquencies", "insufficient length of credit", and "too many credit checks" and as a result she would be moved to a more expensive tier. When Ms. Reineke contacted the credit reporting agency used, Ms. Reineke was told she had a high credit score that would be even higher if she had a mortgage on her home. Ms. Reineke rejects the idea that there is a correlation between her carefully planned finances and her level of risk. Ms. Reineke explained that she uses department credit cards for discounts but does not maintain a balance on

any credit account as she pays off all her debt. Ms. Reinek also rejected the idea that a recent late payment could be accurate as a review of her credit report shows the only late payments (two) were three years ago and were due to the turn around in mail time sent to a company on the east coast. Once it was discovered that making mail payments would result in late payments, Ms. Reineke did not use that card any longer. Ms. Reineke also said that her credit report was over 20 pages long and started in the 1970's so she disagrees that the length of her credit was insufficient. On the credit report received, Ms. Reineke found 2 inquiries from current credit card companies used to update their credit information on her; otherwise all of the other credit checks were unsolicited. Ms. Reineke objected to the fairness of being penalized for "promotional checks" that are not in her control. When Ms. Reineke attempted to get additional details about what is necessary for her to improve her insurance score, she was told this information was proprietary. Ms. Reineke believes that insurance scoring is "too blunt an instrument" and that it should be banned in Iowa. If it is not banned, the insurance scoring rubrics should be made available to the public so consumers can learn where they are deficient in their score. Transparency is necessary.

Doug Johnson:

Mr. and Mrs. Johnson wished to testify that their insurance went up because of their credit. The Johnsons explained that they had no claims, had been loyal customers, had a good credit score, and had paid off their vehicles and property. The Johnsons were notified that their insurance score had decreased and therefore their insurance premium would increase. Mr. and Mrs. Johnson asked their insurance company why and were told that they were more likely to file an insurance claim. The Johnsons disagreed with the insurance company because he and his wife had filed not claims and that the theory was not true. Mr. and Mrs. Johnson explained that they did not believe the statistics because it made no sense that their credit would be tied to filing an insurance claim. Mr. and Mr. Johnson believed the fact that they had no debt does not mean they will file more claims.

Angela Loy:

Ms. Loy explained that her story was personal. She had been laid off and her credit score had gone down. Ms. Loy explained that even though she had not filed any claims in decades her insurance went up because of her credit. Ms. Loy explained that she felt she was being punished for being laid off. Ms. Loy also expressed concerns that her increased insurance rate would cause her to have to make tough decisions on what bills and deciding what should be paid.

Charles Grove:

Mr. Grove shared that he was informed by his agent that he was not eligible for the best insurance rate as he didn't have a credit history. Mr. Grove explained that he paid with things in cash and that he didn't owe anything to anyone. Mr. Grove explained that he thought it was not right that he was not able to get the best rate just because he did not use credit. Mr. Grove explained that in an attempt to develop credit he tried to take out a credit card and was rejected because he did not have enough credit. Mr. Grove then explained that he had discovered that he would now have a negative mark on his credit because he had been rejected from getting a credit card in an attempt to get better insurance. Mr. Grove explained how he believes this process to be unfair for consumers like himself who did not have credit and did not use credit, but were rejected from getting the best rates.

- IV. Individual insurance companies present declined to comment. Testimony was given by their trade group Property Casualty Insurers Association of America (PCI).

Alex Hageli, PCI Manager of Personal Lines:

Mr. Hageli explained the correlation between insurance scoring and claims. Mr. Hageli explained that studies had been done to demonstrate that when compared to historical data individuals with low scores were more likely to file claims. It was also explained that different companies use insurance scores different ways. Mr. Hageli pointed to other state and federal agencies that have concurred with industry findings such as the Department of Texas and the Federal Trade Commission. Mr. Hageli also explained that credit history is just one factor used by insurance companies.

Consumers again objected to the correlation to risk. Consumers also asked Mr. Hageli if consumers who did not use credit would be eligible for the best rates. Mr. Hageli informed those attending the hearing that the NCOIL model used by Iowa allows consumers with no credit to be treated neutrally. When asked about causation, Mr. Hageli explained that they don't know why but there is research that points to risky behaviors in one area of life going into others. Consumers and Mr. Hageli got into a discussion about what information is available from consumer reporting agencies. Ms. Robinson suggested that this was an issue that will not be agreed upon and the third party vendors who are responsible for this area are not present. Ms. Robinson informed those at the hearing that the credit reporting agencies and the model scoring agencies would be invited to

participate in an upcoming hearing and the question could be accurately answered at that time.

V. Summary of closing remarks from Consumer Advocate

Ms. Robinson thanked all the consumers who were willing to share their opinions and personal stories. The consumers were also thanked for coming out on their weekend. Ms. Robinson thanked Ms. Lee for her presentation and Mr. Hageli for his willingness to participate. Consumers were encouraged once again to submit their testimony in writing for the record. The reminder was given that a second public hearing would be held on June 2, 2009. Once more the meeting would take place at the Capitol but in room 103 and would begin at 4:00 pm.

Credit Scores

Use in Insurance in Iowa

Ramona C. Lee
Iowa Insurance Division
5/30/2009 10:00 a.m.

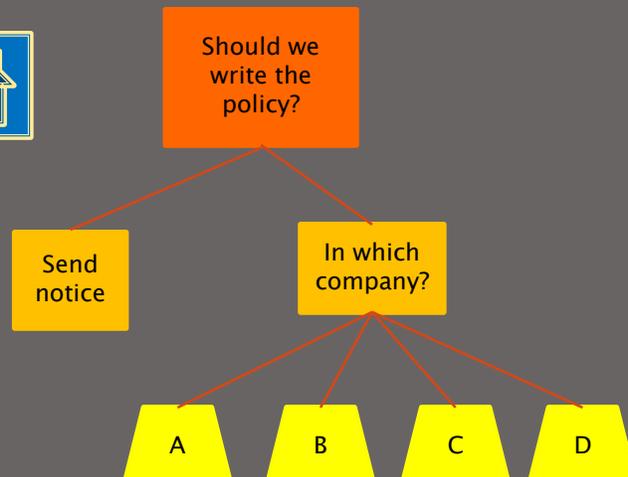
“Insurance Score”

bankruptcy	No	0
	Yes	5.....5
# of credit cards	0-2	3
	3-4	0.....0
	5 or more	5
tickets	none except	0
	speeding**	4.....4
	drunk driving	10
sum		9
Multiply by 80		720

Regulation

- ▶ Federal Fair Credit Reporting Act
15 U.S.C. § 1681
- ▶ Iowa Credit Law for Personal Insurance
515.103
- ▶ Iowa Rating Laws
515.4, 515.5, 515.24

Underwriting



Premium

Base Rate

Des Moines	\$200	\$200
Elsewhere	\$300	

Insurance Score

0-500	-10%	
501-1000	0%	+0% = \$200
101-1600	+10%	

Construction

Class 2.0		x 2.0 = \$400
Stone 1.0		

Loss Surcharge**

No losses	0%	
Prior losses	100%	x 100% = <u>\$800</u>

Notification Requirements

Initial notification

Notification of adverse action
Including reasons

Sole Basis

Cannot

Deny issuance
Cancel
Refuse to renew

Use as basis of renewal rates

solely based on credit information

Disclosure and Dispute Resolution

- ▶ Disclose use in underwriting or rating
- ▶ Re-underwrite or re-rate if incorrect or incomplete information corrected
- ▶ Age of credit information used

Prohibited Factors

Income
Gender
Address
Zip code
Ethnic group
Religion
Marital status
Race
Nationality

Race
Creed
National Origin
Religion

Insurance Scores

Rating Factors

Credit Inquiries

those that may not be used as negative factors

- ▶ Not initiated by consumer
- ▶ For consumer's own information
- ▶ Relating to insurance coverage
- ▶ Medical collections
- ▶ Multiple inquiries for
 - Home mortgages
 - Automobile lending

** if so identified

No Hits

absence of credit information
inability to calculate an insurance score

Underwriting

Exclude credit information
Only use other criteria

Rating

Treat as if neutral credit information
Defined by the insurer

Rate Filings

Competitive markets

Filings by companies and rating agencies

Trade Secret

Other Rating Considerations

- ▶ Minor Traffic Violations
- ▶ Catastrophe Loss Surcharges

Resources

- ▶ Iowa Insurance Division
- ▶ www.iid.state.ia.us
515-281-5705 or Toll Free 877-955-1212
- ▶ Ramona C. Lee, Actuarial Administrator
- ▶ Ramona.Lee@iid.iowa.gov
515-281-4095
- ▶ Iowa Code
- ▶ www.legis.state.ia.us
 - 515.103
 - 515F.4, 515F.5, 515F.24
- ▶ Federal Fair Credit Reporting Act
- ▶ www.ftc.gov
 - 15 U.S.C. § 1681

[Submitted Public Hearing Testimony from Martha Reineke]

Hello. My name is Martha Reineke. I live in Denver, Iowa and have been employed for the last twenty-five years as a professor of religion at the University of Northern Iowa. I appreciate this opportunity to bring a consumer's perspective to the use of insurance credit scores in assigning rates for home insurance in Iowa. Although my insurance company, Horace Mann, has been using credit scores for seven years, I learned of this practice only in April, when I found enclosed with my renewal a notice that my rate has been affected by my insurance credit score. I was informed that I am a Tier 2 rather than Tier 1 client because I have (quote) "an unfavorable number of open or revolving accounts." I was stunned to see myself as Horace Mann apparently sees me: a spendthrift wallowing in an ocean of Visa card debt. If my rates had gone up because of our recent claims—two roofs in ten years because of hail damage—I would not have been surprised. But to be informed that my rate is negatively impacted because of the number of credit cards I own is astonishing. That is why I am here today.

Horace Mann tells me that "the exact components of the Fair Isaac insurance scoring model they use are proprietary." As a consequence, I do not know how many credit cards over the acceptable number I possess or if I would harm or help my score and therefore my insurance rates by canceling some of the cards. When I contacted TransUnion, the company from which Fair Isaac receives the data that they use to create my insurance score, TransUnion told me my credit score is an A rating: 948 out of 990 possible points. The primary reason it is not higher is that I have no home mortgage reported to

TransUnion. TransUnion has no concerns about the number of credit cards I own. I would like to address two aspects of the situation I have just described.

First, I challenge the insurance industry's claim that there is a correlation between a client's credit score and their risk. The letter I received from Horace Mann said that persons who are conscientious about their personal finances take better care of their property. Apparently my 16 credit cards mark me as someone less likely to take care of my property than someone with fewer cards. But the Fair Isaac insurance scoring model is flawed because it has been unable to detect that actually I am extraordinarily conscientious in my use of money. TransUnion does not track credit balances.

Therefore, in using TransUnion data to calculate my insurance score, Fair Isaac has not considered key evidence that I am a careful financial manager: with the exception of a car payment, I pay off all my balances every month. The Fair Isaac insurance scoring model is such a blunt instrument of analysis that it is unable to fairly account for how I use my credit cards. The cards are for stores such as Kohl's, LL Bean, and Talbot's which provide free shipping, coupons, and reward gift cards because I maintain a credit card with them. I use only two or three cards per month but I save hundreds of dollars a year in purchases for my family because of my prudent use of the benefits of my credit card ownership. If the Fair Isaac scoring model was truly fair, I would receive a bonus rather than a deduction in my insurance score because of how much money I save my family through my astute use of my credit card perks.

My second area of concern has to do with my quandary as a consumer about what to do about my insurance score if I want to improve it. Because the Fair Isaac Scoring Model

is proprietary, I have not been able to obtain this information. Let me share an analogy with you. If I used the same approach to grading my students at UNI that my insurance company is using with its credit scoring, if a student asked me why she got a B on an exam and what she would need to change about her work in order to get an A on the next exam I would tell her that I use the Fair Professor Scoring Model. However, because it is a proprietary model I would tell the student that I can not divulge to her any specific information about the criteria I use that would enable her to make changes in her work in order to earn an A in the future. I hope you agree with me that I should not consider my grading criteria proprietary knowledge. As a matter of fact, in my work as a professor, I use a detailed grading rubric so that students know exactly the criteria on which I will be grading their written work and can clearly see what they need to do to more closely approximate those criteria on future tests. I think that the insurance industry should be required to be as accountable and transparent in their scoring as I am in scoring my students.

I recommend that insurance credit scoring not be allowed in Iowa. Based on the issues I have described, insurance scoring is altogether too blunt an instrument because it has been wholly unable to detect my exemplary record of responsible financial management. But if scoring is to be permitted, the insurance companies need to be held accountable for that scoring. Their scoring rubrics should be accessible to the public so that consumers can see exactly where we fall short and can learn how we can specifically redress deficiencies or contest our scores. In the absence of that level of transparency and accountability the insurance industry is doing consumers a disservice.

Late yesterday I received a communication from the assistant vice president and council at Horace Mann who was concerned about my testimony today. She advised me that being a Tier 2 Horace Mann client is actually a very good ranking. To return to my teaching analogy: when a B student comes to my office and asks what she can do to become an A student, I don't tell her that a B is actually a very good grade, thereby second-guessing her concern. Instead, I give her information that will help her become an A student. My point still stands: whether a consumer is assigned to a high or low tier by an insurance scoring model, the use of credit scores in the insurance industry should not be permitted in Iowa unless the industry is willing to bring transparency and accountability to the scoring models that it uses.

Paragraph below was not read at the hearing due to time constraints:

That the Fair Isaacs scoring model is flawed is also shown by three additional negative factors cited from my insurance score. These did not appear on my renewal form but were included in a letter from Horace Mann when I complained. The letter noted "recent delinquency." By this they were referring to two late payments three years ago. I stopped using that particular card when I realized that I had missed two payment dates because the bank offices were located out east and by the time I got their notice and returned it the turnaround time was less than two weeks. Two late payments in over ten years of credit history is hardly a record of problematic delinquency. The letter also said that I had an "insufficient length of credit history" even though my TransUnion credit report lists my oldest credit card, which I got in 1979, the year I got married, and shows cards added through the 1980s and 1990s. The report is almost twenty pages long!

Horace Mann also said that I had “too many recent credit checks.” There were 42 credit checks listed on my credit report – two were for updates on credit cards from LL Bean and Talbots, both of which wanted to upgrade my card status to add more benefits. The other checks were unsolicited “promotional checks” (identified as such on my credit report) from companies such as Discover and American Express who are looking for customers. Unless the Fair Isaac scale judges that two credit checks associated with an upgrade are “too many credit checks,” they are unfairly and illegally penalizing me for promotional inquiries. The Fair Isaac scoring scale appears to have some serious problems. Greater transparency in the Fair Isaac scoring scale is very much needed in order to identify these deficiencies, if my experience is representative.

PUBLIC HEARING: USE OF CREDIT IN INSURANCE

Monday, June 29, 2009
4:00 pm – 6:00 pm
Iowa State Capitol Building, RM 103

Agenda

- I. Opening of Hearing
 - a. Introduction of Consumer Advocate and Presenter
- II. Presentation:
 - a. Consumer/Consumer Advocate questions on presentation
- III. Question and answer session with credit based insurance score model companies FICO and Transunion
- IV. Consumer Testimony and Comments
- V. Close of Hearing
 - a. Announce date of last public hearing on insurance scoring

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance
June 29, 2009 (4:00 pm – 6:00 pm)

The public hearing on the use of credit in insurance commenced at 4:00 pm at the Iowa State Capitol Building, room 103 on Monday, June 29, 2009. Angel Robinson, Consumer Advocate, was present representing the Iowa Insurance Division. Additionally present was one member of the public, two representatives from insurance scoring model companies, and six representatives of the insurance industry.

I. Opening of Public Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with the introduction of herself and presenter Lamont Boyd of FICO. Ms. Robinson informed those present that the purpose of the public hearing was to provide consumers with an opportunity to hear about the topic from experts and to provide a venue for consumers to express their opinions and thoughts on the subject. Consumers were asked to sign in if they were willing to do so. Ms. Robinson presented the agenda and introduced the presentation by Mr. Boyd. FICO was requested to be present to clarify what role scoring model agencies play in the chain of insurance scoring and to speak on what factors are considered in insurance scores.

II. Summary of the presentation by Lamont Boyd, Director of Insurance Market, FICO Scoring Solutions (PowerPoint presentation attached).

Mr. Boyd explained that scoring models had moved from mortgages and lending, to providing trend and scoring information for other areas such as insurance. One of the most common questions FICO has been receiving lately is that of scoring model's effectiveness in the current markets. Mr. Boyd explained that there have not been dramatic changes in scores and that generally they have remained stable. CBIS scores (FICO's version of insurance scores) have shown a slight increase in the past few months. Mr. Boyd stressed that the trends are constantly tracked to maintain accuracy in the market.

Speaking of insurance scoring generally, Mr. Boyd reiterated that insurance scoring has been studied and found legitimate by the FTC and other actuarial

studies. Mr. Boyd shared that insurance scores are objective, accurate, benefit the most consumers, they are independent of demographic groups, and income levels. Mr. Boyd explained that insurance scores measure the management of credit obligations and that restrictions on the use of insurance scores would result in higher rates for better risks. Mr. Boyd shared the five major areas measured for predictability. At forty percent, payment history is reviewed including delinquencies. Thirty percent is based on outstanding debt. Outstanding credit includes how much debt does the consumer have, how much credit is available, and the percentage of open installment loans. Fifteen percent focuses on credit history length. This includes the number of months since the opening of a new account, the average number of months an account has been open, and how old is the consumer's oldest account. Ten percent of the models will focus on the pursuit of new credit (permissible inquiries). Credit mix is five percent of what is reviewed. Credit mix includes what types of credit products are used, the number of bankcards for trade lines, and the percent of trade lines that are installment loans.

Mr. Boyd closed by explaining there are education opportunities for consumers to learn how to improve their scores (lending and insurance) available on their website. Mr. Boyd also shared that an annual credit report may be requested as provided in the Fair Credit Reporting Act.

- III. Summary of question and answer session with FICO and Transunion. Lamont Boyd, Director of Insurance Market, represented FICO Scoring Solutions and Eric Rosenberg, Director of State Government Relations represented Transunion LLC, a scoring company as well as one of the three national major credit reporting agencies.

Ms. Robinson asked where in the insurance scoring process would a consumer contact a scoring model company or a credit reporting agency. Mr. Boyd explained that FICO had no direct contact with consumers. FICO only analyzes credit information and forms a score that is provided to the insurance companies. Mr. Rosenberg explained that Transunion is a scoring company and a credit reporting agency. Mr. Rosenberg explained that consumers can contact a credit reporting agency when they have questions about the contents of their credit reports. Ms. Robinson inquired if consumers are told exactly what can be done to improve their insurance score. Mr. Rosenberg explained that credit reporting agencies cannot provide specific reasons an adverse action was taken. Only the top four reasons are provided by a scoring company as to why an adverse action was taken. Ms. Robinson asked Mr. Boyd to verify that the top reasons for

adverse action are provided by the scoring companies, but there is no communication between consumers and the model companies. Mr. Boyd verified that FICO does not work directly with consumers. Ms. Robinson asked Mr. Boyd and Mr. Rosenberg to verify the following insurance scoring chain: Credit reporting agency sends credit reports (from Transunion, Equifax, Experian) → to insurance scoring companies (FICO) that create an insurance score number that is sent to → insurance companies that incorporate the insurance score into the underwriting and rating for a consumer. Information is shared with consumer and if there is a complaint the insurer sends the consumer → to the credit reporting agency for questions and issues with credit. Mr. Boyd and Mr. Rosenberg verified that was correct.

Ms. Robinson asked Mr. Rosenberg if Transunion provides explanations of adverse action reasons to educate the consumer on ways to improve their insurance scores. Mr. Rosenberg explained this information is shared with consumers who ask. Ms. Robinson asked what consumer education is provided on insurance scoring. Mr. Boyd shared that there was information available on the FICO website.

IV. Consumer Testimony and Comment

Mr. Charles Grove was the only consumer present. Mr. Grove was present for the first public hearing on credit scores in insurance and declined to make additional comments as he felt his position had been made clear at the previous hearing.

V. Closing remarks by Consumer Advocate

Ms. Robinson thanked Mr. Boyd and Mr. Rosenberg for coming to explain their companies' part in the insurance scoring process. Mr. Grove was thanked for his attendance once again. Ms. Robinson made a reminder announcement that the last Public Hearing will be on September 16, 2009, in the same room, starting at 4:30.

FICO® Credit-Based Insurance Scores Score Trends in Dynamic Times

Lamont Boyd, CPCU, AIM
Director, Product Management
FICO

June, 2009

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FICO™

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Agenda

- » Credit Conditions Impacting Scoring Trends
- » FICO® CBIS Models
- » Best Practices

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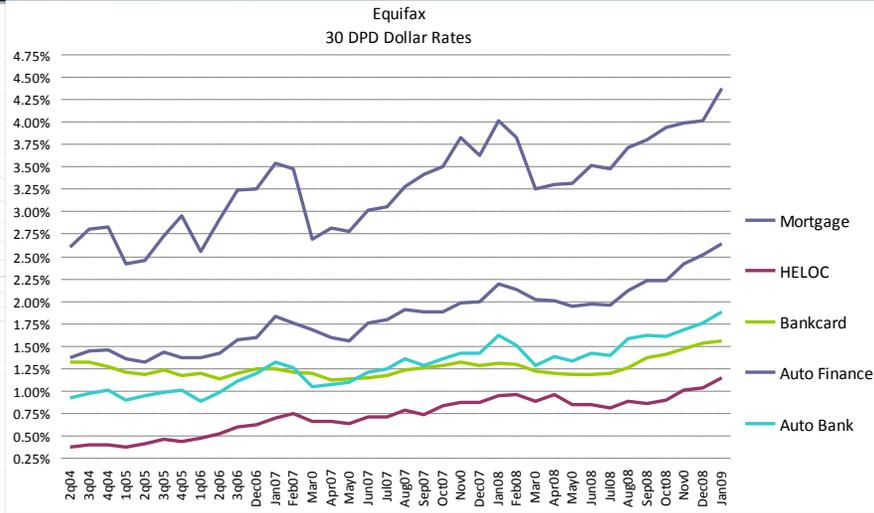
Credit Conditions Impacting Scoring Trends

- » Delinquency Trends
- » FICO® CBIS Score Impacts

3

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Evolving Beyond Mortgage



- » Early stage 30 DPD dollar rates influence late stage dollar delinquency and major derogatory rates.
- » Bankcard delinquencies did not begin to rise until 2nd half of 2008.
- » 30 DPD dollar rates continue to increase for all major industries in January 2009.

4

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Common questions:

- » Have FICO® CBIS score distributions changed over time?
- » Do FICO® CBIS scores continue to effectively rank-order risk under current market conditions?

5

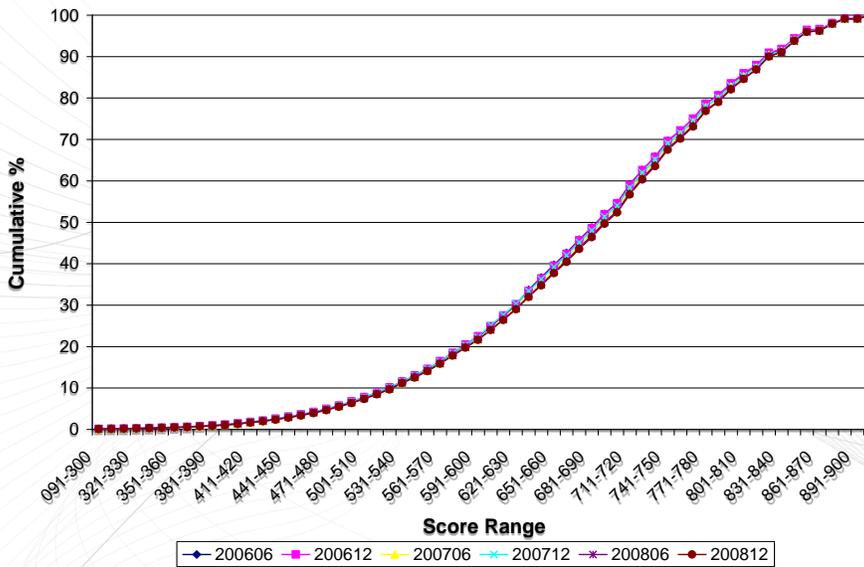
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- » Based on national samples spanning 2006–2008
 - » Score distribution is stable over time at national and state levels
 - » Very slight increase in average CBIS scores in recent months

6

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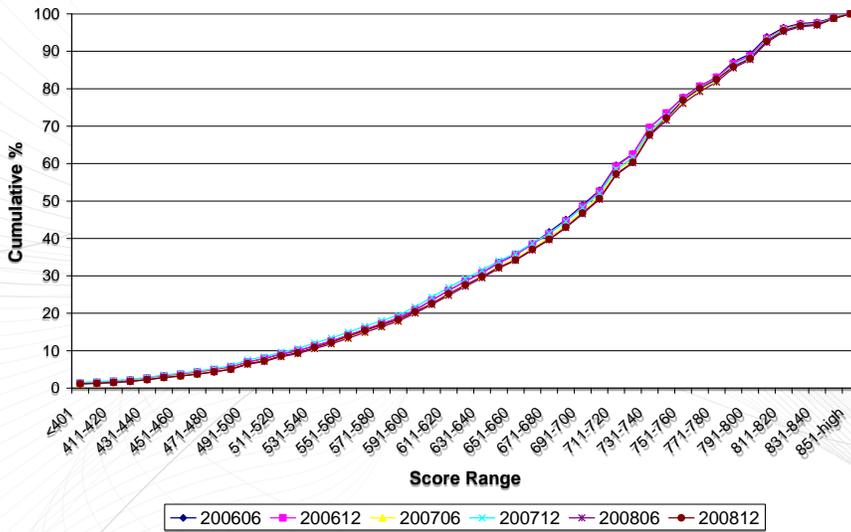
InScore Score Trend Analysis Property Owners – Countrywide



7

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InScore Score Trend Analysis Auto Standard – Countrywide



8

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- » CBIS score distributions – expected to move and shift some
 - » Reflect changes in data reporting, national and regional economic impacts, credit management practices
- » CBIS score predictive power
 - » Consistently rank-orders various insurance populations over time
 - » Ongoing monitoring and analysis

9

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FICO® CBIS Models

- » Introduction and Utilization
- » Validity and Value Proven
- » Predictive Characteristics

10

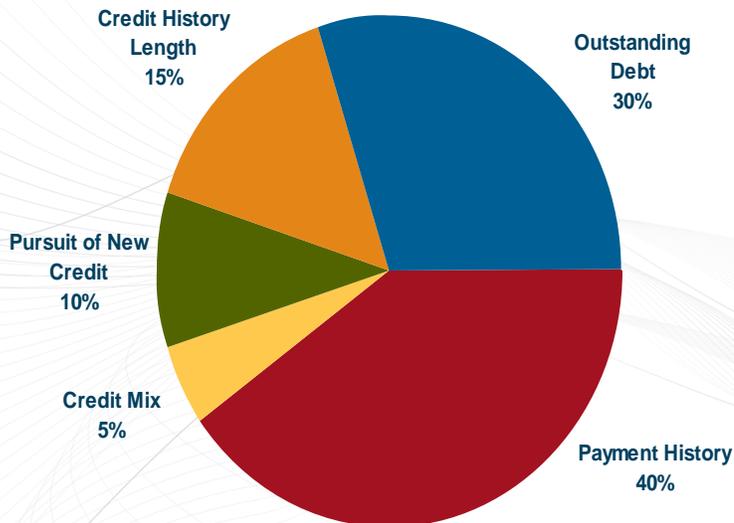
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- » CBIS validity and value proven repeatedly
 - » FICO
 - » Independent actuarial and regulatory studies
 - » FTC Auto Study – July, 2007
 - » CBIS scores are objective tools for more accurate risk evaluation
 - » Use of CBIS scores benefits most consumers
 - » CBIS scores cannot be used to identify demographic groups
 - » CBIS scores are not correlated to income levels but to an individual's management of credit obligations
 - » Restricting CBIS scores would result in higher rates for better risks – without regard to race and ethnicity

11

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FICO® Credit-Based Insurance Scores Five General Areas of Predictive Information



12

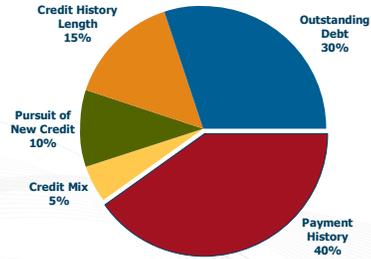
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CBIS Predictive Characteristics Payment History

FICO

Key Factors:

- » How recent is the most recent delinquency, collection or public record item?
- » How severe was the worst delinquency - 30 days, 90 days?
- » How many credit obligations have been delinquent?



13

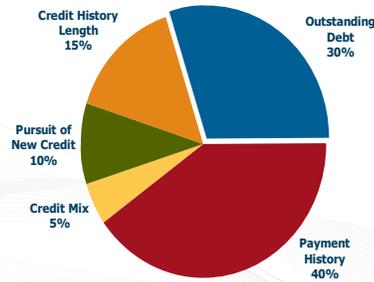
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CBIS Predictive Characteristics Outstanding Debt

FICO

Key Factors:

- » How much does the consumer owe creditors?
- » What percentage of available credit card limits is the consumer using?
- » What percentage is outstanding on open installment loans?



14

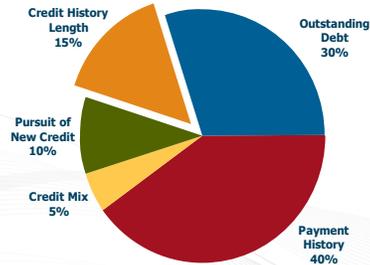
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CBIS Predictive Characteristics Credit History Length

FICO

Key Factors:

- » How long have accounts been established - average number of months accounts have been open
- » New accounts - Number of months since most recent account opening
- » Old accounts – Number of months since oldest account opening



15

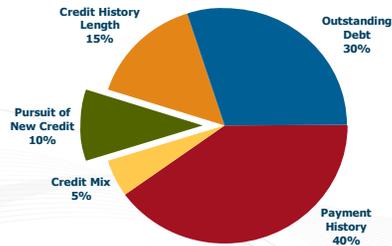
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CBIS Predictive Characteristics Pursuit of New Credit

FICO

Key Factors:

- » Inquiries: Number of recent inquiries (12 months)
- » New accounts - Number of trade lines opened in last year



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Types of Inquiries



- » CBIS scores only consider consumer-initiated, credit-seeking 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
- » CBIS scores have 30-day de-dupe for auto and mortgage loan inquiries

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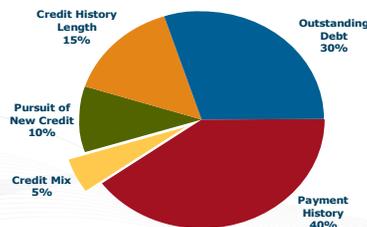
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CBIS Predictive Characteristics Credit Mix



Key Factors:

- » What is the mix of credit product types?
- » Revolving credit – number of bankcard trade lines
- » Installment credit – percent of trade lines that are installment loans



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Information Not Considered by FICO® Credit-Based Insurance Scores



- » 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

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Best Practices

- » Ongoing Monitoring and Tracking
- » Educational Materials

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- » Consider impact of current market trends
 - » Mortgage delinquencies, foreclosures, unemployment rates, bankruptcies, loan modifications on consumer credit
 - » Impact on FICO® CBIS score will depend on:
 - » How information is reported
 - » Other factors in consumer's credit profile

- » Education to help consumers understand and change habits to influence credit-based insurance scores is available at www.insurancescore.com
- » Education to help consumers understand and improve their credit habits to influence the FICO® scores lenders use is available at www.myfico.com
- » Under the 2003 Fair and Accurate Credit Transactions Act (FACT Act), consumers can access each credit report annually via www.annualcreditreport.com

THANK YOU

Lamont D. Boyd, CPCU, AIM
602.485.9858
lamontboyd@fico.com

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FICO[™]

FICO® Credit-Based Insurance Scores

1. Most consumers benefit from the use of insurance scores —

Lower premiums—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission noted “if credit-based insurance scores are used, more consumers (59%) would be predicted to have a decrease in their premiums than an increase.” 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.

Objective and timely decisions—The use of scoring enables insurers to make more accurate, objective, consistent and timely underwriting and pricing decisions. 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.

Most consumers have good scores—Most consumers manage their credit obligations well over time and so 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 —

FTC concludes these scores are effective risk predictors—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission said, “Credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims. The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer.”

Independent studies agree—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: Insurance Information Institute, 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.
- Homeowners insurance loss ratios for people with the worst insurance scores are triple that of people with the best scores.
- Drivers with the best credit history are involved in about 40 percent fewer accidents than those with the worst credit history.

Scores are based on most accurate data—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.

3. **It's common sense that credit habits relate to insurance risk**—

Overall behavior is consistent—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**—

FTC finds scores are not a proxy for race—In its July 2007 report, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance,” the Federal Trade Commission wrote, “Credit-based insurance scores appear to have little effect as a ‘proxy’ for membership in racial and ethnic groups in decisions related to insurance. ...Tests also showed that scores predict insurance risk within racial and ethnic minority groups. ...This within-group effect of scores is inconsistent with the theory that scores are solely a proxy for race and ethnicity.”

Scores are color-blind and objective—An independent study by the Texas Department of Insurance confirmed that credit-based insurance scoring does not discriminate racially or by income. According to that study, 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. This is possible only if insurance scoring is a color-blind, objective process.

5. **Scores remain an effective tool during current economic conditions**—

Scores have shown to be very stable—In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. In a word, more and more consumers appear to be realizing the value of prudent financial and credit management practices.

Scores may decline for those directly impacted—As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.

Scores may change when lenders reduce credit limits:

- FICO® Credit-Based Insurance Scores assess a wide variety of data on credit reports, so the impact to the score 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. The consumer's score could be unchanged, it could go down, or in some cases it could go up in combined response to other changes on the credit report.
- Our ongoing research indicates that lenders have reduced the revolving account limits for a relatively small percent of the population, and those line reductions have been a relatively small amount for that population.
- An important FICO principle is to let data—rather than judgmental factors—drive any changes to our CBIS scoring models. Our most recent score performance studies indicate that our scores continue to appropriately rank-order consumers based on insurance risk.
- While credit card holders don't control their credit limits, in many cases, they do 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.
- FICO plans to periodically analyze this credit industry activity and potential impact on our credit-based insurance scores going forward.

6. FICO® Credit-Based Insurance Scores are fair to consumers —

Evaluate only statistically-proven data—Our insurance models are built with only depersonalized data and our scores 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 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.

Support anti-discrimination laws—U.S. law requires businesses to avoid deliberate bias against minority groups. Through the use of insurance scoring, only individual consumers who represent potentially higher risk pay higher premiums, regardless of their race or income.

Consumers gain control—Consumers with poor credit-based insurance scores can improve their scores by improving their credit habits. Better scores can lead to lower insurance premiums for most consumers.

7. Use of insurance scoring helps stabilize and open the marketplace for consumers —

Competition is good 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.

8. FICO® Credit-Based Insurance Scores are different from FICO® credit-risk scores—

Predict very different things—While both types of scores use information from consumer credit bureau 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.

Insurance scores apply to customer groups—Individuals can have low insurance scores without ever having filed an insurance 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.

9. Use of insurance scoring frees insurers to focus on exceptional cases—

More attention for people with unusual needs—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.

10. FICO is committed to helping consumers obtain credit and insurance coverage fairly and affordably—

Free educational resources—We have established web sites such as www.insurancescore.com 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.

Every score includes explanation—Each insurance score based on credit bureau data is accompanied by up to four (4) score reasons to help consumers identify where they may have lost points, again providing insight into how credit behaviors are impacting scores, approval potential and pricing. Consumers who believe these score reasons misrepresent their credit history can examine their credit reports and request investigation of any information that they find to be inaccurate or incomplete.

Opportunities to address issues—We encourage our clients to use scores responsibly. We also welcome opportunities to address scoring issues with credit grantors, insurance companies, regulatory and legislative bodies, consumer advocates, consumers and the media.

11. FICO recommends the following guidelines to help consumers manage their scores in either a stable or volatile economy—

Make *all* your credit and loan payments on time—The calculation of FICO® Credit-Based Insurance Scores weighs payment history more heavily than any other variable on your credit report. Making all your payments by their due date is a key ingredient for a good score. When money is tight, pay at least the minimum amount due on credit card debt to avoid being reported delinquent. Overdue bills can significantly lower your score, including unpaid non-medical debts sent to collection agencies.

Keep credit card balances low—Individuals with good scores come from every income level, and in tough times they tend to scale back their use of credit cards and pay down their debts. If your credit card balances are close to your credit limits, budget your finances to make debt reduction a top priority. Your indebtedness is the second most important factor for scores.

Open new credit cards or loans only when necessary—Opening new credit accounts may cause your score to go down so be cautious about taking on new debt. This includes thinking twice before opening a retail store card just to get an extra 10 percent off your current purchase.

Get your free annual credit report from each national credit reporting agency through www.AnnualCreditReport.com, and check your credit history carefully for errors. Contact the reporting agency if you spot an error so they can investigate it.

PUBLIC HEARING: USE OF CREDIT IN INSURANCE

Wednesday, September 16, 2009
4:30 pm – 6:30 pm
Iowa State Capitol Building, RM 103

Agenda

- I. Opening of Hearing
 - a. Introduction of Consumer Protection
- II. Testimony on Insurance Scoring:
Birny Birnbaum, Center for Economic Justice
- III. Consumer Testimony and Comments
- IV. Close of Hearing
 - a. Announce that all written testimony should be submitted before October 1, 2009

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance
September 16, 2009 (4:30 pm – 6:30 pm)

The public hearing on the use of credit in insurance commenced at 4:30 pm at the Iowa State Capitol Building, room 103 on Wednesday, September 16, 2009. Angel Robinson, Consumer Advocate, was present representing the Iowa Insurance Division. Additionally present were seven members of the public including one legislator, one consumer protection organization representative, one member of the Independent Insurance Agents, and a dozen members of the insurance industry.

I. Opening of Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with reviewing the agenda and the introduction of Mr. Birnbaum who requested to present testimony on behalf of consumer protection groups on the topic of insurance scoring.

II. Summary of the testimony from Center for Economic Justice by Birny Birnbaum (written statement included):

Mr. Birnbaum supports a ban on insurance scoring. Mr. Birnbaum expressed that insurance scoring is unfair, it is influenced by negative life situations, it is arbitrary and contrary in its results, it discriminates against protected classes, and it goes against the principles of insurance. It was shared by Mr. Birnbaum that insurance scoring is not needed and is not used in multiple states. California was given as a positive example of a state that rejected the use of insurance scores but maintain a competitive environment.

Mr. Birnbaum then discussed the meltdown of the economy due to an economic recession. There has been an increase in foreclosures, bankruptcies, and credit card delinquencies. Mr. Birnbaum stated that Iowa has 61,000 unemployed Iowans. For Iowans that fail to make payments on mandatory home insurance, they will be placed in expensive force-placed policies.

In response to Mr. Birnbaum's comments, Alex Hageli, Property Casualty Insurers Association of America (PCI) Manager of Personal Lines made comments. Mr. Hageli explained that studies have shown that insurance scoring

is predictive of loss. Mr. Hageli stated that insurance rates would increase with a ban on insurance scoring. It was also stated by Mr. Hageli that most benefit from insurance scoring.

III. Consumer testimony and comments on the use of credit scores in insurance (seven consumers were present, but only 3 choose to share testimony):

Lelah Swallow:

Ms. Swallow expressed her concerns that she and her husband were going through difficult times and that it was not fair for her family to be penalized by being made to pay more for insurance because of credit. Ms. Swallow explained that the market is in horrible shape and there are no jobs available right now. Ms. Swallow also said it was not fair for consumers to have to pay higher car insurance when Iowa requires car insurance. Car insurance should be affordable. A concern was also shared for victims of domestic violence who leave a violent situation and as a result it sometimes leads to ruined credit. Ms. Swallow did not feel victims should be penalized for their credit and be forced to pay more for insurance. Ms. Swallow is concerned that people will go without insurance if it becomes too expensive. It was Ms. Swallow's opinion that car insurance should be based on driving records and claims history.

Robert Pinniger:

Mr. Pinniger was a small business owner who was forced to claim bankruptcy because the business failed. Mr. and Mrs. Pinniger always paid their personal bills and debts on time even while the Pinniger's small business was in bankruptcy. This should be seen as a sign of their financial responsibility. The Pinniger's were notified that their insurance would be increasing by hundreds of dollars due to their insurance score decreasing. The Pinnigers felt they had been loyal claim-free customers and it was unfair to punish them for being unfortunate enough to lose their business, when they have paid their insurance in a timely manner.

Lance Horbach:

Mr. Horbach commented that there were some problems with insurance scoring and that it was not perfect. Mr. Horbach explained that just because there were problems with insurance scoring it did not mean it should be completely banned. He is concerned with the possible affect on premiums if a ban was instituted.

One problem area that Mr. Horbach had seen comes from the disparity in the range of prices a consumer may face due to their insurance score. Mr. Horbach also mentioned in response to Ms. Sallow that he was a legislator and that the reason a liability level of \$10,000 was set was to protect consumers who requested assistance for accidents that resulted in major injuries and the party at fault had no insurance. Mr. Horbach explained that Iowa has a really low motor vehicle liability requirement.

IV. Closing remarks by Consumer Advocate:

An industry representative was requested to answer questions about the recently passed National Conference of Insurance Legislators (NCOIL) model act amendment. Representing the industry was Mr. Hageli. Ms. Robinson asked if the industry was participatory in forming that model legislation. Mr. Hageli commented that the industry did participate. Ms. Robinson asked if the NCOIL model allowed insurers to do something new or were insurers already able to provide extraordinary life circumstances exceptions for their consumers. Mr. Hageli agreed that insurers could at their discretion provide extraordinary life circumstances exceptions.

Ms. Robinson thanked the consumers for attending and sharing their comments and personal stories that evening. Mr. Birnbaum was thanked for traveling to Iowa to share his testimony. Interested parties were told to submit any written testimony before October 1, 2009 for review.

Presentation of Birny Birnbaum on Insurance Credit Scoring

Public Hearing in Des Moines, Iowa

September 16, 2009

My name is Birny Birnbaum. I am the Executive Director of the Center for Economic Justice, a non-profit consumer advocacy organization. I have worked on insurance credit scoring issues since 1992 as both an insurance regulator and consumer advocate. Attached is a copy of my resume.

Consumers are facing dire economic conditions due the meltdown in financial markets and economic recession. These factors are causing a crisis for insurance consumers because of insurers' use of consumer credit information for pricing auto and homeowners insurance. While insurers argue that there are few consumer complaints, the number of complaints simply does not reflect the lack of understanding by consumers and the severe problems with credit scoring.

In summary, insurance scoring:

1. Is Inherently Unfair
 - a. Penalizes Victims of Medical, Economic Catastrophes
 - b. Arbitrary and Illogical Results, Unrelated to how well a consumer "manages" her finances.
2. Is Unfairly Discriminatory in a Regulatory Sense
 - a. Discriminates on the basis of race -- credit reports reflect and perpetuate historical inequities.
 - b. violates actuarial principles;
3. Undermines the Core Public Policy Goals of Insurance
 - a. undermines the goal of universal coverage by worsening the availability and affordability of insurance for those consumers with the least means to purchase insurance; and
 - b. undermines the loss reduction role of insurance by encouraging consumers to spend time manipulating credit scores instead of reducing exposure to risk.

4. Is Not Needed – states which ban insurance, such as California and Massachusetts have thriving markets. Insurers entered the Massachusetts auto market after partial deregulation, even though credit scoring is banned.
5. Objective, independent Data show confirm the problems with credit scoring, in contrast to self-serving and unverified statements of credit bureaus and insurers
6. Problems are not limited to auto and homeowners insurance – now see medical credit scores.
7. The NCOIL model provides no substantive consumer protections – no meaningful disclosure, no meaningful prohibitions against unreasonable behavior and no meaningful help for consumers suffering a catastrophic event.

Many agent groups opposed insurers' use of credit information including State Farm, Farmers and Allstate agents' groups. They are not here because of fear of retaliation by the insurers they work for.

The Crisis Caused by Reckless Lending and Dire Economic Conditions

Insurance scoring is inherently unfair because it penalized victims of economic and medical catastrophes. The most recent Harvard study of bankruptcies found that 62% of bankruptcies were caused by medical costs and the majority of these bankruptcies were in families with health insurance. It is simply unfair to charge higher auto or homeowners insurance premiums to consumers who suffer financial distress because of medical costs or job loss. The number of bankruptcies in July 2009 was the highest since Congress changed the bankruptcy laws in 2005 and made it more difficult to file bankruptcy.

The growth in the number of foreclosures is a glaring indicator of financial crisis for millions of Americans. The following data come from RealtyTrac

Number of Foreclosures Countrywide

2005 885,462

2006

	1,259,098	
2007	2,203,295	
2008	3,157,806	
2009	2,246,984	8 months current full year
2009	3,400,000	estimate

Foreclosures were initially concentrated in the subprime market, moved into alt-A and now seen massive increases in prime loan foreclosures.

Bankruptcies are up – even after the new law to reduce bankruptcies

Credit card and mortgage delinquencies are at all time highs – having increased dramatically over the past few years.

Mortgage delinquencies and foreclosures are projected to continue at high levels for several years due to resetting of interest-only loans and high unemployment.

The Census Bureau just released *Income, Poverty and Health Insurance Coverage in the US in 2008*.

Real Median Household Income Decline from 2007 to 2008 by 3.6%, falling to levels not seen since 1997. That was before the severe economic downturn in 2009.

Poverty Rate up from 2007 to 2008, 12.5% to 13.2% -- the highest since 1997 – 40 million people in poverty. The poverty rate for Blacks was 24.7% and 23.2% for Hispanics.

The number of people without insurance in 2008 was 46.3 million or 15.4% of the population. The percentage of people covered by private health insurance declined. The percentage of uninsured Blacks and Hispanics were 19.1 and 32.1, respectively

The Bureau of Labor Statistics reports that unemployment has increased countrywide and in Iowa

Iowa

Jan 2007, 60,809 unemployed, 3.7% rate

July 2009, 109,134 unemployed, 6.5% rate

The number of consumers unable to maintain auto or homeowners insurance policy payments has increased dramatically as measured by increased in the amount of creditor-placed insurance written. Consumers who take out an auto or home loan are required to maintain insurance on the vehicle or property and agree that, if they fail to do so, the lender may force-place the insurance. The table below shows massive increases in creditor-placed homeowners insurance countrywide and in Iowa.

2004	CP Home	CW	\$1,485,338,992
2005	CP Home	CW	\$1,831,583,174
2006	CP Home	CW	\$2,153,104,678
2007	CP Home	CW	\$3,057,956,945
2008	CP Home	CW	\$3,986,950,803

2004	CP Home	IA	\$5,239,337
2005	CP Home	IA	\$5,873,503
2006	CP Home	IA	\$6,341,936
2007	CP Home	IA	\$7,277,143
2008	CP Home	IA	\$9,126,999

Adding to consumer woes are lender decisions to cut credit limits, tighten underwriting, raise interest rates and fees.

Credit scoring penalizes consumers for the business decisions of lenders – even when those business decisions were terrible and included poor business practices, predatory lending, fraud and excessive risk taking. Virtually all of the companies responsible for the hundreds of billions in subprime loans issued from 2005 to 2007 are out business.

Insurance Scoring is Actuarially Unsound

Insurance scoring violates actuarial standards of practice because insurance scores are not objective, are arbitrary and subject to manipulation. See my testimony on actuarial consideration at the April 30, 2009 NAIC hearing for more detail, but the following provides a list of problems.

Not Objective

1. Differences across credit bureaus
2. Differences within a credit bureau due to lender choices
3. Changes in definitions of credit report items – bankruptcy law change
4. Public policy initiatives changing credit scores – moratorium on foreclosures
5. Lack of information – 25% of reports contain insufficient information for scoring, clearly that 25% of population have a variety of risk characteristics
6. Timing of report – balance to limits varies by time of the month
7. Decisions of lenders – not reporting limits, changing limits

Manipulation

1. Invitations/Solicitations for Manipulation
2. Piggy-Back on another consumer
3. Shift balances from one car to multiple cards

Penalize Consumer for Rational Behavior

1. Shop around for best rates
2. Cancel a card when lender acts unfairly
3. Get a card to get 10% first visit discount

Life Exceptions: In other hearings – and in the revised NCOIL model – insurers will ignore the credit score under certain events – divorce, natural catastrophe, job loss, major medical problem. Why do they do this – why would an insurer ignore the credit score – because public policy makers and insurers recognize that scores do not reflect risk under certain circumstances. This means that the use of credit scores is unfairly discriminatory – those who know to ask and are granted a life exception are treated differently than those who don't know to ask. More important, it is an arbitrary practice to ignore the credit score – if the score is associated with risk, then it shouldn't matter how what caused the score. If a score can be ignored for some reasons, then the score is arbitrary – actuarially unsound and unfairly discriminatory.

A Discussion of Data Sources

Suppose I came in and said we had done a detailed survey of 1 million consumers and found credit scoring discriminates against minorities and low income consumers and was not related to risk of loss. You would reasonably ask to see the methodology and the data to verify the claims. And if we said, sorry, the data are confidential, you have to take our word for it – you would not do that. Even though we have no financial stake in this – even though we work on behalf of consumers.

Yet that is exactly what regulators and state legislators have done with insurers – assume that insurers and credit bureaus are providing accurate information even though the insurers and bureaus have a huge financial stake in the outcome of the policy debate.

The credit bureaus and modelers get up and tell you everything is great – yet these folks have a financial interest in the outcome of the debate. It's like going to Enron and asking Enron if its electricity trading in CA benefited consumers.

The credit bureaus come in and say scores are stable – no way to verify that. The insurers come in and say that scores are stable – no way to verify that.

Except we have common sense – we can see the credit scoring models – public in TX and some other states – and we can see the factors in those models and we can see public data on what is happening with economic conditions and it is clear that insurance scores are being creamed for millions of consumers – the very consumers who are victims of abusive lending and the recession.

Insurers have a track record of misleading regulators and policy makers. In the late 90's, there was a debate on whether credit scoring discriminated on the basis of income. The American Insurance Association produced a report claiming that one of its member companies had done a thorough study and found no correlation. It was not true – when the Missouri Department of Insurance did its comprehensive study, it found a powerful correlation to income – as was evident from just looking at the models at the time. Delinquencies and debt burden are correlated to income levels, clearly indicating that credit scores were correlated to income. Yet insurers denied it – misleading policymakers – just as they today deny that insurance scores have not been hurt by the worst economic conditions and credit markets in 80 years.

Insurance Scoring Is Not Needed – States That Ban Insurance Scoring Not Only Show No Market Problems But Outperform Other States.

California and Massachusetts have not permitted insurance scoring for auto insurance. Hawaii prohibits the use of credit information for all personal lines of insurance. Maryland has banned insurance scoring for homeowners insurance. Yet all these markets thrive. In fact, the uninsured motorist rates in California and Massachusetts dropped significantly from 2004 to 2007, according to the Insurance Research Council even as the countrywide uninsured motorist rate increased.

Insurers Claims about Benefits of Insurance Scoring Are Not Supported By the Facts

The insurers' arguments for insurance scoring boil down to one claim: credit scores are predictive of losses. All the alleged benefits flow from this one assertion:

1. More accurate rating – prevents one group of consumers from subsidizing another
2. Promotes competition – insurers who can price more accurately will write more business and take a lower profit because of less uncertainty

This is wrong as a matter of policy and is refuted by the facts.

The logical extension of the insurer argument – more accurate rating is good – is a pay as you go system and the end of insurance.

The purpose of insurance is not to predict risk – it is to pool risk so insurers can provide an essential financial security tool to consumers.

Certainly, it is necessary for a risk classification to be substantially related to expected losses, but such a statistical relationship is not sufficient. Suppose we heard these same arguments for health insurance – pre-existing conditions and family history/genetic makeup are highly predictive of future health insurance claims and, therefore, insurers should be able to utilize pre-existing conditions and genetic tests in rating health insurance. The answer to that is a resounding no – as a society, we realize that the purpose of insurance is to pool risks, not to create a pay as you go system.

Or suppose we heard these same arguments claiming that race and religion were essential risk classification tools for insurers because they were predictive of risk. Again, no way. These classifications are prohibited because they undermine the public policy goals of insurance – and they are not needed to protect the insurance system.

What about the claim that credit scoring creates more competition, more availability and more affordability?

There is no evidence to support these claims. Profitability has increased as loss ratios have declined – a result inconsistent with “more competition.” Uninsured motorist rates have increased as has the amount of creditor-placed homeowners insurance. According to the Insurance Research Council, the uninsured motorist rate in Iowa over the years:

95-97: 10%

2004: 12%

2005-07: 12%

There is no evidence of greater availability or affordability of insurance due to insurance scoring. Insurers attribute the decline in auto residual markets to insurance scoring, but again the data do not support the conclusion – data from AIPSO, the manager of auto assigned risk plans in most states, shows that California experienced a higher percentage reduction in assigned risk premiums from 2003 to 2007 than the countrywide average – despite the ban on credit scoring for auto insurance in California.

Banning credit scores will not raise premiums

On average, insurance scoring redistributes premium with no change in the average premium because there is no short-term impact on claims or expenses which drive overall premium requirements.

Iowa has lower average insurance premiums than the national average because Iowa has much lower population density than most states and because consumers buy less insurance in Iowa than in other state. Insurance premiums are driven by claim costs and claim costs are driven by number of accidents – population density – and amount of claims – amount of coverage. States like NJ and MA and DC have high premiums because they have high population density and higher amounts of insurance.

Insurers defend credit scoring by claiming that a ban on scoring will result in higher rates for the lower risk drivers. And insurers also claim that most consumers have good scores.

Let's take them one a time –

Most consumers benefit:

1. No objective data to prove that – my review of rate filings indicate 50/50 in terms of immediate rate change. Over time, more consumers will suffer because of the absence of loss mitigation incentives and higher uninsured motorist.
2. So what? Would we justify health insurance rating based on pre-existing conditions because most consumers would benefit? Or justify use of race because most consumers would benefit? Profoundly un-American.
3. Over what time period? Consumers' insurance scores change, so a consumer who gets a rate increase this year because credit scoring is banned might avoid a rate increase next year if credit scoring was continued because of cancer in the family or job loss.

Higher Rates for Many If Banned

1. Not believable – push away best customers. self-serving statement with no verification – points out need for department to be collecting data.
2. Analyses likely based on simply removing credit from existing rating plans – not the way it works. Insurers use GLM – rerunning the models without credit would change other rating factors.
3. Tillinghast – eliminate credit, still able to accurately price

4. Cynical ploy by insurers to intimidate regulators and legislators – telling regulators and legislators that rates will increase for most consumers

Insurers can't explain why credit scores are correlated to claims, so they blame the victim – saying scores reflect personal responsibility. But at the same time, insurers argue that insurance scores have been stable during the current economic crisis.

According to FICO:

It's common sense that credit habits relate to insurance risk –

Overall behavior is consistent – 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.

Scores remain an effective tool during current economic conditions –

Scores have shown to be very stable – In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. In a word, more and more consumers appear to be realizing the value of prudent financial and credit management practices.

Scores may decline for those directly impacted – As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.

First, this is offensive. To claim that consumers whose credit scores are hurt because of job loss, divorce, medical catastrophe, natural catastrophe, fraudulent and reckless lending decisions of lenders, changing business decisions of lenders and many other business practices unrelated to how a consumer manages her finances is not responsible is simply blaming the victim for being unfortunate.

And even a cursory review of what goes into a credit report indicates that credit scores are not a measure of overall financial responsibility, let alone personal responsibility – no rent, no utility, no insurance payments, no high-priced lenders, no limits reported by some lenders, no info in some bureau reports. No info on savings, insurance, retirement or other aspects of financial planning. No info on vehicle maintenance.

It is outrageous to claim that an insurer can evaluate a consumer's personal responsibility by looking at the number of inquiries in a credit report or whether the consumer has a department store credit card.

Second, there is a profound contradiction. If scores are a measure of financial responsibility" as claimed by insurers, then scores should be declining as the number of consumers who are delinquent on loan, who default on loans, who have lost homes to foreclosure, who file for bankruptcy, who have higher debt to credit limit ratios because of lender reductions in credit limits. Indeed, the credit bureaus admit that credit scores have declined, but claim that insurance scores are stable

Third, average scores don't tell the story – for every consumer whose score has been trashed by a foreclosure, there may another consumer whose score has improved (from an already good level) because of paying down some debt.

Fourth, the claim of stable scores does not pass the smell test: Look at the models and see that the factors in those models have deteriorated – defaults, delinquencies, public records. Bureaus claim that is is offset by consumers borrowing less and improving credit ratios – debt to credit limits. In contrast to these unverified claims:

Fed Data (consumer lending way down 090908) – revolving debt 8.9 in first quarter from pervious year, 8.2% in second quarter from previous year. Consumer credit 3.6% decline first quarter, 5.2% second quarter.

Experian and Oliver Wyman also state in their Q2 2009 Market Intelligence Reports that lenders continue to manage their risk exposure by aggressively reducing credit lines on revolving loans such as bankcards. Over the last 12 months, bankcard credit lines have declined from \$3.8 trillion to \$3.1 trillion, a 17% decline.

With credit limits declining more than consumer debt, debt to limits ratios must increase.

Insurers defend credit scoring by saying it is objective, factual and accurate – and that credit scores are color blind.

Objective, factual – as if all information was accurate and all relevant information was included. Not true. The fact that scores are produced by pushing data through a model does not mean the score is objective and non-biased.

The models include only credit information – no claims information is included – yet the modelers claim that the models are highly correlated with claims. If this is true, then the models could also be correlated with race or income, even if those characteristics are not used.

What models predict: When insurers talk to investment analysts who evaluate their stock, the insurers tell a different story than the one told to state legislators and regulators. Consider the comments of Ed Liddy, then-CEO of Allstate to investment analysts in 2005:

Tiered pricing helps us attract higher lifetime value customers who buy more products and stay with us for a longer period of time. That's Nirvana for an insurance company. That drives growth on both the top and bottom line.

This year, we've expanded from 7 basic price levels to 384 potential price levels in our auto business.

Tiered pricing has several very good, very positive effects on our business. It enables us to attract really high quality customers to our book of business.

Make no mistake about it, the economics of insurance are driven largely by retention levels. It is a huge advantage. And our retentions are as high as they have ever been.

The key, of course, is if 23% or 20% of the American public shops, some will shop every six months in order to save a buck on a six-month auto policy. That's not exactly the kind of customer that we want. So, the key is to use our drawing mechanisms and our tiered pricing to find out of

that 20% or 23%, to find those that are unhappy with their current carrier, are likely to stay with us longer, likely to buy multiple products and that's where tiered pricing and a good advertising campaign comes in.

It (tiered pricing) has raised the profitability of the industry.¹

As made clear by Ed Liddy's comments, insurance scoring is used to predict consumer profitability, which is not the same as predicting risk of loss.

¹ Partial Transcript of Presentation to Edward M. Liddy, Chairman and CEO, The Allstate Corporation
Twenty-First Annual Strategic Decisions Conference, Sanford C. Bernstein & Co., June 2, 2005.

Presentation of Findings: St. Ambrose Study on Credit Scores in Insurance: Consumer's Perspective

Date/Time: December 15, 2009, 10:00 am – 11:00 am

Location: ICN Des Moines Site – Department of Education, Grimes Building

Hosted by: Iowa Insurance Division

Agenda

- I. Introduction of Parties**
- II. Overview of Consumer Survey**
- III. Overview of the St. Ambrose Study and Findings**
- IV. Questions and Answer Session**

The Iowa Insurance Division will make every effort to make today's presentation available online at the Iowa Consumer Advocate website (www.insuranceca.iowa.gov). Follow up questions from today may be addressed to Dr. Randy Richards with St. Ambrose University at RichardsRandyL@sau.edu or (563) 333-6172.

Ambrose Study Questions:

1. The second paragraph reduces opposition arguments to belief that credit scoring is not predictive of claims and that credit scores have errors. There is no mention of opponents' most pressing arguments: That insurance scoring discriminates against minorities because credit scores reflect and perpetuate historical inequities, that credit scoring is inherently unfair because it penalizes victims of economic, natural or medical catastrophes and that insurance scoring undermines the critical loss prevention role of insurance by emphasizing a factor largely outside of the consumer's control and provides no incentive for reducing risky behavior.

a. Why are these criticisms not mentioned?

2. The report states that 60 out of 1,240 respondents acknowledged receiving an adverse action notification. And you conclude that, since only 3 of the 60 were minority consumers, there is no evidence of racial bias. (Please obtain answers to each lettered question before going on to the next.)

- a. There is no evidence of racial bias in what? Insurance scoring, generally; receipt of adverse action notices; or acknowledgement of receipt of adverse action notices?
- b. What statistical test did you employ as the basis for your conclusion that there is no racial bias?
- c. Are you aware of the percentage of policyholders receiving an adverse action notice with each policy renewal?
- d. Insurers send out adverse action notices related to insurance scoring to between 35% and 60% of policyholders. Yet, less than 5% of respondents acknowledged receipt of an adverse action notice. What do you conclude from this disparity?
- e. How does the disparity between consumers acknowledging an adverse action notice (less than 5%) and the far larger number who actually receive an adverse action notice affect your analysis and conclusions?

3. What is the basis for your statement that the correct answer which best describes insurance companies' use of credit score is "predicts the likelihood of risky behavior" on page 9?

a. Given that insurers have no definitive explanation for why credit scores are correlated to claims and that insurers argue that demonstration of correlation is sufficient and demonstration of causation not needed, why isn't predicts the likelihood of filing a claim the correct answer?

4. Have you ever looked at an actual insurance scoring model? An insurance score is based on much more than payment history, including type of credit accounts (whether or not the accounts are paid in full), number of credit inquiries (regardless of whether the accounts are paid in full), debt to credit limits ratio (regardless of whether the accounts

are paid in full) and other factors other than payment history. An insurance score also suffers from insufficient information – a thin file or no hit. Many financial institutions in low-income communities – check-cashing, rent-to-own, payday lenders – do not report to credit bureaus. Consumers who do not borrow money from traditional lenders, but who pay utility bills and rent on time show no credit information and get a low insurance score.

- a. Why did you rely on uninformed personal bias instead of researching the components of an actual insurance score?

5. You conclude that there is strong evidence that credit history predicts claims (page 10) and cite a number of reports. Do you think it is important to identify those studies sponsored by the insurance industry and not subject to independent verification? Why did you not do so?

- a. You cite as studies some reports that were only literature reviews. Do you think it is necessary to distinguish between a study and a literature review?

- b. Most or all of these studies have been criticized. For example, the EPIC study was funded by industry and performed by consultants who have received millions in contracts from insurers. The FTC study was limited to data hand-picked by insurers instead of data determined by the FTC. The NAIC concluded the Tillinghast study was not useful because it was a mere calculation of data hand-picked by Fair Isaac. Did you actually review these studies? Do you think it is important to review studies before you present them as authoritative?

6. Two independent studies –by the Texas and Missouri Departments of Insurance – have found that insurance scoring discriminates on the basis of race and income. The Missouri study found that race was the single best predictor of insurance score.

- a. Why did you not mention these studies?

- b. You performed no independent study to determine whether insurance scoring is predictive of claims, but concluded the evidence was overwhelming based on an incorrect citation of other studies. Your only evidence on racial disparity was 60 respondents who said they had received adverse action notices – a small fraction of those who actually did receive adverse action notices. Why did you apply such different standards to evaluating predictiveness of insurance scoring vs racial impact of insurance scoring?

7. You conclude that the evidence for the predictive power is overwhelming and that Iowa consumers should be educated to this “because their beliefs about this will have a strong influence on their sense of the fairness of the practice.”

- a. In your view, is correlation to claims – a rating factor is predictive of claims – the only criterium for whether a rating factor is fair? If not, what other factors?

- b. Given that race is predictive of insurance claims, is it your view that race is a fair rating factor?

- c. If a person's credit score is damaged and her insurance premiums goes up because of job loss or medical catastrophe, is it your view that such a premium increase is fair?
- d. Do you think it is fair for consumers who were the victims of predatory and reckless lending practices of banks – as evidenced virtually every subprime lender going out of business and near collapse of the financial system – do be penalized with higher auto and homeowners premiums because of insurance scoring?

8. Why did you not ask consumers – Assume that credit scores are predictive of claims. With this assumption, do you believe insurers should be permitted to use consumer credit information for determining auto and homeowners insurance premiums?

a. You allowed your personal bias – if a factor predicts claims, it is fair – to bias your report. The responses to question 14 are consistent with consumers believing that driving practices should be the main determinants of insurance premium – driving record, driving experience and miles driven. Were you not able to see this obvious result because of your bias?

9. You claim that consumers need to learn more about spreading the risk. Are you aware that insurers' are moving away from spreading the risk to ultra-refined risk classification systems? Do you think you should learn more about insurance scoring and insurance risk classification before you make recommendations based on your personal bias instead of on facts?

10. What percentage of your individual incomes and contributions to your departments come from the insurance industry?