STATE OF WISCONSIN

OFFICE OF THE COMMISSIONER OF INSURANCE

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Hearing on Insurer Use of

Credit Information

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TRANSCRIPT OF PROCEEDINGS

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Date: Monday, September 14, 2009

Time: 10:00 o'clock a.m.

Reported by NANCY L. DELANEY

TRANSCRIPT OF PROCEEDINGS, held in the above-entitled matter, at the Wisconsin State Capitol, 2 East Main Street, in the City of Madison, County of Dane, and State of Wisconsin, on September 14, 2009, commencing at 10:00 o'clock a.m.

B E F O R E:

SEAN DILWEG, Commissioner of Insurance
KIM SHAUL, Deputy Commissioner
BOB LUCK, Attorney for OCI
GUENTHER RUCH, Administrator for OCI

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MR. DILWEG: I thank everyone for coming today. When I scheduled this, I didn't realize it would be so close to the Packer/Bear game last night, so I apologize to those of you. I got to enjoy it in person, so I was back a little late last night, but I am the insurance commissioner, Sean Dilweg, and on my left here I have Kim Shaul, my deputy commissioner and then Guenther Ruch, who is our lead enforcement, head of our division of enforcement, basically. I don't know your full title there, Guenther.

We do have -- today we're going to spend some time on consumer credit and how it affects insurance and this is an issue that has been around for a while. It has came to light more actively here this last few years as one of our largest P&C companies in the state moved to credit scoring. We've put together a very good agenda today and have scheduled this hearing at the request of State Senator Lena Taylor, Representative David Cullen and Representative Terese Berceau, who has long been involved with this issue.

The issue that I see most pertinent as I look at consumer credit scoring is with the recent economic recession that we've been facing, how does that affect the credit scoring for individual consumers, especially in auto and property and casualty and should we be looking at how a personal financial catastrophe that you may have run through as an individual, through no fault of your own, affects your ability to get auto and home insurance, especially as we have moved to mandatory auto insurance.

I believe there's only one state left in the nation, live free or die, I think is their motto, so we have moved to mandatory auto insurance and this becomes even more of an issue. The last time we really looked at this issue, and I'll have Guenther Ruch here speak to that, was in

1997, so it has been 12 years since we've examined the issue. Right now, our approach is that of many states, where companies can use credit scoring, but really cannot use it as a sole factor for providing insurance or not providing insurance.

So I look forward really to having the panels before us. Let me just give you a brief review of the agenda and panels. After Guenther speaks to our current law, we have the first panel which really brings in a few complainants and consumers who have taken time out of their day to come in and discuss issues that they have faced. We also have Representative Berceau who would like to speak to the issue, as she's followed it quite extensively, and we have Birny Birnbaum from the Center for Economic Justice and I believe he was a past regulator in Texas.

Panel number two is looking at the TransUnion credit reporting agency, one of the three that handle credit scoring and also hearing from the agent representatives. Panel number three, we will hear from representatives of the insurance industry. We have four appearing from -- three from various companies and Neil Aldridge from NAMIC, which is the -- it is the --

MS. SHAUL: National Association of Mutual Insurance Companies.

MR. DILWEG: Okay. You tend to run into more acronyms in insurance than you do in state government. I will be trying to limit speakers to 10 to 15 minutes. We will have time at the end with 30-minute rebuttals. We do have a court reporter, as this is really a formal proceeding before my department and we will keep a record open and public comments available for the next 30 days. I am doing this at the request of the legislature.

I want to have a very deliberative process to look at the issues as we face a number of them on this and really provide a good recommendation to the legislature as a whole through the chairs of both of my insurance committees. So I do appreciate your participation and with that, I think we'll turn it over to Guenther and have you speak to our current law status.

MR. RUCH: Good morning. Thank you, Commissioner, for allowing me to give this presentation this morning. You know you're doing well when you come in and your commissioner doesn't know what your title is and then your sign falls off with your name, so it's going to be a fun day. Anyway, what I'd like to do is give a little bit of an historical perspective on the use of credit information in the regulatory framework of the use of credit information in Wisconsin.

I thought the way to start that would be that just to give a little bit of history on the use of credit information and basically, I'll say that credit information has been used for years in the commercial property and casualty lines. Not until the '90s, though, was there a start to use that information in personal lines, homeowners and auto, and that actually started with Allstate and Allstate, I believe, was the initial and primary advocate for the use of credit information and initially, the underwriting process for personal lines.

Allstate advocated this use with regulators by giving them, us, a lot of information with respect to the statistical correlation between claims activity, potential claims activity and a person's credit history and credit score. Then as time went on, more insurers in the personal lines area, in order to compete, also began using credit information in its underwriting and eventually rating criteria.

How credit information is used has also evolved. It was first used primarily or only for underwriting, assessing the risk of whether or not to accept that risk, both on new business and renewal. As it evolved, it was also used with respect to the rating of these personal lines, auto and homeowners policies. It also evolved from the use of the credit history to credit scores and then to insure scores and insurance scores have as a component, for the most part, as we understand it, credit information in the algorithms that come up with the scores.

It will be interesting from our perspective to see how that evolution has -- where it is today and how much of a factor that credit information is in the -- in those scores. Anyway, in 2001, we had a Milwaukee community organization meeting that was sponsored by our office and the CIIC, which is the Community Insurance Information Center, to discuss a variety of property and casualty insurance issues in the Milwaukee area, including credit and the use of credit in the underwriting and rating process for personal lines.

At that meeting, there were a number of concerns and issues that were raised by the consumer and community representatives to include things like disparate impact. There was a -- it was difficult for people to understand the correlation between someone's credit history and the risk that's being assumed, for example, like in a homeowners policy, what does your credit history have to do with a hail storm coming and doing damage to your home, so that was kind of a disconnect there.

Then also what the cost was to consumers as insurance companies more finely defined risk classifications. Out of that meeting, our office actually did a survey of the -- of about 80 percent of the market in homeowners and automobile business in the state. We surveyed 20 or 21 companies making up about 80 percent of the market and the report on that survey is on our website, so anyone can take a look at that whenever they want.

And just to kind of summarize it,

is that 18 of the 20 homeowners insurers surveyed at that time used credit in their risk assessment and 19 out of the 20 insurers surveyed used credit insurance -- credit information as part of their underwriting and rating process. So a substantial majority of insurers that write personal lines, homeowners and automobile in Wisconsin, use credit information in their underwriting and rating process.

As far as I know, not including the small town mutual insurers that are out there, there's about 70 of those, I believe there's only one company left in the state that doesn't use credit insurance, unless that's changed, but that was my recollection from a little bit ago. So what have we learned from our complaint process with respect to this issue? Well, in the complaint activity, again, basically the complainants talk about disparate impact, confusion, concern about non renewals and concern about rate increases.

And I just thought I would provide you, Commissioner, with a couple of numbers on that, and, you know, I'm not going to analyze those and give an opinion of them, but in 2005, we had -- out of 1445 homeowners and auto complaints, we had 16 that dealt with the use of credit information. In 2006, out of 1205 complaints, that went up to 22. In 2007 when our major domestic that has about 25 percent of the market entered into the use of credit information and informing its policyholders of that with a series of letters and so forth, we had 66 complaints, going from 22 to 66 out of 1350 complaints. 45 of those complaints had to do with that one insurer.

In 2008, there's been 64 complaints out of 1340 and so far in 2009, we have 22 complaints out of about 600, so out of the total number of auto and homeowners complaints, there haven't been that many with respect to credit -- abuse of credit information, so to actually get to the point of my talk here, so what is the regulatory framework in Wisconsin right now with respect to credit insurance. The use of a credit -- in the underwriting and rating process.

And quite frankly, we don't really have one. There are no statutes or regulations that prohibit the use of credit information. The only thing that we have so far to date is a bulletin that the Commissioner referenced to that we issued in June of 1997 and I can briefly go over what the provisions are of the bulletin. First of all, the bulletin is limited only to underwriting. It does not talk about rating.

It takes the position that the use of credit information should not be the sole determinant to refuse an application, cancel a new policy within the first 60 days of coverage or non renew an existing policy. Again, this is only for underwriting and the acceptance of risks. It suggests that insurers who use credit information in the underwriting process implement certain procedures to avoid possibly statutory violations of prohibited marketing practices.

That's in 628.34 of the statutes, that they have written underwriting criteria composed of quantifiable underwriting standards on how credit information affects the underwriting decision, disclosure to an applicant on items on the credit report that resulted in the adverse underwriting decision, consideration of any inaccuracies contained in the insured's credit report, use in making its adverse underwriting decision, consideration and establishment of guidelines relating to the timeliness and applicability of the risk being insured of the credit information the company utilizes, procedures to not use credit information on an unfairly discriminatory basis if the information is used only in certain circumstances and disclosure on the insurance application that it uses credit information and lists the circumstances under which it would order a credit report.

The statutory basis for these items, as I said earlier, are basically our unfair marketing and trade practices provisions in section 628.34. Wisconsin, however, currently does prohibit, with limitations, the use of certain criteria in the underwriting and rating process for automobile and homeowners business and that's in section INS .6 -- 6.54 of the Wisconsin Administrative Code.

An example of these prohibitions would include past criminal record, applicant's or insured's physical condition or developmental disability, applicant's or insured's past mental disability, applicant's or insured's age, sexual preference, moral character. The applicant's or insured's credit history, credit score or insurance score is not a prohibited criteria under current Wisconsin law.

I think we're going to have some discussion, for example, on the model and what some other states do and I'd be interested to hear how those are functioning right now, so that's about it. If you have any questions or anything, I'd be happy to answer those, thanks.

MR. DILWEG: Very good, Guenther, thank you for the Wisconsin background and review of the regulations at this time. Next I'd like to invite up the first panel. Thomas Hanby from Iola, Wisconsin has driven down today, Scott Ohlman from Waukesha and Representative Berceau will be here shortly and Birny Birnbaum from the Center for Economic Justice and what I'd like to do is have Tom and Scott go first.

And really, we reached out to them as we reviewed a number of complaints and they volunteered to come down and speak to the issues that they saw and so I'm just going to go -- I'll start with you, Tom, and then just go across the panel, so feel free to go ahead.

MR. HANBY: Thanks a lot for inviting me down here. It makes consumers feel good to be part of something for a change. What happened with me is I've been watching this credit report for some years and warning my insurance man, I said if you ever raise my rates because of this, well, I'm with American Family and I don't know if that's the one you said that doesn't do it, but they told me they were last in the State of Wisconsin to raise rates.

My auto insurance went up a little over $30 midterm this year. My homeowners went up 180 some dollars since last year. Roughly $90 of that was my own fault, I did a lot of improvements in the home, so they raised the price, so we're still looking at about a $90 increase which I am told is for my credit rating. Anything you want to ask me, I have nothing to hide. You've got a copy in front of you. I bought my house three years ago.

I first should say I declared bankruptcy in 2003 and in 2004, I managed to get almost $30,000 for my credit union for a new vehicle. In 2006, I bought my first home ever, no problem, they didn't even care if I put anything down. In 2008, the rates went down enough that I decided to put in a new furnace. I refinanced my house and this June, I refinanced it again. My credit union tells me my credit score is 714, which I thought was pretty good.

The reason he says the insurance company may be looking at it adversely is when Freddie Mac and Fannie Mae went under, they raised that from 700 to 740 to try to get rid of some bad debt in there and so now 714 is looked down on. My credit union is in Kaukauna, it's got maybe 30,000 members. It started out as a little thing in a paper mill down there years ago and they don't look at all this stuff. They look at the real hard facts.

I've got a job, I'm a good credit risk, but American Family or any other insurance company, I mean, I'm just a number, you know. I've been with them over 20 years. The last violation or ticket of any sort I got was in 1989, two days before Christmas, coming down over radar hill there by West Bend and I see the cop sitting there and I said nobody in his right mind would pick me up and he did, so maybe I was out of my mind, but these kind of things just bother me.

I made a couple of notes here quick. One thing I don't understand in some of the literature that your office sent me, Sean, is that you can write a person up because of their credit rating, but you can't refuse them and I think this is kind of a catch 22 and I think it would work better the other way around. Guenther, you had mentioned some things, that, you know, casualty lines -- I might as well tell you, I was an insurance agent at one time, didn't like it, got out of it.

MR. DILWEG: I meant to check your license.

MR. HANBY: This was back in the '70s, actually, but they used it for corporate casualty policies and things like that and I watch our government do this, too. If somebody is using something, they get money out of you, it's a good idea. You know, if it isn't, well, we're not them, we're not following them, we're ourselves. This practice, though, of using the credit rating, in my estimation, is a lot like the governments with taxes. They're always finding a new way to tax you, you know, and they never get rid of the old tax or curtail it.

We just keep paying more and more and more. When I work, I make a pretty good living and a couple of years, I kept track. I used to smoke, there's taxes on cigarettes. There's taxes on alcohol, I don't do that either. When you buy a hunting license, when you pay for your license plates, renew your driver's license, that money goes to the state and that's a tax. My state, Federal, FICA, and Medicaid, on average, as a single person, when I get done, I make over $30 an hour and I take home 47 percent.

This is ridiculous. They talk about us being a democracy. As far as I'm concerned, this is a socialistic state. I just decided that I am the guy that's got to keep people honest. There's a few of us out there. We make a lot of enemies, I guess, but I'm not concerned about that. I think this credit rating thing is a real, real injustice. I think it should be tossed out completely.

That's fine and, again, I appreciate having the opportunity to talk to you people. Thank you.

MR. DILWEG: Thank you, Tom. If you can stick around, I think what we'll do is go through each individual and then ask a few questions. Scott, thank you for coming over from

Waukesha today. Why don't you go ahead.

MR. OHLMAN: As you know, I've got a few things I'd like to talk about. First of all, I don't understand why the insurance companies are allowed to use credit reports at all, because they're selling a product. Most companies who sell products don't get to check your credit report first. I submitted my complaint because my partner and I made financial -- smart financial moves from one institution to another many times.

But the fact is used against us when it comes to our insurance premiums. The -- our credit score, even though it was 800, somehow our insurance score was 7, which didn't correlate and I finally figured out why, but just as financial institutions do, we hang on to our money for as long as we can. We pay the lowest interest we can and we find another institution to finance our debt when a better offer comes along.

Our financial situation is pretty remarkable. We pay $2300 a month in our mortgage. It's more than the necessary amount. We have two credit cards, one with a $100 limit that has to sit open, because if I close it, it will be used against me for insurance policies. We have another credit card with a high limit. We pay it off every month even if it kills us. We have no auto payments. We even have sensible vehicles that get good mileage. We're sensible people.

We have no other debts except regular monthly expenses, but somehow my credit card stayed at 7 for five years. We never had a late payment in our entire credit history. We're model citizens, model consumers, unless the financial institution is looking at good short-term gain, but because of inaccuracies in my credit report, the credit score, like I said, even though my credit report said my score was 800, the insurance credit -- it's called the insurance score, stayed at 7 for five years.

I would think that somebody with a credit score of 800 would get a 9. Just the other day, as you may have heard in the beginning of my statement to the office, when I called the AAA agent and asked them to pull credit score again, imagine that, my insurance score was up to 9. Before our last homeowners renewal, we received a notice that my premium was going to go up as much as $180, possibly because of our credit reports. I know this was quite a shock, since they had reduced it from over $1000 to $517 after a fire rating change or a protection class change.

The jump would have brought the premium to $697, but it only went up to $661, but that's still a 28 percent increase. I don't agree with the way in which the insurance companies obtain credit scores in the form of insurance scores, for that reason. There doesn't seem to be a correlation. One of the big things I seem to have figured out is insurance score 53, which seems to look at paid up, closed accounts, which are numerous in our case.

We rotated a zero percent balance for years and years and years between institutions, taking advantage of the teaser rate and a free $15,000 loan and finally paid that off in January before the 12 months on that card was up so that it would just be done. We've seen the economy going down, down, down and we've been preparing. That insurance score of 53, I believe, is what kicked in, even though our credit score was 743 at the end of the year or -- yes, credit score was 743 at the beginning of the year. That insurance code 53 looks backwards.

The way these credit scores are dispensed is another issue and they don't seem to be as accurate as they should be, especially when you're in the middle of disputing some inaccuracies in your credit report and I'd like to go over a few of those inaccuracies that we encountered. U.S. Bank reported our minimum payment is $1200 on a home equity line of credit when it was actually below $600. We had voluntarily signed up with their automatic payment plan, $1200 taken out.

They reported that as the minimum. In the middle of them fixing that, we went back to the variable rate option which brought the payment to under $200. They still didn't fix it. It took months and months and months, with the big three as I call them, the credit reporting agencies, to report this information through ChoicePoint or whatever to the insurance companies. Another credit -- let's see, on my partner's credit report, it still showed a $14,000 balance on there.

The card didn't show closed, joint card, it shows closed, paid off on mine and then after the U.S. Bank fiasco, we went to try to get a home equity line of credit through somebody else, because we were fed up with what U.S. Bank had done and because none of this was fixed, we didn't get that. Then there is also the timeliness of the information used. I have a chart here. Let's see, score indicators on my policies from AAA, the score factor codes, the score dates, the protection class and premium. Back in 2006, we were --

MR. DILWEG: Scott, if you're comfortable, we can have this put into the record, that chart.

MR. OHLMAN: I really would.

MR. DILWEG: Sure.

MR. OHLMAN: Because it really illustrates how they don't update the credit scores or the insurance scores on a timely basis. Some of this stuff is years old. You would think that at the time they're about to rewrite or renew the policy, that they would get current information and they do not and it was nice and convenient for AAA to keep that same score of 7 for us for five years when I had an 800 credit score and I think I deserve a refund on that.

There's no timely recourse, in any event, of an adverse action by an insurance company.

You have to go -- in AAA's case, I have to go through ChoicePoint, then back to the big three and you can wait for months. In the meantime, you've probably paid a ton more premium than you necessarily have to. My last point here, the very least I'd like to see done here in this forum -- not in this forum, but by the time any changes are made, I'd like it if insurance companies are still allowed to continue using the scoring, I'd ask, at the minimum, that the store information be obtained within two months of renewal, because they usually send a notice of getting any bill change in advance.

That would give them plenty of time, that if after the policyholder receives the premium statement and he or she disputes it, that the insurance company be required to provide a credit report, not the ChoicePoint or other scoring information, so the policyholders can review accuracy, and, three, that if the policyholder finds errors and within six months reports to the insurance company the errors are fixed, the insurance company be required to pull another report and use it to retroactively rerate the policy and refund or credit any overpayments from the consumer.

MR. DILWEG: Well, Scott, thank you and I do have a few questions for you, but we'll follow up at the end. Representative Berceau, I appreciate you taking the time to chime into this issue. I know it's been a big issue for you over the years and I do appreciate all of your efforts on this and the other thing I've learned about working with you and other state legislators is you all have unique driving records, so.

MS. BERCEAU: And we're not talking about that today.

MR. DILWEG: So I appreciate your time and would enjoy hearing from you.

MS. BERCEAU: Those have been cleared from my record and my insurance went down. I'm a danger on the road. Anyway, thank you very much, Insurance Commissioner Dilweg, for your interest in looking at this issue of credit scoring and its impact on consumers in Wisconsin and to the assembly insurance committee for calling for sponsoring this. I want to welcome my insurance friends who are here today. They know that I like them, each and every one personally, and I understand that they're just doing their job.

Last session, I did introduce a bill to end the practice of allowing insurance companies to use credit scores to determine the rate at which or if consumers would be able to buy auto and property insurance. This bill did have a hearing and did pass the Senate. The issue had come to my attention from a constituent who asked me to investigate why after years of paying premiums and no change in status regarding accidents, tickets or claims, he was told his premium was going up because of his credit score.

I thought it was an isolated incidents until I started receiving calls from insurance agents and that was the primary source of my calls for quite some time, who told me of having to tell their long-time customers that their rates were changing. The impetus for the calls turned out to be the Wisconsin company that holds 25 percent of the Wisconsin market for auto insurance had just begun to use credit scoring.

As a result of extensive reading and learning about credit scoring, I came around to the decision that it was indeed unwarranted for companies to use a credit score as a way of determining the cost of the driver's car insurance. The time honored formula of determining a person's premium cost based on their driving record, a formula that makes infinite common sense, was now only and is now only a part of the equation, and how much a part, and I think this is key, how much a part no one but the insurance company knows.

Because we have an eminent expert here to speak on the issue of causation and the effects in general of the use of credit scoring for the purposes of determining insurance rates, I will summarize my concerns. Wisconsin law already contains prohibitions against unfairly discriminating among insurance policyholders by charging different premiums or offering different terms of coverage, except on the basis of classifications related to the nature and degree of risk.

I believe the use of credit scoring is an often unfair discrimination against a class of people. It has come to my attention that the use of credit scoring is now expanding to other lines of insurance, including medical. This goes against the concept, meaning credit scoring goes against the concept of risk pooling and is clearly designed to cherry pick, the term used to describe selecting the customers who are least likely to cost the insurance company money, thereby increasing profits.

And I do want to show you that from my own insurance company, I did receive in my last statement a statement that says, "An insurance credit score is a credit-based statistical measure of the consumer's likelihood of filing an insurance claim," so they're pretty out front about what this is all about. Even before the current recession, credit scoring was already a troublesome practice, as it tends to discriminate against the young who have not established credit, the old, who tend not to use credit, and minorities who have difficulty obtaining credit and people who have had a medical catastrophe not covered or entirely covered by health insurance.

Credit scoring since the recession has become an even more serious public policy issue. The pool of people with adverse credit scores has expanded to include families who have experienced layoffs and thus have had difficulty paying their bills, particularly medical. People of all ages who are having difficulty finding decent paying jobs, if any job, are receiving a double hit when they discover any insurance they want and need costs them more because their credit score has suffered. I have heard from these people.

Credit scoring is based on credit reports, as we heard, and many sources, including Consumer Reports and others, who will tell you that up to 80 percent of credit reports have errors. Many people do not have the means to increase their credit score and thereby enjoy the benefits that the middle and upper class can and credit scoring has more to do with reducing claims, not helping people obtain insurance.

In summary, I believe that using credit scoring to determine personal insurance rates has become a new and expanded form of discrimination against consumers in Wisconsin who are at the bottom of the economic ladder and that it will result in fewer people having adequate coverage because they cannot afford it or possibly having no insurance at all. I believe it's a serious issue for legislators and the Commissioner to address and I hope the industry will agree as well, because insurance agents and owners also pay taxes and the uninsured and under-insured will cost all of us money one way or another.

The industry will tell you that this practice is a valid way for them to stay profitable and they will tell you that some people will benefit from lower rates. Yes, I agree with both, but let's remember, insurance rates were low in Wisconsin before, indeed for many decades before the use of credit scoring for setting rates. The industry was profitable then and is profitable now, but we as policy makers are not here to guarantee an industry profits.

We are here to protect the interests of all of our constituents, especially those most vulnerable. While we value the insurance industry in Wisconsin very much, we need to know that the industry understands that our democracy has survived and our people have prospered because we do maintain a balance of interests in our country, at least try to and we try to make sure that no one is taken advantage of and that everyone is given a fair chance to thrive.

Thank you and I do want to mention since it was brought up that in terms of insurance agents and how they've been responding to credit scoring, it was mentioned that Allstate was one of the first to use credit scoring and the National Association of Professional Allstate Agents has a statement after a study that they did that says, "Credit scoring is a secret methodology not subject to examination by insurance commissioners. Credit scoring appeared when companies were denied the ability to overtly red-line geographical areas and certain minority groups."

"Credit scoring is a new method of red-lining designed to replace the old method. Most adversely impacted are minorities, low-income groups and senior citizens." The National Association of State Farm agents has a statement that says, "We are opposed to any insurance company using credit scoring for the purpose of property and casualty underwriting." Adding, "We believe this form of underwriting is profiling clients who would otherwise be eligible for insurance."

There are other insurance companies with similar statements, I'll mention one more. The National Auto Agents Alliance issued a statement saying that, "Credit scoring is unreliable, inaccurate and so against the public interest as to endanger the insurance industry to the wrath of the public." The NAAA feels that credit scoring may even suggest a level of red lining that segments insureds into haves and have-nots and I am concerned as a policy maker that we have more have-nots.

They are finding it more expensive to buy insurance and I think that this is something that we need to take a look at in terms of its impact, because we do want our citizens insured. We want them to be able to afford it. We will all pay if they are uninsured. Thank you.

MR. DILWEG: Thank you very much for your testimony, Representative. Birny?

MR. BIRNBAUM: Thank you, Commissioner, good to see you today. My name is Birny Birnbaum. I'm the executive director of the Center for Economic Justice, which is a non profit consumer advocacy organization out of Austin, Texas. I've worked on insurance credit scoring issues since about 1992, first when I was the chief economist at the Texas Office of Public Insurance Council, then as the chief economist and associate commissioner for policy and research at the Texas Department of Insurance.

And since 1997, on behalf of the Center for Economic Justice, I've testified in front of state legislators and insurance regulators on dozens of occasions and followed the issue and testified before a regulators at the NAIC, testified before Congress on the issues, written a number of reports, I've also studied the credit scoring models. They are available in a couple of states, just recently in Texas, reviewing the credit scoring models there.

So you can see what's in the model, you can see what types of factors harm consumers and then you can go to published data and you can see how changes in, for example, delinquency rates would affect consumers, how changes in credit limits would affect consumers, how changes in the number of bankruptcies and foreclosures would affect consumers, so in a sense, this isn't rocket science. If you've got the models and you've got some public data, you can pretty much look and see what the results would be.

Not surprisingly, that examination is in sharp contracts to the claims made by credit bureaus, the modelers and the insurers, but what we have now is a crisis. There's a crisis on behalf of consumers, so this hearing couldn't be more timely. The number of consumer complaints simply does not reflect the problems in the marketplace, because consumers don't understand that credit is being used. They don't understand how it's being used and unless their rates have been increased at the point of the introduction of credit scoring, you're not likely to get a complaint.

When a lot of companies introduced credit scoring in the late '90s and early 2000s, there were huge numbers of complaints, because people -- a lot of people's rates were changing because of that. Here are the -- this is sort of a summary of the issues, the problems. Credit scoring is inherently unfair, and when I say it's inherently unfair, it's unfair on a public policy basis and a moral basis. It penalizes victims of medical and economic catastrophes and it produces arbitrary and illogical results and it's unrelated to how well a consumer, quote, "Manages," unquote, their finances.

Contrary to the insurance company claims or particularly the modelers' claims that credit scoring reflects personal responsibility, that blaming the victim strategy is patently untrue. Second, it's unfairly discriminatory on an actuarial basis. First of all, it discriminates on the basis of race, which is a violation of the law. Second, it violates actuarial principles, because it's not objective, it's completely arbitrary.

It discriminates on the basis of race because credit reports reflect and perpetuate historical inequities. Third, credit scoring undermines the core public policy goals of insurance. The public policy goals of insurance are, one, to help consumers recover from economic or other type of catastrophic events in their lives. We don't want a pay as you go system, because under that system, if you have a fire or an auto accident, you're ruined.

Well, the reason for insurance is to prevent that and Wisconsin, as most every other state, requires consumers to have auto insurance and homeowners are required to have homeowners insurance in order to get a loan, so there's public policy goals for universal coverage here. This undermines it, because what it does is it raises the rates for those who have the greatest difficulty affording insurance.

The second thing, the second core public policy goal of insurance is loss of mitigation. Insurance is supposed to provide economic incentives for less risky behavior and disincentives for more risky behavior. Well, credit scoring completely undermines that. Instead of providing real incentives, for example, to put in antitheft devices in your vehicle or your home, you have an incentive to manipulate your credit score which does nothing to reduce your risk profile.

Four, credit scoring is not needed. Insurers have a panoply of tools to segment the market and accurately rate consumers. It's simply not needed. In those states where it's banned, the markets are healthy. In Massachusetts, which partially deregulated its market in recent years, but did not allow credit scoring for auto insurance, new companies have come in, including Allstate and Progressive, two of the most aggressive users of credit scoring. Even though they can't use it in Massachusetts, they're in that market, they entered the market.

It's not in use in California, that market is profitable. Fifth, objective and independent data confirm the problems with credit scoring in contrast to the self-serving and unverified statements of credit bureaus, modelers and insurers. Six, we're not now just talking about auto and homeowners insurance, we now have medical FICO scores, so the problem is not just auto and homeowners, the issue with credit scoring is now moving on.

Seven, you have ample authority to reign in credit scoring abuses. The NCOIL model provides no substantive consumer protections and should not be a model that you look upon. As Representative Berceau mentioned, there are a number of agent groups that oppose credit scoring, including in addition to the one Representative Berceau mentioned, the Farmers agents group also opposes credit scoring.

Let me expand on a couple of these

things, but let me focus first on the crisis. We have had a financial crisis and a recession of a magnitude not seen in 80 years. The number of foreclosures in 2005, nationwide, was about 900,000. In 2006, it was 1.25 million. In 2007, 2.2 million. 2008, 3.2 million, four times what it was just three years earlier. In 2009 to date, we're on pace for 3.4 million more foreclosures country wide. We're talking about 7 million foreclosures in 2008 and 2009 alone.

Now, clearly, those are 7 million people whose credit scores are going to get impacted and over the last four or five years, we're talking about 10 million consumers. It's not just a one-time shot, it follows them. How about Wisconsin? In 2006, there were 7500 foreclosures in Wisconsin. These are data from RealtyTrac. By 2008, that had almost tripled to 25,000 foreclosures. In 2009, we're on pace for 42,000 foreclosures, a six-fold increase from 2006.

We're talking about almost 100,000 consumers in the last -- in four years entering foreclosure in Wisconsin. Now, the foreclosures were initially in the subprime market. They moved to the all day, which is still high rates, but not as bad as subprime, but now what we've seen is massive increases in prime loan foreclosures. Bankruptcies are up and this is after a law a few years ago designed to reduce bankruptcies. After an initial reduction, bankruptcies have now risen again and continue to rise.

A Harvard study published this year showed that almost two-thirds of bankruptcies were medically related, either because people didn't have health insurance, although even the majority of those with medical bankruptcies did have health insurance, because the cost of medical catastrophes was so great that people couldn't handle it and it forced them into bankruptcy. Does that have anything to do with how well you manage your finances, does that have anything to do with personal responsibility that you have cancer or some other dreaded disease and you go to a hospital and your insurance coverage doesn't cover it and you have bills in the tens or hundreds of thousands?

Well, if you're an insurance industry actuary, it's fair to jack up your homeowners and auto insurance rates, but I would suggest that from any moral perspective, it's not fair. Now, mortgage delinquencies and foreclosures are projected to continue at high levels for several years due to the resetting of interest only loans and high unemployment rates. The Census Bureau just released a report on income, property and health insurance coverage in 2008. Real median income declined from 2007 to 2008 by 3.6 percent, falling to the lowest level since 1997.

So while real median income is now at 1997 levels, consumers are still faced with lots of abusive lending practices, all sorts of hidden charges and relatively high interest rates. Given the interest rates that the Fed is setting, the spread between the rates that the Fed sets and the rates that are being charged to consumers is historically high. The poverty rate went up from 2007 to 2008 from 12.5 to 13.2 percent, the highest since 1997, 40 million people in poverty. The poverty rate for blacks was 24.7 and 23.2 percent for Hispanics.

The number of people without insurance in 2008 was 46.3 million or 15.4 percent of the population. The percentage of uninsured blacks and Hispanics were 19.1 and 32.1, so clearly, what we're seeing is the impact of the financial crisis, the impact of the recession is having profound impacts on consumers' financial ability, financial status and it is disproportionately affecting low-income and minority consumers.

Unemployment has risen. In January 2007, there were about 140,000 unemployed people in Wisconsin. The unemployment rate was 4.5 percent. In July 2009, two and a half years later, 276,000 were unemployed, an increase of about 150,000 people. The unemployment rate is now at 9 percent, and, of course, the unemployment rate understates the true problems, because there are a number of people who simply leave the -- you know, stop looking for work.

So all of these issues are clearly going to have an impact on the credit scores. Now, let's look at some of the financial market issues. How about lenders' decisions to cut credit limits, tighten underwriting and raise rates. Credit scoring penalizes consumers for the business decisions of lenders, even when those business decisions are terrible, even fraudulent, including excessive risk taking.

Consider some of the top subprime lenders from 2005 to 2007, Countrywide, $97 billion, gone, taken over by Citicorp. Ameriquest, $81 billion, gone. Option One, $65 billion, gone. New Century, $76 billion, gone. Fremont General, $62 billion in loans, gone. IndyMac, $26 billion, gone. Hundreds of billions of dollars in subprime loans by organizations that went out of business because of their business practices.

Why is it fair for consumers to be penalized for the ridiculous, excessive risk taking and fraudulent practices of business lenders? It's actuarially unsound. There are a number of reasons why credit scoring doesn't need actuarial principles. The basic actuarial principle is that a risk classification has to be objective. If you can manipulate a risk classification, then it's not useful.

Let's say that insurance decided that they had a database of hair to use for determining your rate and they had a score based on the length of your hair, the color, the thickness, et cetera. Well, that wouldn't make any sense, because you can manipulate it. You can put on a toupee, you can color your hair, you could get a haircut, you could let it grow longer. Well, when you think about it and look at credit scores, it's as arbitrary as hair.

Your credit scores depend on not just what information is in your report, but what information is not in your report. Fair Isaac has admitted that 20 to 25 percent of the population is unscorable with traditional credit information. Well, that's a huge portion of the population that clearly isn't uniform in terms of their risk characteristics. It also talks about how arbitrary credit scoring is. The information in three credit bureaus, the three main bureaus is different, and unlike mortgage lending where you get a combined bureau score, you don't have that.

So if your insurer happens to use one credit bureau, you can get a much lower score than if you had another credit bureau that had more information on you and in a Georgia hearing in which I participated, the representative of TransUnion testified that the difference could be substantial, the difference between being highly rated, a good policy, and basically a non standard policy. The data is warped by not only errors, but also information that doesn't get in there.

Some lenders decide they're not going to include the credit limits, so what happens is your balance becomes your limit, which distorts your balance to limits ratio which lowers your credit score. How about changes in credit bureau -- the definition of credit bureau reporting items. A bankruptcy today is different than it was five years ago because of the change in the law and yet the models are the same.

I was just in Texas looking at credit scoring models that were filed as recently as 2008 and this year. These were models based on -- these are filings based on models filed in Texas in 2003, based on data from the late '90s and early 2000s. Companies are using outdated models. They're using models when foreclosures and bankruptcies were at a much different level. A bankruptcy and a foreclosure today simply cannot mean the same thing in terms of an insurance scoring model as it did five or six years ago.

When foreclosures are five and six times more likely today, how can they mean the same as they did five or six years ago? We haven't seen auto insurance or homeowners claims increase by five or six times. How about the timing of reports? Your score can vary depending upon when the score is pulled. If it's right before you pay off your bill, it's going to be different than if it's say a few days later when you have paid your bill.

Credit scoring is arbitrary because it penalizes consumers for rational behavior. You go into a Kohl's department store and they say we'll give you 10 percent off on this massive purchase, your first purchase, if you get a Kohl's credit card. Well, that's great, I've just outfitted my house, I can save hundreds of dollars by getting this credit card which I'm going to pay on the spot by writing a check, except it hurts your credit score.

So there are lots of things that are irrational about this and the bottom line is that it's actuarially unsound. When you have a scoring factor that is so arbitrary, it cannot be actuarially sound. We haven't even talked about ID theft and how ID theft is one of the fastest growing crimes, how identification theft can lead to all sorts of problems for consumers' credit information.

Now, I want to talk briefly about data sources. Now, what I've noticed is --

MR. DILWEG: Just to give you a sense of time, I do want to spend about 15 minutes asking questions of the panel and I know, as Tom has informed me, being in the building trades here, you're due back to get to work tomorrow, so if you can wrap it up in about three or four minutes and then we'll ask a few questions.

MR. BIRNBAUM: Okay, let me just talk briefly about data sources. You've noticed that the data sources that I've used are public information, Census Bureau, Bureau of Labor Statistics, RealtyTrac, things that you can look at. But suppose I came in here and said I've done a detailed survey of a million consumers and found credit scoring discriminates against minorities and low-income consumers and was not related to risk.

You'd reasonably ask to see the methodology and the data to verify these claims and if I said sorry, the data are confidential, you just have to take my word for it, you wouldn't do that. Even though we have no financial stake in the outcome of this, we're just here on behalf of consumers, you wouldn't do that. And yet that's exactly what regulators and state legislators have done with insurers. They assume that the insurers and the credit bureaus are providing accurate information, even though the insurers and the bureaus have a huge financial stake in the outcome of the policy debate.

The 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 electricity trading in California benefited consumers out there. The credit bureaus come in and say scores are stable. There's no way to verify that. The insurers come in and say that stores are stable. There's no way to verify that, even though every bit of objective information says otherwise.

We do have common sense. We can look at the credit scoring models. We can look at the public information and I would say that insurers have a track record of misleading regulators. In 1999, when the debate was did credit scoring discriminate on the basis of income, the AIA produced a report. Our member company has done a thorough study showing no correlation. It wasn't true.

When Missouri did their study, they showed there was a profound relationship, as anyone looking at the data would expect, between credit scores and income. Now, let me just finish up by talking about the blaming the victim strategy and let me move back to what objective information we do have about credit scores being stable. We know that foreclosures and bankruptcies and delinquencies have gone up, so all of those things should be causing deterioration in scores.

So the explanation that Fair Isaac says is that scores have shown to be stable because consumers have gotten more frugal. Basically, consumers are -- you know, they're saving more, they're borrowing less. Well, what's the objective information? Well, the Federal Reserve has stated that the amount of consumer debt has gone down. Revolving debt declined 8.9 percent in the first quarter of this year and 8.2 percent in the second quarter.

Consumer credit overall declined

about 3.6 percent in the first and 5.2 percent. Let's contrast this with the reduction in credit limits. Experion and Oliver Wyman state in their second quarter market intelligence report that lenders continue to manage their risk exposure by aggressively reducing credit lines on revolving loans such as bank cards. Over the last 12 months, bank credit cards have declined from $3.8 trillion to $3.1 trillion, a decline of 17 percent.

So explain to me how reducing credit limits by 17 percent while consumer debt is only going down by five to nine percent can result in an overall improvement in the ratio of credit to -- ratios, it can't. So I want to just finish up by talking about one other piece of data that demonstrates the problem and this is with creditor placed insurance. Creditor placed insurance is insurance that the lender actually takes out and forces on the consumer when the consumer doesn't maintain required insurance.

So when you get a loan, a home loan, you're required to have homeowners insurance and if you don't, the lender tracks this, a lender will place the insurance and it's costly insurance. Country wide in 2004, there was $1.5 billion in creditor placed insurance for homes sold, 2004, 1.5, this is country wide. In 2007, it had doubled to $3 billion. In 2008, they had gone up another 25 percent to $4 billion. This is a huge increase. We're talking in five years an increase of 300 percent in creditor placed insurance, which means that people have let their insurance lapse.

This is -- one, it's either a demonstration that credit scoring has made insurance rates unaffordable for homeowners, or, two, it's a demonstration that the financial crisis is so great that consumers cannot afford to maintain their insurance and will get slammed by credit scoring. In Wisconsin, the data are in 2004, about $10 million in creditor placed homeowners premium, this is from the NAIC credit insurance experience exhibit.

By 2007, that had doubled over to $23 million, in 2008, $31 million, so from $10 million to $31 million from 2004 to 2008, so while Wisconsin is doing better than the country on average, it's not immune to the same types of problems that we've seen across the country. This is a serious problem. We have the worst financial conditions for consumers in generations. This is showing up in credit scores. It's patently unfair for insurers to be hiking consumers' rates because of terrible financial decisions by lenders and because of the worst economic crisis in a generation. Thanks.

MR. DILWEG: Thank you, Birny, thank you for the time and just so people do know, I am keeping track. Each panel will have approximately an hour, so I had a question for Scott and Tom and whoever wants to chime in, I think Scott, you touched upon some of the issues, but navigating correcting a credit score is very cumbersome from your perspective and, you know, are there ways -- and we'll have TransUnion up in the next panel, you know, are there ways to improve that, are there ways to address some of those issues?

Obviously, you can be disputing your credit score not only for insurance purposes, but other lending purposes and is that an issue that could be good to focus on as well?

MR. OHLMAN: Yeah, because ChoicePoint gives you an 800 number to call and gives you prompt after prompt after prompt. You can just go through the menus and get absolutely nowhere, but in the end, you end up getting a copy of a combined credit report from what I call the big three and then you have to really fight with the big three to get it fixed and if they can't get it fixed in a timely manner, you have to deal with the creditor or the lender or creditor themselves.

And in the case of that U.S. Bank fiasco, it took six months and there's no recourse, no provision by the insurance company to help you out in that, since they are the ones who incorrectly come up with the insurance score based on your credit score.

MR. DILWEG: Representative?

MS. BERCEAU: Yes, I wanted to state that we should remember that we have here a consumer who probably has access to a computer, who is educated, determined to correct the situation. I have a neighborhood of -- I have a broad territory, actually, in my district where I have consumers who don't have computers at home.

I myself am so busy that I haven't taken the time to pursue some of the things that he has, but people who don't have computers, who do not have a certain level of education, who do not understand what's happening to them aren't likely to be putting in the time and effort that this person did and I represent them, too.

MR. DILWEG: And Representative, what does bring me to -- as I look at some of the reports out there on credit scoring, when I turn to the 2005 GAO report on credit recording literacy, it starts to address that very issue of what the GAO found is that really less educated consumers, those of Hispanic origin and those with lower incomes and younger and older typically scored lower.

This was only on consumer credit literacy, it was not on credit scores, but it provided some insight into that and I want to ask Birny about some of these reports, but that does come to your point as well. One last thing, Scott and Tom, as far as you have been with your companies for years, I assume, when we spoke.

MR. HANBY: 20 years.

MR. DILWEG: I have a question of looking at renewals, should credit scoring be used in renewals, shouldn't it, that type of thing and so you obviously didn't have -- I think as we spoke, you maybe had a few, a ticket here or there or a minor accident, but you weren't a risk as far as vehicular violations?

MR. OHLMAN: No.

MR. HANBY: I'd just like to point out one other thing. You're probably not going to find it in all those studies and that either. When I got a little upset this spring, I checked every insurance company around my area, 10 to 15, somewhere in that neighborhood and when the conversation came up, all these agents told me they were spending about 25 percent of their energies just trying to keep their customer base because of credit rating.

MR. DILWEG: Thank you. Birny, just so people here in Wisconsin get a feel, the Center for Economic Justice, how many members do you have nationally? I know you spoke to it a little bit, you're based out of Austin?

MR. BIRNBAUM: Our members are private individuals and organizations and the membership, my membership is over 4000.

MR. DILWEG: And when I look at some of the reports done on this, I mentioned the

GAO report, but then I think there's the Texas Department of Insurance that did a study in '04 that I assume led to some of their approaches on credit scoring and then there's the Federal Trade Commission survey, which to me looked like something that they did to spend time doing a survey on credit scoring.

I guess I want from your perspective, I'll ask the same of the insurer panel, how do those stand up? And I referenced the GAO reports, and it's tangentially affected, but.

MR. BIRNBAUM: Well, first, let me talk about the Texas study. The Texas study -- there are two independent studies that have been performed. The Texas Department of Insurance study and the Missouri Department of Insurance study. The Missouri Department of Insurance study was really focused on the impact on availability and affordability and found that race was the single best predictor of your insurance score and it also found that income was a predictor of your insurance score, regardless of race.

The Texas Department of Insurance study was different, in that it went out and literally got millions of records, insurance records and matched them up to credit records, but it did it in two pieces. The first piece was looking at the impact on minorities. It found strong impact on minorities, credit scoring discriminated on the basis of race and income. Then they did a separate part of it which was to look at the correlation between credit and risk of loss.

They also found that credit was related to risk of loss. What they didn't do was combine the two to see if credit scoring was predictive of race which was predictive of losses. In theory, that's what the Federal Trade Commission study should have done. Now, let's get to the Federal Trade Commission study. The Federal Trade Commission study is basically fatally flawed for two reasons.

One is that instead of going out and obtaining the data needed for a study, it used the data that the insurers were willing to give. Basically, it used data that insurers had done with -- basically, it hand picked data by a handful of insurance companies, so there's no ability to make sure that the data were not biased or anything. In the Federal Trade Commission study, the questions were so strong that one of the commissioners of the Federal Trade Commission voted against publishing the study. It's unheard of.

The Federal Trade Commission did the study on auto, they're now doing a study on homeowners. The study on homeowners is completely different, in that they're actually going out and saying here's all the data that we need, we're using subpoena power to get the data, which is a tacit admission that the prior study was not reliable. So let's get to the FTC study. It used hand picked data.

MR. DILWEG: I guess what I'd like to do, I wanted to get kind of a general feel from you and then I would appreciate written comment on those studies and I'll ask the same of the insurer panel, but that gives me a little general feeling in this format, so if you could put something down in writing as well, that would be great.

MR. BIRNBAUM: I'd be happy to, my testimony before Congress. The bottom line on it is the FTC study used data hand picked by insurers, so if you're able to sort of select the data that's used in the study, you can get the outcomes, but even with the hand selected data, the Federal Trade Commission still found bias on the basis of race.

MR. DILWEG: One last question and I think it's maybe to you, Birny, is if -- let's say Representative Berceau's bill were to pass and become law in Wisconsin, and I hear that as you talk to the insurers, one of the arguments is that then you have those people who have a good credit history paying for those who do not. If you could touch on that and there will be rebuttal time as well, but.

MR. BIRNBAUM: Sure, I think this is a cynical ploy used by insurers and trade associations to basically threaten legislators. They're basically saying if you ban credit scoring, we're going to raise rates on a lot of your constituents and you're going to get tremendous complaints because of these raised rates.

The fact of the matter is, one, how could it be that somebody who has a 30 point difference in their credit score on a scale of 300 to 900 or 300 to 850, how could it be that somebody with a 30 point difference could be so much of a greater risk. The fact of the matter is that insurance is about pooling of risk and even without credit scoring, you can segment the population in very refined ways that identify risk, that allow people to reduce risk of loss, number one.

Number two, my own studies of actual rate filings when companies implement credit scoring show that about 50 percent of people get an increase, 50 percent get a decrease. When you factor in the fact that credit scoring doesn't lead to loss mitigation, my guess is the majority of consumers suffer from credit scoring and that if you ban it, the majority of consumers would eventually benefit from not credit scoring.

Point three, why would insurance raise rates on their most preferred customers, because if they raise their rates of the most preferred customers, somebody else is clearly going to be jumping to write that person.

MR. DILWEG: Thank you. Kim or Guenther, do you have any other questions?

MS. SHAUL: I just had one

question. Birny, you mentioned Massachusetts does not allow the use of credit information, how many other states currently have a ban?

MR. BIRNBAUM: California for auto insurance, Maryland for homeowners insurance, Massachusetts for auto insurance, Hawaii for auto and homeowners, all sorts of insurance, Oregon doesn't allow it on renewals. There are other states that have a few different types of changes, but I did want to just briefly mention what was done in Texas.

What the Texas legislature did in response to the problems with credit scoring is they gave the commissioner the authority to ban it. They said that the commissioner can basically decide what the maximum impact on credit scoring can be and the commissioner could have said zero. This is similar to what Maryland does for auto, which they say you can only have so much of an impact.

The other thing that Texas did is they had a provision for life exceptions, in other words, catastrophic events. They put something in the legislation about that and the third thing is they made the filings public. Now, even with that, those are all things that are above and beyond the NCOIL model, which -- but the fact of the matter is that those things still don't address the problems.

You asked the question earlier about how you fix -- how do you fix a bad credit score. Well, one, the notices that you get are very poor. They give you very little information on what exactly in your credit report was the problem and use those explanation codes that are completely mysterious to consumers. Then you get the three card monty, well, call --

MR. DILWEG: We'll spend some time this afternoon on that, but I don't have any further questions at this point on the first panel and I really appreciate your time and effort and Representative, your time and effort on this issue. What we're going to do is just take a brief break to switch out the panel.

We have up next Eric Rosenberg from TransUnion and Ron Von Haden from the Professional Insurance Agents of Wisconsin. We'll spend an hour with them and then take a lunch break at about 12:30, so thank you, gentlemen, for coming in and Birny, I know you'll be here all day.

(A short recess is taken)

MR. DILWEG: Thank you. For our second panel, we will start with Ron Von Haden, is that how it's pronounced?

MR. VON HADEN: Von Haden.

MR. DILWEG: From the Professional Insurance Agents of Wisconsin. Ron, you have been an agent for more than 30 years?

MR. VON HADEN: Yes.

MR. DILWEG: And you're located in Boscobel, correct?

MR. VON HADEN: That's correct.

MR. DILWEG: Why don't you start off and then we'll go with Eric next from TransUnion.

MR. VON HADEN: Thank you, Commissioner. I appreciate the opportunity and the invitation to be here. As you said, I have been in the insurance business for perhaps more years than I will care to admit in public, but it goes back to the very early '70s. I do along with my wife own an independent insurance agency in the small town of Boscobel, which is 70 miles west of here. In addition to that, I am the executive vice-president of the Professional Insurance

Agents of Wisconsin, which is a trade association representing approximately 3500 independent insurance agents and their staff located all across the State of Wisconsin.

I want to say that the issue of insurance scoring has been challenging for agents since it first arose many years ago, as we've heard the history from Guenther, and in fact, when the concept of somehow relating insurance pricing to credit history was proposed, I was an enormous skeptic and I said there is no way that you're going to tell me that you can predict I'm going to run my car into a tree because I didn't pay my Sears bill, I couldn't grasp it.

I refuted it and said it's not going to happen, it will never fly and then a revelation happened. I became a believer, I guess, after a number of years of talking with agents, seeing the results of credit scoring, seeing some of the studies that have been done across the country and I now do believe that -- I do believe in the concept. I believe the concept is valid.

The agents that I work with, the agents that I represent from all across the state tell me they see definite trends in their individual businesses. Those consumers with higher insurance scores have a lesser number of claims. Those consumers with lower insurance scores generate obviously higher premiums and they have more claims and they require more service time, just like the gentleman was talking about, talking to an agent that -- or talking to agents saying that they were spending 25 percent more time dealing with insurance scoring issues, that may be borne out.

Agents are spending an inordinate amount of time with those folks who have troubles with their insurance scores or have had claims or both. It costs them a great deal more time than dealing with folks who have higher scores and lower premiums and typically have less claims activity. I find it somewhat interesting even that when Mr. Birnbaum stressed the increase in foreclosures and bankruptcies. In my unscientific minds, that relates to foreboding an increase in insurance claims.

It seems to be a direct correlation between increases in foreclosures and bankruptcies and insurance claims activity for those people involved, so he's actually convinced me more that there is a correlation, rather than convincing me that there's less of a correlation. Are there some issues with insurance scoring, certainly, there are. Is insurance scoring perfect in every situation, absolutely not. I don't believe you'll ever find the ultimate mechanism to predict insurance claims activity.

It's always -- there's always risk factors involved that we cannot accurately predict. Sometimes there are incidents when life changes and a couple of them were mentioned earlier, divorce, loss of a job, identity theft, medical emergencies, all can have a negative impact on insurance scores and those negative impacts may not be totally warranted at that time because of the unusual nature and circumstances surrounding those life changes, but I do believe that the insurance companies have made grade strides in trying to refine the accuracy and predictability of their ratings structure and they kind of take those things into consideration.

From an agent's standpoint, the most challenging aspect of scoring is the fact that they are on the front lines. They're the people who sit across the desk from a consumer. When a premium increase occurs, the agent must explain the rationale. Now, you have to understand that rationale is not usually met with a smile and a shrug when the premium has just increased, but it's the agent's job to go through the explanation anyway.

Fortunately for many consumers, independent agents like the ones that I represent are able to search many -- through many companies and perhaps come up with a lower rate, because the variance from company to company can be substantial on a credit score, because of the different factors that they build into their own unique insurance company's scoring process. In my analysis, I guess, of insurance opinions and dozens and dozens of agents, elimination of the use of insurance scoring would be very detrimental to many, many consumers, especially those who are the most conscientious, who take the time to pay their bills, manage their credit usage.

Those people would have, I believe, an unwarranted premium increase if credit scoring were to go away. I use credit scoring -- I do that all the time and should never do that, for me it's insurance scoring, but if insurance scoring goes away, we're going to see some of the best customers that we have get a hit. They are going to see a premium increase.

Now, is that going to be a little bit tough for an agent to sit across the desk from them and explain to them that, yes, you're getting a rate increase and the reason that you're getting a rate increase is because someone else is getting a rate decrease, and yes, they may have a poorer insurance score than you and they may have more claims activity than you, but in the interest of fairness and pooling of all of this data and rates, you're going to have to pay for it.

That is going to be a very tough pill for the very best of the best customers to swallow and it's not going to put agents in a very comfortable position. I did pick up on something else that was mentioned, the American Family -- National Association of American Family Agents and I think the National Association of State Farm Agents were mentioned this morning.

MS. SHAUL: It was Allstate.

MR. VON HADEN: Both of those groups were opposed to the continued use of insurance scoring or relatively of credit to rates and I will tell you that it is my understanding that it might be a touch misleading, because the percentage of American Family agents and State Farm agents who belong to and participate in those two groups is very, very small relative to the total number of American Family agents and State Farm agents.

So I'm not too sure that's reflective of the average or the general American Family or State Farm agent, although I don't represent those people and can't speak for them totally.

MS. SHAUL: Just to clarify for the record, it was the national group of Allstate agents.

MR. VON HADEN: Not American Family.

MS. SHAUL: That Representative Berceau referenced.

MR. VON HADEN: Thank you very much, and the same thing applies, relatively to the size of the people belonging to the group versus -- in relation to the total number of agents, it may be skewed a little by saying that they're against insurance scoring. The bottom line for me is I feel that insurance companies should continue to refine their systems so they are as statistically accurate as possible and that credit scoring, insurance scoring should not be abandoned at this time.

It's my opinion that the insurance changes in the recent state budget probably have a much more adverse impact on consumers than insurance scoring. Thank you very much.

MR. DILWEG: Ron, thank you and I'll turn to Eric Rosenberg from TransUnion and if you could describe a little bit how TransUnion fits with -- I think there's basically three big -- you have two other major competitors, so if you can touch upon that a little bit, that would be helpful.

MR. ROSENBERG: Thank you, Commissioner Dilweg and staff for inviting me to speak to you today about insurance scoring and how it's used and I hope to shed some light on understanding the development of credit based insurance scores and the trending of these scores in light of the current economic conditions. TransUnion is one of the three principle consumer reporting agencies. We're headquartered in Chicago.

How we relate to the other three -- the other two bureaus is there's three principal bureaus, TransUnion, Equifax and Experion. We all provide raw credit data to businesses across the globe who want to make risk decisions about folks they want to do business with. We also -- TransUnion provides insurance scoring models that are used by carriers across the country. In that light, we compete with Fair Isaac and ChoicePoint who are other third party modelers.

So all of us take the raw data, make scores and then insurance companies then can use either a proprietary model, some have their own proprietary models, or they can use the third party model or they can choose not to use one all together and not use scores. We provide objective credit reports and credit based insurance scores. The security and accuracy of our information are our highest priorities.

Our insurance scores are developed to be completely transparent at every level of the policy cycle. Our hope is that agents and consumers would have a clear understanding of the credit characteristics impacting each score and how scores may potentially be improved or may not be improved. With each insurance risk score adverse action reason code message that consumers would receive, we provide a clear explanation detailing why the score is less than ideal.

All characteristics and algorithms used by our scores are available upon request by consumers and they provide a clear understanding of all the credit elements that impact the consumer's insurance score. All of our insurance scores that are used by our customers as well are based exclusively on objective, factual, accurate credit report information, including consumer accounts such as credit cards, retail store cards, mortgages and auto loans.

Also included is public record information including bankruptcies, liens, judgments and collection accounts. In addition, the scores take into consideration consumer initiated inquiries associated with the request for new credit accounts. Multiple consumer generated credit inquiries associated with shopping for a mortgage or auto loan are deduplicated to minimize the impact on the score.

All this factual information is received from tense of thousands of financial institutions, retailers and courthouses on a monthly basis.

I should also note what is not included in any credit report or score. That is medical history and records, consumer buying habits, checking and savings account information, income or any other prohibited characteristic identified by the controller of the currency, which includes information regarding marital status, race, age, religion, family status, color, receipt of public assistance, disability, gender or national origin.

As Ron mentioned, it is important to note that while the term credit score is often used interchangeably by many for credit and insurance decisioning, they are not synonymous. Credit based risk scores are designed to predict the likelihood that an individual will repay their credit obligation, while an insurance score is designed to predict loss ratio. Our insurance risk scores were designed to meet the needs of our customers who desired a transparent, objective and accurate predictor of consumer insurance risk.

Our scores were developed from a

pool of policies collected directly from many different insurance companies. We analyzed approximately 1.1 million consumer accounts, accounting for about $741 million in premiums with claims amounting to about $540 million from 127,000 claims. The average loss ratio was 73 percent and the average premium was $650. The claim frequency totaled .11 per consumer and the average claim was $4200.

When we developed the scores, we looked at approximately 2000 predictor candidates from all the credit characteristics. You really can slice and dice the credit information in an infinite amount of ways and obtain one year prior -- the accounts one year prior to establishing each consumer's loss ratio. We use logistic regression in determining that only certain credit characteristics should be included as part of the insurance score, only those that were highly related to loss ratio, and that includes about 75 characteristics out of the more than 2000 that could be used.

Some of the credit characteristics include, for example, the number of collections within five years, percentage of all accounts with balances greater than 50 percent of the limit, months since the oldest bank card account has been opened, the average balance of financial installment accounts, number of previous bankruptcies and ratio of total balance to credit limit for all credit accounts.

What is important to note, once again, is that each credit characteristic is highly correlated to loss ratio and this correlation has been studied and verified by our customers time and time again, independent actuaries time and time again, state departments of insurance, including Virginia, Alaska, Arkansas, Texas, et cetera, and Federal regulators, including the Federal Trade Commission. We continue to study our models and their performance in light of changes in the economic landscape.

Thus, for this hearing, I'm going to provide our perspective on two major questions, including the trend and volatility of credit based insurance scores and how actions taken by lenders to minimize their risk exposures are impacting credit based insurance risk scores. We studied approximately 28 million consumers from each of the 12 most recent quarterly archived credit files and each of the different consumers sampled was scored by all three of our developed risk scores.

In addition to appending the score from each risk model, thousands of credit characteristics were also appended to the approximately 340 million unique credit reports in our analysis. What we found was that during -- from the first -- fourth quarter of 2005 through the second quarter of 2009, the national averages for our risk scores, our insurance risk scores for all three models exhibited very small fluctuations.

As an example, during this time, the national average auto insurance risk score, which ranges on a scale of 150 to 950, shifted from a low of 840.7 in the first quarter of 2006 to a high of 843.7 in the second quarter of 2009. That's only three points in an 800 point scale. The most recent national average as reflected in the second quarter of 2009 is 842.7, so it's a very narrow band in which it's moving at all.

The national average risk scores show -- for our property and combined auto property models, also show very similar fluctuations. In general, our insurance risk scores exhibit far less fluctuation than our credit risk scores and that's because credit scores are inherently more volatile, because they rely upon various forms of revolving credit utilization, recent new account openings and recent delinquencies more heavily than the insurance risk scores.

Although different aspects of the utilization, account openings and delinquency are contained within our insurance risk scores, these are defined differently and not weighted as heavily as our credit risk scores. Our insurance risk scores tend to place more emphasis on credit characteristics that demonstrate a consumer's depth of credit history, as reflected by the number of and type of accounts maintained over time and a longer term view towards account delinquencies.

A recent concern regarding credit based scoring systems, and particularly insurance risk models, is that proactive actions taken by lenders to reduce potential losses by lowering revolving credit limits may artificially lower a consumer's insurance score. We've heard that during the testimony previously. The assumption is that this would penalize consumers in the form of higher premiums and less favorable terms to the consumer.

However, based upon our analysis, it appears that from an insurance risk score perspective, the action of lowering revolving credit limits has not played at all a significant role in the small fluctuations that are in our national averages or Wisconsin averages for insurance risk scores. This is attributed to the manner in which credit utilization and credit characteristics are designed and weighted within our risk scores.

For example, revolving credit utilization credit characteristics are included in credit risk models, but by the themselves, they are not included in the calculation of our insurance risk scores. Based upon empirical evidence uncovered when we developed the insurance risk scores, only a few credit utilization characteristics of the dozens tested were highly correlated to insurance loss ratio and then subsequently included within the models.

In addition, a majority of the

credit characteristics calculated credit utilization as a function of consumers' revolving credit limits, combined with the original installment loan amounts. This different approach dilutes the potential impact associated with a lowering of revolving credit limits. So I'd just ask as you review the subject insurance scores in this hearing and beyond, I ask you to consider a few points, that our insurance risk scores and many of our -- many of the other providers are completely transparent to consumers and insurance companies within the entire cycle of the -- the policy cycle.

That our insurance risk scores and our competitors' risk scores do not use any variable that unfairly discriminates against any class of consumers, that insurance scores provide many benefits for consumers and insurance carriers, that a number of valid studies show a high correlation between credit data and future insurance losses and that credit data are highly predictive of such losses and analysis of TransUnion credit based insurance risk scores show they are not volatile, rather, they are stable and continue to be highly predictive.

Once again, I thank you for the opportunity to speak with you today and stand open for any questions.

MR. DILWEG: Thank you, Eric. Ron, I had a question for you, just do you find -- obviously, as an independent agent, as you attested to, you need to find insurance for individual consumers, but when I look at it as they face a credit score or insurance score issue, you said about 25 percent your time or their time is being spent on this issue, or I mean, give me a feel for that, and then another question I had, do you guide them? I assume there's still some companies out there that don't use credit scoring and if you have someone who's struggling, do you guide them to those companies? That would just intuitively make sense.

MR. VON HADEN: I think, first of all, the 25 percent comment was made by one of the previous panelists and I think he said when he was checking with other agents, the agents were telling him they were spending about 25 percent of their time dealing with credit scoring problems or issues with their customers. I don't believe with the independent agency force, I certainly couldn't put a valid percentage on it.

Yes, they do spend a considerable amount of time because of the fact that they rate most of their customers with a multitude of different companies to find out who has the best rate and I've forgotten the second part of your question.

MR. DILWEG: Just that, I mean, you're kind of getting to it, as you look at all the different companies, if someone is not using credit scoring, you know, would there be --

MR. VON HADEN: There are some companies who don't use it, I'm aware of some and if the independent agent has a contractual relationship himself with that company, certainly they would look at them, just as they would look at any other company, to try to find the place where the consumer can get the best pricing and the best deal, the best policy and coverages, I'd rather say, but agents are very aware of which companies use scoring and which don't.

They have those built into a lot of their rating -- their computerized comparative rating mechanisms right now.

MR. DILWEG: Eric, a few questions

for you that I have and then I'll turn it over to others. I assume you work with companies licensed in all 50 states and so you are -- and I think we visited this in the past, you need to interact with all of those various regulations for those companies, could you speak to -- I mean, as far as an agency, you have been able to work with all the different regulatory structures that are out there and the demands on insurance or credit scoring, is that correct?

MR. ROSENBERG: That is correct. All of our models and everything we do as a business is regulated by, first of all, the Fair Credit Reporting Act, the Federal law that governs all of credit reporting and governs the way insurers do business with consumers when they use credit information. Secondly, we must deal with all the Federal regulations that impose restrictions on the use of credit reports for equal opportunity or for restrictions on whatever might go into the specific model.

The same thing at the state level, we can't develop an insurance model and take it out to the marketplace without considering what laws and what restrictions govern what goes into the insurance scoring model or what may be included in the insurance scoring model, so whenever we roll out a new product outside of insurance or including insurance, complying with the law is, of course, our number one obligation.

MR. DILWEG: And I'll ask the companies as well, but when I start struggling with some of the policy issues that I and the legislators will struggle with, if we were to list 10 catastrophic events, be it losing your house, losing your job, I did notice that you don't track medical problems and I recognize medical issues can cause major financial hardship.

How do you -- do you have to handle that in other states currently? And I'll probably be asking the companies that as well.

MR. ROSENBERG: I guess you're asking how do we --

MR. DILWEG: I guess one question I had is is there an issue with that approach or are you better off taking the Maryland approach where you can't swing more than 10 percent based on a credit score, I mean, you know, there's various ways to address some of these issues and so I'm trying to just -- from your agency perspective, I know the companies will have an opinion, but you must have implemented Maryland's law and you must service companies in Maryland and must have some other states that require exceptions, so if you can give me a feel for that.

MR. ROSENBERG: First of all, let me preface this by saying we only provide the objective credit information and so we don't do the rating, so I wouldn't know really, for example, about the fluctuations in capping or adjusting things for Maryland, because that would be really done with the rate setting or the underwriting and that's really not what is germane to our business.

But I can say, for example, that Federal law prohibits medical information from being included within the credit report. The Fair Credit Reporting Act was amended in 2003 and specifically forbids any sort of medical notations besides a medical collection code, which would be an M code, from appearing on a consumer credit report and the reason for that is you don't want that information to be used against a consumer if they have a medical catastrophe or some other situation from adversely affecting their ability to get employment or insurance or other sort of benefits.

You don't want a notation that somebody visited a Betty Ford clinic to infer that they might have received drug and alcohol treatment, so that information is not included and is not part of any sort of score and thus, all the other protected information that we can't include can't be part of a score as well. Other things like when you go out and you seek your own -- seek -- check your own credit report or check -- try to get employment or even an insurance policy, none of that can be included in a score.

Also, the models are adjusted so that if you're shopping around for autos or for cars or for a home, all the inquiries within a 30-day period are deduplicated and show only as one inquiry. Now, as far as catastrophes, we certainly at TransUnion and our credit database don't really -- we don't understand the background of why a consumer's situation is the way it is. We leave that to the relationship that an agent might have, an agent might have with their prospective customer or their existing policyholder to explain to them.

We encourage our customers to have a manual review policy, that if a consumer has extraordinary life circumstances, that they potentially will go through manual review to either consider these extraordinary life circumstances such as a divorce, a medical catastrophe or some other major catastrophe. For Hurricane Katrina, we set up hotlines and worked with insurance companies and the like to address those concerns.

But certainly, at our level, what we can do is we can take up to a 100 word statement from a consumer noting their situation and we'll pass that on to an insurance company for them to consider when they're rating or underwriting that policy.

MR. DILWEG: So you would just -- and then I'll turn it over to Kim, and obviously for HIPAA reasons, I understand the medical issues, but you would know if Froedtert Memorial Hospital has a collection out on a consumer, when you say collection code, I mean, if it was a stressful medical problem, so you would just have that piece of it?

MR. ROSENBERG: We wouldn't have

the name of the institution. Well, we do and that's only communicated directly to the consumer, but it wouldn't be shown directly to the insurance company or the -- or any other lender. You wouldn't have any idea of who that -- who would be doing that collecting, it would only say an M code for a medical collection and it would be for a specific amount that they would be trying to collect.

Normally, you know, to do collections, medical institutions are 180 days to 360 days even to 720 days before they send things to collections through the bureaus, so they're usually very forbearing with their activities, because they realize -- what they want to do is more of the counseling up front so they can reduce some of the collections at the end.

MR. DILWEG: The hospitals tell me they've brought a lot of the charity care, so I just assume they don't collect those things. I'm kidding.

MR. ROSENBERG: Well, in fact, the charity care is the way they use consumer financial information as a way to determine and verify that a consumer would be eligible to get charity care. Because we have consumer financial account information, they'd be able to verify a consumer's information to do -- to determine charity care and that's really what you're talking about when you're talking about a med FICO score, it's to determine and help the hospitals assess who can receive charity care, not to red-line them out of receiving service.

It's a segue out of this sort of topic, but I'm happy to talk about that at another time.

MR. DILWEG: Thank you, Eric. Kim?

MS. SHAUL: Thank you. Eric, can you spend a few moments talking through the process TransUnion uses when a consumer has a dispute regarding information contained in their credit report?

MR. ROSENBERG: Sure. As it relates to -- first of all, what's going to happen is there's a couple different avenues and I suppose you want to know how --

MS. SHAUL: So let's say I call your 800 number.

MR. ROSENBERG: Well, first of all, normally consumers receive an adverse action notice from an insurance company and in this case, right, that adverse action notice will state the name, the address and the telephone number of the consumer reporting agency, such as TransUnion, which provided the credit report. It also must include, and it's specific under law, the statement that the consumer reporting agency did not make that decision to take the adverse action and is unable to provide a consumer with specific reasons why that adverse action was taken.

That notice also must contain a notice of the consumer's right to obtain a copy of their credit report and also gives notice of the consumer's right to dispute that information. So the consumer normally will contact the consumer reporting agency, such as TransUnion, to receive a free copy of their credit report. Under law, we're obligated to provide that consumer a free copy if they want to dispute something on their credit report.

MS. SHAUL: So I've got the copy and I see a problem.

MR. ROSENBERG: Once they review it, if they see a perceived inaccuracy, and I say perceived because everybody has, you know, a different level of what they think might be in their account or might not be, sometimes they don't realize that they have something on there that should be and sometimes there are inaccuracies. I would say we strive to be 100 percent accurate, but that's just impossible, given everything -- all the information.

We're required then to investigate that dispute and get back to the consumer with a resolution within 30 days and 45 days in certain circumstances involving public records. If a dispute can't be verified, the information must be removed in the consumer's favor. Under the fact act, consumers -- and this is going through rule making right now, the FTC rule making, they will be -- they should be able to resolve disputes directly with the creditors.

And so if there's a correction made to the credit report based upon the dispute resolution, then consumer reporting agencies such as us will send the consumer a corrected copy of their credit report. All of this is -- all this dispute resolution is done uniformly. It's done electronically via what we call the e-OSCAR system and that's an online solution for complete and accurate reporting system that was established by the three major consumer reporting agencies and our trade association to service in a uniform way all of the -- our 85,000 plus data furnishers. It resolves things rather quickly, efficiently, user friendly and accurately.

The majority of all disputes are resolved within seven days or less and an additional 18 percent are resolved within days 8 to 14, so more than 80 percent of the disputes are resolved within five days and most -- and the rest happen within 8 to 14. The reason why a dispute might drag on is because a lot of times, you go back and forth with consumers for months about providing the right documentation, so they'll just dispute something without proper documentation so you have to go back and that elongates the process.

MS. SHAUL: Can you give me a percentage of total reports that TransUnion issues that have inaccuracies, is it less than 10 percent?

MR. ROSENBERG: We don't know, because it's really a fluid thing, I mean, we're only -- we would only know what the consumer would dispute as inaccurate and what would be resolved, so our dispute rates are under, you know, around five percent roughly, I think it's been stated in Congress, Congressional testimony, that would say for 100 consumers who get their credit report, roughly five percent dispute something on their credit report.

A smaller percentage of those consumers actually have something resolved in their favor, but I don't know the specific numbers.

MS. SHAUL: Flipping to the insurance score which I understand TransUnion has a model that calculates that, correct?

MR. ROSENBERG: There are three models, yes.

MS. SHAUL: Three models, okay. Some of the complaints we've seen involve long time consumers that have had no claims activity in say a 10 or 20 year period, additionally they have not been late on any of their insurance premium payments. Explain how those are factored into the insurance score, a history like that?

MR. ROSENBERG: Well, the insurance score doesn't consider claims and it doesn't consider any of the late payments, any late payments to insurance companies. It's really only going to consider objective factual credit information, so it's your trade lines, your bank accounts, your revolving accounts, your mortgages, your auto loans. It's going to inquiries -- it's your hard inquiries outside of insurance, employment, medical, that sort of stuff.

It's going to include public records and collections and based upon that, that's how you're going to get a raw insurance score. Now, I don't know, you know, all the other factors insurance companies might use, up to 75 factors to consider, but I can only speak on the raw credit data and the models only include -- to get a score, the score is solely based upon credit information.

MS. SHAUL: In terms of updating consumers' credit scores, I thought I heard you say that you run data monthly, so can I interpret that to mean that consumers' credit scores are updated every month or do you use a different time frame?

MR. ROSENBERG: The consumers' credit scores are updated on the day that an insurance company or a consumer would request that a credit report or score be generated, so we don't run a score every month. What we do is only run it upon, let's say -- the credit report is very fluid, right, it's updated with names and address and other information on a daily basis, so whenever we get fresh -- for example, a fresh telephone number or fresh account information, that goes on the report.

When insurance companies then request a credit report or a score be generated on a consumer, that's when the score is generated, so if it's -- if you -- on the first of the month, if you -- if the insurance company requests that this policyholder or this prospect have a credit score generated, that's when we generate the score based upon the credit report at that time, so if a day later a consumer has a bankruptcy or something falls off because of data obsolescence laws, it expires from the credit report a day later and you run a new score on that individual, because the credit report has changed, thus they're going to have a different score.

MS. SHAUL: Consumers aren't adversely affected by asking for their free credit reports?

MR. ROSENBERG: Never.

MS. SHAUL: Finally, in your last comments, you stated that there are benefits provided to consumers by credit scores, can you expand on those benefits?

MR. ROSENBERG: Sure. What I can say is this is what we hear from our insurance customers and from consumers, and I've talked to groups across the country, I've testified like Mr. Birnbaum in dozens of hearings across the country. We hear from our customers that what it does is increase its objectivity for insurance decisioning, so because you're talking about insurance -- a product that is based solely on factual information that doesn't include race, gender, all the other protected information, it takes race and other things -- protected classes out of the equation.

And because it's processed and we get to over three billion updates to the credit files, we get those updates very fluidly, all of the -- because it's updated frequently, we're insured that we get the latest and the greatest objective information. We also hear that it improves risk segmentation and pricing, because what it does is applies uniform decision criteria over a long period of time.

The expectations are that the portfolio of business can be expected to perform with greater predictability over time and this is really important to our insurance customers, because the more predictive of the risk, less hedging that needs to be built into the price of their insurance policies, but I'm sure that the insurance carrier representatives can elaborate a little more upon that later.

A third benefit is that it helps insurance companies and others scale their systems. Decision making systems using scoring models such as ours are very important because they're independent. They can be used uniformly each and every time and objectively to evaluate 10,000 or a million decisions every single day and they can be scaled to create tiers of risk, so in the old days, you'd have a binary yes/no decision.

So when you might sit across from an agent, and this is not to disparage agents or anything like that, but way back in the old days, you'd have a -- you might have a yes/no decision and you would have maybe based it upon race or some other criteria, who knows, but when you use an objective system such as insurance scoring, you can finely tune the instrument based upon somebody's level of risk.

So our scale goes from 150 to 950, which means that individuals pay the risk of their -- that they're -- that is appropriate, and our customers continue to tell us that those with the highest scores have the lowest loss ratios and those with the highest scores -- I'm sorry, have the highest loss ratios.

MS. SHAUL: Thanks.

MR. ROSENBERG: It also promotes competition, so because it's objective, it helps insurance companies reach out to those who are previously under served. What I've seen in at least two studies is that insurance scores and credit reports in general are not -- do not correlate to income. As a matter of fact, what we've seen from the Federal Housing Administration study is that those with lower incomes actually produce higher scores and thus, this has helped individuals at lower incomes receive greater benefits of an objective credit scoring system.

And lastly, the benefit of using a system such as insurance scoring is that it heavily promotes and relies upon existing Federal law and all the rights and responsibilities of access to consumer credit reports, correction within a certain time period and Fair Credit Reporting Act, this is the nation's first privacy law, the first real acknowledgement of privacy with data information, so this access and error correction and promotion of rights and responsibilities for everybody who gets a credit report and uses it is paramount for establishing consumer protections and responsibilities.

MR. DILWEG: Guenther, do you have any questions? We have about ten minutes.

MR. RUCH: Okay. Let me start off by -- help me out here, though, I'm just a little bit confused. You said that insurance scores, your three different types or your three models are made up completely of credit information, right, that comes off the credit --

MR. ROSENBERG: Correct.

MR. RUCH: -- reports, so can you tell us what's the difference then between an insurance score and a credit score, what are the factors that differentiate those two things?

MR. ROSENBERG: Well, the credit scores -- we have literally hundreds of different scores, insurance scores are just three out of our hundred scores, hundreds of scores that we provide to lenders. So for example, a lender will look at a credit score because a lender is lending money and a credit score is a situation where you're assessing somebody's likelihood that they're going to repay a debt.

That's not the situation with insurance scores. Insurance scores are predicting the likelihood of claims or the loss ratio that somebody -- that a consumer is going to have, so they're not credit based, they're not predicting the likelihood that somebody is going to default on a loan. Insurance companies don't lend money to consumers that I'm aware of. This is not a lending situation.

This is a policy granting situation, a risk decision, so there are different things and the factors that go into producing each. When you develop a credit score, you're looking at things that are going to be more likely to predict somebody defaulting or somebody going into bankruptcy or some other predictive nature than a lender is looking at. Insurance companies are solely looking at the ability to predict a loss ratio, so there are different aspects.

Now, as I mentioned earlier, we have -- there's 2000 plus characteristics that go into producing -- that could go into producing scores. What we've done is we've run all our numbers and shown that really only 75 factors out of those 2000 plus are highly correlated to loss ratios, to producing that insurance score, whereas when producing a credit score, there might be 200 plus that go into producing or that go into predicting the likelihood that somebody might, for example, default on a loan or pay back that loan. That's a predicted outcome.

MR. RUCH: Are those 75 factors public?

MR. ROSENBERG: Yes, as a matter of fact, we've had a meeting here with the Commissioner and his staff earlier this year and in other states, in Texas and Florida and others, we've -- and Washington and we have gone out on record as being 100 percent transparent, meaning the information that goes into the model, how to correct that information, et cetera, all the variables, all those factors are public information and we've lifted trade secret protection on those in the State of Wisconsin and other places.

We provided those to the State and we've communicated that to the Commissioner, et cetera. On request, we will provide that to consumers or to your department for providing to consumers. A lot of it might not mean a lot, because algorithms aren't that meaningful, but the variables that go into it and how to correct it and how to take action are very important and we provide that as well.

MR. RUCH: So, thanks for that. I guess my -- one final question is so you have three different insurance scoring models?

MR. ROSENBERG: Yes.

MR. RUCH: So what would be the difference between those, generally, I mean.

MR. ROSENBERG: One is for auto and one is for property and one is a combination auto and property model, so on would be used in the auto business, one would be used in the property and one would be used as a combination, if companies want to do a combined.

MR. RUCH: Okay, thank you.

MR. DILWEG: Thank you for the time. I appreciate it and you'll have a chance to come back up at the end as well. At this time, we will take a break until 1:30 and reconvene with Mike Doerfler, Dan Merk, Marty Arnold and Neil Aldridge. Ideally, I wanted both Birny and Neil together, but people said that would be bad, so.

MR. ROSENBERG: Thank you Mr. Commissioner and staff, I appreciate it.

MR. DILWEG: Thank you.

(Noon recess is taken)

(12:30 p.m. to 1:30 p.m.)

MR. DILWEG: Next up is our third panel and why don't we start off with you, Neil, from NAMIC and as before, I'll keep it to about an hour and I want to stop you in time so we have time for questions.

MR. ALDRIDGE: You'll need a caffeine drip before then.

MR. DILWEG: You guys live this stuff, so.

MR. ALDRIDGE: Thank you,

Commissioner and thanks for the opportunity to speak with you today about this issue. Unfortunately, I've had the pleasure of doing this routine all around the country in a variety of forums, legislative hearings, NAIC meetings, for the last nearly 10 years. I'm Neil Aldridge, senior vice-president of state and policy affairs for the National Association of Mutual Insurance Companies.

Our members here in Wisconsin, we've got about 161 members who do business here, 100 odd that are domiciled here. We've got about 70 percent of the homeowners market and 64 percent of the auto market, I believe, in Wisconsin. This issue for the insurance industry is obviously an important one, one in which the companies' perspective really has been the same from the beginning of the debate that's been going on about this issue for the last 10 years.

And then ultimately for the companies, this issue comes down to the fact that insurance scores are predictive of loss. One thing you did not hear from Mr. Birnbaum earlier is that all of the studies that have been done, there have been 17 of them now to date by either

State or Federal agencies or universities in a couple of cases, have all concluded one thing, and that is that insurance scores are predictive of loss.

People that are in the low score category are anywhere from two to four times more likely to have a claim and those claims are more severe than those in the higher score categories. Those facts -- there are lots of numbers that get tossed around about this debate, lots of issues get brought up in nearly every forum, but those numbers tend not to be refuted and for the companies, that I think gives you the best insight into why the companies prefer to use this tool in a way that is -- along with other tools, because it's predictive of loss.

And I think we should not forget about that as we debate this issue as we go forward. My role today here is to talk a little bit about this issue, a bit nationally and I'm going to talk a little bit about some of the studies that you've heard about already and talk generally about the issue and kind of where it sits in relation to Wisconsin and your deliberations, because you've heard already 47 states govern the practice, regulate the practice in some fashion or another.

Most of those states are based on their regulation or their law, some fashion of the NCOIL model that was adopted in 2002, elements of it, if not the whole thing. That model creates disclosure requirements for companies, both on the fact that credit is a factor. It provides that insurance score will not be the sole factor being used in underwriting. It provides the adverse action requirement. It also governs what kind of information is used in the score.

For instance, medical information is something that's a prohibited factor in that model and that is something as you go forward, I know there's been some talk about it here this morning about that particular factor, you may want to look at here in Wisconsin as well. Most states have some version of that on the books, if not the entire model. In many cases, this issue is -- we're sort of in our second iteration of this issue, nationally speaking.

Most of the states that have adopted the NCOIL model did so by six years ago. In many cases, those laws were done in response to what was then a fairly new tool being used by the industry. There were consumer complaints as well as frankly complaints in the agent community at that point in time. You heard earlier this morning from the agent community particularly that those complaints largely do not exist anymore from the perspective of the agents.

I think that the education about the tool has improved a lot in that community. Today, we kind of are seeing a second round of interest in this issue, but one thing that has changed in many cases is that we don't see the consumer complaints rising. The numbers that were cited earlier, I think you'd find, would be very consistent with the numbers your colleagues in other states would be seeing. There just aren't large numbers of complaints about the issues from consumers.

We like to think and we may be a little delusional on this fact, but we like to think in the industry that one of the reasons is because consumers understand the issue a little better than they did initially as it relates to insurance scoring. We also believe that the reason why you don't see the high number of complaints goes back to that predictive of loss issue and the number of consumers that benefit from the tool.

More people would be complaining, but for the fact that they get a discount based on their insurance score, not something that many are going to complain about. That then gives you a reason to look at what other states have found in these studies. As I mentioned, there's really been no tool probably in the last 10 years in the entire insurance world that has been more studied than this one has been or maybe had more hours of legislative debate than this one has had.

As I mentioned, there's been 17 state, Federal or university studies on this issue. A couple of them are noteworthy. Let's start with one that has not been discussed yet this year and this one I think may be -- or this morning, I think it's probably the most simple one. That probably explains the reason why I like it the most, is because I can understand it and that is the survey that the department of -- in Arkansas does.

The insurance department in Arkansas when they passed their law in 2005, they have a unique feature in their statute. The legislature, when they passed the NCOIL model, required the department to do a survey every year of the impact that insurance scores have on insureds in Arkansas. Simply, a simple counting of heads, basically, the number of policyholders that get a discount, the number of policyholders that have a rate increase and those that are treated neutrally, neither one way or the other by their score.

That report has been done now three times by the Arkansas Insurance Department. Virtually, the results have been virtually identical all three years and that is that roughly 90 percent of consumers in Arkansas either receive a discount or are treated neutrally because of their insurance score. 10 percent receive an increase in their rate due in part to their insurance score. That, as I said, is one of the more simple, but based in real life, not, you know, a matter of who collected the data or what data was submitted or anything else.

This is the department's collection of data from companies and a real life review of the rate that people pay, so I think it is instructive to point that one out for the record. I should also mention as we look at the other studies, the Texas study was mentioned earlier and I do think it's important to really kind of correct the record in one regard and that is, when you go back and look at the record of the Texas department study that was conducted in 2005, as Birny mentioned in two parts, Texas -- then Texas commissioner Jose Montemayor, going into the study, made public statements to the fact that he thought when they got done with the study that he would find that there was disparate impact or that minority and low-income classes would be adversely affected by this tool.

And I just want to read to you a little snippet from a letter that Jose Montemayor then sent to Governor Rick Perry of Texas when he delivered the report. This is a letter that's public record and I'll be happy to give you a copy of it for the record, but this is what Texas Commissioner Jose Montemayor said.

"Initial suspicions were that while there may be a correlation risk, credit scoring's value in pricing and underwriting risk was superficial supported, by the strength of other risk variables. The study, however, did not support these initial suspicions. Moreover, credit scoring is not unfairly discriminatory as defined in current law because credit scoring is not based on race, nor is it a precise indicator of one's race."

That is a direct quote from the commissioner talking about the issue of proxy, you hear about that, that somehow this is reflective of scores as a proxy of one's race and I think it's important to note that that's what the findings from the commissioner were in that particular finding. The other study I think that's worthy of note is the study done by the Federal Trade Commission.

Mr. Birnbaum indicated that there was some suspect doubts raised about the data in that study. I can tell you that the FTC does not share those concerns. In fact, if you look at the testimony that the Federal Trade Commission gave to Congress, was that they did not question the validity of their findings. That is their official position. They did have one commissioner who did vote the way that Mr. Birnbaum represented, but the official position of the

Federal Trade Commission is that that study is valid.

That study was -- concluded that insurance scores are not a proxy for race or income, that insurance scores are predictive within racial and income groups. In other words, there are people with high scores and low scores in all income levels and all racial categories. That again gets to the notion that you can't tell someone's income or someone's race by their score. In other words, the proxy effect does not exist.

Those studies are available for review and I would encourage you to do so, to review those as you look at going forward with policy making here in Wisconsin. Finally, I think we have to turn an eye to the marketplace in Wisconsin. I think you have to look at the fact that you've got low rates. Depending on what you look at, you're 47th or 49th or 46th, they're low, is the bottom line.

I don't see the fact, if you look at the marketplace, a real crisis here that needs to be addressed in a significantly heavy handed way. Yes, there may need to be some attention paid to the margins, issues about, you know, using particular kinds of information in a score, but not a wholesale ban on the practice, because likely, you'll find that many more folks in Wisconsin would be adversely affected by that kind of action than currently are receiving a discount.

Finally, I believe we have to also look -- and this is also an issue that generates consumer interest. If we saw large swaths of the population of Wisconsin not being able to afford or buy insurance because of their insurance score, you'd see your residual market mechanisms increasing and you'd frankly have people out the door around this capitol building complaining about it and they're not doing that.

There are certainly complaints that need to be dealt with, but I do believe you have to look at the marketplace and apply some sort of real world, common sense to what the issue is that we're dealing with. So with that, I'm happy to answer questions. We have other folks here who are a lot smarter than me from companies that can answer a lot of the technical details, but I'm happy to answer any questions that I can.

MR. DILWEG: Thank you, Neil, and I think we'll just go through your panel and then ask some questions. I think Mike Doerfler, you wanted to be up next from Progressive. Good to see you again, Mike.

MR. DOERFLER: Thank you, Commissioner. My name is Mike Doerfler and I'm here today to answer your questions about how the Progressive Group of Insurance Companies uses credit report data for insurance rating purposes in the State of Wisconsin. I am the product development manager responsible for our use of credit information in rating for Progressive.

Progressive's business model is to offer accurately priced auto insurance that provides the coverage consumers need along with superior policyholder and claims service. We want to be the consumer's first choice for auto insurance in Wisconsin. Our company was founded over 70 years ago and is now the third largest auto insurer in the State of Wisconsin. We started as a company offering insurance to high risk drivers, but today, serve all segments of the auto market and offer a rate for virtually every risk.

Our companies offer products through independent agents, over the phone and on the internet. We have grown significantly in the State of Wisconsin since 1996 when insurance scores based upon credit report data were first introduced into our business model. Personal lines insurers have been using credit report data for many years and its use is expressly permitted under the Federal Fair Credit Reporting Act. We don't use such data simply because the law allows us to, we use credit report data because it is an accurate predictor of loss.

And by using this data, we are able to build a better pricing model. Our use of credit report data along with other factors that are accurate predictors of loss allows us to provide more accurate rates for Wisconsin consumers. Without credit report data, we would have to reallocate the premium we charge across our entire book of business. This would result in substantial rate subsidization and cause rates to increase for many of our Wisconsin policyholders.

Of course, others would see rate decreases, but our data would indicate that they are being subsidized. The ability to price accurately cannot be over emphasized, as it is absolutely critical to our business strategy. An accurate price is, by definition, a fair price and the more accurately we price, the better we can compete. Our experience is that more accurate pricing means that we are able to offer lower rates to more drivers who deserve it.

The predictive value of credit report data is supported by both our data and by numerous studies conducted by independent third parties and governmental agencies. There is an overwhelming body of analysis establishing that credit report data is an accurate predictor of loss. Progressive has been a leader in the responsible use of credit report data for insurance rating and underwriting.

We are among the first insurers that called for the enactment of statutes that would provide reasonable consumer protections for the use of credit report data. Even before these statutes were enacted, Progressive made a decision never to refuse to insure, cancel or non renew a policy based upon information contained in a credit report. We also decided not to consider any credit report data disputed by the consumer in our credit scoring models.

We are one of the first companies to disclose to consumers that their credit report data would be used in the rating process. We were the first company to file our credit models without confidentiality protection. We also have a special credit information team which is specifically designated -- with specifically designated members to assist consumers with credit questions. The credit information team can provide a personalized report to applicants, explaining how their insurance score compares to the scores of others consumers who have received a quote from us.

The report also includes an informative and useful explanation of how we use credit report data for underwriting purposes. The credit information team is empowered to provide reasonable exceptions when a consumer's credit is unduly influenced by extraordinary life events, such as a temporary loss of employment, death of a spouse, dissolution of a marriage and medical emergency. The credit information team also facilitates communications between our customers and consumer reporting agencies when errors are identified on a credit report.

Additionally, if an error that affected the premium rate is corrected, we will recalculate the premium and make an immediate credit or refund. Today, the Wisconsin auto insurance market is healthy and operating efficiently. Numerous insurers offering insurance through multiple distribution channels provide consumers with many auto insurance options. We submit that the ability of insurers to use credit report data contributes to the health of the Wisconsin market.

We believe that Wisconsin consumers benefit under a cost based pricing system where insurers are allowed to use those rating factors that provide the ability to set the most accurate rates. Thank you for the opportunity to be here today and I'd be happy to answer any questions that you have.

MR. DILWEG: Thank you very much, Mike. Next up, we'll have Marty Arnold from Secura Insurance Companies, president and chief actuary.

MR. ARNOLD: Thank you, Commissioner. I appreciate the time to come in front of you in a forum like this for such an important issue. To give you folks a little bit of background, you might not know about Secura. We're a 109 year old company based in Appleton Wisconsin. We do business in 13 states, but Wisconsin is by far our largest state. Our structure is mutual, which means we're owned by our policyholders.

So our mission, unlike some publicly traded companies, is to be a stable market, not to maximize the returns of some disinterested shareholders. We pride ourselves on being a stable employer of choice in the Fox River Valley. One of the many reasons that personal lines is so intensely competitive in Wisconsin relates to the large number of competitors in our space.

Many of these competitors are mutual like us, so the profit motive is different in our industry than in many others. Incidentally, that also explains why the average profit margins in property and casualty insurance are significantly lower than many other industries. According to Brian Sullivan, the editor of the Auto Insurance Report, Wisconsin residents pay relatively low premiums today. He said we have the third lowest pain index, which measures affordability of insurance by comparing auto premiums to income on a state by state basis.

We believe that we'll still be quite competitive even after the most recent changes flow through from the budget bill that was just passed. I think that backdrop about us being a mutual company and our industry not making obscene profits is really important to keep in mind as we discuss this one element of how we underwrite and price our business today, insurance scores.

At Secura, we feel that these scores are a really important underwriting tool and pricing tool for our business and in my short remarks, I'm going to touch on three key themes for you. The first deals with how the insurance scores actually help assess the risks of loss and help set a more accurate price for the exposure. Secondly, I'll touch on how we feel that using these scores responsibly is important and that we do that at Secura.

And the third point might be the

most important that I'll touch on near the end, and that talks about how these tools help smaller companies like Secura compete in a tough marketplace which creates a more competitive and more choices in the marketplace for Wisconsin customers. In terms of the right price per exposure, we've done any number of independent actuarial analyses and it's irrefutable that insurance scores are a very, very strong predictor of insurance losses, both for auto insurance as well as home insurance.

In auto insurance, it's just one of many factors we use, in addition to age and gender and marital status, historical loss experience, the type of vehicle people drive, their driving records. The best class plans and rating plans reflect, to the extent possible, the risk characteristics of the individuals we insure. We feel personal responsibility as indicated by insurance scores is one of those very important factors.

Age is obviously a huge factor for rating personal auto as well. I've got two young boys, both of whom swear they're going to be terrific drivers when they turn 16. The objective statistics, I remind them, however, indicate that on average, 16 year old boys have significantly more accidents than other cohorts. When my boys argue that that won't be fair if they have to pay more for their insurance because they can't control how old they are, I've explained to them that that's not the only factor in their insurance pricing.

If they drive a certain type of car, they're going to get into more accidents. If they get speeding tickets and have some historical accidents, their premiums are going to go up and it's also within their control to get a good student discount, which many companies in Wisconsin offer, so there are many factors that go into determining that price, but just as 16 year old boys irrefutably have more accidents, the data regarding financial stability is very similarly predictive for auto insurance, as well as home.

So long as these factors are applied in a reasonable manner in conjunction with other relevant factors, they make our rating plans much more accurate. The second point that I wanted to make is that we do use those scores very responsibly. I was interested to hear Guenther's stats at the beginning about how many complaints the insurance department has gotten this year. I think you said that out of the 600 complaints here to date, 22 have related to credit scoring.

As you were talking, I Blackberried my general counsel and asked how many complaints we've gotten in the last four years for use of credit score. Here to date, it's zero. In 2008, it was zero. In 2007, it was zero and in 2006, it was zero. We believe that we use this tool in a responsible way. We can explain it to our agents who can explain to it our customers and that's why this is an important tool for the majority of our insureds who benefit from this.

These scores are not used in isolation to make decisions about who to insure or at what price we insurance them. We use them in conjunction with many other factors. We do not use financial stability or lack thereof as the reason to deny or cancel any policyholder. As was pointed out this morning by Eric from TransUnion, insurance scores are very different than credit scores. They are incredibly stable in spite of the current economic situation.

Commissioner, in your opening

remarks, you raised the question about the impact of the recession on scores. While some at Secura had postulated that our scores would drop with the economic slowdown, our average score impact has been increased one percent over the last 18 months before the financial meltdown started and we believe this relates to the fact that we don't use 2000 factors that go into a credit score.

For the insurance score, we use a much smaller percentage of those that are directly relevant to auto insurance and to home insurance loss experience and we think we use it responsibly and it's a very stable indicator of personal responsibility. One of the other aspects of using this information responsibly as an insurance company relates up to dating the data. Right now, we run the insurance scores every three years and upon request, we'll run them every year for our insureds. We feel that's a good practice.

One of the other criticisms we've heard about insurance scoring or credit scoring is that there are people who just don't have a hit when you look for their insurance score. We looked up what percentage of our insureds had a no hit in the credit score or insurance score field and it was less than 1 percent. In fact, it was 0.1 percent of our current book had no hit on the insurance score and for those insureds, we actually give them the average discount for financial responsibility, so they still get a benefit from it.

Finally, in terms of using this responsibly, of course all of us in the insurance business are subject to the Fair Credit Reporting Act which obligates companies to notify consumers who don't get the best score, so we believe very strongly that we use this responsibly. We've had literally zero complaints from our customer base over the last four years and we think it's an important tool to keep in mind.

The third point that I wanted to touch on today briefly is that how it helps small companies compete in a very interesting marketplace. At Secura, like other smaller companies, we don't have the massive amount of data like State Farm or American Family or Progressive might have, but using variables like financial stability helps keep us in the game in terms of pricing sophistication and thus makes the market more competitive for Wisconsin residents, because more small companies can help compete.

To the extent critics say that companies using credit information in different ways is a bad thing, we simply disagree. From a consumer's perspective, it actually fosters more competition among insurance companies and thus more choices for consumers, because we use different models than some of our competitors and we create different discounts based on the scoring ranges, so an independent insurance agent has a lot of choice when he's shopping for insurance and if we all did it the same way, it would actually be anticompetitive.

One final point, if we went forward with some proposals that have been put forth about banning use of insurance scoring for any underwriting or pricing of our business, we calculate that 62 percent of our personal lines book in Wisconsin would receive a rate increase. Furthermore, 80 percent of drivers over the age of 60 would see an increase from eliminating their financial stability discounts.

We believe these discounts that we give customers are in the best interests of Wisconsin residents and they are very much justified to the entire customer base and we believe that since we have been able to use this in a very, very responsible manner, and we've had no complaints over the last four years, we believe that this is an important tool to keep in place for us. Thank you for the time to come and share some of our thoughts and I look forward to answering any of your questions after Dan speaks.

MR. DILWEG: Thank you very much, Marty. Finally, Dan Merk, vice-president of actuary product at Rural Mutual Insurance, go ahead.

MR. MERK: Thank you, Commissioner Dilweg. On behalf of Rural Mutual , we just wanted to take the opportunity to thank you for being part of the hearing today. Just first what I'd like to do is just give you a brief background of Rural Mutual . We are a small Wisconsin only company and our roots tied closely to the Wisconsin farming community here in the state.

We were formed 75 years ago and today, we still remain affiliated with the Wisconsin Farm Bureau. Like Secura and some of the other companies in Wisconsin, we are a mutual company and accordingly, we don't serve the interests of stockholders, we're here to provide stability and to be there for our customers when they need us in the event that they have a claim.

Rural rates policies that not only cover farms, but also auto and homes and businesses throughout the state. In total, we insure about 22,000 autos, 20,000 homes and 12,000 farms and country estates. Currently, Rural Mutual uses insurance scoring for only one of our products, for our auto product. We began using insurance scoring about four to five years ago and we plan to implement insurance scoring next year for our homeowners product and will consider looking at our farm and country estate products following implementation of the homeowners.

I'm going to focus on a couple different areas here today. First, I'm going to explain why Rural Mutual uses insurance scoring and then secondly, I want to discuss some of the consequences for our customers and our policyholders that would result in insurance scoring -- if it was unable to be used. First, why does Rural Mutual use insurance scoring. In determining how much premium we're going to charge any one of our individual customers, we need to determine the expected likelihood that the customer will file an insurance claim on their policy.

Some customers file claims more often than others. For determining premium, customers are categorized into groups based on how often they're going to file a claim and to create these groupings, Rural uses many different characteristics to group the customers, of which insurance score is just one. We use insurance score, because as you've heard from many others, it's very predictive. The probability that an individual customer will file an insurance claim is highly correlated to the customer's insurance score.

Customers with high insurance scores submit fewer insurance claims, whereas customers with lower insurance scores submit more claims. One thing that, you know, I think it's important to maybe understanding is we hear the term good and bad used in reference to insurance scores from time to time and one thing that we look at, we try to use the terms high and low, because best and worst can maybe incorrectly imply something about that customer.

We don't look at our customers as good or bad. They're all good customers, so when we're using insurance score, it's simply as an indicator of the likelihood that they're going to file a claim. It has nothing to do with whether they're a good or bad customer. As I said, insurance score is one of the more predictive variables that Rural Mutual has available. For example, insurance score is similar in power to driver age and driver territory or where they live or garage their vehicle.

Insurance score is a better predictor of the likelihood that a customer will file a claim than their individual driving record. Essentially, to sum all that up, at the end of the day, what insurance score does is it helps Rural Mutual do a better job of matching the customer's premium to their expected cost. The use of insurance score allows Rural to provide policies at a lower cost to a majority of our customers.

About 7 out of 10 Rural customers pay a premium that is either the same or less than the premium that they would pay if Rural was unable to use insurance score. Insurance score has proven to be a consistent predictor over a number of years, so it's not something that we just looked at one year. Year over year over year during the past four to five years that Rural has used insurance scores, its predictive power has been very consistent.

Last, insurance score for Rural Mutual customers has proven to be consistently predictive over the last two years during the economic downturn. During this time, individual customer scores for Rural policyholders have remained relatively stable. As a matter of fact, Rural customer insurance scores have increased slightly during this time.

Now, we've looked at that a couple different ways. We've looked at it in the aggregate, so if we take all of our policyholders, not just the ones that were there the whole four to five years, that insurance score has increased slightly, but the second way is we broke it down and looked at only those policyholders and customers that have been with us during the entire four to five year period and the same thing is true. The scores have been stable, increasing just slightly.

Now, moving on to what if insurance score was not allowed, what would some of the consequences be. First, over half of Rural Mutual auto insurance customers would receive an increase in their premium that they pay. So when you break down the numbers, that's on the auto side about 12,100 customers that are Rural Mutual customers would get increases in their premium, whereas only about 5500 would get a decrease in their premium. That would leave us in a situation where we'd be forced to group customers that submit claims relatively more often with customers that submit claims relatively less often.

Secondly, some of the customers that Rural Mutual is currently able to offer a policy with relatively low insurance scores would no longer be offered a policy. Why is that? By having insurance scoring on the rating methodology, that gives us more confidence in the accuracy of our overall premiums. By taking insurance scoring away, we would need to look at other factors not related to insurance score. We'd have less confidence in our overall premium and we would end up referring some of these customers to a high risk market.

Some of the customers that Rural is currently able to offer a renewal policy to, despite the fact that they've missed a payment, would no longer be offered a policy. Instead, these customers would have to be cancelled. Last, a majority of Rural customers would be forced to pay higher premiums than the expected cost of their policies. We feel that that is not appropriate.

In summary and closing, I'd just like to thank you again for the opportunity to speak here today and would be happy to answer any questions.

MR. DILWEG: Thank you, Dan. I'll start with just a few questions. I guess if you're seeing the insurance score tied to kind of the expectation of claims, I mean, there's other factors going into that as well, I assume. I know when we looked back over the last two years with the high gas prices, we're facing record low driving levels, for example, things we haven't seen since the '70s, so I know there's a lot of bike accidents, but I think driving is low and that miles driven definitely factors into that as well.

So I'm trying to understand kind of the paradox that occurs. I assume, you know, the insurance score, say a Progressive may use much it more heavily than a Rural or Secura and could you speak to that a little bit, could either of the companies or Neil? Because it must go into the mix, but you may or may not rely on it as heavily.

MR. ARNOLD: I can take a shot it and let others chime in. I can't speak to other people's rate making techniques, but I can tell you that we use statistical techniques to try to isolate interdependency, so we use techniques to try to say that if we give you a discount for a billing plan that might be correlated to your insurance score, we don't want to double count that discount.

So we use techniques to try to isolate the impact of every variable one at a time and to the extent we make a marketing decision to not use a particular variable, then we'll put more weight on other variables that might be correlated. So for an actuary, one of the key challenges is to understand the statistical interdependence of different factors you use.

There's always a trade-off from an actuarial standpoint to a marketing standpoint about what makes sense to tell and what's statistically predictable and there's also an element of simplicity that's generally desired in rating plans. It's easier for our agents to describe fewer factors than more, which is why we have a bias to include fewer factors unless they give a lot of statistical lift in the plan and we feel that insurance score is so unique and so different than driving record or age or the type of car you drive or other things that it actually is probably the second or third most powerful variable in most of our models.

MR. DOERFLER: I'll add at Progressive, we do the same thing. We isolate the effect of each of our rating variables and insurance scores come in at number five for us, they're not the strongest. The strongest is the driving record, followed closely by what kind of car you drive and your age, so we do take measures to make sure that we're not double counting as well.

MR. DILWEG: And how is the -- Marty, I know you referenced a percentage of your book that would say be a thin file of someone without a credit score, be it a young person or an older person or simply someone who doesn't use credit, is that -- do you all have various internal policies on this, do you run across this, how common is it? Marty, you've kind of spoken to it.

MR. ARNOLD: Yeah, it's one tenth of one percent for us and it's actually not young people. When we delve down into it, it's basically the seven that I saw were farmers that pay cash for everything and who don't have a credit record.

MR. DILWEG: Probably living in Sheboygan, too.

MR. DOERFLER: Our numbers at Progressive aren't nearly as good as our friends' here in town. We looked at quotes in Wisconsin and we have about nine percent of our quotes that are either a no hit or a thin file and as far as our policies go, it's four percent, just under four percent.

And we have found that we can fairly segment that classification by using the age of the insured so that we can offer a better rate to some of the more senior citizens who have a thin file, and we have seen the number come down as well. We didn't start at nine percent, but we are seeing a trend in coming down.

MR. MERK: The Rural Mutual numbers are fairly similar. Our numbers are in the four to five percent on no hits, which would be a file you just can't find or a thin file where there's not a record. We've seen across the spectrum it does affect some individuals, but it also effects, as Marty had indicated, some of the older policyholders that just simply haven't utilized credit during their lifetime.

MR. DILWEG: And how do you handle -- you know, one issue and then some of you touched upon it that I struggle with is how personal financial catastrophes occur and it sounded like Mike, you referenced that you do have some internal policies there and I'd be interested, is it a list of ten issues and then likewise if there's -- if you all have -- if someone appeals to you that they may have gotten a divorce or had a medical problem, do you take that in account, just as an example?

MR. ARNOLD: I can give you a

couple of quick examples. At Secura, we did a couple of things. First of all, we chose an insurance scoring model does not use bankruptcy as one of the variables. When you think about the 2000 variables you could use and when you boil it down to 50 or 75, we chose a model that didn't have that included, because we understand that those situations are somewhat unique.

The other thing we do is that we do not raise people's prices solely for the insurance score deteriorating. It needs to be that plus another triggering event. If you had speeding tickets or accidents, if you file claims with us. Deterioration of an insurance score in conjunction with another factor that is more intuitive would warrant a rate increase, but insurance score deteriorating in and of itself does not justify that in our company, so we chose a practice which makes sure that's it's not solely driven by one thing that appears not to be related to the insurance risk.

MR. DOERFLER: At Progressive, any call that we receive that has a comment or complaint about our use of credit and insurance scores, it goes to our credit information team and they are specifically designed and trained to help consumers understand our use of credit and they're able to make reasonable exceptions if someone has recently lost their job or they've had a medical catastrophe or maybe they were affected adversely by a divorce and it's affected their credit data. We will go ahead and make an exception for those.

MR. MERK: At Rural Mutual and as you might imagine, we're smaller, so we don't have our own model. What we've done is we contract with a vendor, ChoicePoint, who's developed a model and then we tested that against our data. The model that we've chosen similarly takes into consideration some of these catastrophic events such as the medical situation, et cetera.

When we have a customer that has a deterioration in their loss score, what we do is we will instead of taking that rate up because they have a lower score all at one time, we'll gradually increase that over a period of time, so there isn't a big jump at one point in time for that customer.

MS. SHAUL: Mike, I believe Progressive has been using credit scores the longest from this panel, how long have you been

using that?
MR. DOERFLER: Since I believe 1996 in Wisconsin.
MS. SHAUL: You indicated that -- I'm sorry, it was Marty who indicated that the credit scores are run every three years for your insureds?
MR. ARNOLD: Our standard practice is to run them at least every three years and on request, we'll run them every year.
MS. SHAUL: And how are consumers notified of that option?
MR. ARNOLD: We distribute exclusively through independent agents, so it's incumbent upon our agents to make sure that if their customers are concerned about that, that they know Secura's policy.
MS. SHAUL: And Progressive's policy on that?
MR. DOERFLER: Very similar, we run credit information every three years and we'll run it once a year at request and we expressly train our agents to know that's our policy and of course, we do an awful lot of business over the phone and on the internet, so we know who calls us

or contacts us with any questions about credit. We'll go through that credit information team and that is one tool we will offer.

If they feel that something is wrong, we'll help them get in touch with an agency and they can dispute anything on their credit report and we'll adjust for that and also, if they think that they'd like to have it rerun, we can do that as well once a year.

MS. SHAUL: And do you have -- is that notification in the policy form or is that -- you rely on your agents?

MR. DOERFLER: That's our policy, so we rely on anyone who calls and contacts us about credit.

MS. SHAUL: To the actuaries in the group, the panelist earlier said that credit scores are not actuarially sound because they are manipulate -- able to be manipulated, do you have thoughts on that statement?

MR. ARNOLD: Yes, I disagree. I think that depending on how you define manipulation, many other variables that are acceptable to others are included there, including speeding tickets, including miles you drive in a year, including -- you take an extreme example, gender is manipulative, but it requires expensive surgery. I think that there are many other factors that are within the control of the insured that are intuitive.

And I think the personal responsibility for how you shop which correlates to driving in congested areas is a very intuitive factor for us.

MS. SHAUL: And when you -- just staying with you, Marty, when you implemented credit scoring, what percentage of your customers received a decrease in premium?

MR. ARNOLD: Well, I started at Secura just over nine years ago and the practice of starting to use credit scoring preceded my starting there. At the time, we had simple discounts available, I believe they were five and ten percent discounts if you had a good or a very good insurance score and now we have a more robust group.

Based on today's statistics, you know, 62 percent of insured's would get an increase if we took that tool away. Those are the best factors I can give you. I don't know off the top of my head what it was before I started here.

MS. SHAUL: Well, we only see the complaints, so we don't get a lot of letters saying my insurance rate went down.

MR. ARNOLD: Right.

MS. SHAUL: So do you --

MR. ARNOLD: We've had -- as I mentioned before, we've had zero over the last four years and I think a lot of that has to do with the way in which we've implemented responsible policies about not taking the rate up, so.

MS. SHAUL: And do you have any stats on that? Rural implemented that six years ago?

MR. MERK: We implemented it four to five years ago and at that time, it was about five and a half to six out of ten customers received a reduction in their premium, about two out of ten premiums stayed the same and then the other two and a half or so out of ten, the premiums increased.

MS. SHAUL: Mike, how does Progressive handle rating and underwriting in the states that disallow the use of credit information?

MR. DOERFLER: Well, the State of California has promulgated what factors we can use, so that's settled with the state. We simply take credit out of our factor determination and run the same sort of generalized linear model progression analysis and come up with factors for many other rating variables that are legal. That's about as much as I can comment on that.

MR. RUCH: I'd like to get a little bit more into the insurance scoring model itself. Dan, you mentioned that your company uses the -- uses a model from a vendor?

MR. MERK: Yes.

MR. RUCH: ChoicePoint, right?

MR. MERK: Yes.

MR. RUCH: What about Secura and Progressive, do you also use a vendor?

MR. ARNOLD: We use a vendor, we also use ChoicePoint, I'm not sure if it's the same model.

MR. RUCH: And Progressive?

MR. DOERFLER: We have our own proprietary model.

MR. RUCH: Surprise, surprise. So

maybe I missed this, but how much weight does the insurance score use for the overall underwriting and rating process, I mean, how much do you weight it, what's the percentage with all the other factors?

MR. MERK: I can answer that first. First on the underwriting side, Rural Mutual does not use credit scoring at all for underwriting. We only use it on the writing side. Our factors -- the maximum discount is approximately 30 percent and the maximum increase is approximately 30 percent.

MR. RUCH: Okay, now, just to be clear, not what -- you know, how much of a discount or how much of an increase you can give, my question was more like what weight do you give that in your overall process, I mean, is it like 50 percent of the process, 10 percent of the process, you know, to get that discount? Let's say how much of the insurance score makes up that 30 percent discount?

MR. MERK: The 30 percent discount is exclusive in the insurance part, so when we do the process, we don't actually give it a weight, but we compare the correlation of insurance score to other variables. It all gets considered at one time in a general linear model and then out of that comes the premium. I think maybe the way you can think of it is an auto average, an average auto premium per year is probably around $1000, so of that $1000, 30 percent would be approximately $300, does that help?

MR. RUCH: Okay.

MR. MERK: Okay.

MR. ARNOLD: I think I know what you're saying as well and my answer is similar to Dan's. We don't have a precise weighting, but if you look at the ranges of possible scores by age, if you look at the biggest discount you can get for a 45 year old or a 50 year old, wherever the best part of the age curve will be and you look at a 16 year old which would be the worst age in our rating plan, the gap is much bigger for age than it is for insurance score.

So if you look at kind of the ranges, the largest range to the most narrow range, insurance score I think is the third or fourth most powerful variable we have on our auto plan and I think it's about maybe fourth other fifth for homeowners.

MR. RUCH: Before we get to Mike on that, for Secura, do you use it for both the rating and the underwriting?

MR. ARNOLD: I --

MR. RUCH: Rating classification and for --

MR. ARNOLD: For rating, for underwriting I don't believe it can be used for a sole criteria and I think the goal is to try to put out a proper price for exposure for any risk and if we decline the risk, it wouldn't be solely to the insurance score, it would be that in combination with other factors.

MR. RUCH: Mike?

MR. DOERFLER: At Progressive, we use it in rating and it is the fifth most powerful, we're gauging it the same way in looking at the lowest to highest factor that we determine in any one classification. It's behind the driving record which is number one in our book of business, it's behind the garage address, the garage zip code, it's behind the age of the principally named insured and lastly, the type of vehicle and right after that would be our insurance score and then many others after that.

MR. RUCH: Okay, thanks.

MR. DILWEG: I guess one question I have as is I look at this issue, you know, we had two consumers up who had a long history with their companies and, you know, I think some of the struggles that we've seen is the renewal issue and so if you know a consumer for 20 years, does it dial down the significance of that insurance score? I can see your desire to find a sense of claims for a new applicant, but I guess I'm trying to understand, do you see a difference on a long time customer?

MR. ARNOLD: I can answer that. One of the variables in our predictive models is tenure with Secura and the longer you've been with us, the bigger discount you get. So if you've been with us 20 years, that gets more weight than the insurance score and other things get less weight, so all else being equal, certainly tenure offsets that to some extent and secondly, I'd just like to reinforce the point I made that you will not get a rate increase if you're a Wisconsin insured solely because your insurance score changed.

There has to be another catalyst

event. If you got into an accident and filed a claim, if you have had speeding tickets, those types of things, so we believe that a responsible way to use it is not to make it the sole determinant.

MR. MERK: Similarly, we do take into consideration at Rural the tenure of the policyholder and how long they've been claim free. For us, that's a separate discount, treated separately from credit score. So you get one discount based on your insurance score and then a second discount based on how long you've been with Rural claim free.

MR. DOERFLER: At Progressive, we don't have anything based on tenure. We do rerun credit every three years, as I said before, and we'll run it on request once every 12 months and I know, I believe I'll probably get the channels backwards, I'll try to get them right. In our agency channel, if we do rerun your insurance score and it has deteriorated or has gotten worse, we won't use it, so you won't get a rate increase.

In our direct book, we will use the change either way, currently. I know the product manager is in the process of changing that to be more like the agency model. It's a much better treatment for the insured, so that if we do rerun your insurance score and it gets worse, we'll just stick them with the same insurance quote that they started with, but we will improve it.

MR. DILWEG: And Neil, I would request that you kind of -- you referenced more studies than I, but if you want to give me an overview, maybe some comments on the ones I referenced in writing, that would be helpful, nothing right now. You spoke to them somewhat in your testimony, but I would request that that would be helpful to me.

MR. ALDRIDGE: Sure, okay.

MR. DILWEG: And then as I -- before I lose Bob here, I wanted to turn to you and just ask, as far as the current structure that we operate under with simply a bulletin, which is fed off our statute, if we were to get into -- whether it be Representative Berceau's banning of the credit score, thin files, personal financial catastrophes, that to me appears to be statutory, is that your view?

MR. LUCK: Depending on what you

do, it probably would be statutory. There may be things that you can do under current law, but the cleanest way is to have clear statutory authority to do whatever you're going to do, or to have clear statutory guidelines that set out exactly what can be or can't be considered. Then you don't get into a contest of whether you have rule making authority or anything.

MR. DILWEG: Okay, thanks, Bob. I don't have anything else at this time. Thank you. With that, we'll just move into being able to rebut the panels, so why don't I -- I'll just go in the same order, so I'll have the consumer panel back up which I think will just be Birny and then Scott, I think that you wanted to also chime in as well, so let's take a minute here just to switch out.

What I'd like to do is just give each panel a half hour to kind of rebut anything that they've heard. It's just a chance in the oral testimony here to kind of look at the issues that have come up and that you may want to make or provide further clarification, so we'll hold the three panels to that timeline. If it's shorter, that's great, but I'll try and hold you to the half hour. So Scott, why don't you go ahead and thank you for staying.

MR. OHLMAN: Thank you. From my perspective, creditor insurance scores are only as good as their timeliness and accuracy. Regarding accuracy, unless consumers are provided a copy of the credit report, they don't even know what the adverse information is that might be problematic, so that they have an opportunity to dispute it.

Insurance companies that change ratings or at renewal change ratings should provide copies of both the credit report and/or the insurance score that outlines why they're being downgraded or upgraded or whichever. As far as timeliness goes, I heard that -- I think it was Progressive runs the scores every three years. That's not good enough.

In a day and age when accounts are being closed, opened, accounts -- more accounts closed and opened because of all the offers we receive in the mail, that's not good enough and it's only done on a per policyholder basis, from what I understand. It should be per policy period, because those things don't necessarily renew at the same time.

Transparency is another issue. If credit information is going to be used to determine insurance rates and -- scores and rates, as I said, we should have a detailed insurance score report, kind of just like a credit report that goes to the consumer in the event of an adverse action. One insurance representative said they would only -- or they would pull a credit report on request. Nothing in either of my two policies indicates that.

My insurance agent never told me that. I just found that out the other day. I requested it. My insurance score went up. I shouldn't have had to go through that, only to find out I could do that after years and years and years of having a lower score. It should be very clear on the policy that you can do that. It's still a mystery to me as to how a credit report and the data therein can be massaged enough to produce a product that can predict a driving record or a risk assessment or anything else.

I can't see how account longevity, shortness of credit reports, the number of accounts or payment pattern can correspond to this or be extrapolated on that. So far, I haven't heard what most of these variable criteria are. One person said zip code, well, in my case, that doesn't work. I live in the Town of Raymond. My zip code is 53108 for Caledonia, Wisconsin. Two separate municipalities are covered. We have two different rates.

So they have to use something other than zip code. I went through hell with AAA explaining that. I live in the Town of Raymond, I don't live in Caledonia and it was a totally different auto policy that they wrote with a much lower premium, so zip code isn't good enough. AAA even gives me a discount for having a platinum credit card, regardless of the credit limit, credit worthiness or payment pattern. I got a discount for having a platinum credit card.

That has no relationship to this, to insurance whatsoever, but somehow I get a discount for that. It's nice, but I wonder how many of those other insurance companies are doing stuff like that, too, that really have no relationship to insurability. That's about all I've got.

MR. DILWEG: Thank you, Scott. Birny?

MR. BIRNBAUM: Thanks. Let's assume that everything the industry has told you today is true. It's not, but let's assume that it's all true. There's a strong correlation, there are all these consumer benefits, all of it. Now, let's assume that the same arguments were made about the use of race and religion as a rating factor. The arguments would be rejected because unfair discrimination is not justified because the majority of consumers benefit.

We don't allow race to be used, even though the majority of consumers in Wisconsin would benefit from it. We don't allow the use of religion, even though the majority of consumers might benefit from it. So this argument that the majority of consumers benefit as somehow a rationale or justification for an unfairly discriminatory factor is bogus. You know, what is striking is the number of unverified claims made in response to your questions.

And there are two really large regulatory failures, not just in Wisconsin, but across the country. The first is that regulators have failed to collect data from insurers on a regular basis about applications, policies, and claims so that you can independently answer questions about what's happening in the marketplace. How many consumers have seen high -- their scores increase, how many consumers have been turned away because of high credit scores or have been priced out of the market.

I mean, in the home lending, there's Home Mortgage Disclosure Act data. Regulators and the public can tell you where all the subprime loans have gone, but as insurance regulators, you have no information about this. The second major regulatory failure is the failure to regulate the credit model. You regulate the insurance services office as a rate services organization or an advisory organization. They collect data from insurers, they analyze those data and then they give those data back in the form of loss costs which the insurers use to basically price their product.

That's precisely what the credit modelers do. They get data from insurers, they analyze it and they give back rating tools. They are the definition of rate service organizations and they've never been regulated as such.

MR. DILWEG: Birny, just for the

rebuttals, I may jump in a little bit more than I did on the panels.

MR. BIRNBAUM: Sure.

MR. DILWEG: Talk to me -- and I'm also going to ask the industry group about the -- what you've seen in Texas with the transparent model and the effect of that, what that's done, you know, in your words.

MR. BIRNBAUM: Well, transparent in the sense that the models are available to the public?

MR. DILWEG: That the models are filed publicly with the department.

MR. BIRNBAUM: Well, it's enabled consumer organizations like ours to look at the models and thereby refute some of the claims that are made. In terms of the average consumer, there's no transparency to the average consumer. I mean, most consumers really don't know that credit is being used. They don't know how it's being used.

If they get to the point where they get an adverse action notice -- here's the adverse action notice I get. Congratulations on your discount. That's an adverse action notice. What insurers have done is they've raised the base rate so that if you have a really bad credit score, you don't get a discount and everybody else gets a discount, so even if you're getting say a 20 or 30 percent discount, you're still paying a higher rate than you would have if they hadn't use credit scores, because the base rate has been increased.

So when consumers get a thing that says you didn't get the greatest discount possible, you know, the notices don't inform consumers and then most of the notices have very obscure things like too many open accounts or too many inquiries. There's very little information that a consumer can use to go to their credit report and track it.

MR. DILWEG: And that goes back to Scott's point as well.

MR. BIRNBAUM: Yes, and so you know, what Texas has done, as have a couple of other states, is they've made their filings public, but Washington is the only state that I know that has really made an effort to make the disclosures more useful to consumers, but even Texas which has a provision for life exceptions, doesn't include anything like actually making sure that insurers offer it. There's no tracking of it.

So you can go to the Texas department and say how many consumers have sought a life exception, how many have been granted, they wouldn't know.

MR. DILWEG: Birny, on that point, isn't that something that also could also be done simply through a market conduct exam, I mean, it's --

MR. BIRNBAUM: Well, no.

MR. DILWEG: I know your desire is to have it tracked, but I mean, as you examine these companies, you could ask that same question.

MR. BIRNBAUM: No, getting information through a market conduct examination is not the way to monitor the marketplace. I mean, that's like saying, you know, instead of collecting data for, you know, through a statistical plan from ISO or PCI, what we're going to do is we're just going to collect statistical data through market conduct exams or we're going to collect annual statement data through market conduct exams, instead of having the companies report it.

Well, that's absurd. Of course, you have the companies report the data to a formal statistical plan so you can look at the data on a proactive basis. Going through market conduct guarantees that you're going to get bad data, because it's a one time shot. I wanted to respond to this thing about what if no credit. What you've heard is 62 percent would rate a rate increase or X percent would get a rate increase. Here's why that's not true.

Those analyses are based on if we took our existing rating system and we simply got rid of credit, what would happen. That's not what they would do. You heard what insurers would do, they did what Progressive does in California. They take all the remaining factors and they run it through the same multi variant, generalized linear model so that all the other remaining factors would get recalibrated, so you wouldn't see that kind of number of consumers getting a rate increase.

It's a scare tactic. There's no way these folks are going to raise the rates for 62 percent of consumers who they think are their best consumers. Personal responsibility --

MR. DILWEG: Just before you move off that point, Birny, what I heard was about anywhere from four to nine percent were thin files or no credit, at least in the companies that were present here, so I'm assuming that's one perspective.

MR. BIRNBAUM: It's a separate issue.

MR. DILWEG: But just on the thin file issue.

MR. BIRNBAUM: That's completely separate. One is -- we're talking about if credit scoring is banned, how many consumers would see a rate increase, then the other question is how many consumers are penalized because there's not enough credit information and what you've heard is from Secura .1 percent served and you've heard four to five percent for some of the other companies, so again, wouldn't it be nice and useful if you actually had the information, if you and other regulators were collecting that information on an ongoing basis, because how are you going to verify that.

Let me get into a couple of other things to respond. Personal responsibility. The argument that insurers have made and the trade associations and the credit modelers is credit scoring works because it's a measure of personal responsibility. If you manage your finances well, then you're likely to manage your risks well. Well, if that's the case, if that's true, if credit scoring is a measure of your personal responsibility, then how is it that when all of the credit characteristics are declining, credit scores are remaining the same, according to their claims.

They can't have it both ways. You can't say that credit scoring is a measure of your, quote, "Personal responsibility," as measured by your credit performance and say that credit scores are staying the same. There's an inherent contradiction there. Now, let me talk about the representative of the agents who provided zero facts to support his claims. He said it makes perfect sense that more foreclosures would lead to more claims.

Well, no. When you have a foreclosure, you lose your home. You no longer have insurance. There's no way to make a claim on a policy that is no longer in force, so what you have here is no facts to support a position. Correlation to risk. You talked about the studies and there really are only three substantive studies, Texas, Missouri and the Federal Trade Commission and the Federal Trade Commission one is flawed by the fact that it's hand selected data and it did in fact find the proxy effect that you claim is small.

But here's the problem with the Federal Trade Commission study. It only looked at policies. It didn't look at applications that didn't result in a policy, so if all you're looking at are just the policies that consumers bought, you're already screening out bad credit scores, because people didn't buy from that, so the idea that the Federal Trade Commission could make some determination about proxy effect when it didn't include information on applicants that didn't buy a policy and all of the other conclusions is baseless.

In the Texas study, there were two pieces. They were not combined. One was correlation to race and income, the other was correlation to risk. You cannot make a determination about whether credit scoring is a proxy for race unless you do the two together. You have to include all of those in the same analysis. Texas didn't. Montemayor's conclusion was completely unsupported by his own study. He drew a conclusion that could not be found in the report.

Simple as that. It's like saying I have a correlation to claims and I have a correlation to race, but there's no proxy effect. Well, how can you tell unless you put race in the same analysis with claims. That's what the Federal Trade Commission was supposed to do, but because they used the hand picked data by the insurers, they failed in that regard.

Let's take some of the arguments put in about how this benefits insurers. One, it takes race out of the consideration, objective and factual. How many times did the TransUnion guy say objective and factual. As if all information in credit reports was accurate, it's not, and as if all relevant information which needs to be in a credit report is included, it's not. So what does factual mean in this regard, that you include -- it's factual if you include incorrect information and if you don't have information, what's factual about that?

That's objective. The fact that scores are produced by pushing data through a model, a computer model, does not mean that the score is objective and non biased. Let me give you a simple example. The models only include credit information. No claims information is included in the model, yet the modelers claim that the models are highly correlated with claims. Okay, credit information can be correlated with claims, that's what they assert.

There's no race information in the models. The models could be correlated with race, too, why not? I mean, the fact of the matter is that if you look at the factors that are in the model, they're highly correlated with race, so it's logical that the models will be highly correlated with race. Let me talk about what is the end goal here. The modelers say we're trying to produce a prediction of loss ratio.

Well, if you look at what Ed Liddy when he was the head of Allstate said to investment analysts, he said they use credit scoring because it helps them identify high value customers. They weren't interested in people who shopped around for the lowest price and changed insurers every six months, bought a minimum limits policy and didn't buy other products. Credit scoring enabled them to identify their high value customers, people who stayed with them longer, would buy higher limits and would buy other policies.

That's what credit scoring is about, it's about increasing profitability. Now, they've claimed credit scoring allows more competition. Well, if that were the case, if there was more composition, then we would expect the uninsured motorist rate to drop. Well, here, facts, again, not assertions, the Insurance Research council using, you know, their studies over the years from 1995 to 1997, they estimated the Wisconsin uninsured motorist rate at 11 percent.

From using 2003 to 2005 data, it had gone up to 14 percent and in the most recent data in 2007, they estimate it at 15 percent, so how is an increase in the uninsured motorist rate consistent with greater competition and more availability and affordability? It's not. What about the actual data about creditor placed homeowners insurance, the massive increases in that. Inconsistent with these claims.

Now, I would submit that credit scoring hampers competition. It's clear that the biggest insurers have the most data. They can fine tune their models. The smaller companies have to use these out of the box models, you know, the standard industry models, so the idea that somehow they're going to get on a competitive playing field, a level playing field using standard models with these larger companies who are now in a position to really pull away from the pack with their massive amounts of data doesn't make any sense.

The fact of the matter is, there's no evidence that there's -- there is this greater competition. Premiums are low in Wisconsin and have been low. Banning credit scoring isn't going to raise the average premium. It will change the distribution of premium, but it won't raise the average premium. It will likely reduce the average premium by giving consumers much greater incentives for less risky behavior and thereby reducing claim costs.

The TransUnion guy said that, you

know, he had seen two studies that were not correlated to income. He didn't mention them, but he referred to the FHA study. This was incredibly misleading, because the FHA study didn't talk about insurance scores. It referred to a study of credit scores, not insurance scores. Every independent study of insurance scores has found a correlation to race and income, Missouri, Texas and the FTC.

There was a discussion of the Arkansas survey, 90 percent. Well, again, absurd on its face. It's just not credible, number one. Number two, when I saw this, I contacted the Arkansas department. Tell me about this survey, what do you do? Well, we just ask the companies how many people benefit. Well, do you define the terms, no. There's nothing there. They send out a few questions and they get this garbage back, the idea that that would somehow be useful, but let me get back to the main point.

So what, so what if 80 percent of people benefited, which they don't. So what if it's unfairly discriminatory and it offends public policy and it undermines the insurance mechanism, why would you -- why is that a rationale that a lot of people benefit from, I mean, it just -- it's so un-American. Let me just talk about manipulation and then I'll finish up with that.

Ms. Shaul asked well, what about -- are these -- you know, is this actuarially sound, you know, that these credit scores are subject to manipulation and the response was well, lots of factors are subject to manipulation. Well, yeah. If I drive fewer miles, I can get a lower rate, I can get a lower premium. Well, I've reduced my exposure in the process.

If I put an antitheft device in my vehicle, I can get a lower premium, but that discount was paid for by lower claim costs. If I put a hail resistant roof on my house, I can manipulate my premium by getting a discount and I've reduced the exposure. So yeah, there are ways that you want to encourage consumers to change their behavior to reduce their exposure and reduce the loss of life and property, but credit scoring isn't one of them.

What does credit scoring do? Instead of spending $150 to get an antitheft device, you go and spend $150 to get your credit score manipulated by some scam operation and/or you decide well, you know, instead of using one credit card where I rack up all my frequent flier points, I'm now going to get two credit cards and have my balance over two cards. Now, are you telling me that that has reduced that consumer's risk of a loss of an accident? But that's what the models do. That is what the models do.

So I come back to, you know, let's look at the facts that we can verify. Let's look at sort of the basic concept here. Let's cut the chaff away and say what we have here is, at best, a very problematic risk classification. At best, it requires a tremendous amount of regulatory oversight, because it's so rife for abuse, there's so many errors in the data, it's so difficult for consumers to understand, et cetera, et cetera.

What's the benefit? The benefit comes down, according to insurers, to we can predict risk more accurately. Well, correlation to risk is definitely a necessary rationale and justification for a risk classification, but it can't be sufficient. If it were, then race and religion would be used. There's got to be more than just a correlation to risk. When you look at all of the problems of credit scoring and you look at all the difficulties and all of the unfair attributes about it, all of the arbitrary aspects of it and the nonsensical aspects of it, it's not worth it.

And the idea that banning credit scoring would cause a cataclysm is absurd. We have evidence in states where it's not used where the markets are healthy. We know that insurers have very refined rating tools now, so that if you took credit scoring out, they would be able to recalibrate the other things. The author of the first credit scoring study by Tillingham's back in the '90s who was basically hired to calculate numbers that Fair Isaac had given to Tillingham's, that same person a few years ago said insurers could stop using credit scoring and they could retain their ability to predict risks because the other rating factors would be used more intensively.

And the reason is that insurers have much more refined tools. They didn't have generalized linear models 10 years ago. That's not what they were using 10 years ago. They can use it now, so rating factors are used more intensively today than they were in the past and intensively means in more detail. So taking credit scoring out of the picture will not ruin their ability to do it.

Finally, the reason that you use credit scoring, the reason that you use risk classifications, even in the actuarial standards, is to prevent adverse selection. In other words, if you charged everybody the same rate, then what would happen is people who knew they were risky would buy a lot more insurance and that would pose a financial risk to the insurers. We're not talking about that.

Pulling out credit scoring will not create adverse selection on the part of consumers. Consumers don't go buy a bunch of insurance. Hey, I have a bad credit history, I think I will go buy a lot of insurance. That's not going to happen. We know it's not going to happen because it hasn't happened in California and Massachusetts, Hawaii and Maryland.

So if you look at the actuarial basis for using risk classifications, which is to prevent adverse selection, prevent the financial -- protect the financial condition of the company, it's not necessary. If you look at the actuarial standards which say that the rating factor has to be objective, credit scoring fails that. How can a credit -- how can a rating factor be objective if it's different whether you go to one of three different agencies.

How can it be objective if you can manipulate it by simply changing how many credit cards you use. How can it be objective if you have had a cataclysmic event in your life that causes you to spend all your money on medical bills. How can it be objective if depending on the time of the month when your credit score is pulled, your score can vary. How can it -- I mean, you can go on and on and I won't, although I should.

MR. DILWEG: And you are starting to bump up against your half hour here already, yours and Scott's.

MR. BIRNBAUM: My point is, you have the authority to take action on the basis of unfair discrimination laws right now, number one. Number two, you also have authority to say look, you credit scoring modelers are rating agencies, you need to be regulated as such. But the most important thing that you need to do is you need to start collecting data on a routine basis, if you will, market conduct annual statement type of information, so that you are in a position to verify the quality of the data and answer these questions, not rely on insurers who have a vested interest in the outcome of the debate. Thanks.

MR. DILWEG: Scott, briefly?

MR. OHLMAN: Yes, he brought up Fair Isaac, they are still using the system today this they brought out in 1981. It doesn't take into a lot of considerations like changes in our society, the zero percent credit card barrage that we received in the '90s, our financial meltdown today, or societal changes and I still question the validity of the credit card system based on that law.

MR. DILWEG: Thank you both. The next is Eric and I don't know, Ron, if you have anything? And you have up to a half hour, so.

MR. ROSENBERG: Thanks again, Commissioner Dilweg. Really I just want to talk briefly about what we're hearing about the timeliness and accuracy of the data. The GAO report a few years back came to the conclusion that there is no statistically valid way to assess accurately the accuracy of consumer reports, credit reports, giving all the definitions of what constitutes inaccuracies or accuracies, all the touch points of credit data, et cetera.

But what I can say is that we feel, and our customers feel that consumer credit reports are highly accurate and highly predictive. The system is fed into by over 85,000 data furnishers who update the information over three billion times a month. It's tested tens of millions of times per month by insurance companies, by lenders, by employers and the like.

Insurance companies really want to get the best picture of risk of their policyholders or their prospects as they can and they wouldn't be using this system if it wasn't highly accurate and highly predictive. We have seen no evidence in all our studies, in any of the studies that scores correlate to race. There's just no evidence to that fact, to that.

And the last thing I want to talk about is the assertion that modelers are unregulated. It's true in certain states, third party modelers are not allowed to file on behalf of insurance companies. Where we can, though, TransUnion files models on behalf of insurance customers and thus, we are subject to regulation by the states and subject in our models and our -- and our data calls, et cetera, are all subject to that disclosure if the third party is allowed to file on behalf of insurance companies in those states.

The last thing I would like to say is that insurance scores, for us, we realized years ago that they should be available to consumers upon demand and that's why we have done and I know ChoicePoint as well has made our scores available to consumers upon request, our production model scores via our website. For a nominal fee of $5.95, you can get your insurance score and much like you get your credit score before getting a mortgage or an auto loan, we encourage consumers to look at that, shop around and be able to evaluate their score in relation to getting their policy and know where they stand and that's all I have to say.

MR. DILWEG: Thank you, Eric. Neil, do you want to -- the third panel, whoever else would like to speak, and you don't get TransUnion's time, but you do have a half an hour.

MR. ARNOLD: I'd just make a couple quick points. From a regional mutual company's perspective here in Wisconsin, I think I just wanted to respond to one of Birny's points in particular about the actuarial standards. I am a credentialed actuary and I do take my professional obligations seriously. The argument about adverse selection was disingenuous.

We're not thinking that people with good insurance scores are suddenly going to buy three auto insurance policies to cover one car. That was the insinuation. Our point about adverse selection is that it relates directly to the number of competitors in the market and this relates to small companies like Secura helping make the market more competitive in a state like Wisconsin.

I'm looking at the Wisconsin private passenger auto marketshare statistics. Three companies, American Family, State Farm and Progressive own 50 percent of the marketplace, roughly, today. My point to you is that allowing tools like this for great Wisconsin companies like Acuity, General Casualty, West Bend, Sentry, Wisconsin Mutual, Rural and Secura makes sure that

that 50 percent of the market doesn't move to 80 percent of the market controlled by three people or three particular companies.

So to me, the strongest argument about adverse selection is that it helps these small companies stay in the game with a very powerful tool and it makes the market more competitive.

MR. DILWEG: Thank you, Marty, Neil? And could you just touch upon for me at some point in your comments your view of kind of filing a model, as Texas requires?

MR. ALDRIDGE: Sure, that's a good place to start and I won't spend much time here, but I do think that is an interesting point, in that on one hand, we are accused of keeping these secrets that we don't let anyone see and then on the other hand, when the state requires a model to be filed, that transparency doesn't do anybody any good, according to Birny.

It's sort of hard to have it both ways in this case and I think that is something that you see insurance departments routinely -- you can ask the companies how they use the information, have a meeting with them, do what we're doing here today. This happens all over the country routinely. The issue of there are differences, certainly, in state law regarding the requirements of filing, but we shouldn't be under any illusion what regulators don't have the ability to gather information, should they need it or if you desire it, simply ask for it.

The same thing on your point, I think about market conduct is another good example of that. One of the biggest complaints that the industry has is the authority that departments have when it relates to market conduct exams and how they're conducted and the reasons for them to be conducted and those can be used to ferret out any abuses that may be existing, so that certainly is an option that's available to you.

I just don't frankly give a lot of credence to this, that the 50 state regulators in this country are marching around completely in the dark about this tool. It doesn't reflect the vigor in which regulators pursue the issue or have pursued it for the last several years. I just reject that notion, that you can't -- that you don't have the ability to get the information you need to make the right decisions for the constituents you represent.

I would also just mention for a moment about the Missouri study, I didn't mention that earlier. That study -- I encourage you to look at it. You will come with one conclusion, that there are people in zip codes in Missouri that have low scores. That will be the only conclusion that you're able to come to. The study does not have any insurance loss information at all.

It took an average score and looked at zip codes in Missouri that have low incomes and found that there are people with low scores in those zip codes. That is not exactly a revelation. We know that today and I don't think it really has much bearing on the question of whether or not, you know, those zip codes have higher traffic densities or a lot higher loss frequencies or anything else that may result in the findings.

So I do encourage you to look at that study as you look at things, as you gather more information about this tool. I really don't have a whole lot more to offer, other than to say this: I think the one thing you heard from the company panel is really the diversity that exists in the marketplace. Marty is right, Secura and the smaller companies, many of which are in NAMIC's membership are doing just fine, thank you, and they're thriving.

One of the reasons is because of tools like this. In many cases, they're growing, but what it ultimately reflects is that consumers have choices. The companies use this tool differently. If a consumer doesn't like the outcome that they get from a quote, they have options. They have other companies that they can pursue. That's good. That's one of the reasons why Wisconsin's rates are what they are.

That is really a reflection of the diverse, vibrant market you have here and it just taxes the imagination that it needs to be tinkered with very much, frankly, particularly when we compare -- really, we're going to sit in Wisconsin and point to California and Massachusetts as examples in which we ought to follow. Those two states probably, if not number one and two, are two and three in terms of the highest rates in the country.

It doesn't stand to reason that we

should emulate those practices there, sitting in a state with a vibrant, healthy market that benefits consumers with the lowest rates in the country. It just doesn't stack up logically. So with that, I'm happy to answer questions and thank you again for having us here today.

MR. DILWEG: And Neil, I would be remiss, if you could just describe your association a little more in detail, as I asked Birny, I believe. How many members do you have nationally?

MR. ALDRIDGE: Sure, about 1300 member companies, they range in size from the very largest, State Farm nationwide, Liberty Mutual, Companies in the world, to the very smallest, the town and county mutuals that exist in the Midwest and virtually everybody in between.

MR. DILWEG: And you do not have -- you're predominantly property and casualty?

MR. ALDRIDGE: Yes, correct. We do not represent life or health.

MR. DILWEG: Thank you very much. I really appreciate the time that everybody has taken today and as I've said before, we will leave open a comment period 30 days from now and then I will take all the information back that we receive and have some recommendations for the legislators that showed an interest in this issue, Representative Berceau and the two chairs of the insurance committees.

So I do appreciate your time today and I do look forward to this being a very deliberative process, so thank you all for coming today and with that, we'll be adjourned.

(3:10 p.m.)

STATE OF WISCONSIN

OFFICE OF THE COMMISSIONER OF INSURANCE

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Hearing on Insurer Use of
Credit Information

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C E R T I F I C A T E

I, NANCY L. DELANEY, hereby certify that as the duly-appointed shorthand reporter, I took in shorthand the proceedings had in the above-entitled matter on September 14, 2009 commencing at 10:00 o'clock a.m., and that the attached is a transcription of the proceedings so taken.

Dated at Madison, Wisconsin this 17th day of September, 2009.

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Notary Public, State of Wisconsin