STATE OF FLORIDA
OFFICE OF INSURANCE REGULATION

IN THE MATTER OF:

USE OF CREDIT SCORING AND CREDIT
INFORMATION IN INSURANCE RATEMAKING

Public Hearing
_______________________________________/

VOLUME I

February 18, 2009
9:00 a.m. - 12:20 p.m.
Cabinet Meeting Room, Lower Level, The Capitol
Tallahassee, Florida

Reported by:

CLARA C. ROTRUCK

Court Reporter

PANEL MEMBERS:

Steve Parton, General Counsel, OIR
Stephen C. Fredrickson, Assistant General Counsel, OIR
Mike Milnes, Deputy Director, Property & Casualty, OIR
Howard Eagelfeld, Actuary, Property & Casualty, OIR
Sean M. Shaw, Florida Insurance Consumer Advocate

P R O C E E D I N G S

MR. PARTON: If everyone could please have a seat and we will get started? There are members of the panel that are not here yet that will be coming and going as we proceed. As everybody is aware, we do have a legislative session that's going on.

I would appreciate it if you would at least put your cell phones on vibrate so we don't get entertained by some of your more unusual ringtones. Thank you.

Good morning. My name is Steve Parton. I am the General Counsel for the Office of Insurance Regulation.

I want to, first of all, say thank you for having accepted our invitation to appear here today. The purpose of this hearing is to take a look at the use of credit scoring by the insurance industry.

There have been at least five companies that were invited to come and attend, and I want you to understand that it was not because there was anything that we thought was wrong, but you all unfortunately represent some of the major portions of the market and it seemed best to talk to those companies who have major portions of the market

that are using credit scoring to see, number one, how they're using it, and number two, other related matters to credit scoring.

The industry has made a number of claims about credit scoring. They have indicated that it has allowed greater affordability and availability. These are claims which have been made and we have yet to see any empirical data that would suggest that that is correct, so we're kind of interested in those particular claims. This is the primary value that the industry ultimately points its finger at for the use of credit scoring.

Moreover, the industry has also claimed that if you didn't have good scoring that, in fact, rates would go up, and certainly we're going to be asking questions with regards to that to see what support for that issue or that statement actually is.

We have a number of concerns about credit scoring. These concerns have, frankly, been ongoing and, in fact, preceded the passage of our credit scoring law.

There have been issues with regards to whether or not there is discrimination going on with regards to race or other factors through the use of

credit scoring, either intentionally or otherwise. Frankly, we have studied this for the last five years. We don't believe that there is any intentional discrimination going on by the industry, but there certainly are questions that have arisen.

The last study I saw was a study done by the FTC that made a number of findings. One of those findings was that credit-based insurance scores are effective predictors of risk.

One thing I have noticed is that the industry loves that finding. It's consistent with what they have always said, which is that it's a very good tool for identifying risk factors for claims, but there were other troubling, more troubling findings that were made by the FTC.

One was, and I am quoting from the report, "Credit-based insurance scores are distributed differently among racial and ethnic groups, and this difference is likely to have an effect on insurance premiums that these groups pay on average. Non-Hispanic whites and Asians are distributed relatively evenly over the range of scores, while African-Americans and Hispanics are substantially over-represented among consumers with

the lowest scores, (the scores associated with the highest predicted risk), and substantially under-represented among those with the highest scores." And I emphasize the word that they use, which is substantially, and that is a concern.

So the questions we are going to be talking about here today is what the industry may or may not have done to address these particular concerns with regards to that. It's even a larger concern now. We're at a time of an economic crisis. We have a downturn in our economy that's affecting a great number of people. People are losing homes to foreclosure, they're losing jobs. All of these have a potential impact on credit scores, and ultimately, then, the price of insurance that the insurance-buying public will have to pay. So the question then arises, what should we do about that?

So these are some of the issues that we want to address. We also want to take a look at how the use of credit scores is being implemented by the individual companies, which is why we have asked you to be here today, among other concerns that we will be addressing with you.

I do appreciate those of you who have responded with documents. I do know that there was

a short notice with regards to the subpoena, which I apologize for. I was glad that you finally called me so that we could try to work out some sort of arrangements so that you did not have to take extraordinary efforts to deal with our request for documents.

We going to start this morning, Senator Storms, how are you this morning?

SENATOR STORMS: Hello, how are you?

MR. PARTON: Very good. I appreciate your being here. It's really unusual for me to be sitting with you on one of these daises, usually I'm out there.

And I have to tell you, I am really uncomfortable sitting here. I mean, after all, this is where the Governor usually sits and the

Cabinet, and it's really uncomfortable.

I would like to introduce Senator Storms. Senator Storms is sponsoring a bill regarding occupational, educational and credit scoring and she has indicated the desire to address this particular hearing and we're going to allow you to do first off.

SENATOR STORMS: Thank you very much.

As you know, I chair Children and Families and

Elder Affairs, and so I have to hop on my horse and get to that meeting immediately after this, so I will be leaving immediately after my comments.

I just wanted to take the opportunity to thank Commissioner McCarty and you and everyone on staff for hosting this meeting and also for giving me the opportunity to address the body.

I think this matter is very important. And I guess we don't need to rehash what's happening in the economy right now, but certainly if it weren't for the economy then perhaps this would not be so timely, but it's particularly timely for people who are, through no fault of their own, who are really suffering from this economy.

I think of the dad with five kids who has had his hours cut back or maybe been laid off and he's doing everything he can, picking up odd jobs here and there just to keep his family fed and to pay the bills, and then to be faced with, because of this problem, to be faced with a downturn in his credit, which means credit is going to be tighter for him, and then as a result of that to see his insurance rates go up through no fault of his own, and the driver that he was the day before his job was cut back and the driver that he is after has

not changed at all, and yet he'll experience an increase in his rates.

People are being crushed by the economy right now and families are being crushed by the economy right now. The last thing that we need to do is to enable, to continue to allow insurance companies to crush the family further.

So I think that this is a matter of great public importance for our families. It's an economic stimulus, because any time we allow people to keep more money in their own pockets to pay the bills and to do the things that they need to do, then they will have more, hopefully more disposable income either to pay the bills or to go out into the economy and buy towels and groceries and maybe have a little bit of extra discretionary income.

The hearing today is so important, because I'd like to hear the testimony, I'd like to receive a copy of the testimony, if you don't mind. I'd like to review it. It would be very helpful to me as I shepherd this legislation through.

And I want people to understand, this is not beating up, this isn't taking an opportunity to beat up on the insurance industry or to blacken anybody's eyes. This is more of an opportunity to

protect Florida families, and to say for the people who disproportionately are being impacted by credit scoring methods, that -- when they may have had no control over their credit scores, then this is something that we absolutely need to address, and particularly when it goes to the issue of the disproportionate impact upon minorities and people at the lower socioeconomic level. Their lives are hard enough, and we need to do everything that we can to make sure that we give them an opportunity, that's what this is, is the land of opportunity.

So I just wanted to take this opportunity to say, we're going to help make sure people who are hard workers and who are not out there crashing into things, not out there speeding around, those are all legitimate things that insurance companies can take into account in the calculations of insurance rates, but credit scoring has no impact on their driving skills, on their ticketing, on any number of things. So there is not a cause and effect, in other words, between somebody having a credit score that's challenging and somebody who has a better credit score.

We all probably know people who have a very high credit score and yet maybe have gotten a lot of tickets, or drive like Mr. Magoo, I bet Mr. Magoo had a really great credit score, but the fact of the matter is there is no cause-and-effect relationship between credit scores and a person's driving skills and insurability.

I know that the industry has argued for a cause, a cause and effect, but it's not a cause and effect. At the very, very least it would be correlative, and in my opinion correlative is not enough to support charging additional rates.

So I won't take too much longer. I have to hop on my horse, as I said, and up to my meeting that I chair.

So thank you for allowing me to be here. Anything that I can do to be helpful, I want do.

MR. PARTON: Thank you, Senator Storms. As you know, the Commissioner and the Office is concerned about the credit scoring and what the appropriate way is to deal with those particular facts. We will be having a transcript prepared for this. We may even provide some sort of summary report which may make it easier for you as well.

SENATOR STORMS: Thank you.

MR. PARTON: Thank you again.

We have a tentative agenda, I say tentative because there may be folks that we have to perhaps interrupt in order to accommodate their having the opportunity to speak here today. We're expecting some members of the House and perhaps other members of the Senate who would come in and we're going to give them the opportunity to speak, too. So be patient and flexible if we have to interrupt you.

So first on the agenda is Mr. Birny Birnbaum. Mr. Birnbaum is the executive director of the Center for Economic Justice. I think he's also a consumer representative for the National Association of Insurance Commissioners, and he has agreed to be here this morning and to present his concerns and ideas with regards to credit scoring.

Mr. Birnbaum?

By the way, everyone that's going to be testifying, we're going to be doing so under oath. Don't be offended, but it's appropriate when we have these sort of evidentiary hearings that that be done.

Before you begin, Mr. Birnbaum, would you raise your right hand? Do you solemnly swear or affirm to tell the whole truth and nothing but the truth in the course of this hearing?

MR. BIRNBAUM: Yes.

MR. PARTON: Thank you.

MR. BIRNBAUM: Thank you.

My name is Birny Birnbaum. I am the executive director of the Center for Economic Justice, and I appreciate the opportunity to visit with you today about credit scoring.

Before I get into my qualifications and my general comments, let me try to put the urgency of this issue into context.

The rate of delinquencies, of foreclosures, of bankruptcies have skyrocketed over the past few years. Consumers are under incredible stress, financial stress because of job loss, which has doubled in many states, and not just unemployment, but underemployment.

The available -- resources available to consumers for paying bills has dropped while the pressure to pay those bills has increased. Health care costs have increased. A lot of consumers have either lost their health care coverage or the amount that their employers are paying has been cut back. So the pressure on consumers has increased dramatically.

Everybody seems to recognize that consumers are under tremendous financial pressure. Congress

is working to address the foreclosure problem for homeowners. They're trying to address the problem in financial markets with banks not making loans. They're trying to address the abuses in credit cards by passing laws that stop abusive credit card practices that gouge consumers. They passed a stimulus package to stimulate the economy. So everybody seems to recognize that the consumers are under pressure and that's reflected, obviously, in credit scores and other things.

Well, that is, everybody except the insurance industry. For some reason, the insurance industry seems to believe that credit scoring is good for consumers. They seem to be the only ones who believe that.

The idea that if you've lost your job, if your lender has cut back on your credit limit so that now your debt is the greater percentage of your limit, the fact that you're under this financial pressure, insurance companies think that the proper award for that is higher auto and homeowners insurance rates because your credit score has gone down.

Now, that's probably fair in the eyes of some actuaries, but I can't imagine that anyone else

would think that that's a fair practice.

MR. PARTON: Mr. Birnbaum, I hate to interrupt you, but if I could, we have a member of the Legislature here that would like to speak.

Representative Priscilla Taylor, welcome.

REPRESENTATIVE TAYLOR: Thank you.

MR. PARTON: I appreciate you coming and be willing to address this hearing, and we do appreciate you being here today. Thank you.

REPRESENTATIVE TAYLOR: Well, good morning. Having served as an insurance agent for many years I have seen the effect of using credit scoring as part of the underwriting guidelines in determining whether an individual should receive a preferred or a standard rated policy. I have had customers who have actually had no tickets, no accidents and prior insurance who could not qualify for a preferred rate simply because their credit score was low.

Now, the question that the customers who are affected by this always ask is, how does having a low credit score make me more likely to get into an accident, and why should a person with a low credit score, a perfect driving record, pay more for insurance than someone with the financial means,

some who are rich, who might have just totaled a car within the past six months?

Now, unfortunately this practice seems to have a disparate effect on minorities. Now, as we all know, red-lining is illegal. We know that. There was a federal challenge to that which made it illegal to do. But, however, this practice seems to be a back-door way for companies to charge higher rates to minority and ethnic groups which typically have lower credit scores, while all the same seem to be ignoring the customer's ethnicity.

Now, after having so many customers, because my agency has always been basically in the minority community, but after having so many customers being shut out of getting preferred rates, I did a little research on my own to determine if, in fact, there is a real correlation between credit score and frequency of claims.

Now, the correlation is so slight that 96 percent of those with less-than-perfect credit have perfectly normal claims frequency. In other words, 96 percent of those with weak credit are being punished for the behavior of a handful of individuals, most of whom would have been charged higher rates based on their driving records and

past claims history without ever looking at their credit score.

So the question that I ask still remains: How does having a low credit score make you more likely to get into an accident? And the answer, of course, that I have is that it doesn't. Thank you.

MR. PARTON: Thank you, Representative Taylor. I appreciate you coming and provide us those insights, and we look forward to working with you in the future. Thank you.

My apologies, Birny.

MR. BIRNBAUM: No problem. It's good to hear those comments.

Let me get into, I've been working on

insurance credit scoring issues since 1991, when I was the chief economist at the Texas Office of Public Insurance Counsel. I have continued to work on insurance credit scoring issues since then, including my role as Chief Economist and Associate Commissioner for Policy and Research at the Texas Department of Insurance, where I was responsible for the review and approval of rate filings.

I have been accepted as an expert on both economic and actuarial issues related to rates and risk classifications. I have worked on insurance

scoring issues at the NAIC, both as a regulator and as a consumer representative, over the years, and I have testified before Congress on the issue of insurance credit scoring.

The three points or three topics I would like to talk about today, time permitting, are these.

One is that insurance scoring is unfairly discriminatory, in violation of both actuarial principles and statutory requirements in Florida. Consequently, the Office of Insurance Regulation has the authority and the responsibility to disapprove insurers' use of consumer credit information for underwriting, tier placement and rating.

Second, insurance scoring is unfairly discriminatory in a broader sense. It violates public policy and should be prohibited by statute.

Third, I have some comments on the proposed
rule if you have a time and interest on that today.
First let me talk about insurance scoring
being unfairly discriminatory in violation of
actuarial principles and statutory requirements.
Risk classification, which is basically the
factors that are used to determine how premium is
allocated to different groups of consumers, must be

equitable or fair. The factor, which is the
characteristic of the consumer, the vehicle, the
property, must accurately reflect differences among
expected costs and it must be objective and
consistent. It must be a specifically determinable
fact, not subject to manipulation.
Let me give you an example. Let's say that we
were going to use your hair, we were going to use a
model of your hair, or lack thereof, to determine
your rate, and we had a model that factored in
color, hair length, hair thickness, the amount over
your ears, et cetera.
MR. PARTON: This is really personal, Birny.
MR. BIRNBAUM: I know.
Well, why wouldn't that be a good risk
classification? Well, because it's so easily
manipulatable, right? You can shave your head, you
can cut your hair, you can change your hair color,
you can thicken it, you can thin it, you can do all
sorts of things. So once you know about the risk

classification system, you can engage in anti-selection or adverse selection; you can manipulate the system, you can manipulate the risk characteristics.

But clearly it's not an objective

characteristic, it's not an objective factor, and violates both actuarial standards and statutory provisions.

Well, credit scoring is really quite analogous to using your hair. I'll go through a very lengthy list of things and reasons why credit scoring is not objective and why it's subject to manipulation. Not only is it subject to manipulation, there are companies out there advertising to manipulate it. So think about that. Think about other rating factors that are used.

Well, we use your driving record. Come on in, we'll manipulate your driving record. We'll expunge that accident or we'll make it not as severe. Well, we know that's not going to happen, because companies have claims databases that they rely upon.

Well, what about miles driven? That's very popular. Well, I'm going to manipulate that. How am I going to manipulate that? Well, if I engage in fraud and turn back my odometer, perhaps, but otherwise you can't manipulate it. What it is is what it is.

Look at other factors that are used, your age, driving experience. You can't manipulate those

things. The type of vehicle that you drive, whether you have an anti-theft device, whether you have wind-resistant construction on your home, these are not subjective criteria. They're objective facts that you can use.

Now, let's look at credit scoring. How about let's start with the definition of a bankruptcy? If you have a bankruptcy on your account, that's a very negative thing. Well, what's a bankruptcy? Well, you filed this thing, except Congress a few years ago changed the criteria for bankruptcy, so now it's different than it was a few years ago, the things that you have to do in order to qualify for a bankruptcy and the type of bankruptcy that you can get.

So what happened is there was a huge surge in bankruptcies right before the law became effective, then it dropped off dramatically because everybody rushed to file bankruptcy, and then it has increased since then.

Well, if in fact there was a relationship between bankruptcies and auto claims we would expect the kind of relation, we would have expected a huge surge in claims, then a huge drop, then a gradual increase. That hasn't been the case, of course.

What about foreclosures? Well, if you can't pay your debt, your home goes into foreclosure. That's a serious problem. Well, except that companies have now, Fannie Mae and Freddie Mac have said, we're doing a moratorium on foreclosures. So again, where is the objective criteria by which you determine what a foreclosure is and how you come into foreclosure? Yes, it's objective if there's a foreclosure on your credit report, but what's not objective is how you came to that.

So if you, if it's completely arbitrary how these things become an item on your credit report, then it can't be an objective characteristic.

Fair Isaac is the originator of scoring models. They are the originator of insurance scoring models. They reported a couple of years ago, they admitted, finally, 25 percent of the population is unscorable using traditional credit information. 25 percent, which is approximately 50 million households across the country.

Well, what does that mean? Well, what it means is, the way insurers use it, is that all of a sudden there is this humongous block of consumers who are treated poorly, because by and large if

you're unscorable, if there is a no-hit, then you get a worse credit score and higher premium.

Now, clearly, within that group of 25 percent there is a whole spectrum of consumers, some of which are high risks, some of which are low risks, but you have this huge group that's being put in there.

Now, why don't people have information on their credit report? Again, does it have something to do objectively with the risk of loss? No. People don't have it in there for a variety of reasons.

One, the lenders don't report it. There are a variety of lenders who don't report to credit bureaus, not just types of lenders, like payday lenders or check-cashing operations, but small lenders. The credit bureaus won't even take report information from lenders unless they meet a certain threshold of volume. So one of the reasons that people don't have information is that their creditors, their lenders don't report it.

Another reason is they don't use credit, they pay cash. So when we get to the industry defense which is blaming the victim if you have a good credit score, it means you're financially

responsible, therefore you're more likely to manage your risk, that's the insurer mantra, we find out that that's clearly not the case. There are plenty of people who are financially responsible who choose not to use credit for a variety of reasons.

Here's another example, another reason why it's an arbitrary risk factor. The information in the three credit reports vary, in some cases dramatically. I know from my own experience that inquiries, for example, when I checked my three credit reports there was not one inquiry that was common to all three. And inquiries have a very big impact on the credit score, for some reason. They're using the models -- well, I know the reason, it's a data-mining exercise, but there is no logical reason why inquiries would be involved with this.

So the three credit reports have different things, and depending upon which credit bureau you use, your credit score can be high, low or in between. Well, that's clearly an arbitrary event, depending upon which credit bureau your insurer happens to use.

Now, consider how that issue is addressed in the whole lending market. Number one, most lenders

use all three credit bureau reports, they get a merged report so you don't have that issue.

Now, remember, your credit score is a function not just of what's in your report, but what's missing from your report. So missing information can hurt you just as much or more than having negative information in your report.

So when you have a situation where, depending upon which credit bureau you go to, you get a bad score or a good score, that's arbitrary. That's not an objective criteria for risk classification.

Lenders have also started coming out with new scoring models that not only merge them, but produce a common score, the so-called VantageScore from the three credit bureaus, in which they try to address the problem with the differences among the credit reports. You never see any of that in insurance credit scoring.

So that's an arbitrary thing that, number one, clearly indicates that it shouldn't be used for risk classification, but number two, even if it is allowed, any rule regulating insurance scoring should mandate the use of the three major credit reports in a merged fashion so that consumers aren't penalized because of the differences between

the three credit bureaus.

The timing of the report, factors that have a big impact on your credit score include the balance on your credit to your limits. Well, if you happen to have your credit report taken right before you make your payment, your balance is going to be high. If it's the day after you make your payment, the balance is going to be low.

Well, how can something be termed an objective characteristic when the score can change within a

three- or four-day period based upon when you got that credit report? The fact that it can vary over time, a short period of time like that, indicates it's not objective.
MR. PARTON: Is it not also an issue that creditors, banks, credit cards can arbitrarily reduce what your credit limit was, which then again would change overnight the relationship between what your balance is and what your overall credit is?
MR. BIRNBAUM: Well, exactly. That's a few down on the list.
MR. PARTON: My apologies.
MR. SHAW: If your credit score is so arbitrary, why do banks use it to determine if

you're going to get a loan?
MR. BIRNBAUM: Well, first of all, banks use it because they're in the business of lending money, so they want to gauge, they want some measure of whether you have paid your loans back in your past. They're looking at your loan payment history. So the information is directly relevant to their purposes, number one, and number two, they actually take precautions, they address some of the problems with the arbitrary nature of the credit report, such as the use of the merged reports, use of the VantageScore.
In addition, lenders are also getting into the

use of non-traditional credit information. You remember I mentioned before that 25 percent of the population is unscorable. Well, there's now additional what's called non-traditional credit information, including rental payments, utility payments, things that don't make it into a normal credit report but that do make it into these non-traditional credit reports, and that information is being used because that provides a richer description of whether consumers are paying their bills on time. So that's exactly what lenders are looking for, does somebody have a history of paying

their bills on time.

Now, let's say I went into a lender and they said yes -- I wanted a loan for my car and they go, well, you know, I know that most banks are looking at whether you've paid your previous loans back, but we're not interested in that. We've got a new model. It's based on your driving record and your claims history, and based on your driving record and claims history we're going to decide whether we're going to give you an auto loan. We don't care whether you've paid your previous loans back like clockwork. You have an accident; therefore, we're not going to give you an auto loan. Consumers would be outraged, and rightly so.

Why should the ability for me getting a loan be contingent on whether I got a ticket or an accident? It shouldn't, it's not relevant to that, but that's exactly what happens. The inverse of that is exactly what happens with credit scoring. You go in, you get a policy based upon -- and the rates should be based upon the expectation of your claims and your driving record, and it's based on this information that was collected for lenders.

MR. PARTON: I've got one question, Birny. I was once asked the question, and I'm going

to address it to you, and I don't think I answered it very well. It's along the lines that you just talked about. I go to a bank, they ask for this information and we're perfectly okay with that being information for purposes of a loan. Why is it not appropriate, or how is it being used, if you will, by the industry, when the insurance industry, who shouldn't be concerned about whether I can pay back a loan, but is actually using it to predict when they will actually have to pay? Do you have any comments about that?

MR. BIRNBAUM: Well, I'm not sure I follow.

MR. PARTON: If it's okay for the bank -- I understand you have addressed part of this, okay, because what the banks are trying to do is to determine is who is a good credit risk in terms of paying money back. How is that relevant, if you will, to insurance, if at all?

MR. BIRNBAUM: Well, it's not. I mean, let's take a step back and say, how did the use of insurance scoring come about? Was it because insurers had this idea, we have a theory that credit is going to somehow be a good predictor of claims, and therefore, we're going to test that out? Is that the way it happened? No.

The way it happened is people who were in the business of collecting credit information and developing credit scoring models wanted to go beyond banks. It's a data-mining exercise. It's not an exercise created on the basis of any kind of theory, it's a data-mining exercise which says, look, credit scores and credit histories are a huge database that we have on almost everybody in the population, this is great, we can do data-mining on it. And what data-mining means is we can sift through the data to see what sorts of relationships there are.

It's not as if there's any kind of theory that links credit to insurance if any of the explanations are after-the-fact rationales. It's simply a result of data-mining using an existing database.

I guarantee you if there was a huge database of genetic information available to industry, they would be using it, and, you know, they would be figuring out how the genetic information relates to auto claims, using data-mining. They'd develop a model for it, they would implement it, and then after the fact they would rationalize why it's relevant. But going in, it's just a data-mining

exercise.

Which really gets to the second point that I'm going to talk about, why it should be prohibited, because it undermines the insurance mechanism, the use of credit scoring.

So still I want to really focus for the initial part on why this is an arbitrary risk classification and therefore in violation of actuarial principles and statutory requirements.

I talked about the timing of the reports. What about errors? The 2004 Federal Reserve Board study said that 25 percent of the reports, credit reports have out-of-date information.

Now, we already know that the credit reports don't contain information from certain types of lenders. They don't contain information on other types of payment history, like rental payments or utility payments.

So remember, it's not just errors in terms of you have a bankruptcy stated here when you don't really have one; it's errors of omission. The absence of credit information is just as harmful as the presence of negative information. So errors of omission are critical here, and we know that there are plenty of errors of omission.

Now, the key issue here in a risk factor is, can you manipulate it? Can you take a factor, is it objective and non-manipulatable, or is it something you can manipulate?

Well, credit scores are clearly something you can manipulate. There are businesses out there who advertise, "Manipulate your credit score." They tell you how to manipulate your credit score. They tell you all the things to do within a 30- to 60-day period.

Now, clearly, something cannot be an objective characteristic if you can manipulate that, if you can manipulate the score significantly in a short period of time. It's like the example I gave you with the hair.

Now, the thing that's so bizarre about this is that so much in your credit report is a function of the business decisions of lenders.

Now, again, when you think about a risk classification as an objective characteristic, you think of it as a characteristic of the consumer, of the vehicle or the property, but when it comes to the information in your credit report, it is information that changes based on business decisions of lenders.

Look at a variety of things that lenders do. First of all, let's talk about the decision to loan money. Let's talk about auto and home loans over the last three years or four years. Let's talk about predatory lending in the sub-prime crisis, lenders choosing to focus on minority communities for abusive and predatory lending practices as identified by a number of fair housing groups. Let's talk about lenders' decisions to throw money at consumers with stated income loans, no down payment, with exorbitant appraisals of homes. So consumers are basically having money thrown at them and beyond their capacity to pay, and somehow consumers are supposed to be the ones who know, yes, this is a good for me in terms of my credit score.

How about auto loans? It used to be you put some money down for an auto because the auto was the collateral for the loan. Over the last several years, what's happened with auto loans? The term of the loan has increased, the amount of the loan has far exceeded the amount of the vehicle, so that the amount of the loan far exceeds the collateral.

Well, that's irresponsible lending practices in auto, just as there were irresponsible lending

practices in homeowners. So the credit reports of consumers suffer because of those irresponsible lending practices.

Now, let's talk about the reporting decisions of lenders. Some lenders have decided they're not going to report the credit limits, which means that what's in your credit history is the balance, your credit limit is the balance, because the lender doesn't report the actual limit, which means that instead of the actual balance-to-limit being used in your credit score, you have 100 percent used, which is your balance to your balance.

Now, that's clearly arbitrary. It's clearly not an objective description of the risk or of the consumer or of the characteristic.

How about lenders deciding all of a sudden, I'm going to cut the limits on your home equity loan, I'm going to cut the limits on your credit card and I'm going to raise the rates and I'm going to raise the fees on this? All of these things come into play.

Well, what happens with that decision? Well, immediately the credit score changes, because some of those objective, quote, unquote, objective characteristics change, but what else happens?

Well, now, consumers who were paying a certain amount in interest for carrying a credit card balance are paying more, all the penalties increase, so those thing changed because of the credit decisions based on -- of lenders, not because of the behavior of consumers.

Again, it's an arbitrary set of characteristics that can be manipulated and that are, by and large, the result of business decisions of lenders, not things that are the actions of consumers.

Now, let me say I'm not trying to excuse consumers who engaged in reckless borrowing, and certainly there are consumers who borrowed and have borrowed over the past few years when they shouldn't have and could have known and should have known better.

But the evidence is pretty strong that there was a lot of irresponsible lending going on. The fact that we have had a financial crisis, a meltdown, we're talking about literally a trillion dollars of home loan defaults rippling through to collateralized debt obligations and mortgage-backed securities, suggests that it wasn't consumers who were the ones who were saying, "We have to have

this." It was business decisions of lenders and Wall Street investors who were throwing the money out there and making irresponsible loans.

Why should consumers be penalized with higher auto and homeowners insurance rates because of that? Again, we're not talking about consumers saying, okay, we borrowed too much, now we can't get any more loans, but why should the irresponsible actions of lenders in throwing money at consumers translate into higher auto and homeowners insurance rates because of credit scoring?

Now, the defense of the industry is that, look, we have a statistical relationship between credit scores, basically the output from your credit reports, these things that we call credit scores, and the risk of loss. We use sophisticated statistical models, generalized linear models to show that there is this relationship.

Well, the problem with that is that, one, you can model anything. For anybody who has an economics background, econometric models have been used for a long time by economists who predict and model the economy, and while you can get an econometric model that describes perfectly

historical experience, it's rarely effective in predicting the future. You can model historical experience to a point, because you can model anything, but if there was truly a relationship, if there was truly a relationship between credit history and expected losses, then what we would expect to see is the same type of relationship that we see between other rating factors and losses, which are, as there is an increase in risk factors, there is an increase in claims.

For example, we know that youthful drivers are involved in more accidents than more mature drivers. Well, as the population ages and the percentage of more mature drivers grows, we see a lower frequency of claims. If the population of youthful drivers were to quadruple, we know there would be an increase in the frequency of claims. But when it comes to credit scoring, when the number of bankruptcies quadruples, when defaults and delinquency doubles, when all of the characteristics associated with, quote, unquote, bad credit increase, we're not seeing the huge increase in claims that you would associate with that type of activity.

In fact, as credit scores have worsened, as

credit characteristics have worsened, we've seen a flattening or a reduction in the frequency of non-catastrophe claims, which of course, doesn't even get into the issue of catastrophe-related claims and how that could possibly be related to credit history.

The other thing is when you look at the models, when you look at the output that the companies produced, what they're looking for is something called lift. They segment the population, they segment their policyholders in such a way to produce the greatest lift, meaning the greatest difference between those with the worst credit scores and those with the best credit scores.

Well, the problem is that when we look at the actual data of the segments in between, it's not a smooth curve. You go through there and you'll see that there are some groups with an average credit score below another group of an average credit score, but because they're ahead on the curve they get lower rates or they get higher rates even though they should be getting lower rates. In other words, when you look at the actual segment it's not a smooth curve, there are contradictions

in there, but it's modeled as if it were a smooth curve.

Well, the result is that consumers who actually had better credit scores get worse rates because of this smoothing.

Now, let me move on to some of the public policy reasons for banning credit scoring.

First off, there are two core functions for the insurance mechanism. One is to provide essential financial security tools for consumers so that in the event of a catastrophic event, a car accident, a fire, a hurricane, that the consumer isn't wiped out.

In the absence of insurance, consumers would, particularly low- and middle-income consumers, would not be able to develop any kind of financial assets, would not be able to engage in economic development and progress. Insurance is clearly essential for economic development and community development.

So in order for that to be true, insurance has to be available to consumers and it has to be affordable, and, of course, most states, including Florida, require insurance to be available because it's mandatory for auto insurance, and lenders, of

course, require insurance for home mortgages. You can't buy a home unless you can really get homeowners insurance.

So availability and affordability is an important aspect of this, because it's part of insurance serving its role as an essential financial security tool.

The second role of insurance is loss mitigation. Insurance is the preeminent tool for providing feedback to consumers about engaging in less risky behavior and avoiding more risky behavior.

Risk classification should be providing economic incentives to consumers to reduce their risks. For example, one of the best examples is discounts for wind mitigation. If you weatherproof your home to withstand hurricanes, you get large discounts. Why? Because you're engaging in loss mitigation. And discounts like that, just like discounts for anti-theft devices in automobiles, not only promote less risky behavior, but they pay for themselves. They're discounts that pay for themselves, because nobody else has to pay for you getting that discount.

If I get an anti-theft device in my vehicle

and I get ten percent discount of that, that discount is paid for by the lower likelihood of a claim. If I do retrofitting on my home for withstanding hurricanes, nobody else has to pay for that discount because that discount is paid for with the lower exposure, lower risk of loss.

Compare that with credit scoring, where there is no reduction in claims. In fact, I would submit there is an overall increase in costs due to credit scoring, but at a minimum, there is no reduction in claims. All it is is a redistribution of income, and when you combine that fact, that there is no true loss mitigation, with the hyper of sort of rating that's going on, the ultra-refined risk classification where you have great differences between lowest rated and highest rated, what happens is that consumers see huge differences in their premiums based on this factor that has nothing to do with loss mitigation, but which increases the spread between the highest rate and the lowest rate.

Of course, the people who are penalized the most are the ones who are already least able to afford the insurance, because credit scoring has a disproportionate impact on lower income and

minority consumers, and now has a disproportionate impact on middle income consumers because of the economic crisis.

So now let's talk a little bit about the discriminatory effects based on income and race.

Now, for anybody who has looked at the credit scoring models and seen the factors that are in the models, for example, balance-to-limits, payments, delinquencies, things like that, as well as types of credit, you look at the models, you see what types of factors penalize consumers and you see those are clearly related to, strongly correlated to income and race.

Since the mid-'90s I've been pointing out data produced from the Survey of Consumer Finances, published by the Federal Reserve Board. It shows the number, the percentage of consumers who are 60 days overdue on a loan, broken out by income. Well, the percentage of consumers overdue on a loan is much higher for the lowest income group than for the highest income group, much higher. It's ten times, 15 times higher. So the idea that somehow that criteria, that objective fact wouldn't ripple through the credit scores and provide a correspondingly disproportionate impact on consumers based on income is, of course, ridiculous. Of course, it's going to have that impact.

There's no real debate, there's no serious debate about whether credit scoring has a disproportionate impact based on race or income. The Texas and Missouri Departments of Insurance studies found that strongly. Even the FTC study, which was a wildly biased study, using data hand-picked by insurers for a small segment of the population that they didn't have any idea whether the data had been prescreened for credit or not, so even with all those limitations, the FTC still found a disproportionate impact. So there's no serious debate about this.

So the question arises, if you can't use race and income directly, why should you be able to use it indirectly? And there's no question that credit scoring represents an indirect use of that.

Now, let me get to the fact about the models. I just talked previously about how if credit scoring was truly related to risk we would expect that, over time, as characteristics of the model that are associated with bad scores increased, we should see an increase in claims, such as an

increase in delinquencies, an increase in foreclosures, an increase in bankruptcies, an increase in debt-to-limit ratios.

Well, we've seen all that, but we haven't seen any kind of corresponding increase in claims, which sort of brings up the issue of whether the models are, in fact, legitimate for this period of time.

Now, remember, I said, I talked earlier about how econometricians have always modeled the economy and it's easy to model the past, but predicting the future using those models has been difficult.

Well, that's no different than credit scoring models. Fair Isaac admitted that its lending scoring models did not work in predicting sub-prime defaults. They revised their credit scoring model for lending to address some of the problems that they identified because of the sub-prime crisis and the resulting impact on the credit scoring model.

We have seen nothing like that for insurance scoring models. We have seen nothing that says, look, these models need to be recalibrated at least once a year, they need to be tested on an ongoing basis. If you look at the credit scoring models in other states and the justification that's provided to them, it's data that's two, three, four, six,

seven years old.

Now, in most states, the Insurance Service Office files loss costs every year, and they have a methodology in which they develop loss costs for auto and homeowners insurance. Now, they use the same methodology by and large each and every year, but they recalibrate the results of that model by putting in fresh data each year.

You don't see that same type of activity with credit scoring models. It's like, once the model is developed, it's good in perpetuity. Again, it's a problem with the models, it's a fundamental problem with scoring.

Now, how am I doing on time?

MR. PARTON: About another 15 minutes, and then we have to call it.

MR. SHAW: I just want to ask this. So what you're saying is it's good at explaining the past, but not predicting the future?

MR. BIRNBAUM: Well, yes, and let me expand on that.

When you do any sort of modeling, particularly a data-mining exercise, you take all these characteristics, and remember, you can get something 450 different credit characteristics out

of a credit report, and you do data-mining on that with a huge population, and you say, look, what I'm trying to predict is the likelihood of a claim, or I'm trying to predict the likelihood of a consumer renewing in six months, or I'm trying to predict the likelihood of a consumer buying other products from us, including life insurance.

So what happens is you take that historical experience and you model it and then you compare it to some recent data. You say, did it work or not. That's how the models are done, that's how they're tested.

But what happens is when there's a sharp change in the underlying data, then that model is no longer predictive, and that's what econometricians have always found. It's like, okay, we've been able to model inflation and unemployment, and yet for some reason the models were always wrong. Why? Because there are all these other factors that are in play, number one, and because, number two, there are always new circumstances about these things.

So first of all there's a fundamental limitation of modeling, and two, the models are being used today in a period for which the experience is completely different than the period in which they were developed and generated.

Does that answer your question?

MR. SHAW: Yes, thanks.

MR. BIRNBAUM: Do you want any comments on the proposed rule, or is that a separate issue?

MR. PARTON: That is a separate issue that we had a hearing yesterday, Birny. However, any comments that you want to produce in writing with regard to that we will include in that other matter if you want, but I would rather you stay on the topic that we're on now.

MR. BIRNBAUM: Let me take a few minutes to respond to some of the industry arguments and the industry defenses.

Ultimately, the insurers' argument has come down to one, which is that insurance scoring is good because it enables us insurers to more accurately price our risk, and by more accurately pricing the risk, number one, it's fairer to consumers, and number two, it enables us to write more business. So basically the whole premise on this is more accurate pricing, more accurate risk classification is going to result in benefits for consumers.

And the problem with that is that it's not a universal truth. Surely if you're going from average pricing for everyone to some type of risk classification, you're going to have those benefits. It's going to be fairer to use some risk classifications than no risk classifications. You're going to avoid anti-selection by using some risk classification than no risk classification. But at some point additional risk classification simply doesn't achieve that goal.

All additional risk classifications add complexity to the system and they undermine the risk classification system in the ways I told you about, by introducing rating factors by credit scoring that provide zero feedback to consumers about risk mitigation and loss prevention, and encourage consumers to manipulate their scores instead of actually taking steps to lower their risk profile.

But there's no objective data to substantiate any of the insurer claims. If, in fact, credit scoring enabled insurers to write more business, then what would we expect to see? We'd expect to see great reductions in assigned risk plans, great reductions in uninsured motorist, and we'd see

agents standing up, going, "Hallelujah, this is the greatest thing since sliced bread because we can now write more business."

Well, what's the facts? Most agent groups are vehemently against credit scoring. The State Farm agents, the Allstate agents, the Farmers' agents. Aging group after aging group is against credit scoring. Now, if credit scoring were so great for consumers, these aging groups wouldn't be opposed to it.

Second, what has been the experience since the onset of credit scoring in intense ways since the early 2000s? Have we seen a decline in the uninsured motorist rate? No. The Insurance Research Council recently came out with a study showing an increase in uninsured motorist rates.

Have assigned risk rates dropped? Well, first of all, the primary reason why the number of people going into assigned risk plans goes up or down is where those rates are set, whether they're competitive or not competitive with the voluntary market, but the bottom line is that the FTC study found that there was no decrease in the incidence of assigned risk.

So there's no evidence to support the insurer

contention that the use of credit scoring enables them to write more business. Moreover, the studies that have looked at it are fundamentally flawed because they only deal with policyholder information. Basically they only deal with information on consumers who purchase the policy.

If you wanted to actually look at whether credit scoring had an impact on the availability or affordability of insurance, then you need to get data on applications. You need to get data on everybody who applied for insurance, what their credit score was and what the result of that was. That's the only way you're going to be able to decide and to see what the market impact of credit scoring is.

Looking only at policyholder data is not going to get you there, because you're not going to get people who were denied coverage, you're not going to get people who were priced out of the market because of credit scoring, you're not going to get the critical information that you need. And that, of course, is one of the problems with the FTC study. Had they used application data, it's clear that they would have found a much stronger disproportionate impact based on income and race,

and the reason I know that is because if you look at the data that they had, it was dramatically underrepresented, the policyholder data they had was dramatically underrepresented in areas of low income and minority consumers and they had to adjust the data accordingly.

Again, insurers never advertise their use of credit scoring. When you look at the ads, they say, "We're looking for great drivers, we've got discounts for everybody, if you're a responsible driver, if you've had no accidents." You never see advertisements for credit scoring. Why? Why is that?

Because they don't want consumers to know that they're using credit scoring, and when you look at the disclosure that they provide and the reasons that they provide there's no useful information provided to consumers.

MR. PARTON: Birny, if I could just make one comment about that, I understand what you say, but I will tell you that there are insurers in Florida that are advertising credit scoring. However, they may very well be in violation of Florida law, because the way they're advertising it is, if you reduce your credit score we'll get you a better

rate, which suggests that the sole reason for the rate that individual is getting is based on a credit score; or, if you have a particular credit score, we'll give you a better rate, again suggesting that the only matter that's being considered is the credit score, which, frankly, under Florida law is unlawful.

So I agree with you, and not necessarily advertising the way that you say, but they may be misusing it in the market out there.

MR. BIRNBAUM: Well, let me finish up, and I appreciate you providing me with all this time.

MR. PARTON: Please do, because I think there may be some questions. I'm not sure. So let's just sort of wrap it together here.

MR. BIRNBAUM: Yes. I just have two more quick points.

So the basic argument that insurers make is it enables them to price more accurately and write more business. The fact is that pricing more accurately, there are limits to how useful that is in terms of achieving things like anti-selection, avoidance, achieving loss mitigation, any of the benefits of risk classification, there is a limit, and at some point going beyond it doesn't achieve that and can harm that.

With credit scoring, what happens is you get this ultra-refined risk classification system, where, in effect, there aren't classes of consumers, it's just a continuous set of rates that are generated for any individual consumer.

Insurers argue most consumers benefit from credit scoring. That's the main argument that they use when they're trying to fight back bans on credit scoring. They basically threaten legislators, saying, look, if you ban this, most consumers are going to see rate hikes.

Well, first of all, it's highly unlikely that insurers are going to jump to raise their rates on the customers that they think are their best customers and their most preferred customers. But again, having said that, when they say most consumers benefit, again, it's within this context of people who have purchased policies. It doesn't include the broader population of applicants.

And finally, I would like to ask you when, if and when, and I'm sure it will be when, insurers come up here and explain to you or argue to you that credit scoring is a measure of financial responsibility, that you denounce them on the spot.

This idea of blaming the victim, that somehow consumers who have a bad credit score are financially irresponsible and consequently morally irresponsible, is not only untrue, but it's truly offensive.

There are so many reasons why consumers will have a bad credit score unrelated to anything related to financial responsibility. The credit history doesn't contain any information about your savings, about whether you have life insurance. It doesn't contain information about whether you're financially responsible. It contains information about a small set of loans and whether you repaid those loans.

So the idea that insurers will try to villainize the victims of credit scoring, people who have lost their jobs, people who are the victims of a hurricane, people who have lost their health insurance, people who have gotten divorced, people who have had dread disease and have lost all their savings and are spending all their money to fight health things, to turn around and call people who have experienced this kind of economic crisis, to call them financially irresponsible, to call them morally irresponsible, is not only wrong, but

it's something that should be denounced.

So I will finish with that and I'll be happy to take some of your questions.

MR. SHAW: I've got a couple. What is your credit score a reflection of? If I were to look, I mean, what is it?

MR. BIRNBAUM: Your credit score is a reflection of information contained in the credit report that your insurance company is using, so it's a reflection of the information that some lenders have recorded and it will be a reflection of payment history on some of the loans that you have, perhaps, not necessarily the whole loan. It will be a reflection of information that's in that credit report.

MR. SHAW: I mean, it's a small component of the overall financial picture of that person is what you're saying?

MR. BIRNBAUM: Well, depending upon who the person is, it could be a very small component.

For example, if you have very little information because you pay cash, you don't use credit, if you have very little information because you live in a low-income community and your lenders are check-cashing operations, payday lenders, rent-

to-own operations that don't report to credit bureaus, yes, it's not going to be a reflection of very much, which is why Fair Isaac has said 25 percent of the population is unscorable and why there is now a movement to get non-traditional credit information and why lenders consolidate three credit bureau reports to make sure that there's not missing information.

MR. SHAW: And just one more, are there any other states that have totally banned the use of credit scoring in the auto industry?

MR. BIRNBAUM: Yes. Hawaii bans it for both homeowners and auto. California has banned for auto because of Proposition 103.

MR. SHAW: And what happened to the affordability and the access to auto insurance in those states that totally banned it?

MR. BIRNBAUM: Well, I mean -- what happened?

MR. SHAW: I mean, the claim is that if you don't use credit scoring that it will become less affordable and less accessible. I just want to know in the states that did ban it, did that happen?

MR. BIRNBAUM: Well, the reason I'm not just answering there's been no impact, basically you

can't see any difference in states that don't allow it from states that do allow it, I'm going to try and be a little more nuanced in my answer.

In Hawaii it's been in effect for decades. So in theory insurers have never used credit scoring in Hawaii, so there is no before and after to check. But clearly auto insurance is available in Hawaii and there are people writing it, even though it's a small market.

In California, it's not allowed for auto insurance and hasn't been since the late '80s, so that was before the period of time in which insurers started using credit more intensively. So for all intents and purposes, there is no before and after in California. But California is a big state and the absence of credit scoring clearly hasn't prevented all national insurers from operating there and it hasn't prevented competition in that state.

It's also been banned in Massachusetts. Massachusetts banned it because they promulgated auto insurance rates and auto insurance rating factors and it was never included there. Massachusetts in the last couple of years has gone to a different system in which they allow insurers

to use their own rating factors and to file their own rates, but they did not permit it for auto insurance, and yet companies have come into the market, new companies have come into the market and there has been, even by industry standards, there has been an increase in competition in Massachusetts.

In Maryland, they've banned for homeowners insurance and there is a limitation on the impact for auto insurance, which means, I forget the percentage, I think it may be 50 percent, but there is a specific percentage in which the rate for the two consumers, otherwise identical, one with the worst credit score and one with the best credit score, can be a maximum percentage difference in those rates. And although insurers have claimed the restrictions on credit scoring in Maryland have really had an impact, again, there's no objective evidence that there's been an absence of a competition there because of the limitations on credit scoring.

Those are the only states I know that have banned credit scoring, but clearly if you compare states you don't see differences in claiming activity, you don't see differences in insurers'

writing based on the fact that there's credit scoring or not credit scoring.

MR. EAGELFELD: Does the state of Washington also ban credit scoring?

MR. BIRNBAUM: No, Washington doesn't ban credit scoring. They have a little more detailed regulation than most other states, typically related to disclosures of reasons.

Oregon has a little more restriction, in that I think Oregon allows it for initial underwriting but doesn't allow it for renewals. So there's that. Of course, there is, again, no experience that the limitations in Oregon have restricted competition or driven anybody out of the market.

MR. PARTON: I have a quick question and maybe
an observation. I'm interested in the fact that
more than 25 percent of the people out there are
not scorable and we have this huge category both
here in Florida and elsewhere called no hits/no
scores, and Florida law basically provides that if
you have a no hit/no score which would involve that
25 percent of the people that are out there, that
the insurer, among the things they can do, is put
them into a neutral scored group.
Of course, what is defined as neutral is left

up to the company, but in all respects it is not
the best rate, it's somewhere above what the best
rate is, but below what the other rate is.
Given you have this broad area called no hits/
no scores and, as you indicated, that you may be
capturing a whole bunch of different groups of
people within that area, would it be prudent to
require insurers to further test that group, if you
will, based upon either age or sex or other
factors, to see whether or not there is, from an
actuarial standpoint, an unfairly discriminatory
impact as a result of lumping all these people into
this score?
And I ask that because at least one insurer
actually did that one time. What the insurer
discovered was that there was a group of people
based upon age that, frankly, had a better claims

history than what this neutral scoring group has done, and had they not bothered to analyze it further, it would have never shown up.

How do you feel about that? Again, I understand you don't think credit scoring should be used at all, but in terms of other things that may be done, what are your thoughts?

MR. BIRNBAUM: Well, I think first the fact

that 25 percent of the population is lumped into this basically unscorable category in and of itself indicates that we have an arbitrary and unfair, unfairly discriminatory risk classification, because it's clear that within that 25 percent there are distinct groups with different types of risk exposure. So that's the first thing.

Now, in response to your question, should insurers be required to try to segment that group to better identify classes of consumers within that that have demonstrably different claims experience, well, I guess in theory it should be. I mean, if you're going to allow credit scoring, then sure. I mean, the idea that you just sort of say, okay, here's a group that -- everybody else and we're going to treat them as this homogenous operation doesn't make sense and is unfair.

And you also mentioned the part about they need to be treated neutrally. That is another problem, which is in theory people who are unscorable should be treated as if no credit score was being used in their premium evaluation.

MR. PARTON: Well, that's one of the options insurers have. I don't know that it necessarily is used that often, but they do have that option at

least under Florida law. You either treat them neutrally or you treat them using -- not using credit scores at all, and there's a third way as well. So the option is there, but the option is left up to the insurance company.

MR. BIRNBAUM: Well, the problem with that is to treat somebody as if credit scoring weren't being used would require a parallel rating system and parallel actuarial analysis to determine what the rates and the rating factors would be if there was no credit scoring.

Well, with credit scoring you can't just say, oh -- you can't just say, here's a rating program that's incorporated, that incorporates credit scoring and now we're going to just say, well, we're going to use that, but just say we're not going to use the credit score factor.

Well, the credit score factor impacts all the other factors within that rating framework. They may be off-level factors, because, for example, if you decide that you're going to use credit scoring only to offer discounts to consumers, so you raise the base rates 200 percent so that now you either

get no discount if you're the worst credit score or
you get a 50, 60, 70 percent discount if you have

the best credit score, how do you say, well, we're
not going to consider credit score within that
framework? You can't do it. You would have to
literally have a parallel rating system in order to
use that option of, you know, let's not consider
credit.

MR. PARTON: Would you expect to find, within
this 25 percent of thin files, would you expect to
find a fair number of what I would call senior
citizens, and I use that term loosely since I may
be in that group, say from 55 to 65 that, frankly,
are not using credit, they have cut back, are
getting ready to retire or they have retired?

How would this whole classification of no hits
or thin files affect those folks? Would you expect
to see a fair representation of what I would call
senior citizens -- and again, I use that term
loosely -- in that group?

MR. BIRNBAUM: Well, yes. I think, we know
that group is going to be disproportionately
represented by immigrant populations and unbanked
populations, but it's also likely to include a
disproportionate percentages of seniors for a
variety of reasons.

Consider senior women who are now widows because their husbands died, but their husbands had all the credit, all the information was in the husband's name. Given that women outlive men and given the large percentage of retirees down in Florida, I would think that problem would be particularly acute in this state.

But to give you an example, again referring to the Survey of Consumer Finances. This is a survey done every three years and it's analyzed and published by the Federal Reserve Board. It talks about, it gives information on who actually has debt and it has information on the nature of that debt. So it's not only those characteristics, whether you have any kind of debt at all, which means whether you have credit information and whether you are late, whether you're 60 days late. The other factor they looked at is the ratio of debt to income, and the specific factor was whether your debt exceeded 40 percent of your income.

So those are three factors that clearly are related to your credit scores and those factors are also strongly related to both income and age.

For example, and this is the 2007, for -- these are the percentages of debtors with any payment past due 60 days or more. For those with

less than 20 percent, the 20 percent pile of income, it's 15.1 percent. For those in the top ten percent, it's .2 percent. So the lowest income group is what, 30, 300 times more likely to have debt greater than 60 days past due. Of course, you will see that even people in the 20 to 40 percent have much higher percentages.

The same types of patterns are true for debtors with ratio greater than 40 percent; in other words, the debt burden. The lowest income group, 26.9 percent, are above that threshold; in the highest group it's 3.8 percent.

And when you get to the actual consumers having debt you'll see a different type of relationship. You'll see that as the age increases, once you get to those higher ages, all of a sudden the percentage with debt decreases.

So again, if you look at objective information, and this has been around since the mid-'90s, clearly, you can see that the characteristics that are in the credit reports are strongly correlated with age, income and minority status.

MR. PARTON: Any other questions?

MR. EAGELFELD: There's another sensitive

group that I've lately come to appreciate that I wonder if you could comment on that is not in the usual bleeding heart retinue, and that is religion.

I listen to talk radio and there's certainly a great movement afoot, as I can hear it, in fundamentalist circles to eliminate credit card debt from people's financial portfolios. There's a Financial Peace University that's going around a number of churches and it seems to me that, anecdotally, that conservative Christian groups may either currently or come to be underrepresented in -- or overrepresented, I should say, as unscorable persons if they push this idea of not using the system. Any thoughts on that?

MR. BIRNBAUM: Well, yes, just a couple of quick thoughts. The first one is that, again, how arbitrary credit scoring is, given that a person's use of credit can be guided in large part by his or her religious beliefs.

If your religion says that you shouldn't take on debt and you should pay in cash, then you're penalized. I mean, I know there isn't a big Amish population in Florida, but think about an Amish population that pays everything in cash and never uses credit cards and never borrows money. Are

those folks financially irresponsible? No. Should they be penalized with higher auto and homeowners insurance rates? Well, fortunately they don't drive, so it's not an issue.

But, given that there are some religious groups and some religions that have strong beliefs about debt, number one, it points to sort of the arbitrary nature of credit scoring, and that clearly an entire group based on religion can't be all bad or good drivers, number one.

And number two, it's indirectly a way of discriminating on the basis of religion, which again, if you can't do it directly, then why should you be able to do it indirectly?

MR. PARTON: I appreciate it, Mr. Birnbaum. I think you've provided some interesting information which to consider. I found it interesting. I hadn't really thought about the manipulability, if you will, of this particular characteristic before. It's odd that today my debt-to-credit is bad, I'm a bad risk, and yet tomorrow if I have the wherewithal to pay off those credit cards or to go back and clean up those open credit cards that I don't use anymore, all of a sudden I become a better driver and less likely to make a claim. I

think that's an interesting point to have been made, so I do appreciate you coming today and providing the information.

MR. BIRNBAUM: Can I just add one more quick point? I know you've been generous of your time.

MR. PARTON: And here I am trying to get you out of here.

MR. BIRNBAUM: One of the things that I didn't mention about manipulation is that in some cases you increase your credit score by piggybacking on somebody's else credit score.

That was one of the issues that was prevalent in the home lending market, and Fair Isaac changed their scoring, their lending scoring model to prevent people from basically improving their credit score by piggybacking on somebody else.

But that was one of the techniques that credit score improvers were using, was to basically piggyback on somebody else. I don't see any provision or restriction on the continued ability to do that for insurance scoring. Well, that's the height of manipulation.

Let me finish by pointing out one other thing. And this is the perverse results that occur for consumers who act in a financially responsible

manner.

I recently got notice from my credit card company telling me that they were increasing the maximum interest rate from 22 to 30 percent, they were increasing the fees, they were shortening the grace period and they were cutting the credit limits.

So my initial reaction was, this is outrageous, I'm not going to use you. I'm going to cancel you, I'm going to cancel my card with you and I'm going to go to another credit card issuer that offers more favorable rates, more favorable terms, because, number one, I don't like the way you do business, but number two, this is financially responsible for me to have this better terms.

What would the results of that be? Well, the result is I would get nailed on my credit score. Why? I've canceled the credit card which means now I've shortened my length of credit history, which is a terrible no-no.

Second is, I've got a new inquiry, so that nails my credit score. I'm obviously desperate for credit, which is why I've been looking in the first place, according to any kind of theory behind this.

The problem with credit scores is that by and large they penalize consumers for rational behavior. More often than not, you're in a catch-22 situation. I have dozens of articles in mainstream papers, the Wall Street Journal, the Washington Post, you name it, all these papers, how to improve your credit score, and they say don't cancel old cards, keep them in place even if you're not using them. They say -- get this -- if you have a delinquent account and it's old, don't pay it off right before you go and seek credit, because if you pay it off right before you go and seek credit it makes it current. The fact that it's old means it has less weight, but if you pay it off, then now it becomes a current item. So they tell you that you hurt your credit score by paying off delinquent accounts a few months before you go to solicit new credit.

Now, again, I ask, how can a system like that be considered objective, reasonable and not arbitrary?

MR. PARTON: I understand your point and I do get it. I was sitting here thinking, in a few years I'm going to be retiring and right now my credit score is great, but one of the things I

contemplate doing, of course, is paying off all my credit cards, getting rid of them, perhaps even paying off my house. Now I don't even have a long-term debt.

If I do that, I'm actually going to hurt my credit score, and even though my driving habits and I'm being very responsible with regards to my finances, if I go out and look for insurance again I'm going to be penalized by all that, and that's kind of counterintuitive to what we ought be doing here.

But I appreciate your comments in coming here today, but we do need to move on. Thank you.

MR. BIRNBAUM: Thank you.

MR. PARTON: Is there a Mr. Charles Milsted here who wants to make a comment?

MR. MILSTED: Yes.

MR. PARTON: Mr. Milsted, would you come forward, please?

MR. MILSTED: Yes.

MR. PARTON: Mr. Milsted, I don't know if you were here, we're placing everybody under oath who is actually testifying here today.

Do you solemnly swear or affirm to tell the truth, the whole truth in this proceeding?

MR. MILSTED: I do.

MR. PARTON: Thank you. Would you go ahead and identify yourself and proceed?

MR. MILSTED: Sure.

MR. PARTON: Thank you.

MR. MILSTED: I'm Charles Milsted, Associate State Director for AARP here in the Tallahassee office, and I'd just like to say good morning to you and to the members, and we appreciate the opportunity to speak on behalf of Florida senior consumers as relates to credit scoring.

It is several criteria for assessing the risk and creditworthiness of potential customers for insurance and other products. It has been shown in some surveys to be an indicator of consumer reliability, but definitive data is still forthcoming. An AARP survey within the last five years indicates that a scant minority of members who responded, all 50-plus, indicated a favorable response to credit scoring.

However, a considerable majority indicated that if this was to be used as the model that it be publicized so that the consumers could shop around for policies that might differ in their application of the method.

AARP does not recommend or discourage the use of credit scoring, but suggests that all vendors of products using credit scoring publish the particular model that it employs and its implications for consumers thinking of purchasing such products so that they may make informed choices among what is hoped to be a variety of reasonable choices.

The goal is transparency in a market where additional research is needed. The objective is to establish the best model to afford fairness to consumers in a reasonable and fair market environment. We support the bill's objective of establishing fair scoring criteria when credit scoring is the model used.

Short statement, but thank you very much for the opportunity for being able to speak for seniors here in the state of Florida.

MR. PARTON: I appreciate it. I do have one question. Has AARP ever, for instance, done a study of credit scoring with regards to its membership before, for instance, they reach 55 versus where they may be now, at 60 or 65, to see whether or not as a result of the time and as a result of whatever financial decisions that they made in going into their retirement, that in fact it has either positively or negatively impacted their creditworthiness?

MR. MILSTED: Sir, I'm not familiar with it, but we do have the Public Policy Institute in Washington and I'll be happy to talk with them and see if we have done a study, a survey. I'll be happy to pass that along to you.

MR. PARTON: That would be real helpful if they have. I appreciate that. Thank you, I appreciate you being here.

We're going to take a short five- or ten-minute break and then we'll begin some of the testimony with the insurers.

I wanted to take the opportunity, I realized as I was sitting here I neglected to allow the other members of my panel to identify themselves and I didn't mean any insult to them, so I'm going to allow them to introduce themselves so that you all will know who you will be speaking with.

MR. SHAW: I'm not insulted, I appreciate it. I'm Sean Shaw, I'm the Florida Insurance Consumer Advocate.

MR. EAGELFELD: And I'm Howard Eagelfeld, an actuary with the Office of Insurance Regulation, primarily charged with auto insurance analysis.

MR. MILNES: I'm Mike Milnes, I'm the Deputy Director of Property and Casualty Product Review.

MR. PARTON: We will see you in about ten minutes, thank you.

(Brief recess.)

MR. PARTON: Folks, if we could get back to our seats so we can continue on?

The next speaker is Mr. Chuck Hobbs who, as I understand it, is a representative from the NAACP. Mr. Hobbs, welcome.

MR. HOBBS: Thank you.

MR. PARTON: Mr. Hobbs, you may not have been here earlier, but we have indicated to everybody that testifies we're going to put them under oath, so if you would raise your right hand?

MR. HOBBS: Yes, sir.

MR. PARTON: Do you solemnly swear or affirm to tell the truth and nothing but the truth in this proceeding?

MR. HOBBS: I do.

MR. PARTON: Thank you.

MR. HOBBS: Thank you, sir.

MR. PARTON: If you would identify yourself and proceed.

MR. HOBBS: Yes, for the record, my name is Chuck Hobbs. I'm a Tallahassee-based attorney, and

I'm Associate General Counsel for the Florida State Conference of Branches of the National Association for the Advancement of Colored People, and I bring this statement on behalf of the organization.
MR. PARTON: Thank you.
MR. HOBBS: Good morning to you and the panel, Mr. Parton.
Last week the NAACP celebrated our centennial. For over 100 years we have fought for equal rights under the law and the elimination of racial discrimination in America.
Our organization harbors grave concerns about the rampant use of credit scoring as a determining factor in the cost of insurance for thousands of African-Americans and other ethnic minorities in the state of Florida.
We're both cognizant and appreciative of the efforts of the Florida Insurance Commissioner, the Honorable Kevin McCarty, who has been one of the leading advocates of exposing the disproportionate impact of the use of credit scores on the rates that are provided to minorities, in particularly African-Americans and Latino Americans.

Our organization is aware that Florida Statute 626.974(11) was implemented following an exhaustive study of former Commissioner Tom Gallagher's task force on the use on credit scoring. It's our position that the said statute serves as a floor, and, accordingly, we support the spirit of the proposed rule before the body as an attempt to provide further guidelines for this practice, and, as a byproduct, also provide greater understanding of the use of credit scores and understanding it will ultimately help consumers as well as our governmental leaders determine whether the same should be eliminated outright.

To that end our, organization supports the spirit of the proposed rule and look forward to working with Commissioner McCarty, as well as other governmental agencies, in ascertaining the gravity of the impact upon the constituents that we represent as an advocacy group.

Our support is based upon the information that's currently available detailing the pedantic nature of assessing risks within the insurance industry. This information has helped us better understand the history of the use of rates and, subsequently, education and occupation as tools to

provide one rate for minorities and an entirely different rate for non-minorities.

While we believe that the use of credit scores on its face appears nondiscriminatory, we have concluded that its disparate impact provides evidence that the use of these indicators is arguably a progression in an age-old industry practice of separating rates based upon group classifications, including groups that enjoy certain protections under the Constitution.

We recognize that a distinct line in the sand that has been drawn. Industry proponents argue that the use of credit scores is predictive of an insured's future claims experience and is necessary to draw a conclusion concerning a proper credit rating.

Opponents counter that the use of credit-based scores constitutes discrimination, and places an undue burden and hardship on the affected classes of people.

We understand the insurance industry has a proprietary interesting in ensuring that it can use the best data available to determine who to insure and what rates to charge. However, whenever the spectre of discrimination is raised, we believe it

is prudent that the same be analyzed carefully to determine if any equal protection issues exist, and if so, that industry practices are tailored to avoid such implications.

As an organization, our concern is ascertaining the truth, thus our participation in the workshop yesterday as well as today's hearing. Among the myriad of reports that we have considered to date include the 2007 Federal Trade Report that indicated that the use of credit scores disparately impact certain classes of people.

In his testimony before a Congressional Subcommittee on Oversight and Investigations, Commissioner McCarty testified that quote, "Myriad information may be obtained about an individual through health provider visits, special spender databases, insurance claims histories, consumer purchase preferences, Internet usage, DNA gene testing and credit scoring."

Commissioner McCarty further stated that, quote, "It is important to understand that although many of these tools may show mathematical correlations with insurance claims, this does not necessarily make them fair and valid criteria for insurance purposes," end quote.

If there are other nondiscriminatory objective criteria that can be used by the industry to assist in its proprietary interests that does not discriminate on its face, then we question why such practices have not become the industry standard.

Our concern is made even more heightened when considering that there is a dearth [sic] of data that will prove that those with lower credit scores, while filing claims more frequently, do not necessarily file claims that warrant higher payouts.

Again, out organization's concerns are rooted in the dark history with which race has been used in the insurance industry. Many of us are aware that for many years race was used as a determining factor in the issuance of life insurance policies. Arguably, one can make a race-neutral argument that actuary tables suggest that non-Hispanic African-Americans have a lower life expectancy than whites, but still, from a policy standpoint, as our national standards evolved following the Civil Rights Movement, so did the policy aspects of the Equal Protection Clause, so much so that these practices are no longer deemed acceptable.

We realize that the practice of utilizing

genetic testing to determine the issues of health insurance and predisposition to certain diseases was forbidden also in 1996, through the passage of the HIPAA Act.

Our organization maintains many concerns that will be addressed in the months to come. A sampling includes, number one, what measures are to be taken by the individual insurance companies to ensure that credit reports maintain accurate information? For example, on a personal note, my full birth name is Charles Edward Hobbs, II, obviously named for my father, Charles Hobbs, Senior, who passed nine years ago. For years bills that my father accrued while battling cancer would appear in my name and on my credit report. The removal process was somewhat akin to Hercules' 12 labors, but fortunately it was accomplished.

Now what about the individual who is not even aware that his or her credit report maintains errors? What about the individual who is a victim of identity fraud or theft? What happens to individuals who, once learning of discrepancies within their credit reports, still have a difficult time securing the correct reporting. In the interim their insurance rates are being impacted by

factors that may be beyond their control.

A second concern: What measures are being taken to rectify the disproportionate impact that the use of credit scores has on account of race and, in many instances, age? What measures are used to answer the concerns that some individuals practice religions that forbid use of credit, thus leaving them with no credit score? And that has been addressed somewhat this morning already.

We are concerned that while race has been outlawed as a factor in credit determinations, that credit scoring is used as a substitute variable that has the same disparate impact.

Another issue is whether there are any correlations between credit scores and the frequency of automobile accident claims or the amount paid out.

And lastly, we have a question with respect to are there any correlations between credit scores and the life expectancies and/or payouts of prospective claims on homeowners insurance policies or life insurance policies.

In his report on the use of underwriting rating factors for private automobile insurance, Commissioner McCarty stated that his investigations

yielded the fact that the insurance industry does not believe that corporate responsibility extends to ensuring its practices do not disparately impact minority or low-income Floridians, but instead maintains that it is the Florida Legislature's responsibility to define public policy on the matter in an insurance marketplace.

Accordingly, it is our belief that it is critical that our government, both its agencies and the Legislature, diligently fight to ensure that any vestiges of discrimination, be it overt or latent, be eliminated in Florida.

And I can also tell each of you that our organization at present is studying, with a group of private lawyers, the possibility of a class action lawsuit against the industry. Again, no decision has been made as of yet, but we're studying the information that's available to us at this time and that could be coming forthwith.

MR. PARTON: Thank you, Mr. Hobbs, I appreciate you being here.

Does anybody have any questions?

Again, thank you very much. We look forward to working, frankly, with your organization with regards to these issues.

MR. HOBBS: Thank you very much, sir.

MR. PARTON: The next speaker is Mike Miller. It was pointed out to me that he is speaking as a public speaker even though he's representing the insurance industry through FIC here this morning.

Welcome.

MR. MILLER: Thank you.

MR. PARTON: Would you raise your right hand? Do you swear to tell the truth, the whole truth and nothing but the truth in this proceeding?

MR. MILLER: Yes.

MR. PARTON: If you would introduce yourself, I'd appreciate it.

MR. MILLER: My name is Mike Miller. I live in Carlock, Illinois. I'm a consulting actuary and I testified, as you know, here yesterday at the workshop on the rule.

What I'd like to do this morning is go quickly through eight or ten issues that were raised in Mr. Birnbaum's testimony and comment on those. I think I can be very brief.

MR. PARTON: Thank you. We do have five insurers who have to talk, but go ahead.

MR. MILLER: I know that. I actually want to start with something that I agree with Mr. Birnbaum on, and that is labeling folks with poor credit based insurance scores as financially irresponsible people. I don't endorse that.

I grew up in a family that had no money. We weren't a poor family, we just had no money, and my folks still today have little money. I mean, they live comfortably and they're happy, but they have no money, and yet I think if someone was looking for a financial manager they might go to my folks to handle that.

So just because someone is short on funds doesn't, in my opinion, say anything about their abilities to manage.

Early on this morning we heard comments about cause and effect. Credit-based insurance scores do not cause accidents. Neither is there a cause-and-effect relationship with any other rate factor used to assess risk.

Past accidents do not cause future accidents. Past driving tickets do not cause future accidents. It's the correlation, the predictive power of these risk factors that we're relying on, not whether they cause an accident or not.

In fact, although it's intuitively appealing, it seems, for most people to think that past

accidents and tickets are very powerful indicators of bad drivers, they're not. They're predictive, but they very barely make it into the top ten, whereas credit-based insurance scores, according to a study that I co-authored in 2003, were in the top three for every auto coverage, and far more powerful than past accidents or tickets.

MR. SHAW: What are some other things that might be in that top ten?

MR. MILLER: In the top three for every coverage was geography or territory and credit score, age of driver and, for the physical damage coverages, make and model of the car.

MR. SHAW: And all those things are more predictive than driving history?

MR. MILLER: Yes.

MR. SHAW: Accident history?

MR. MILLER: Yes. Driving history was down in the eight, nine and ten range, depending upon which coverage you were talking about.

This notion about the rate of delinquency is skyrocketing, everyone is under great economic stress, is -- I think that's obvious.

What is not so obvious to me is that you can jump to the conclusion without facts that that

necessarily means that everybody's credit score is going to get worse. I don't have the facts to refute that contention, but I would not be surprised to learn that the credit scores, the insurance-based credit scores and maybe the credit scores for financial institutions, too, will remain relatively constant or possibly get better. I mean, spending is down, the use of credit is down.

One of the important factors that go into these scores is the relationship between outstanding balances and maximum credit available on the various credit lines that you have. That may actually improve. I don't know for a fact that that's true, but there surely are facts out there that one could determine what's happening to credit scores before jumping to the conclusion that the economic situation necessarily means that credit scores are going to get worse.

MR. PARTON: That may be true, but by the time we get that evidence in, a lot of people will have suffered as a result of that, potentially. But I would tell you that certain practices by banking institutions, such as reducing credit limits, actually have a very definite impact, and that is going on.

In fact, we have a situation in our own office, I won't identify the person, but this person is a very responsible individual with a very responsible job and one of his credit card companies decided to reduce his credit limit and it whacked his credit score by 30 points. He had nothing to do with it, didn't change his driving habits, but nevertheless, it directly impacted in a negative say.

So I understand what you're saying. We don't have all the data in, but the question is, did we have to wait a year to declare a recession when we knew we had a recession in September? Do we wait now because we think we may have a problem, to determine that we really did have a problem, which is now even worse because we didn't do anything?

MR. MILLER: Well, some would have us believe that we've been in a recession since December of 2007.

So there is data. You begin to look at the credit scores, and you can cite these anecdotal situations about this change is going on and that change is going on, but I still would recommend to you that the bottom line, before you make any decisions, would be based on what, in fact, is

happening to these credit scores. Are they going up, are they going down, are they staying the same?

There was testimony this morning about the use of credit scores violating actuarial principles and standards of practice.

Mr. Birnbaum is not an actuary. He's not a member and subject to practicing within our standards of practice. He's not subject to discipline. He can -- by our profession he can say and do whatever he wants without fear of being disciplined; I cannot. But I can tell you that a reference to hair color and comparison of hair color to the use of credit scores was out of bounds.

MR. PARTON: I thought so, too.

MR. MILLER: Hair color is manipulative, it is not objective. I mean, how many gray hairs do you have to have before you would be classified as gray-haired?

MR. PARTON: Let's get away from the hair.

MR. MILLER: And there is no reason to believe that it has much, if any, measurable correlation to losses.

Credit scores, on the other hand, are objective. They're not subject to serious or

significant manipulation, to my knowledge, and they are strongly correlated with loss propensity.

There was a question about, it didn't seem quite right because with this manipulation of the credit score you could change something, you could make some changes that would cause your credit score to change, and I think it was actually your question, Mr. Parton, that didn't make you a better driver, so somehow that seemed illogical that a credit score would change and somehow that would indicate that you were a better driver, but you really wouldn't have changed your driving habits.

Well, credit scores, like every other rate factor, are just one tool for assessing risk, and all of the rate factors can change over time and that doesn't change your driving ability and whether you're a good or bad driver, it changes the assessment of your driving ability. You have new facts, you have a new assessment.

For instance, let's suppose you had an accident two or three years ago, and that would be a rate factor. That would be a piece of information that would be included among all the other risk factors in assessing your risk, but then that information changes. After three years that

accident record drops off of your rating. Does it change whether you're a good driver or bad driver? No, it doesn't. It changes the assessment.

All of the information that goes into the assessment of the risk changes over time. Credit scores will change over time, and with that what is changing is the assessment of the risk.

It may not -- changing the assessment of the risk is not the same as saying the risk changed, because nobody knows for certain what the risk is. This is an assessment, an estimate of what the underlying probability of accidents is and the assessment of what their likelihood of the cost of claim will be.

MR. PARTON: That's where I want to draw a distinction. I want to make sure we're talking about the same thing.

The assessment you've talked about with regards to credit scoring really has to do with claims, not necessarily accidents.

Now, let's face it, if I have the wherewithal, I've got insurance, and I do something stupid like run into a tree in my own yard and I decide that I want to handle that, you're never going to know that I had an accident. You're also not going to

have a claim from me. None of that is ever going to appear. It seems to me --

MR. MILLER: I lost you.

MR. PARTON: Well, let me finish.

-- that what credit scoring is really kind of measuring is whether somebody is going -- the likelihood of a claim, and the likelihood of a claim, when you're using credit scoring, which has always been used to assess the financial responsibility of somebody, is really kind of assessing whether or not they have the wherewithal to actually take care of it themself or is he going to have to rely on his insurance.

MR. MILLER: No, no, no. First of all, the credit score is not an assessment of the probability of having a claim. Credit scores are more closely correlated, are more closely correlated to the occurrence of the claim, that's true, than the cost of the claim. It doesn't mean there's no association with the cost of the claim, it's just that there's stronger correlation with the occurrence.

But at the end of the day when that credit factor, credit score is converted into a rate factor, it is measuring both the expected frequency

of the claim and the expected cost of the claim. Both go into the calculation of the rate factor. That's what the rate factor assesses.

MR. PARTON: I understand.

MR. MILLER: Measures.

MR. PARTON: Historically, credit scores are a measure of an individual's ability to pay, as it started out, pay for a loan. In essence, you're still measuring the same thing. You're looking at things like how many credit cards does he have, what are the limits on that, is he paying minimum balances, what is the debt-to-credit ratio, all of which kind of measure, well, is he going to have to jump in and rely on the insurance policy, or does he have, for instance, room on his credit card or the financial wherewithal, since he's paying off minimum balances, to pay for the claim itself, isn't it?

MR. MILLER: Now, maybe that's what the credit scores the banks -- I think you're talking about credit scores used by financial institutions, and maybe that's what those folks think they measure and maybe not, I don't know, but we're talking about a different animal here.

MR. PARTON: We're talking about an animal

that, frankly, evolved from exactly what I just talked about. And the only difference here is you may be adding in some factor of, maybe, sex. You may be adding in a factor of claims history. You may be adding in a factor that the sky is blue, because the State of Florida doesn't let you use credit scoring alone. So whatever your factor is you're adding it into that, but in the end the credit scoring itself is historically based on what was going on in the banking industry.

MR. MILLER: No, no, no, wait a minute. There may be some overlap in the parameters that go in there, but it's not so simple to say that a credit-based insurance score is just like the credit score used by financial institutions, except maybe we're adding in some other things, like age.

MR. PARTON: But the problem is, Mr. Miller, you don't really know why that correlation exists, and that correlation may actually exist based upon what I just said, mightn't it?

MR. MILLER: I don't know why the correlation exists --

MR. PARTON: Exactly.

MR. MILLER: -- between past accidents and future accidents.

MR. PARTON: That wasn't my question, was it?
MR. MILLER: Well, it was an answer to your question, in that I was pointing out that we don't know why the correlation exists for any rate factor. We can only observe that it does exist. We can observe the strength of it and we can observe the consistency of it from year to year.
MR. PARTON: But you cannot refute the statement I made that, in fact, that what this is actually measuring and the reason there is a correlation is that it's really a determination of an individual's ability to pay for the claim to avoid making a claim.
MR. MILLER: I don't think so.
MR. PARTON: Not necessarily that I'm a better driver, but that I can avoid making a claim on my insurance policy.
MR. MILLER: I have never heard that rationale. That makes no sense to me.
MR. PARTON: Why does it not make sense, Mr. Miller? I mean, have you done a study to see whether this is true or not?
MR. MILLER: It never occurred to me to do such a study.
MR. PARTON: Well, that's interesting. We had

a trial a few years ago where I posed this same sort of argument. You weren't listening when we were in that trial?

MR. MILLER: Well, I think I was stunned by it, as I am now. The credit-based insurance score is not intended to be a measure of financial payment ability of the insured.

MR. EAGELFELD: Sir, whether it's intended or not, the question is -- here's a question that I think zeros in on this point.

If, as an insurance person, if I could find a way of segregating the population into those -- and finding a group of insureds who would take every claim, liability claim, potential claim, involvement in an accident, take out their credit card, settle it on their own with the party whose car they had damaged, wouldn't you think that that would be something that would induce an insurer either to offer more insurance to such a population or to offer it at a lower price?

MR. MILLER: Perhaps, but that would be a different model than the one that has been developed here.

MR. EAGELFELD: But it may well be exactly the same model.

MR. MILLER: It may be, but we don't know that.

MR. EAGELFELD: The calibration of the insurance credit models is against the pure premium of insureds. That pure premium considers both the frequency and the cost of their insurance claims. Their insurance claims don't exist if they haven't made them.

MR. MILLER: I don't want to argue, I really don't want to. I just want to say that the credit-based insurance scores that are in use now, to my knowledge, have never been tested and developed to see if it's correlated with an insured's inclination to enter a claim or pay their own claim or anything. That's not what they've been tested against, so I have no reason to believe that that would be the model. If you were intending to develop a model to estimate that, the current models would be the ones that you would use.

MR. EAGELFELD: Ignorance is bliss.

MR. MILLER: Well, it's something else for research, I guess, if you're interested in that kind of rate factor. I just think it's wrong to suggest that that's what the current credit-based insurance scores do, because to my knowledge they

have not been tested to see if that's what they're doing.

MR. PARTON: Well, I don't think that I said that's what they're doing. I raised the possibility that they're doing that, just like while, in fact, credit-based scores in insurance were not designed to have a disparate impact on minorities, nevertheless the FTC has found that, in fact, it does have a substantial impact on them, and I'm sure that those models weren't designed to do so.

But at the end of the day, again, it's clear to me the industry really doesn't know what credit score is doing other than it appears to correlate with claims history, and -- historically. You don't know why.

MR. MILLER: They know that that's what it's doing, and that's exactly what it's supposed to.

MR. PARTON: You don't know why, you don't know how it's impacting various categories of people within those scores. You don't know much about it other than here it is and here's what it seems to predict.

MR. MILLER: It's not fair to accuse the industry for not knowing why, because that's not

really knowable for any risk factor.

As to the impact --

MR. PARTON: I'm not accusing the industry. It's what they tell me all the time, Mr. Miller, is that they don't know why this is occurring. I'm not accusing, I'm merely making a statement that they don't know why it correlates and you're telling me they don't know why anything else correlates and I understand that. I'm just saying they don't know.

MR. MILLER: The reason I'm sensitive to this statement is because it's made in a way that implies that that's a fault of credit-based insurance scores, and I'm just pointing out that what you think is a weakness in not knowing why there is a correlation is not a knowable thing, and it's not knowable for any risk factor.

If you were going to say the test of whether you can use a particular risk factor is if you can prove to us why it's correlated, then every risk factor would fail that test.

There were comments made this morning about the findings of the Texas, Missouri in the FTC studies as to adverse impact.

First of all, the adverse impact findings of

the Missouri study were largely contained in the title to the report. They really didn't have any data to determine what the impact was going to be and they didn't determine it, but they declared in the title that there was an adverse impact.

The Texas study found differing impacts by racial groups, and we talked about that yesterday. The differences in the average scores had a wide range for the six auto studies that they did. They did six separate studies on six separate data sets from six different companies, and they did a study of three homeowners.

They got a wide range, and I raised the issue yesterday that if they were really measuring differences in average scores among racial groups, then I would have thought that they would have got an answer that was fairly consistent across the six auto studies and the three homeowners studies.

Every time you look at this, every time you analyze it you wouldn't expect that sort of answer to be widely variable, and, as I said yesterday, I asked the chief actuary in Texas if they had an explanation for that and they really didn't. I don't know what is going on in those data sets to cause that variable answer. I don't know if it was

something in their analysis or if it was something that had to do with the accuracy of the data.

I did note that the low end of the range, the ten percent difference in average score for the African-Americans and the four or five percent difference in average score for the Hispanics that were tested in Texas was consistent, generally consistent with the findings in the FTC study. So we had another study to verify that lower end.

In my view, there has to be some --

MR. EAGELFELD: Mr. Miller, do you think those two studies, if you had to rate them, A, B, C, D, F, what would you say, the Texas and the FTC, in terms of the quality, the methodology?

MR. MILLER: Well, the methodologies were generally the same, so if you're talking about overall methodologies, in the same ballpark.
MR. EAGELFELD: The conclusion is based upon the data that was employed in each of those?
MR. MILLER: Well, I think -- I have more confidence in the FTC study, only to the extent that I know more about what they were doing and the data that they were using. I think the two studies are in a family of reliable studies. The only concern, my principal concern with the FTC study is

that they had an inadequate control for geography.
Territory is one of the top predictors, and the FTC, trying to do a countrywide study, they had to find a way to put all of the geographical areas in the country into a common group of territories, and they ended up using five territories to do the study, and I believe that that's a weakness, and they acknowledged that, in their study.
Whereas if you go to Texas --
MR. EAGELFELD: So you were not concerned about --
MR. MILLER: -- they had less of a problem in Texas controlling for an important factor. So that one part of the study would make me lean, put reliance on the Texas study because of my concerns about controlling across state lines of the territories in the FTC study.

MR. EAGELFELD: So in terms of A, B, C, D, you would say they're both Bs or so?
MR. MILLER: No, higher. Those are sophisticated studies. They had a good database and they had nearly all of the risk factors.
MR. EAGELFELD: You weren't concerned with the FTC in terms of the insurance data that they obtained and whether it was random sample?

MR. MILLER: It was a random sample. It was across -- it was stratified. It was varied from company to company that took into account each insurance company's particular writings in various states.
MR. EAGELFELD: But not its applicants, just its actual writings?
MR. MILLER: Yes. These were actual policies on the books, and the intent was to get a consolidated sample that reflected the demographics of the entire book of business, all insurers from all companies.
So we were looking for a distribution of business across all territories in the United States, across all age groups, across all the various risk classifications, and it was tested to make sure that the sample was representative of the entire demographics.
MR. EAGELFELD: And the measurement of the demographics within the study, in other words, the

identification of which individuals were minority, that also you think was not good enough?

MR. MILLER: Actually I had some involvement in helping them build the starting database.

MR. EAGELFELD: Really?

MR. MILLER: The policyholder database, and editing that and setting up the samples, and then the FTC took that database and attached racial information to those policyholder records.

They had access, to some extent I think they had access to Social Security records which were relatively reliable with respect to race. Now, that didn't solve that issue on all the policy records. They had to do some kind of estimation rate on some of the policyholder records, and how they did that, I don't know.

MR. EAGELFELD: You had involvement with this study and you don't think that at all biases you in your evaluation of the study's quality and outcomes?

MR. MILLER: Well, if you pull a random sample, how can you be biased about pulling a random sample if it's random?

If you ask insurers to pull every sixteenth policy starting with a policy number, you know, a random policy number and go every sixteenth policy or pull every eighth policy, how could I bias that?

MR. PARTON: I thought you indicated that you

did some editing of that. What kind of editing
were you talking about?

MR. MILLER: Well, the policy records had to be filled out. I mean, there had to be some information there, and if there was nothing reported then it had to go back and be completed.

What we did was mechanical. It's what anybody that does a study is going to have to do. They're going to have to define the sample, then they're going to have to get the sample from a number of companies and they have to consolidate it into a data set. There's no way to manipulate or bias the data set.

Think about this. If you had a particular outcome in mind, what would you do to manipulate the data set? You wouldn't know at the beginning how the results are going to come out, so you wouldn't know what to do to get the results. The contention that the data set was wildly biased, what does that mean? I mean, it's a random data set. You can look at it and figure out whether it's random or not. You can look at the distribution of the business by class and territory and see if it represents the insured population or not.

MR. EAGELFELD: I was not at all contending that. I was just thinking about the idea that a person who is involved with a study, no matter what that involvement, has an unconscious or a natural tendency to want that study to succeed and to have meaningful results and to view it positively.

MR. MILLER: It just seems to me that that concern rests, at the end of the day, when the study is done and someone is writing a report, in how they pick the language and how they interpret the results of the data set, and that's where people are going to take a look at that and say, well, is this a biased interpretation, a biased report. I have no idea how you would begin to predetermine the results and bias the results at the beginning when you're just gathering the data.

The problem with the different impacts on various groups of insureds, premium impacts, the FTC found some and we talked about those yesterday.

There is going to be a different impact, premium impact on any subset of the insured population. In this case we're talking about racial subsets. There will be a different premium impact on any subset of the population unless the distribution of insureds by all of the rating classes, territories and so forth within each subset are identical, and there is no way for that

to happen.

We know that the distribution within racial minority groups, within racial groups -- the FTC was looking at African-Americans, Asians, Hispanics and non-Hispanic whites -- within those groups the distribution of insureds will be different by territory, they are different by age of driver, they are different as to whether -- the mix between single car and multiple car, they're different by the credit score distributions. There's some difference in all of the rate factors, and because there is no way to expect, no one should expect that the distributions will be identical in all these subsets, then you have to expect that there will be some difference in impact when you look at the averages.

There must be some tolerance, and to me the issue should not be whether there is some difference in impact, but is the difference in impact within a reasonable range that we can tolerate, that can be tolerated here.

MR. SHAW: You would agree that race is a different classification than the other factors you just talked about, right?

MR. MILLER: Well, the FTC study broke those

out as a subset to look at. They're not a class in terms of rate, but were checking the impact of all the rate factors with emphasis on the credit score among those four racial groups that I mentioned, and so the difference in impact on rate for any of those risk factors is going to vary some from subset to subset, because the distribution of business by territory, age, multiple car versus single car, limited coverage, all of that stuff is going to vary.

MR. SHAW: My point is, there are different types of subsets?

MR. MILLER: Yes, sir.

So there's going to be some differences in impact. Then I think you have to look for how much differences are tolerable, because if you set it up with a criteria where there can be -- where the tolerance level is zero, then every rate factor will fail. Every rate factor cannot -- there is no rate factor that can meet this zero tolerance level.

MR. PARTON: If I could interrupt you just a minute, Mr. Miller, I think what Mr. Shaw was kind of pointing out is that -- that may be a true statement and it may be true that you may want to

have some tolerance for number of cars and for sex or age or something of that nature, but race is a little bit different and has been treated differently -- wait a minute, I'm not talking about insurance, let me finish -- but race has been different as a factor in everything in this country for hundreds of years.

And the question really ultimately comes down to whether or not credit scoring and the differences that we see here that have been outlined by the FTC are, from a public policy standpoint, a vestige, if you will, of hundreds of years of discrimination that have impacted a group economically that is now being judged from an economic standpoint, that is, credit scoring, in the provision of insurance.

And the question really comes down to, well, should there be any tolerance in that, and then, how are you going to establish what just a little bit of unfair discrimination is going to be in that aspect?

MR. MILLER: Now, wait a minute, wait a minute. Now we're going to have to back up, because if that's what you were asking me, then I misunderstood.

I'm not suggesting tolerance for racial discrimination. That is not my testimony.

MR. PARTON: I didn't think it was.

MR. MILLER: Thank you.

MR. PARTON: And I didn't take it that way, either. I'm saying with regards to this issue.

MR. MILLER: Let me try again to make sure we get the language precise here.

The FTC looked at the effects of rating factors, including credit scores, on subsets of the total insured population. The four racial subsets that they looked at were African-Americans, Hispanics, Asians, non-Hispanic whites. Within each of those subsets, within each of the racial groups, the distribution of credit scores is somewhat different across each of the four groups, and so the different impact on race -- there will be a different impact on race on average across each of the four groups.

The distribution of insureds within each of those four subsets is different by territory, and so the impact on the rate coming from the territory factor will be somewhat different across each of the four subsets. The distribution of insureds within each of those four subsets is different

somewhat by age, so the impact of age as a rate factor on the premium will be somewhat different across each of the four subsets, and the list goes on.

It's different based on multi-car versus single car. It's different by gender, actually. It's different by driving record. It's different by every rate factor, which means that if you tested every rate factor as to that rate factor's impact on premium within one of those four subsets you'd find a difference.

So what's going on here is we found, the FTC found some measurable impact, different impact, due to credit score on each of those four subsets, and that's what's being labeled as disparate impact or disproportionate impact, and what I'm suggesting is that there has to be some practical tolerance level for some degree of different premium impact within each of those racial subsets, because it's impractical to think that you could get the same, absolutely the same impact in every racial group. That's the tolerance that I'm looking at.

MR. PARTON: I guess the problem with that argument --

MR. MILLER: Let me just finish.

MR. PARTON: Sure.

MR. MILLER: Believe it or not, I wasn't quite finished. It was a long answer.

I've been involved in some disparate impact type cases that deal with insurance ratemaking or underwriting or coverage issues, and that's caused me to take a look at how courts have dealt with disparate impact in employment and housing cases arising from civil rights violations, and so far the courts -- and that's where all the disparate impact cases are, so far as I know -- so far the courts have tolerated some difference, some differences in impact.

MR. SHAW: But they do treat race in a very special way. That's why it's labeled a protected class.

MR. MILLER: But even within race on -- I mean, there's no forgiveness if there is intent, but if there's no intent to discriminate, if you're just looking at impact of the practice, let's say it's a hiring practice, no intent to discriminate against racial minority, but it turns out that the hiring rate for the racial minority is less than the hiring rate for the majority, okay? I mean, that's kind of a general case for a lot of the

hiring cases. The courts tolerate some differences in the hiring rate.

One of the first standards that they used, and later they've used some different standards, was the so-called four-fifths rule. In other words, if the hiring rate for the protected minority is within 80 percent for the hiring for the majority, then it passed muster.

I'm not suggesting, I'm not here to suggest to you exactly what the tolerance level should be for differences in premium impact on insurance. I'm just suggesting that there has to be some tolerance, it can't be zero, or it destroys the entire risk assessment process.

MR. SHAW: If credit scoring was the only factor, yes, it would, I guess, destroy it, but there's other things that can be used. I mean, it's not a question, it's just a comment I'm making. I don't know if that's an overstatement.

MR. MILLER: Well, there are certainly other risk factors being used, you know. Credit score is just on a long list of other risk factors.
MR. SHAW: The absence of credit scoring wouldn't destroy the ratemaking process.
MR. MILLER: What it would do is change the

competitive landscape. When you're in a competitive market with multiple providers in the marketplace where the customers are free to choose among those providers, it's going to distort the competitive marketplace and cause competition.
Now that we know people with relatively good credit-based insurance scores are better-than-average risk, if you legislate against the use of that in a rating plan, then there will be a tendency for the competitors to find a way to market directly to the better-than-average risk in the marketplace and stay away from the above-average risk because they can't get the price that they need on those. And I would suggest to you that the public is not well served by that.
MR. SHAW: Well, I asked Mr. Birnbaum in those states that have outlawed it, what happened, and his answer seem to be that it was fine, the marketplace was fine. There was no negative impact, I'll say.
MR. MILLER: Well, I don't know how he knows that.

MR. SHAW: I hope I didn't mischaracterize it.
MR. MILLER: Think about it. I guess it's -- let's say you outlaw the use of credit scoring in

rating, and we know that those with better-than-average credit scores should get the lower rate and the worst ones should get a higher rate, so now an insurer wants to find a way to avoid providing as many of the bad credit score people as they can. Before they were happy to write them, because they had a rate. Now they don't have a rate that they can charge. Now competition is avoiding those insureds and finding a way to attract a disproportionate amount of those with good credit scores. How do you do that? Prescreen, and then focus your marketing efforts on the good scorers. I don't think the public is well served by that.
MR. PARTON: Well, the problem I have is the industry may be doing that right now with credit scoring. The problem you have with any data that's going on out there is that what we're looking at is policies in effect.
Every time, for instance, when we did a rule that suggested that we want you to report the applicants that you deny -- which, by the way, when you do that, distorts, frankly, the ultimate results over here -- the industry may very well be denying that because of credit scoring, but we don't know, because, of course, the industry fights

against producing that information.

So we don't even have a whole picture of how the market is really working out there. You're suggesting that if credit scoring is allowed, it would encourage insurers to insure risks they might not otherwise insure. It also may encourage them to not write other risks that it might otherwise insure as well.

MR. MILLER: Which ones would that be?

MR. PARTON: It would be the ones with the bad credit scores.

MR. MILLER: Why, if they could can an adequate rate?

MR. PARTON: First of all, you're assuming, Mr. Miller, that there is an adequate rate for that group and that they do want to insure that group, and I don't think that's a fair assumption.

We don't know what is happening with regards to applicants that never make it into the policy pool of a given insurance company, because those records are not kept. We don't know what they were told, we don't know what the evaluation was. All we're looking at right now is those people that were accepted by the insurance industry.

MR. MILLER: They're insured someplace.

MR. PARTON: Well, maybe not. There's an awful lot of bare going on out there, and I suspect in the future there may be even more bare coverage going on out there.

MR. MILLER: And there always has been. The question is whether that's better than it used to be.

MR. PARTON: Well, that is the question, and I thought Mr. Birnbaum suggested there are statistics that indicate that it isn't any better. Do you have anything that would indicate that it is?

MR. MILLER: Actually, I think I do. The residual market population in this country has been coming down since the early 2000, 2001.

MR. PARTON: Well, residual markets are historically very costly. Part of the reason they may be coming down is because, again, people in economic times such that we're having now are deciding to go bare, correct?

MR. MILLER: The reason they are overpopulated traditionally has been because they could not -- insureds could not get an adequate rate in the voluntary market, so the only place that the insureds could go would be to a residual market.

MR. PARTON: I agree, but then you're making

the assumption that somehow because those markets are being reduced that they're finding insurance elsewhere, and frankly, there are no studies out there that suggest that people necessarily went from a residual market to an insurance company as opposed to going bare.

MR. MILLER: I believe that this market, the voluntary market has opened up substantially since 2000 and 2001. It is coincidental with the use of credit score. I'm not here to tell you that I know for certain that the use of credit score has caused this, but I think it is interesting that -- how the voluntary market has opened up and served a broader spectrum of a market at the very time the credit score began to be used. I think that's of interest and I think it's indicative that credit score has been, has had a favorable impact on the availability of insurance in the voluntary market.

MR. PARTON: There were other factors in play from 2000.

MR. MILLER: There were a lot of other factors in play. The FTC study, assuming their numbers are correct, said a credit score -- it was about 50-50 on Hispanics. About 50 percent of the Hispanic population received a higher rate because of the

use of credit scoring and 50 percent received a lower rate solely because of the credit score factor.

And on the Asians, I think it was about two-thirds got a lower rate, benefited from it, and one-third got a higher rate; the African-Americans, about 40 percent who benefited and about 60 percent that got a higher rate.

Now, if you outlaw the use of credit, 40 percent, assuming those numbers apply here in Florida, 40 percent of the African-American insured population is going to get a rate increase. I know it's not the majority, but that's a lot of people.

Roughly 50 percent of the Hispanic population are going to get a rate increase. Roughly two-thirds of the Asian population is going to get a rate increase. If you put them all together in just one large class of racial minorities, it's going to approach 50-50, depending upon what the split is by racial group here in Florida. I don't know that off my head, but it's going to approach 50-50.

Ban credit score, roughly half the minority population is going to get a rate increase. I don't know how you're going to tell them exactly

why you did that, because you got rid of this so-called evil of the disparate impact arising from credit score, but how do you tell half the minority population that you protected them from disparate impact when their rates are going to go up? They're going to say, thanks very much, but I didn't need that kind of help.

MR. PARTON: Let's examine the truth of what

you just said, Mr. Miller.
MR. MILLER: Even on the African-Americans, I know 40 percent is not a majority, but that's a lot of people that are benefiting.
MR. PARTON: Your example assumes that, in fact, the only factor -- and you keep telling us about all these other factors other than credit scoring that are being considered. You're assuming that that one factor is going to change by 50 percent the exact numbers that are in the study here, affect those groups in an adverse way as you have described, but yet you have gone through meticulously, over and over, talking about all the other factors that are out there.
If what you say is true, then it means that the only decision-making with regards to rates that companies are doing is based upon credit scoring,

and that's unlawful. So the impact you're describing, if you're correct, there are other factors actually being considered, is not necessarily correct, is it?
MR. MILLER: No, you misunderstand. What I'm assuming is exactly what the FTC study said.
MR. PARTON: You're assuming, in fact, the one factor is the only thing?
MR. MILLER: No, I'm not assuming that that's the only thing that affects their rate. What they posted in their study was the effect on the rate

solely from the credit score.
In other words, if you removed the credit score and left all the other rate factors in place, 40 percent of the African-American population, on average, would receive a rate increase. About 50 percent of the Hispanics would receive a rate increase and about two-thirds of the Asians would receive an increase solely because of the removal of one factor, the credit score factor.
MR. PARTON: Do you believe, really believe that if, in fact, credit scoring were eliminated that insurance companies would not adjust their factors, that they would not look for another way to properly rate these things?

MR. MILLER: I believe that there is no other way known to rate those insureds. I believe that if there were a substitute for credit score, a known substitute for credit score, they would be using it right now, to avoid these kind of debates.
There would be no advantage to them to be using credit score if something else was available. I have looked at a lot of data on this issue and have done some projects where we're looking for alternatives, but there are none that have been identified so far that could replace credit score.
MR. PARTON: My question still was, do you really believe that everything else will stay equal in the rating of insurance if credit scoring is not

available?
     MR. MILLER: If credit scoring is not available, the immediate impact is going to be, if that's the only change made to the rate factor, and that will be the immediate change, pass a law banning credit score, the immediate change will be to take the credit score out of the rating formula.
     MR. PARTON: Agreed.
     MR. MILLER: The first renewal after that change, 40 percent of the African-Americans, approximately 40 percent of the African-Americans

will get a rate increase, 50 percent of the Hispanics will get a rate increase, two-thirds of the Asians will --
     MR. EAGELFELD: Well, you've said that three times now. What is the magnitude of that rate increase that you're talking about?
     MR. MILLER: Pardon?
     MR. EAGELFELD: What is the magnitude?
     MR. MILLER: Don't know.
     MR. EAGELFELD: Don't know.
     MR. MILLER: Don't know. It depends on a company's rate factors, how much spread there is in the rate.
     MR. PARTON: Also it depends on their claims, the expenses and other factors which are, frankly, not going to change.
     MR. MILLER: No, it doesn't.

MR. PARTON: Which are, frankly, not going to change as a result of you losing credit scoring. Those factors will remain the same.

MR. MILLER: It does not depend on that at all. It depends on the existing rate structure that's on file with the Insurance Department, the rate factors that are on file, pass a law, pass a law that bans the use of the credit score, those

rate filings are going to have to be changed to take the credit score factors out.

And when that happens, those rate increases that I just listed are going to happen. Now, what happens years down the road, I don't know, but that's what will happen immediately.

MR. EAGELFELD: Well, the average renewal will happen somewhere between three and six months after this dreaded moment. Do you think that the private market will not react or will not recalibrate the rest of the classification system or incorporate other adjustments that, I grant you, will not perfectly substitute for the missing variable, but will go some ways towards improving the classification system in order to make up for the missing variable?

MR. MILLER: There's nothing out there to replace the missing variable.

MR. EAGELFELD: To partially replace the missing variable or adjust for the fact that that variable is no longer there?

MR. MILLER: There's nothing out there that they know of. If there was another rate factor out there, Howard, that could replace it -- that was predictive, they would be using it now.

MR. EAGELFELD: I can tell you that I have listened to a seminar put on by a professional actuarial consulting firm about what to do when or if credit were no longer permitted. Were they just blowing smoke?

MR. MILLER: Yes. They were selling services.

MR. EAGELFELD: Selling services?

MR. PARTON: Do you do that?

MR. MILLER: What usually comes up -- I don't, actually.

MR. PARTON: You don't?

MR. MILLER: I don't.

MR. PARTON: What are you doing with FIC?

MR. MILLER: I don't market, if that's what you're referring to.

MR. PARTON: Okay, I'm sorry, you're not marketing.

MR. MILLER: What usually comes up in those conversations are liability limits, tenure, but those rate factors are already built into the rating plan in most cases in some form.

There are no replacements out there, and I would suggest to you that if there were, they would be used, but they're not there.

MR. EAGELFELD: And there is no

reconfiguration of the other rating factors that would better measure the expected costs if credit were eliminated? You just eliminate credit, leave everything else the same, is that what you would advise clients if that happened?

MR. MILLER: Eliminate credit from the rating plan, then for those using the multi-variant analysis, they're going to -- they should recalibrate all the other rate factors, but that doesn't mean there will be much, if any, change, and you can't know ahead of time whether those changes are going to compound these increases or mitigate these increases.

You cannot wish this away. I mean, you take a rate factor like this out, the immediate impact is going to be a significant proportion of the minority insured population are going to get rate increases, first thing out of the chute.

MR. EAGELFELD: I just don't think you've done the studies to show that that first thing out of the chute won't be simultaneous with, in fact, you just endorsed the idea, that they should recalibrate the rest of the class plan.

Of course you say that, and I agree, that I don't know what effect that will have, but that's something that should be studied before one just says it will have no effect. We shouldn't think about that effect, we should only think about the effect of the elimination variable.

MR. MILLER: Well, there is no way, there is no way to reasonably speculate what's going to happen down the road several years from now. But what I can tell you is that if -- if this credit score factor is eliminated, the initial and immediate impact, no matter what else you do with the rate factors, credit scores already just measuring credit score, all the overlap of the other factors have been taken out, these rates are going to go up and will go up for a significant portion of the minority population. You're going to have a lot of people calling, finding out what you did to protect us, and they're not going to like it.

MR. SHAW: So the very group that it's alleged are being disproportionately impacted by this will then suffer a huge rate increase if credit scoring is taken away?

MR. MILLER: I didn't say a huge rate increase, because I don't know the size of it.

MR. SHAW: They will have a disproportionate

rate increase?

MR. MILLER: Those that are currently benefiting, because of good credit scores, having below average rates, those that were identified by the FTC in their study on a national basis, 40 percent of the African-Americans, about 47 or 48 percent of the Hispanics, I think, 66 percent of the Asians, those people are currently receiving lower rates solely because of the credit score.

I mean, the credit score works to their advantage in terms of rates. If you take that credit score rating factor out, those rates go back up to the average. There will be some rate increase there.

I fear that there might be a lot of people out there thinking that this disparate impact means that all the minorities, you know, everybody in the African-American community is being -- receiving higher rates because of the credit score or all the Hispanics are, and so forth. That's not true.

I mean, there is a distribution of good and bad credit scores within each one of those racial subsets of the insured population.

MR. PARTON: That's true, but of course the FTC has found that, in fact, they're

underrepresented in the good scores and overrepresented in the lower scores, so you're right, there are some people in upper scores, but even when you take a look at it, African-Americans, as a rule, start out lower than everybody else.

MR. MILLER: And 40 percent of them receive the benefit, and I agree that that's not the majority, but that's a lot of people.

MR. PARTON: Anything else?

MR. MILLER: I do not. Thank you.

MR. PARTON: One question: Am I correct in assuming -- and I hate to use that word, assume, but I do -- that the weight, if you will, of credit scoring in any given insurance model that's being used by an insurance company will vary from company to company?

MR. MILLER: I would think most likely. It's not going to be identical.

MR. PARTON: How would you go about testing the sensitivity of the credit scoring variable in a given insurance credit scoring model?

MR. MILLER: Well, actually the weights, if you have an insurer that has calculated all of their rating factors using a multi-variant analysis where all the rate factors are in the one formula,

the weights are right there for each of the rate factors. That's the coefficients to the X values, the independent variables.

MR. PARTON: So if we wanted, all we would have to do is just change the credit scoring and see what happens at the other end? The credit score, I'm sorry.

MR. MILLER: I think I lost your question. I'm sorry.

MR. PARTON: My question to you is, how would we go about testing the sensitivity of any insurance scoring model that uses credit scoring, the sensitivity to a change in a credit score?

MR. MILLER: You're not talking about the effect on the rates, you're talking about --

MR. PARTON: Yes, ultimately I am.

MR. MILLER: Ultimately you are.

MR. PARTON: Yes.

MR. MILLER: The first thing I would look at, I think, is whether it's changing the distribution of insureds by credit score. You can change the model and get a different numerical value, but that doesn't necessarily follow that that will change the distribution of scores across the various ranges.

In order for it to really affect the rate factors, I think you'd have to -- I think you're going to have to change somehow the distribution, significantly change the distribution of credit scores across the full range of credit scores.

MR. PARTON: So I couldn't just sit there and say, and I'm just going to throw out numbers, I don't know what are good numbers or bad numbers, but assume for a minute I've got 750 credit score and I run it through the model, all things else

being equal, I get a result.
     And then I reduce that credit score from 750 to, say, 720. Isn't that a way to test what the impact, the sensitivity of that particular model or any particular model, is to a change, either slight or great in a credit score?
     MR. MILLER: Well, I still may not have understood your question, then. If you're saying, if somebody's credit score changes from 750 to 720, we're not changing the model, then.
     MR. PARTON: No, we're not changing the model. What I'm looking at here is the sensitivity of the model to a change, an input, if you will, credit score change.
     MR. MILLER: My previous answer was geared to

the notion you're changing the model.
     MR. PARTON: Well, I apologize. What I'm trying to do is to test the sensitivity of a model to a change in a factor.
     MR. MILLER: If you keep the model the same and you keep your rating plan the same, if somebody's score changes from 750 to 720, you just look at which rate class did the 750 put you in and which rate class does the 720 now put you in and what's the difference in the premium.
     MR. PARTON: And that's all we have to do?
     MR. MILLER: I believe so.
     MR. PARTON: Okay.

I apologize to the insurers. I had hoped to have gotten through one or two of you this morning. Obviously, we did not.

We're going to take about a 30-minute break for your convenience to get some lunch and then crank back up at 10 minutes to 1:00.

(Lunch recess.)

(Proceedings continued in Volume II.)

CERTIFICATE OF REPORTER

I, CLARA C. ROTRUCK, do hereby certify that I was authorized to and did report the foregoing proceedings, and that the transcript, pages 3 through 132, is a true and correct record of my stenographic notes.

Dated this 4th day of March, 2009, at Tallahassee, Leon County, Florida.

____

CLARA C. ROTRUCK

Court Reporter

STATE OF FLORIDA
OFFICE OF INSURANCE REGULATION

IN THE MATTER OF:

USE OF CREDIT SCORING AND CREDIT
INFORMATION IN INSURANCE RATEMAKING

Public Hearing
_______________________________________/

VOLUME II

February 18, 2009
12:55 p.m. - 5:12 p.m.
Cabinet Meeting Room, Lower Level, The Capitol
Tallahassee, Florida

Reported by:

LISA A. BABCOCK

Court Reporter

PANEL MEMBERS:

Steve Parton, General Counsel, OIR
Stephen C. Fredrickson, Assistant General Counsel, OIR
Mike Milnes, Deputy Director, Property & Casualty, OIR
Howard Eagelfeld, Actuary, Property & Casualty, OIR
Sean M. Shaw, Florida Insurance Consumer Advocate
Belinda Miller, Deputy Commissioner, OIR

P R O C E E D I N G S

MR. PARTON: I apologize for things not moving as quickly as I thought it would. These things sometimes don't. I do apologize for that. We will try, and I'm sure some of you will be very glad about that, to do something like 45 minutes per company in speaking.

And so in anticipation of that, I've indicated that each of you can make an opening summary or statement. I'd ask you to keep those short. But I'd also ask that the principal person who has the most knowledge about how the credit scoring or credit scoring model is being used in the company then provide us a thumbnail sketch of how it's used by the individual companies, what type of factors are considered in it, and then we can kind of go from there and try to look for ways that we can move this along quicker than it is.

The first insurance company that we've asked to appear here today is Allstate Insurance Company. And Allstate, there's a bunch of you, aren't there, Mr. Carlton?

MR. CARLTON: Yes, sir.

MR. PARTON: I'll ask you to identify them when you speak. First of all, let me thank you for

being here, and frankly, all the companies. Everybody has been very cooperative in this, very cooperative with regard to the documents that we need to take a look at. I do understand, at first blush as the subpoenas came back, it's kind of like "Oh, God, he wants the world." I really don't. And really, I look at subpoenas as kind of an invitation for you to call me so we can then work together to narrow things down and get to the issues at hand.

So without further explanation, welcome representatives of Allstate. Mr. Croft, I ask you, if you would, to identify yourselves and let me put you under oath first for those who are going to testify.

Do you solemnly swear or affirm to tell the truth, the whole truth and nothing but the truth?

(Collective affirmation.)

MR. CROFT: Thank you, Mr. Parton. We appreciate the opportunity to be here and explain how it is that the Allstate group of companies use credit information in the rating and underwriting of products for our customers.

MR. PARTON: Is there a button on that mic?

MR. CROFT: I think it's on. Let me get a

little closer. We have provided documents that are responsive to the subpoena today and, of course, we're going to continue to produce documents as we have agreed to in our various discussions. And we appreciate your willingness to cooperate with that. We, of course, in those conversations talked about a lot of the documents that are responsive to the subpoena, which are already filed with the Office of Insurance Regulation. We did not duplicate that. So there are hundreds of thousands of pages of documents that are already on file with the Office of Insurance Regulation that are directly responsive to the subpoenas.

And one of the documents that had asked to be put in front of you is just a one-page document that it's titled, "Florida Credit Use." And I'd suggest that that particular document will be helpful to you when you review all of the material that's already been filed with the Office of Insurance Regulation. The other document that you have in front of you is just a brief presentation that Mr. Lamb is about to go through, which we hope is -- addresses the seven items that are outlined in the media release that went out yesterday, and as you indicated, Mr. Parton, you were interested

in today in your opening comments.

I'll turn it over to Mr. Lamb. He will go through this presentation. It's a short one and I'm very hopeful it will answer the vast majority of your questions. And after that, he's ready to enlighten you as to how we use credit with our customers.

MR. PARTON: Thank you. Welcome.

MR. LAMB: Thank you. Good afternoon. I must say it's a little daunting to be presented as the person most knowledgeable on a certain subject, but I will do my best to live up to that designation and answer any questions that you might have. I want to start my comments today with just a little bit of an overview on insurance principles, and not that it's stuff that you're not familiar with but more just to set the context for the topic that we're talking about in terms of credit-based insurance scoring.

It's clear that insurance is about selling a promise, a promise to reimburse customers for losses they're going to have in the future. And when you determine the premium for an insurance policy, there is a large portion of the costs that are really uncertain at the time the premium is

determined; those relate to loss and loss adjustment expense. So the rate-making process is really forward-looking in nature. We're trying estimate what is the likelihood of someone having a loss on a policy. That doesn't mean we can predict with certainty whether someone will have a loss or not. It's not to value a particular person, but we're making estimates based on risk classification, taking people with certain groups of characteristics that are predictive of loss and using that information to make an estimate about the loss potential that they have under the policy.

MR. PARTON: When we talk about "loss," we're talking about a claim; are we not?

MR. LAMB: Right; the amount of the claim or the fact that there is a claim under a policy.

Now, here's -- to best understand the risk of the underwriting market, the underwriting marketplace are the ones that are going to be able to best serve that market. And this has led, over the years, to an evolution of more and more sophisticated risk classification plans.

We have begun using insurance scoring over the years, but it's not the only thing we use. That's been mentioned already. It's just one of the many

factors that is used. And it is one of those things that we have found to be a valid predictor of loss, and then it provides a value above and beyond the rate that insurance companies already had considered prior to that.

I think there's been testimony this morning to suggest that maybe there's other things that aren't captured in a credit-based insurance score that might also be useful for the purposes of evaluating risk. But I would argue that that doesn't mean that insurance scores are not valuable information. For example, think about the rate variable that we use, years of driving experience. We look at the driver's license and say, "This is the year you got your driver's license. How many years have you been driving?"

Well, clearly, if you knew how many hours somebody had been driving, that would be useful information. Somebody might get their license and

drive once a month; somebody might drive eight
hours every day. That information may be useful,
but it's not captured when we look at the date
somebody was licensed.
     So I would argue that just because there may
be more information that may be valuable doesn't

create a situation where we say we shouldn't use
this because in light of the other information that
could help you predict risk better. I would argue
that insurance scores are measurable; they're
objective. The same scoring model is applied to
all risks after it's filed, and it's based on
objective standards that are used in terms of
identifying those things that are most likely to
predict risk. And by having this in our rate plan,
it enables us to avoid adverse selection, which is
really the tendency to be insuring a larger
proportion or risks that are underpriced relative
to the risk that they present.
     MR. MILNES: Taking a look at this, it states
that, "The rate-making is not to predict past
losses or to predict when a particular individual
will have more losses." You're saying that use of
credit scoring is not predictive in an individual
filing a claim?
     MR. LAMB: It's useful for predicting how much
we expect somebody's losses may be based on the
characteristics of the group that they would be in.

For example, 16-year-old drivers. The fact that somebody is 16 is a risk characteristic that we use to say this person is probably more likely to have

a loss than someone else. But we can't go and say this 16-year-old will have a claim, this 16-year-old will have a claim, this 16-year-old will have a claim. It doesn't really allow you to pinpoint which particular insureds will have a loss, but it does allow you to take that characteristic and say this enhances our ability to predict.

MR. MILNES: But with all the characteristics being the same with a 30-year-old, the only difference being credit score, you're going to then go back in and say they're more likely to have a claim or file a claim with us with a worse credit score?

MR. LAMB: If everything else is equal and we look at the insurance score and it's more favorable, then we would expect they would have less losses under the policy. Did that answer your question?

MR. MILNES: Yes.

MR. LAMB: Okay. In general, let me say that in a competitive market, insurers are in a position to try and sell as many policies as possible, provided the price of the product is reasonably related to the cost of providing that product. And in a competitive market, there's pressure to keep your rates from being too high, because if they're too high, business is going to go to a competitor. On the other hand, you want your rates to not be too low, because either it would create a situation where you're not willing to write the risk or you could be subject to adverse selection.

We would argue that consumers are best served by a competitive marketplace where insurance companies compete on price, product and service. And again, when you think about it from a standpoint that this is a prediction that insurance companies are making about the risks that somebody presents for the policies that come in the future, each insurance company that's doing business in the state is making a projection about that risk. Everyone's prediction or everyone's projection is going to be different. And by having many companies competing, the consumer is able to pick and choose which of those propositions, in terms of that risk prediction, the level of service the company provides, and how they provide and make a decision about what they think is going to be most favorable for them.

We would argue that Florida auto insurance market currently is competitive, which is evidenced by the fact that there's currently only six policies in the Florida Underwriters Association. Now, Allstate has been using insurance scoring or use of credit information in Florida since 1990, when it was first introduced as a tool for underwriting homeowners insurance. In 1994, we started using it as an underwriting tool for automobile insurance. And then starting in 2000, we began to introduce it into our rating plans, which we think is a more advantageous way of using that information. Part of the reason is it's allowed us to relax our underwriting guidelines, because with it in the rating plan, the rates that are being charged more accurately reflect the risk that somebody presents.

In fact, Allstate did a study back in early 2002, where we looked at all the business that had been written in our Allstate Property and Casualty Company, a new company that had been introduced to use insurance scoring for new customers written in 2001. And what we found was about 20 percent of the customers that were written into that company would not have been eligible in the standard market using the underwriting guidelines that had been

previously in place for that line of business. And that's a study that we've included in the documents that we've provided today.

MR. PARTON: I was going to ask you if a study was being provided and I appreciate that.

MR. EAGELFELD: If they had been eligible in the standard market, would they have been eligible in your Allstate Fire and Casualty Company, your other company?

MR. LAMB: Well, the Allstate Fire and Casualty Company wasn't in existence at that time. We had previously written business in, typically, the Allstate Insurance Company. And then Allstate Property and Casualty Company was the first company that, in many states, introduced credit scoring for rating purposes.

MR. EAGELFELD: So you did not have a nonstandard vehicle?

MR. LAMB: We did have nonstandard vehicle still. Allstate Indemnity would have been used for nonstandard risks.

MR. EAGELFELD: But would those 20 percent have been -- could those 20 percent have been written in Allstate Indemnity?

MR. LAMB: A portion of them probably would

have been eligible for Allstate Indemnity. I don't know if it would have been the entire segment or not.

MR. EAGELFELD: Do you have any estimate of how much your total market share or absolute amount expanded as a result of the limitation of credit scoring?

MR. LAMB: It's hard to isolate that as one factor, because there's so many things that impact your market share, competitive position in terms of overall rates, rating plans, number of agents. So, I mean, we can look at what our market share has been and how much we've grown, but I think it would be very difficult to isolate that one contributing factor by itself. So I've given a little history of how we've used insurance scoring over the years.

The federal law, FCRA, expressly has allowed the use of insurance scoring for many decades. But in 2004, there were some changes in how we used insurance scoring based on the law that was enacted, Senate Bill 40A, that came out of the Florida Legislature. We would argue that that bill has actually more consumer protections than the original model bill and some of those things that are included in there, that insurance scoring

cannot be the sole basis for decisions made by insurers.

It also establishes an appeals process for people who are subject to certain extraordinary circumstances. It helps or it requires updated credit information be re-run every two years at the consumer's request. And once that information is reviewed, the rates cannot go up. The rates can only go down when you reevaluate that information. As a result, at renewal, no one will see their insurance score result in an increase in their premium when it's reviewed on that two-year cycle.

MR. EAGELFELD: I'm not sure that that's in that statute.

MR. PARTON: Yeah, it is.

MR. EAGELFELD: That a review update in consumer information, credit information, can only result in lower rates?

MR. PARTON: As I understood it, I thought the statute did say something like that. I think our rule does, too.

MR. LAMB: That's currently our interpretation of the statute, and that's the practice that we are -- that's how we issue insurance in the State of Florida today. Also, there is a provision that

no-hits be treated neutrally or as otherwise approved by the Commissioner. And over the years in our filings with the OIR, they've consistently taken the position with us that we should treat no-hits as neutral, and that's the way we treat it in our rating plans today.

I want to comment briefly on the FTC study that was released back in July of 2007. I think there was a significant study in terms of debate over use of insurance scoring. Some of the things that were found in the study were similar to what had been seen in other studies, that credit-based insurance scores are predictors of risk for automobile insurance policies when you control for other normal factors for use of a rate plan or when you control for race, ethnicity, or income.

It's still a very powerful predictor. The thing that the FTC study had done that was different than any of the other studies that had taken place before was to look to see if insurance scores actually work because they're a proxy for membership in a protected class, racial groups or income groups.

What it found was that because scores do not predict risk within racial and ethnic and income

ethnic groups, they do not act solely as a proxy for these characteristics. And it also said that credit-based insurance scores appear to have little effect as a proxy for membership in racial and ethnic groups and decisions related to insurance. Actually, my reading of the report says it would be a very ineffective proxy.

Now, there is a small finding in the report that tends to show some slight proxy effect that I think is actually very questionable when you read the details of the report because of the fact that was mentioned this morning, that the process they use to control for geographic risk or territory really wasn't adequate to describe the way that insurers were actually using it. And actually, if you read the report itself, there's actually about, at least four occasions, where the report actually cautions the readers that some of the information may not be reliable because of the fact that an adequate control for geographic risk isn't included in the study.

So, if insurance scoring was removed, we would see that over half the consumers would experience an increase in the rates because of that. I think the FTC study shows that those that would receive

the rate increase are those that are most likely -- or less likely to incur losses and yet their rate would go up even though their propensity to have a loss would be much lower than what the rate would be. Also, if the use of insurance scoring was banned, we think it would have a negative impact on the competitive marketplace. Again, when we go back to some of the earlier points we made about a competitive market, it's premised on the fact that insurers have a rate that matches the expected risk.

Clearly, if the use of insurance scoring were to be banned in the State of Florida, I want to make it clear that Allstate would comply with the law, but there would be a tendency to be more restrictive, potentially, in underwriting guidelines, again, taking the same effect that when we put in insurance scoring, it matched risk better to loss; we became less restrictive in our underwriting guidelines. Underwriting guidelines, that would be something that we'd want to look, at least evaluate if we should make some changes.

Now, based on the information that we've seen in this study, it doesn't mean that there aren't things that we would like to see happen and there

aren't actions that Allstate is taking to trying and address some of the issues around the use on insurance scores. First, one of the things is we'd like to see many groups have better insurance scores and benefit from the fact of having even lower rates available to them associated with good insurance scores. Allstate has had a long history of funding initiatives that further economic empowerment and, we've listed some of the things we're involved with.

Currently, we're funding literacy campaigns with Larasa in the National Urban League. Also, a key component of our signature program, providing assistance to those victims of domestic violence, includes the use of financial empowerment curriculum. We've also been working with Junior Achievement since 2003 to include "Economics for Success," a program that we use with middle school students, teaching them the basis of financial management. And since 2002, we've also worked with the One Economy Corporation. It's a nonprofit group that's helping low-income families raise their standard of living by leveraging technology.

Also, one of the things that we've recently introduced in the State of Florida is, at least in

some of our lines of insurance and I know we're working with your office to get that included in some of the other lines of business we write as well, is an expanded appeals process. Again, we talked about some of the protections that were put in Senate Bill 40A, there is a provision that if someone has an extraordinary circumstance, like a divorce, a dissolution of marriage, that there be a process where they can receive an appeal and receive a neutral rate as opposed to a rate that would be indicated based on their credit history.

We're in the process of rolling out an expansion to that rule, and this is already in place in some of our lines, where we would add several categories to that appeals process, including involuntary unemployment, catastrophic medical expense, care of adult dependents, identity theft, long-term injury, illness or disability, care of a dependent grandchild or domestic violence. And again, there has been discussion today talking about what is actually happening with insurance scores in today's economy.

Now, the times that we are actually living in are very uncertain, and so it's hard to predict actually what will happen in the future, but

definitely, we're able to comment on what we've seen so far. In many states, based on the in-flow model, Allstate actually reorders people's credit information on a three-year basis. And we've looked on a quarterly basis at the percentage of changes in insurance scores as part of that review from 2006, 2007 and 2008. And in the states where it can get better or it can get worse, what we've found is the majority of people -- there are more people whose scores are getting better than are getting worse.

Also, we've had some discussions with TransUnion, which is the vendor we use to order credit reports, again, because they can look at a large segment of the credit reports that they have to see what trends they've seen with their insurance scores. And while there are some variations in some of the variables they look at, they've said that their insurance scores, at least over the last two years I think as of third quarter, they changed very little. Now that doesn't mean that there aren't some people's scores that are getting worse. I think, at least, it helps put in into context that, on the whole, it's hard to say that the average score is getting much

worse.
But clearly, there are going to be some individuals who are impacted by the things that are going on. And that's why we think that this extraordinary appeals exception process is a way of addressing that. For those people who have circumstances where you would look and say maybe this person's credit report isn't an accurate reflection because of the unusual circumstances that they experience, it creates a process where they can be moved to a neutral level. And that's part of our rating rule in the State of Florida.
Finally, I just want to make a couple comments on the proposed rule. We think that the law that was passed in the State of Florida gives a lot of detail around the parameters which insurers must operate and to use insurance scoring. And we would say that to a great extent, a lot of the items that are included in the proposed rules are already actually being used in the requirements that the OIR is making of companies to file their insurance scoring models and the way it impacts their rates, which in our mind raises the question why formal rules are necessary.
But be that as it may, we do see one thing in

the proposed rule that we actually think is very positive. You know, that allows companies to refer to their most recent prior filing if the company has already demonstrated to be a valid model and no changes are being made as part of the insurance scoring methodology. And we see that as a positive step in streamlining the filing process.

Our primary concern around the rule centers around the requirement to provide all the data used in the derivation and calibration of the model parameters in light of the OIR's apparent position that insurers may not assert trade-secret privilege for that data. Now, I will mention that we have actually gone through the process of submitting all of our data that's used to calibrate the model parameters for our most recent insurance scoring model; we've made that public. We've provided data, again, to facilitate your review and allowing you to see the information.

But I think in the long run, this may hinder the introduction of potential enhancements to insurance scoring models if companies may feel they will lose a competitive disadvantage by introducing brand new changes that they might want to keep from their competitors. I have a couple other comments

in there but we can wait until a little bit later so you have time to ask questions.

MR. SHAW: I wrote a letter to Allstate on January 23rd. Mr. Croft, I appreciate your response to that letter. Well, your response to me was on January 23rd; sorry. I want to look at page four of your response, the first paragraph. It talks about -- and as your presenter just talked about, the appeals process and the credit history neutral rate that's assigned to a policyholder if he shows one of these emergency conditions. That person getting a credit history -- I mean, your model, I guess, has the ability to just take the credit score out? Do you just keep all the other factors the same and just take the credit score out, or do you make or emphasize other factors, or how is that credit history neutral rate assigned?

MR. LAMB: In our rating plan, we take the scores that are calculated, and we assign it to one of several groups. And the number of groups varies based on the line of business. Some of our initial filings had, like, five groups; some of our current companies use up to 16 different groups based on somebody's insurance score. So what we do is we go ahead and calculate which of those 16 groups, for

example, equates closest to the average rating factor.

So if the highest rating factor was a factor of 1.6, and the lowest rating factor was a factor of .6, and the average somewhere came out to a 1, and that was equivalent to group number eight. What we would do is say, rather than take the score that was generated, put them in the group that would be associated with that and we would take and put them into group eight. And we actually filed what that neutral group is as part of the rule, so that it's clear that that's where they will be placed if they have no-hit based on one of these circumstances.

MR. SHAW: Okay. Thanks.

MR. EAGELFELD: How frequent would you say no-hits and no-scores are in your proprietary models? That is, out of 100 applicants, how many would come back with a no-hit, no-score?

MR. LAMB: It can vary a little bit based on the line of insurance. But I think general numbers for homeowners insurance might be about four percent; for auto insurance, it would be more like six to ten percent.

MR. EAGELFELD: That's about half the number

or less than half the number we've heard from about Fair Isaac. Do you have more rigorous procedures to make sure that they don't get no-hits?

MR. LAMB: I'm really not familiar with where that Fair Isaac's number came from. Obviously, the information you use to build the model, we try and take the information that's on the report and create a score with it. We think we've got enough information. Now, how a different model might respond to the amount of information that they

think is necessary to calculate a score might be different. But it could be part of the difference that's there, but I don't know the real reason.
MR. EAGELFELD: What has driven your choice of which of the three, I presume, I think you only used one, which of the three national credit bureaus you're using?
MR. LAMB: Well, yeah, we had a contract with TransUnion when I started working on credit-based insurance scoring models. And clearly, there's a lot of work that's done to get used to the data that's provided in a specific format, the information. We've looked at the option of maybe using certain other of the credit reporting agencies to provide us information, but there is a

big, at least one-time cost, in terms of getting familiar with their data, developing the information. So it's something we haven't ruled out in the long run, but clearly it's, because we've already got this relationship established with TransUnion, it's easier to use their reports.
MR. EAGELFELD: Have you undertaken any efforts or heard of any cooperative efforts within the industry to create scoring products that would incorporate information from more than one of the credit bureaus?
MR. LAMB: Well, clearly, with regards to rate making, we're very careful to avoid any anti-trust

issues. So we pretty much keep to ourselves in terms of our efforts to --
MR. EAGELFELD: Ferguson clean-type of cooperation. You haven't advanced that and you haven't heard of any industry -- legal, industry effort that has --
MR. LAMB: No. And again, we use the information that we can. What we're trying to do in the process of developing rates is to look at the cost of the information being provided versus the predictive value and ask. Clearly, ordering credit reports has become a process that's pretty

streamlined, pretty efficient. We can get a credit report that's very predictive of risk for pretty marginal cost.
MR. EAGELFELD: As I understand, these three bureaus differ in their completeness, depending on various circumstances. Probably, the lender you use, the region of the country you're in, they have subsidiary and puppy bureaus and all kinds of things go on in that industry. But I guess you've answered the question. You haven't really undertaken. You're worried about cost and, of course, you should be.
MR. PARTON: What sort of information do you get from the credit company? What was it, TransUnion?
MR. LAMB: Right.

MR. PARTON: What information are you getting
and then you're using?
MR. LAMB: The information that we get in the
calculation of our score -- and again, as I
mentioned, our ISM7 insurance scoring model has
been filed, not only with your office, but made
public so that it's available to the public.
There's 18 different variables that are used in the
calculation of a score. The majority of them have

to do with information about performance of
accounts, in terms of late payments, derogatory
items like public records, the length of time since
those public records or delinquencies happened. We
also look at inquiries. We look at the length of
time that we have accounts on file, newly opened
accounts, and inquiry information. I don't know if
I specifically mentioned that, but that's one of
the categories we look at, too.
MR. PARTON: And this is used to come up with
your insurance score, the insurance score you use?
MR. LAMB: Right.
MR. PARTON: All right. What other factors
are in that insurance score other than, you know,
the information that you get from the credit
company?
MR. LAMB: Our insurance score is based solely
on information from the credit report.
MR. PARTON: And how is that -- again, I know

you filed this with us, but on the other hand, this is not just for us, and that's why I'm asking these questions. Within that, the insurance score is used how?
MR. LAMB: Primarily, it's used in the rating plan, to help determine the rate that somebody

pays. There are some of our companies where we also use it as an underwriting tool. But essentially, the way it's used from an underwriting standpoint is if somebody has typically better than, say, the top 20 percent of insurance scores, I mean the -- I would characterize it, make sure that our score in our model, the lower score, is better. So sometimes it's a little confusing when you're trying to compare direction.
If you took the people with about 20 percent of the worst scores, typically the number of accidents that they're allowed to have to meet the eligibility guidelines would be a little more restrictive than it would be for people falling below that category.
MR. PARTON: Again, I'm just trying to understand how you guys are using this. So you get an insurance score, and then what other factors are considered in ultimately either putting this person in a particular tier or pricing within the tier?
MR. LAMB: Well, for automobile insurance, it would be several factors.

MR. PARTON: Right. I focused on auto because it's the biggest user of this. So what --
MR. LAMB: So we look at the age of the

insured; marital status; the number of cars in the household; different ages of the people in the household; we look at the use of the vehicle; the type of the vehicle; not only the price of the vehicle, but the experience we've had on specific makes and models; we look at where the vehicle is garaged; we look at the limits of coverage, the deductibles purchased on the various coverages. I'm probably forgetting a few in that process, but there is a large number of factors that go into the determination of the rate.
MR. PARTON: In looking at those other factors, are you somehow combining them together? Is there some sort of formula, weighting, if you will, that's a factor in arriving at your ultimate conclusion?
MR. LAMB: In the process of developing our rating plan, yes, we would run a multi-varied analysis where we would actually simultaneously solve for what the various factors should be assigned to each one of those rating factors to be used in the rate plan. So it's a -- I mean, it is a mathematical process that takes a look to say that each of those pieces of information are relevant, each of these pieces of information has

some information about the predictive risk, and it solves for the indicated factors to be charged on a simultaneous basis.

MR. PARTON: Would it be fair to say that the insurance score is the most heavily weighted factor?

MR. LAMB: Not necessarily. Again, when you go through a process to try and determine what is the most important factor, you know, there is a lot of different ways to approach that question. I think in Mike Miller's testimony, he actually did a study with the epic study that was done that actually ranked specifically the top variables for each of the major coverages. And insurance scoring wasn't the most important factor for coverage.

MR. PARTON: I understand that but, of course, all the testimony I've heard here is it is the most important factor to the industry. So I'm trying to get a sense, if you will, in your company and others, just how important it is in the ultimate outcome. I understand, in not necessarily every case, it would be the most heavily weighted factor. But the bottom line, is there a general rule?

MR. LAMB: Well, again, I wouldn't say that we've got a specific procedure for measuring. We essentially rely on each factor to the extent that it adds predictive value. But it does seem to have greater predictive value than other things, even like driving record.

MR. PARTON: Have you tested it for sensitivity; that is to say, if adjustment and insurance score, all things else being equal, just how sensitive that credit score is on the outcome?

MR. LAMB: Once you've created the actual rating plan, yes, you can easily look at the factors and say, okay, what if somebody is in the very best insurance score, what would their rate be; if they're in the very worst insurance score, what would they be; and in the middle. And you can see some differences.

MR. PARTON: Actually, I know you can do that. My question really was, has Allstate done that? Have they taken a look to see what the sensitivity is on that insurance score in the overall formula?

MR. LAMB: Yes; we look at that when we're actually creating the rates.

MR. PARTON: I'm still not sure that answers my question. I guess what I'm getting at, have you literally taken -- can you sit here today and tell me what is the range of your insurance scores?

MR. LAMB: Again, it would be different for homeowners insurance.

MR. PARTON: Again, we're just talking about auto.
MR. LAMB: Typically, for auto insurance, if you used a company with, say, five groups, what you'd see is the people in the fifth group would probably be 30 percent higher than average. The people in the first group would probably be 30 percent lower than average, maybe a little bit bigger spread.
MR. PARTON: And how much change in insurance quote are we talking in one group or another? That's what I'm asking.
MR. LAMB: Yeah. I mean, typically, it would be -- it could be dependent on where you are in the range. In some parts of the range, you might be 30, 40, 50 points that's required to change your score; in some it might be 10 to 15. Again, when you talk about a change in score, again, this is a unique proprietary model that Allstate has developed. So the score range would not necessarily be comparable to, for example, somebody's FICO score. I think a lot of times, you think of a 750 versus a 720. That's a totally

different scale than what we use. So a 10-point change in our scale might be different than a 30-point change in some other scale.
MR. PARTON: Are you looking at the actual credit score that TransAmerica or Union, whoever it

is, provide to you, or are you merely looking at the factors that are contained in there; in other words, the number of outstanding credit cards, the number of late payments, debt ratio, things of that nature? Or are you somehow using the actual score you get from them, that 750 or that 720?

MR. LAMB: No; we don't use that score. We actually build our own scoring model. So we get the information, all the different variables that are available on the credit report and we actually go through the process of developing our own unique proprietary model, trying to incorporate those factors that we think best reflect insurance risk. And in some cases, it allows us to do, obviously, some unique things.

I think one of the things that's been brought up as a potential concern here today, for example, is the effect if somebody has a credit card and the credit card lowers the limits that they have. There are situations where people look at the

balance that you carry on your credit card versus the available limit. Well, we look at information like that. But rather than use the actual limit, in our model, what we've done is said let's look at the balance on the credit card compared to the highest balance that ever existed on that credit card. So, for example, if somebody had charged $2,000 dollars at one point and their balance right now is $500 dollars, that would be a ratio of 25 percent. You know, by looking at that comparison, if the limit is actually lowered, it's not going to change the highest amount that ever appeared on that credit card.

So in situations like that, we can construct our own variables that we think would maybe have an advantage in terms of how big of the risk that exists on the credit report.

MR. PARTON: And I'm glad to hear about that you have an appeals process in place. One of the concerns I have, though, is what the criteria are for ultimately either granting a dispensation or not granting a dispensation. And what recourse does the insured have if you don't give them a dispensation, what's the course of action? Can you speak to that a little bit?

MR. LAMB: Sure. I can give some insight into that. When we have somebody trying to avail themselves of the appeals process, we're essentially looking for two things: One, some documentation around the extraordinary circumstance. So for example, if they've got a catastrophic medical situation, you should have some type of evidence that they were in the hospital or something like that. And then just a statement as to how it impacted their credit report, you know, some direct correlation between the event and the items that are impacting on their credit report.

What we've seen so far with this appeals process is typically about 70 percent of the appeals are granted and almost all the ones that aren't granted essentially stem from the fact that we ask people to provide documentation and they just don't send it. But most of the ones that provide documentation are approved.

MR. PARTON: And this appeal process is available not just for, for instance, a coding, if you will, in TransAmerica. This is a medical thing. The fact that it's not coded but they can demonstrate to you that it was a medical issue,

they can take advantage of this process; correct?

MR. LAMB: Well, the appeals process is essentially designed for situations where someone has poor credit information but they want us to not consider it for these special circumstances. If somebody's credit report is actually incorrect, if there's something, for example, not coded right on their credit report, what we want for them is to actually get that credit report corrected so that we can give them the benefit of where they truly belong.

Again, in the appeals process that we've established, if your appeal is granted, you end up in a neutral rate. But if there is something in your credit report, for example, that keeps you from being in the very best rate and you get it corrected, then we'll actually move that person down to the lowest rate. So, for example, if someone had a collection that was medically-related and it's not coded appropriately at the credit reporting agency, we would encourage them to get that corrected so that they can actually have that excluded from the insurance scoring model and actually get the benefit of wherever their insurance score would place them.

MR. PARTON: But what if they can demonstrate to your satisfaction that it was a miscoding, why wouldn't you just go ahead and do it through that appeals process? And the problem I have with the notion of you need to go to the credit scoring, there is no relationship between a company and TransUnion. The relationship is with the insurer. So why wouldn't you just address that issue through the appeals process?

MR. LAMB: A lot of cases, there is no way for us to know if that information is correct or not. And in working with TransUnion, TransUnion doesn't want to work with the insurance company. They'll only work with the specific person whose credit report is at issue. But as part of our filed rules, if somebody goes through the correction process, we will actually go back retroactively to the time that we used that credit report and refund any difference in premium between their old score and the corrected score. So if they go through the appeals process, they're still not disadvantaged in terms of the fact that that lower rate will be applied retroactive to the time we first used the credit report.

MR. PARTON: And I appreciate that. I think

that's a very nice thing. I guess my problem with that is, as I started out by saying, there is no relationship between the insured and TransUnion. The relationship is with the company. It kind of bothers me a little bit that you suggest that somebody has to take care of it with the credit union before you, even though they can demonstrate that to you. I'm talking about a situation they can show you: "There was a catastrophic illness. Here is all the data. I don't know why it's on my report. And why can't I get the advantage of this?" And your answer is, "Sorry. Can't do anything about it. Go see TransAmerica."

MR. LAMB: Well, I wouldn't characterize it as saying we don't want to do anything about it. This is the process that we use to try and ultimately get it corrected. Because we're in a difficult position of trying to verify the accuracy of credit information.

MR. PARTON: Well, you know what? You're

using it. It seems to me that ought to be your
job; okay?
MR. LAMB: Well, in the process of allowing insurance companies to use it, when the Fair Credit Reporting Act was set up, there were specific

practices put in place that would require insureds to be able to get information if their credit report was used. There had to be a correction process established. There are time limits on how long it takes for that correction process to take place. So there are safeguards that are put in place now.
And actually, the Florida law that was enacted also requires companies to go back and give people the benefit of lower rates when those corrections have taken place. So, again, does it always work as quickly as somebody would like? Probably not. But I think the safeguard's in place to see the ultimate rate reflects the correct information when the correction process is used.
MR. EAGELFELD: It may not work at all, though, because TransUnion and credit bureaus are not under any regulatory authority as far as what they code. So whether they code it as medical or not is not something that the consumer can legally insist that, "You, TransUnion, must recode this item as a medical bill. You've made a coding error here."

If the amount that's there is incorrect or
their factual information is incorrect -- certain

items they can insist be corrected and certain others, the bureau is not under any obligation to code at all. And if they do code, there's no legal enforcement of the quality of the coding. It's a catch-22 that certain individuals find themselves in.

MR. LAMB: But it is -- in the circumstance like you've talked about, a catastrophic medical situation, they could avail themselves of the appeals process as well.

MR. PARTON: Well, that's what I was asking you. And I thought your answer was no, you couldn't and go to the credit company.

MR. LAMB: Well, again, what I'm saying is the appeals process has the ability to address that and move them to a neutral rate. But if somebody thinks their credit can even be better than the neutral rate based on the correction of the information on the credit report, then it needs to go through the correction process.

MR. EAGELFELD: I have another question. You have at least one major subsidiary, Encompass Floridian, that appears on your table as using the Fair Isaac Insurance Bureau score. Are you aware of when the last time Fair Isaacs did a study to update that score?

MR. LAMB: No, I'm not. And actually, part of the reason that that company uses that, it was using information from Fair Isaacs before we actually merged with that company. So it predated them being part of the Allstate family. Over the years, we've tried to transition them to the Allstate proprietary models, but it hasn't taken place in that company yet.

MR. EAGELFELD: The reason I ask is that it has to do, both, with your own company and also with Fair Isaacs. Would it surprise you if I proffered to you that it's been ten years?

MR. LAMB: No.

MR. EAGELFELD: It doesn't surprise me either because that's how long I think it has been.

MR. SHAW: We heard some data today that most consumers don't know that credit scoring is used in terms -- as part of the their auto premium. So I want to ask a basic question: How does a consumer become aware of this appeals process if they don't know their credit scoring is being used?

Do they get a rate, and they say this is too high, and then they become aware somehow? If most people don't know their credit scoring is being

used, how are they availing themselves of the

appellate process?
MR. LAMB: Well, as part of our expanded appeals process, we're actually sending notices to the consumer as part of their renewal package that would list all the circumstances that they could appeal. And that's being sent to everybody whose score is above neutral. In other words, all those who would benefit, potentially, from moving their rate -- their score down to a neutral rate will get a notice at the time that the renewal is sent.
MR. SHAW: Do you send something that -- is something sent to the consumer that says credit scoring is being -- Allstate uses credit scoring?
MR. LAMB: There is for everybody who's not in the very best rate -- anybody who doesn't get the very best rate possible based on credit information will be sent a letter informing them that we've used their credit information, that they can contact TransUnion, that we'll allow them to get a free copy of their credit report. And we also will provide them, and again, this is one of those things that was enacted by SB 40A, we will provide them with the four top reasons, based on their particular credit history, that impacted them not

being in the very best group of scores.
And I would add also that one of things we've done is to take a look at the reasons that we explain -- use to explain information to our

customers, to actually use some consultants to help us clarify that language, make it more understandable, expand the length of the reasons that we use to describe that information so that it's more informative about the particular -- what that particular element of the credit history was that was impacting their score.

MR. SHAW: Just one final one, but I think this is the $64,000-dollar one. If you don't use insurance scoring, I see those less likely to incur losses would receive rate increases. So people with good credit would receive rate increases. So if credit scoring is taken out, premiums are going to go up for people with good credit scoring. Why would that happen? I see the bullet points you have right under it that seems to get to that. But can you kind of tell me in plain English what would be the negative impact on consumers if credit scoring was banned?

MR. LAMB: Well, clearly, if you ban the use of insurance scoring, the underlying risk will not

change because of that. So people who have the lower likelihood of loss, their losses will be the same but their rates will go up. We won't be able to reward them the lower rate that's commensurate with their lower-level credit risk. So the rate will increase, and they'll be paying more than their predicted level of risk.

MR. PARTON: I guess the part that troubles me about that statement is that, again, it sounds to me like credit scoring is being used solely to determine the ultimate premium paid by your policyholders. If you take it away and you say it's automatically going to cost those people more, that's kind of troubling.

MR. LAMB: And again, I think, you know, there was some earlier conversation about what would be the impact. And the FTC study -- I think it's important to clarify, what did the FTC study actually show? The FTC study, there's actually a figure in the study, I think it was figure five, that showed how many people would see a rate increase, how many people would see a rate decrease, based on the removal of insurance scores. If you read the information in the report, what that -- essentially two indicated rating plans.

One rating plan, they've taken all known factors that are used to rate for auto insurance, come up with indicated rates by person. And then they've developed a second indicated rate plan that includes all those same factors and insurance scores. So if some of the other factors, the different rating factors, change because, again, they're doing a multi-varied analysis. They're solving for all the specific rating factors simultaneously.

And then that comparison is actually taking those two rating plans and saying, under these two rating plans, this one or I use this one, what happens to the predicted risk of each individual? And what it showed was 59 percent of the time, it would go up; 41 percent of the time, it would go down if you moved from one rate plan to the other.

MR. PARTON: As I've indicated, that's troubling because, again, it still sounds like it's solely based on credit score.

MR. LAMB: No, it's essentially saying if I had everything and insurance scoring, and I moved to a rate plan that had everything except insurance scoring, here is what the difference would be.

MR. PARTON: And the sole thing that's changed

is the removal of the credit score or the addition of the credit score. I understand you modified all the other factors, but the single factor that caused that was the credit scoring.

MR. LAMB: But that's the one factor we're talking about banning. I mean, in your hypothetical example, you said if this was to be banned, what would be the result? Clearly, we wouldn't take out other factors besides insurance scoring. It would just be that one factor.

MR. PARTON: And you might add other factors to make up for that; correct?

MR. LAMB: In the FTC study, it actually

accounted for as much as could be made up with the other factors. It actually said, let's solve, using a multi-varied analysis, what the new indicated rate should be for every other factor, and then it compared those rate plans.

MS. MILLER: Has Allstate actually been through that? Have you been in a state that banned credit scoring after you've already written there for a while?

MR. LAMB: The only example, really, would be the State of Maryland for homeowner's insurance. And, again, we saw significant rate increases for a

lot of people as a result of pulling out insurance scoring from the homeowners' business in Maryland.

MS. MILLER: And when that happened, did you just take that one thing out of the score -- or take that one thing out of the rating methodology and leave everything else the same? Or did you change anything else?

MR. LAMB: I know we changed some things over time. I don't know if it was done simultaneously when the law was first enacted or if we just simply pulled it out and then went back and revisited some changes. But I know changes to other factors actually did occur, if not initially, over time.

MR. PARTON: Two things that I'm kind of concerned with here. One, we talked about and it has to do with the economics that are going on now,

both in the state and across the nation, and how
that may impact. And you've indicated, at least
today, with regards to those individuals who may be
affected, it doesn't seem to be having that much of
an effect on credit scores, or insurance scores, or
whatever you want to call them that you're using;
is that correct?
MR. LAMB: Well, I think the testimony was
that it didn't have -- didn't seem to be having a

major impact on the averages. Now clearly, when
you talk about specific individuals who are going
through difficult times, clearly, that's still
important to them. It's something that we need to
consider. But, yeah, in terms of the averages,
that's true.
MR. PARTON: At least with any company or
policyholders, you have those sorts of things
happen. There is an appeals process that is set up
to address that; correct?
MR. LAMB: For those extraordinary
circumstances, yes. But again, remember it's in
addition to the fact that in Florida, when we look
at credit for renewal customers, when we look at
their credit information, it's only used to allow
the rates to get better not to get worse.
MR. PARTON: So the only impact that we would
expect to see, at least at Allstate, is the moment,
God forbid, this thing gets much worse and credit

scoring now is taking a hit and is a major issue.
Or even on a single basis, the only people that are going to go affected, in terms of the use of credit scoring in your methodology, are those that are new policies, new applicants; correct?
MR. LAMB: Right.

MR. PARTON: And those new applicants have the ability to address their circumstances in the appeals process?
MR. LAMB: Yes, they do.
MR. PARTON: To the extent it would put them in a neutral tier.
MR. LAMB: Right.
MR. PARTON: But not to the extent that it would necessarily put them in the best rate?
MR. LAMB: Right. Essentially, the appeals process tries to put them in the same position if credit information wasn't used at all.
MR. PARTON: The last thing I want you to address is one of the issues that the FTC reports, as well as others have suggested, is that using credit-based insurance, there -- and I'll just read it to you: "Credit-based insurance scores are distributed differently along racial and ethnic groups, and this difference is likely to have an effect on the insurance premiums that these groups pay on average. Non-Hispanics, whites and Asians are distributed relatively evenly over the range of

scores, while African Americans and Hispanics are substantially overrepresented among consumers with the lowest scores and substantially

underrepresented among those with the highest scores."

That's kind of a troubling finding, for us at least. And my question is what has Allstate done to take a look at this and to take any -- make any efforts, if you will, to nullify this type of effect; that is to say that there are certain racial groups that, in fact, start out with a credit score that's worse, and we assume the credit scores you're getting from TransUnion would also be worse, and how you are addressing this issue, if at all?

MR. LAMB: Well, that's a good question. And I think in setting the stage for what I would say is some of the things we're doing, I think it's good to set an analogy. And again, it's interesting because I know there is an analogy that's been used about life insurance before and the fact that maybe --

MR. PARTON: As long as it doesn't involve hair, it's okay.

MR. CROFT: I second that.

MR. LAMB: But clearly, for life insurance, you know, one of the things that you'd think would be important would be life expectancy. Now, in the past, I think there's been criticism of the fact that race was used as a rating factor for life insurance. And we would think that's inappropriate and shouldn't be used. But some of the things do predict life expectancy. For example, there's rates that vary based on whether someone is a smoker or a nonsmoker.

Now, if you look at the percentage of the population, and I haven't done those studies, but let's say there are certain protected classes that are more likely to be smokers than nonsmokers. Now, one could make an assumption that maybe we should just get rid of that factor for life insurance because then everybody would pay the same. It wouldn't impact certain groups more than it would others. I think from a public policy standpoint, your question is, is that really the best thing you'd want to see happen? Ideally, what you'd want to see is people smoke less and have better life expectancy.

So on the analogy, when you take that over to the insurance scoring side, ideally what we would like to see is these groups actually have more people benefit, improve their financial literary, improve their ability to not only move to a neutral group but a better group through better insurance scores. That's why we listed a lot of the advocacy efforts, in terms of the economic education of various groups.

MR. PARTON: And I appreciate that, and I'm sure, frankly, these groups that are underrepresented in the upper-level scores would like that as well. But there's certainly an argument to be made that these groups, because of historical discrimination, that literally the process you're using is perpetuating the economic disparity that's created by hundreds of years of economic, socioeconomic discrimination.

So it's nice that you're going out and you're educating people, but one could argue that there is a whole group of society that, unlike a smoker who can quit, a smoker who can get treatment, didn't have a choice, one, about the race that they are, and number two, didn't have a choice in history, economic history, socioeconomic history, of this country and how it may have impacted them. So I understand your analogy, but I still have a problem with that.

MR. LAMB: And I think it is interesting when you read through the FTC study and look at all of

the things that they did. And one of the steps that they took in trying to evaluate why insurance scoring works and the different impacts, is they actually built not only a base model, they built their only insurance scoring model, but they also built an insurance scoring model that was based only on information for non-minority groups. So again, none of the information for any minorities was used in the creation of the model.

And what they found was the factors that came out as predictive were essentially very close, the predictive power was very close, and the distribution of how it impacted the different segments of the population was also very close. So again, even if you eliminate that information from the model-building process, the same factors show up as positively related to insurance loss.

MR. PARTON: Which argues for the elimination of it, so that it doesn't impact minorities this way.

MR. LAMB: That's not the conclusion that I would come to. Again, I go back to the point --

MR. PARTON: I understand that.

MR. LAMB: -- in an ideal world, that we could have everybody benefit to the same extent. I think

that would be a much better solution.

MR. PARTON: I do too. But the real world doesn't always translate that way. Have you -- I think you did indicate that you have an done analysis with regards to credit scoring and its

impact, in terms of affordability and availability?
MR. LAMB: Yes. There was, again --
MR. PARTON: That was 2002, you said?
MR. LAMB: -- when we started first using it for rating purposes; yes.
MR. PARTON: Thank you. Any other questions?
MR. SHAW: How much did rates go up in Maryland when credit scoring was banned?
MR. LAMB: It was a very big rate increase. I'd have to go back and look at it, but I think it was more than just the impacts of banning insurance scoring. But there was also, I think, a general rate increase because the overall rates were underpriced at the same time. So the impacts for certain customers would have been very dramatic.
MR. SHAW: How much would you expect them to go up -- auto rates to go up in Florida if credit scoring were banned?
MR. LAMB: Well, clearly, there would be some people who would get more than a 30-percent

increase. There's some people who would get more than a 30-percent decrease. So it would be a pretty wide range.
MR. PARTON: Are there any states that you're in that insurance policies are not understated?
MR. LAMB: I'm sure there are.
MR. PARTON: I just thought I'd ask. I do appreciate you coming today. And frankly, I have

to extend to you compliments of the Office in terms of your cooperation in providing this information in regards to your computer model. I understand you have concerns about trade secret. Our interpretation isn't that you can't claim trade secret. We believe, however, the Legislature said trade secret or no, it's not going to be considered to be exempt and confidential from Chapter 119. And that's not necessarily the position of the Office but as a result of the Legislature intentionally not reenacting the exemption that had previously existed in credit scoring law.

Now, as I indicated yesterday when a law professor came in here, his analogy and analysis of other conditions of the statutes and a court case called Sebro, was absolutely correct; okay? In fact, I argued that five years ago when I suggested

to the industry you really don't need this particular provision. But in going forward with it, what the Legislature said is it doesn't really matter whether it's a trade secret if it has to be credit score. That's not going to automatically exempt -- we're going to provide you with separate exemptions despite the fact that it's trade secret and they took that away.

So when we talk about trade secret, you can market trade secret, we're not going to disclose it without giving you the opportunity to go to court.

But I just wanted to correct you. We're not saying it's not a trade secret. We're just saying it's no longer exempt from public records requests; it's no longer considered to be confidential as it relates to credit scoring.
MR. LAMB: Okay.
MR. CROFT: Thank you.
MR. PARTON: The next company we'd like to talk to is GEICO.
MS. GORDON: I wanted to make an opening statement and then just turn it over to our witnesses.
MR. PARTON: That will be fine. Can I go ahead and swear them in and then you can make your

statement?
Would you raise your right hand? Do you swear to tell the truth, the whole truth -- or affirm -- the whole truth and nothing but the truth in this proceeding.
(Collective affirmation.)
MS. GORDON: My name is Bonnie Gordon and I'm senior counsel with the GEICO group of companies. Thank you for the opportunity to be here to talk about the use of credit in insurance underwriting and rating and the benefits that competition and choice have brought to Florida drivers. I'd like to make a brief statement and please save your questions until after I finish.

We've produced tody Paul Lavrey and Bill Costa, who are actuaries for the company, to answer any specific questions about how GEICO uses credit scoring in Florida. Government Employee's Insurance Company was founded in 1936 on a simple philosophy: To offer customers excellent auto insurance coverage at low prices. That business model has succeeded. GEICO is now the third largest private passenger auto underwriter in Florida and countrywide. I'm also pleased to say that we employ more than 1800 associates in our

Florida offices to service our Florida customers. GEICO continues to grow in Florida in double digits.

In order to be able to offer the most competitive rates to Floridians and to most accurately match the risk of insuring a new policyholder to an adequate rate, our actuaries consider more than 20 factors, not just one or two. Credit is one of those factors, and credit is part of GEICO'S initial risk review process. But credit is not used by our companies at renewal. And no single factor, including credit, is ever used exclusively, or even primarily, to set rates.

Let me be clear: GEICO does not believe that race or ethnicity are at all relevant to risk evaluation, and our rating and our underwriting and rating processes are entirely blind to race and ethnicity. We do not assume that any members of any racial or ethnic minority group are less capable of prudently manging their finances.

We understand the OIR's interest in the credit issue at a time when the country is experiencing an economic downturn. GEICO is continually monitoring its underwriting and rating factors. And we have, to date, not seen a meaningful change in insurance

scores. If there were meaningful changes, we would consider making appropriate adjustments in our processes. We do try to work with our customers in the event that special circumstances may arise. For example, in the event that a customer advises that they have been impacted by circumstances out of their control, we neutralize their credit score so that they would not be adversely impacted. For those customers having trouble making their payments, we've recently expanded our payment plan options.

We also work with the general public on financial literacy efforts. GEICO sponsors the National Urban League Economic Empowerment Tour, which helps attendees improve their financial situation on all fronts. I think it's important to say that Florida drivers currently enjoy the benefits of one of the strongest auto insurance markets in the country. The most recent data from the Florida Auto JUA shows there are only six policies in the residual auto market in this state.

Competition for Florida auto insurance customers is fierce. Consumers have many choices and auto insurers must compete for business based on price and service. Florida auto insurance

buyers are extremely price-sensitive and they shop. The fact that GEICO offers a policy to more than 98 percent of all Florida applicants is indicative of just how competitive this market really is.

We hope the information we provide today will assist the Commissioner and his staff in our mutual goal of maintaining that healthy marketplace.

MR. PARTON: Thank you. One thing I need to emphasize -- I haven't so far -- is that when any of the witnesses speak, they need to identify themselves for the court reporter and the proceeding.

MS. GORDON: Would you like me to introduce our group?

MR. PARTON: Pardon me?

MS. GORDON: Do you want me to introduce each --

MR. PARTON: Yes, I would. This is Gordon, Bonnie Gordon.

MS. GORDON: -- senior counsel with the companies. Paul Lavrey, assistant vice president with GEICO Companies and Bill Costa, assistance vice president with the GEICO Companies.

MR. PARTON: Who would you like to speak with
regards to the overall --

MS. GORDON: Mr. Lavrey.
MR. LAVREY: I will speak first. Just to give you a little bit, I am the assistant vice president of Government Employee's Insurance Company in pricing and product management department. One of may areas of responsibility is for the State of Florida. So I kind of oversee the whole -- all of the rating and underwriting in Florida and other regions in the company.
I haven't really prepared any sort of a presentation, but I will kind of run you through quickly some of what we do on the credit information, some of the questions you've been asking and hopefully answer some of your questions.
MR. PARTON: That would be helpful. And again, everybody listen up, because if you can anticipate our questions and you answer them upfront, we can pick up speed and get out of here, and I won't lose my voice; okay?
MR. LAVREY: And Bonnie did mention some of this, and I will kind of just reiterate some of it. But we use a credit-based insurance score, along with many other factors, in determining the placement at new business. We do not use credit information at renewal. We use the Fair Isaac,

FIIRS 2.0 model. Unlike Allstate, we don't have our own proprietary model. We use the Fair Isaac's model and that's been filed with the state.

We advise people of our use of credit information at the point of rate quote. If they request that we -- that they do not want their credit run, we actually will neutralize their credit and offer them a rate quote with a neutral credit score at that point. We treat no-hits and no-scores as neutral in our credit model. And Bonny mentioned that we have procedures for special circumstances where we also neutralize credit. If they've had extraordinary circumstances or, as I mentioned, if they just feel like they've been impacted by a special event or something and they want their credit neutralized, we would neutralize that for them.

And I guess the last thing I would say is, you know, we think the combination of credit information, along with all the other underwriting rating factors, has helped make this a very competitive environment. We are able to offer very low rates to our customers and to people calling us for a rate quote. And currently, we're able to save people about $600 dollars on a rate quote for

people who switch to GEICO.

MR. SHAW: That sounds like a commercial. "This is the money you can save."

Allstate said something about the Urban League, too, and I think you're involved with the Urban League. What do you do with the Urban League? Is that an attempt to assist minorities to improve their credit score? Or what is your urban work?

MS. GORDON: Let me put on my glasses. I can speak to that one. Do you mind if I speak to that, Steve? Okay. My understanding about the National Empowerment Tour is that, I think it was first devised in 2006 and that it goes to a variety of different cities and tries to educate folks about how -- elements of financial products. So it educates them about insurance. It would educate them about banking. I think it also helps to educate them about the importance of their credit and credit score.

MR. SHAW: Isn't that sort of gets right to the point that those communities are the ones that are -- that have credit problems, that are much more prevalent in those classes?

MS. GORDON: I don't think I would necessarily

say that. I'd say that it's probably just an effort of an outreach for us in a variety of different kinds of community works in which we're involved. We're also involved in a variety different areas.

MR. SHAW: Okay. And what do you -- if credit scoring is banned, what do you think the rate increase would be? Do you have an estimate?

MR. LAVREY: I would say the best study that we've been able to do, we do know that when we first put in credit, we were able to offer our preferred rates to more customers. But I don't know that that -- that was a long time ago. Our rating plan is different now. I don't know if that's necessarily still applicable.

I guess the best example I have is we don't really have a study, but there's been a lot of talk about what happens in the state if you ban credit. That does happen a lot. I'd say, the best counter example I have to that is in 2004, New Jersey implemented a lot of reforms and actually started allowing the use of credit information, along with other factors, at that time. They had a severe availability issue in the state at the time.

And the New Jersey Department of Banking and

Information did a study recently to show what the benefit was. And, you know, they quoted a 75 percent reduction in the residual market. It has really opened up the market, made it much more available. They've also seen some improvements in affordability, although that was not really the intent with the changes in legislation, but that's

been exciting. They didn't quantify those, but
that's kind of the best example I can give you.
MR. EAGELFELD: Well, the New Jersey reforms
included a lot more than just --
MR. LAVREY: It included a lot more. They did
give some credit to the use of credit in that.
MR. EAGELFELD: Yeah; that was amongst the
reforms.
MR. LAVREY: Yes. There was many reforms.
This was one of the things. I think it really goes
to the point of they allowed the companies to use
underwriting and rating factors to improve
competition in the state and offer more
opportunities. And that's really, at least in New
Jersey, it has worked very well in that state.
MR. EAGELFELD: I have a question about your
use of credit. You -- I understand you use it for
new business only. But upon becoming a GEICO

insured, presuming one doesn't go this no-credit
route but one actually does have the credit report
ordered, about how many groupings do you employ,
perhaps 100? I don't recall.
MR. LAVREY: You're talking about the credit
score ranges?
MR. EAGELFELD: Yes.
MR. LAVREY: I'm not sure exactly. It's 12 or
15, somewhere in that ballpark.
MR. EAGELFELD: Now, if I attained the best of

those, if I were in the best of those groupings, and if he were in the worst, come three years from that date we both entered GEICO, how likely is it that his rate, or is it possible that his rate, would be as good as mine at that renewal that occurred three years later, six renewals later?

MR. LAVREY: Yes, it is. We reevaluate the risk, and I know the requirement is after -- within three years, you need to kind of reevaluate them. We actually reevaluate them after a year and then every six months thereafter, eliminating their credit and placing them wherever they would be placed regardless of where they -- how they were placed initially.

MR. EAGELFELD: So there's no remnant of where

they were placed before as new business or at their first renewal? None of that remains as part of the impression that keeps your rate --

MR. LAVREY: Except for the fact that we would not raise their rate or eliminate the use of credit at that point.

MR. EAGELFELD: You would not raise their rate?

MR. LAVREY: They could only benefit from that reevaluation. We would not increase their premium as a result of that.

MR. EAGELFELD: Okay. And at the point, though, where, at the three-year point -- the law requires it at three years. I don't know whether you stop using credit completely earlier than that.

MR. LAVREY: At one.

MR. EAGELFELD: At one year; okay. So even at the one-and-a-half year renewal point, there will be no comparative advantage that will continue to inure to me the better credit score a year-and-a-half ago as compared to him?

MR. LAVREY: As I said, we would reevaluate you and place you in a better tier, but we would not, if your -- you know, the only way we would move you to a higher rate is if you have some sort

of actionable activity, if you had an accident or injury or something like that. But otherwise, yes, we would.

MR. EAGELFELD: Is there any limit to how much better a tier placement you can get at renewal?

MR. LAVREY: No.

MR. EAGELFELD: You can run the gamut.

MR. LAVREY: Yes.

MR. PARTON: I'm confused. I think what I heard you say is after a year, you don't use credit.

MR. LAVREY: Correct.

MR. PARTON: But we are talking about reevaluating somebody, let's say, 18 months out. In reevaluating that person, then, you are not using credit; is that correct?

MR. LAVREY: Correct.
MR. PARTON: My question, and I think what Mr. Eagelfeld is asking and I'm not sure I understand it yet, is if I'm in the worst tier, he's in the best tier, and we're 18 months out, now you're going to reevaluate us and you're not going to use credit. Am I going to be able to get as good a rate as him? Or am I being evaluated differently than him, because he's already up here

and I'm already down here?
MR. LAVREY: You would both be evaluated the same way. And if you had characteristics that were just as good as Mr. Eagelfeld, you would be moved to the same.
MR. PARTON: So in 18 months when you are not using a credit score, my rates are not necessarily going to go up?
MR. LAVREY: I'm sorry; say that again?
MR. PARTON: So in 18 months out, at the time when you're not using credit scoring to reevaluate me, my rate is not necessarily going to go up because you're not using credit score; correct?
MR. LAVREY: Correct.
MR. PARTON: Okay.
MR. MILNES: Who had the better credit score up here, you or Mr. Eagelfeld. Mr. Eagelfeld's would go up if you're not using the credit score anymore?

MR. LAVREY: Mr. Eagelfeld's -- we would not --
MR. MILNES: Oh, that's right. You would not be based on the credit score. Very good; very good.
MR. PARTON: He was asleep.

MR. EAGELFELD: What's your experience in no-hits, no-scores? How prevalent do you find that in your applicants?
MR. LAVREY: How prevalent do we find that? I would say the combination of the two is probably somewhere around 20 percent. I'm not sure of the exact number but somewhere around there. That includes everybody that would get a score. And the biggest two of those is no-hits and no-scores. We also, as I said before, we do allow people to refuse. Most people don't but we do allow them to, and they would be included in that 20 percent as well.
MR. EAGELFELD: In your appeals process, can someone do a subjective appeal for reasons other than the, I think it's four, that are stated in the Florida Statute? Do you consider other things?
MR. LAVREY: Yes. We would consider, really, any special circumstance that's impacting that.
MR. PARTON: But again, that would be just to get them into a neutral score. It would not necessarily get them the best score; correct?

MR. LAVREY: That's correct.

MR. EAGELFELD: Are you aware of Fair Isaac's plans or the most recent review of their model that

you are using, that you're a client of?

MR. LAVREY: Am I aware of their --

MR. EAGELFELD: Of when they last reviewed that FIIRS model?

MR. LAVREY: I don't recall the dates; no. Sorry. We do evaluate, you know, how that model is performing on our business, and we still find that it is extremely predictive. So we look at the results on our end, but I'm not sure about their evaluation of the model.

MR. MILNES: Just for the record, GEICO's position is that the use of credit scores is a good predictor in evaluating whether or not a policyholder will file a claim or not; is that accurate?

MR. LAVREY: Yes.

MR. MILNES: Good enough.

MR. LAVREY: A good predictor of the future loss experience, yes.

MR. SHAW: And let me ask a simple question. I think I've got it. GEICO does not use credit scoring for any kind of renewal? Like, after this initial period, credit scoring does nothing, even in a relative manner, even from where one started and one ends up, credit scoring is done with after the first initial use of it?

MR. LAVREY: After a year.

MR. SHAW: After a year, it's not used anymore?

MR. LAVREY: It's not used. Unless somebody -- we do allow them to, as required under Florida law --

MR. SHAW: It won't negatively --

MR. LAVREY: -- if they want to -- if they request that we update their credit score, we would do that, and then they -- but it would only be to their benefit.

MR. SHAW: Okay.

MR. PARTON: If you would, please explain to me a little bit more in process. You've indicated that Fair Isaacs is the one that does your insurance score. Am I correct?

MR. LAVREY: Fair Isaac has our -- Fair Isaac developed the model. We order the score from TransUnion. It is run off the TransUnion database.

MR. PARTON: TransUnion provides the information to Fair Isaac to run your model? Or is it the model that's used by --

MR. LAVREY: No. TransUnion has the Fair Isaac model, so we request the information from

TransUnion. They run the model and send the information back to us.

MR. PARTON: Okay. What sort of information do you get back?

MR. LAVREY: We get the score back.

MR. PARTON: Is this a score, and again, drawing a comparison with regards to Allstate, is this the sort of score we would see on the credit report, or is this something else? In other words, is this one of those 750, 680, you know, that sort of thing? Or is it like what Allstate had, 1-point-whatever and that's the insurance score?

MR. LAVREY: It is not the mortgage credit score. It is their insurance scoring model, so it is developed for auto insurance, predicting auto insurance claims. The ranges are fairly similar to the normal mortgage credit scores that you would see.

MR. PARTON: And then you take that information and you do what with it?

MR. LAVREY: We take that information and include it with all of our underwriting factors and determine that based on that.

MR. PARTON: Is there, like, a mathematical calculation that occurs involving your insurance

score and the other factors that you consider?

MR. LAVREY: Yes; there is a model.

MR. PARTON: So you assign certain values to each one of the risk factors that you're looking at, I'm assuming?
MR. LAVREY: Yes.
MR. PARTON: Is it fair to say that the credit score is the most significant factor in that rating process?
MR. LAVREY: Well, let me differentiate the rating process and the tier placement.
MR. PARTON: Okay.
MR. LAVREY: This is only a factor in the tier placement, and the normal territorial relativities and class factors and all that get applied on top of that. I would, given that, I would characterize it as it is probably the most predictive characteristic in the tier placement.
MR. PARTON: In the tier placement. And when we talk about the tier placements, is that taking into consideration all those other risk factors, not just the insurance score?
MR. LAVREY: Yes.
MR. PARTON: And when we talk about tier placement, what are we saying? What are you

saying? What do you mean?
MR. LAVREY: When I talk about tier placement?
MR. PARTON: Yes.
MR. LAVREY: There are different -- we have different tiers that have different -- a rating

factor. I'm not sure what the range of the rating factors is, but it may be from .5 to 1.0 or 1.1 as a rating factor. We may have, and I don't know a number, but 15 or 18 tiers. So you get placed in a tier, and you get the tier factor and then that is a part of the rate that would be calculated.

MR. PARTON: And then there is some other factors that are applied to a rate within that tier?

MR. LAVREY: Well, within the tier, then that tier applies to the -- within the rest of the rating plan. So you would then apply your class factors, your base rates, increased limit factors, model year vehicle, all those other factors.

MR. PARTON: Would that be where you would be considering sex or age, or would that occur in the evaluation in tier placement?

MR. LAVREY: It certainly would be in the rating part of it. I'm trying to recall whether sex or age -- I believe those could also be

included in the tier placement as well.

MR. PARTON: Is occupation or education used in the tier placement or in the rating aspect of what you do?

MR. LAVREY: They would be in the tier placement.

MR. PARTON: Okay. So we have occupational, and education and credit scoring are operating in the tier placement?

MR. LAVREY: Yes.

MR. PARTON: I know you've heard us talk about the FTC study and its findings with regard to the impact of credit-based scoring and insurance scores on African Americans and certain Hispanic groups. Are you familiar with that report?

MR. LAVREY: Yes.

MR. PARTON: And have there been any actions on the part of GEICO to take a look at this to see if there is something that they can do to eliminate this impact that may be occurring or appears to be occurring, based on what the FTC is indicating.

MR. LAVREY: I guess I would go back to a point that Mike Miller made earlier today that there is -- well, first of all, I think the important point that the FTC study found was that

even within minority groups, it was still predictive of future loss experience and that the point that Mike Miller made was that you can't expect the same distribution of risk within any class. And if that is the standard which you used, you really wouldn't have -- you really wouldn't be able to have a rate that varied by any of our current rating factors.

MR. PARTON: Well, I don't know whether I agree or disagree with that, but I find it interesting that non-Hispanic whites and Asians are distributed relatively evenly over all the range of scores. So we're not talking about just factors within a particular group here.

What we find is, is that, at least in regards to non-Hispanic whites and Asians, they're represented everywhere. But that's not even true with African Americans or Hispanic groups. And I've got a real problem with that sort of reasoning. So how have you addressed that issue, if any?

MR. LAVREY: I guess I would say that we have not addressed that issue, because we don't believe that that's a reasonable standard to apply to any rating factor. It cannot apply equally to every

class that this has been --

MR. PARTON: Well, one could argue that they may be correct, but race is different. Wouldn't you agree?

MR. LAVREY: I would agree with that if there was any -- that if a factor was found to be discriminatory against racial minorities, that it should not be used. But I don't believe that that's the finding that the FTC study found.

MR. PARTON: So you don't believe that a finding that use of credit scoring with regards to African Americans being underrepresented in the upper echelon and overly represented in the lower, substantially, by the way, is the term used by the

FTC, is not an indication of discrimination?
MR. LAVREY: No, I do not believe that --
MR. PARTON: Is that because you --
MR. LAVREY: -- it says that that is discrimination; no.
MR. PARTON: Is that because you are not doing it intentionally? Or whether intentionally or not, you don't think that it shows that there's discrimination.
MR. LAVREY: It's certainty not being done intentionally, and that, you know, that would be

totally unacceptable. I think that the fact that there are not the same distributions across all of the classes is just a fact of -- it's something that no rating factor could stand up to. In fact, the FTC studied that and they looked at four other factors and found that those also didn't have equal distribution, I think, including claims history and tenure.
MR. PARTON: Well, I -- you're saying that, but, in fact, the FTC did find that a non-Hispanic white characteristic and an Asian characteristic was distributed relatively evenly through all the ranges; maybe not perfectly, but relatively evenly. And with regards to other racial groups, they found that not to be true. So to sit there and say to me other factors can't be evenly distributed, what they found in this report is sure it can. If

you're a non-Hispanic white, you're going to be basically evenly distributed throughout the range, and if you're an Asian, you're going to be evenly distributed throughout the range. But if you're an African American, you're not.

MR. LAVREY: But I think that what the study shows is that that could be true of many rating factors. And sometimes, they may be better and

sometimes they may be worse. And it's really the combination of all the factors that really matters in the premium. But no single factor can stand up to that.

MR. SHAW: So it's the combination of everything that evens it out?

MR. LAVREY: We use factors that are predictive of the risk. And, you know, I believe that -- I do not believe that race is at all relevant in determining the risk, and I believe that the final premiums, when you include all the factors, is representative of the expected risk.

MR. SHAW: How do your consumers know that credit scoring is used to determine their rates, in part? Is that something you tell them when they sign up with GEICO or a notification they get?

MR. LAVREY: Yes. There's -- you know, we write the majority of our business over the phone and over the internet. And if they call us over the phone, the counselor will notify them that we

use their credit information. If they go on the internet, we have a notice on there that we use it.
MR. SHAW: Okay.
MR. EAGELFELD: A question that probably only other actuaries will be interested in the answer

to: Do you use a generalized linear model to drive all your other classification factors and tier rating factors?
MR. LAVREY: I would say in Florida at this point, that is not how our rating plan was developed. But as far as the tier plan, it is not a generalized linear model. It's more in line with a minimum bias-type of analysis.
MR. EAGELFELD: Probably you've heard that Mr. Miller has high regard of generalized linear models and their abilities to make sure that all the factors are in order with respect to possible biases and cross biases. Why would you not be using such a technique?
MR. LAVREY: We are currently working on developing plans that use those.
MR. EAGELFELD: So in the real world, there is at least one fairly substantial company that does not yet use the generalized linear model?
MR. LAVREY: We have not in Florida, yet; yes.
MR. PARTON: The other example that you used in New Jersey, has GEICO done any empirical studies or have access to any empirical data that suggests

that credit scoring has increased the availability
and affordability of insurance?

MR. LAVREY: Just the two things that I said: The New Jersey study and we know that we were able to offer a more preferred rate to more people when we first implemented credit, but that was a long time ago.
MR. PARTON: Okay. When was that law passed?
MR. LAVREY: The law passed?
MR. PARTON: The one that you've indicated that allowed credit scoring and other changes to occur in the marketplace in New Jersey.
MR. LAVREY: I believe it was 2004, somewhere around there. But GEICO went back into New Jersey in August of 2004, and it was as a result of those changes in the law that we went back in. But I don't remember exactly the date of change.
MS. GORDON: If you'd like us to get you a copy, Mr. Parton, of that date, we can surely get it to you.
MR. PARTON: I would surely appreciate it.
MS. GORDON: Okay.
MR. PARTON: Thank you. That will be good. But you don't have any proprietary work that you've actually done?
MS. GORDON: No.
MR. LAVREY: No.

MR. PARTON: You have access to this other? And you haven't conducted an analysis yourself with regards to what the effect on GEICO business would be if, in fact, credit scoring was eliminated?

MR. LAVREY: Not the impact. We have done some work to try to develop the best model that we'd be able to use. We haven't finished that, but, you know, that's something we're certainly working on. What we have found at this point is that even after we've built the best model we can, if you throw credit back in, it's even more predictive.

MR. PARTON: One more question and this may be an unfair question because we're here on credit models and credit scoring, but as I pointed out earlier in one of the questions I asked you had to do with the occupational and educational rating as well. And we had a hearing, actually almost a year to today, actually, last year, regarding the use of occupation and education. As I recall, a number of witnesses went up dealing with census data, dealing with the representations of certain minorities and various occupational groups. And I'm curious as to whether or not, as a result of that hearing, GEICO has taken a look at those sort of distributions as

they may relate to its occupation and education

rating?
MR. LAVREY: We have not looked at the census data. I will say that I think we pointed out at that hearing that there was a study that was done by the Maryland Insurance Administration that found that there was no evidence of a disparate impact. And there was a more recent study, again by New Jersey, on the use of occupation and education that also found that there was no disparate impact.
MR. PARTON: Can I get you to get me a copy of New Jersey?
MS. GORDON: Sure; because actually, Mr. Parton, it talks about some of the very things that you looked at and they came to opposite conclusions.
MR. PARTON: Where are you based?
MS. GORDON: Where?
MR. PARTON: Where are you based?
MS. GORDON: Washington, D.C.
MR. PARTON: And you are -- where is GEICO, Maryland?
MS. GORDON: Well, it's kind of -- we're in a funny situation. It's a Maryland domestic, but on one side of the street, it's Maryland; the other

side of the street is the District. So the Post Office asked us to keep our D.C. mailing address, but we are technically Maryland.
MR. PARTON: If you can get me a copy of that,

I would certainly appreciate that --

MS. GORDON: I'd be happy to do that.

MR. PARTON: -- particularly since I have a credit debate with a commissioner from New Jersey in D.C. in about a week. So it might be nice to know what he had to say.

MS. GORDON: Actually, Mr. Parton, you know, that report has been on --

MR. PARTON: It's online?

MS. GORDON: It's on the Adobe site and has been on for a very long time.

MR. PARTON: I am not computer literate so that has no meaning to me.

MS. GORDON: We can get it for you. We can get it for you.

MR. PARTON: Thank you very much. I appreciate you coming, and I appreciate, frankly, the straight forward answers you gave.

Number seven, Nationwide. This is getting real complicated for our court reporter, so it's going to be real important that when anyone changes

speakers that they identify themselves verbally before speaking. First, of all, for me, because I don't want to insult you by saying, "Hey, you." And so it may be helpful for us to avoid.

Who all is going to testify, everybody, potentially? Let's raise your right hand, please. Do you swear or affirm to tell the truth, the whole truth and nothing but the truth?

(Collective affirmation.)

MR. PARTON: Thank you. If you would, maybe just identify everybody at the table, at least initially. But that does not relieve you of the responsibility of doing it yet again when you speak, please.

MR. JONES: Fair enough. Good afternoon, Mr. Parton, and what I will do as part of my opening comments, I will also introduce the Nationwide team, if that's okay.

MR. PARTON: That's fine.

MR. JONES: Fair enough. Thank you for the opportunity to speak with you today about credit scoring and how Nationwide uses it in rating and underwriting insurance. I will likely address many of your questions in the course of my opening comments as well.

My name is Ramone Jones. I am the underwriting and product management leader with Nationwide in the State of Florida. My family and I live in Gainesville. I am also one of nearly 1200 Nationwide associates, not including our agents, across the State of Florida. Needless to say, I have a vested interest in making sure that the Florida insurance market is successful.

I'd also like to take a minute and introduce the Nationwide team, starting with Davis Bass.

Like me, David and his family lives in Gainesville. David represents our regional underwriting product staff. Chris Cooksey represents our specialty products pricing operation. Robert Sechen is our lead counsel. Angel Bostick is our regional counsel, also based in Gainesville. And Phil Baum joins us from your corporate product office. Phil is our authority on the use of credit and will be the lead during the course of our discussion today.

I do have some brief comments that I'd like to share as we begin. We've worked closely with the OIR in the past and appreciate the opportunity to have conversations about issues that impact Florida residents, our customers, and our business. Nationwide's goal has always been to serve the

citizens of Florida and to protect what matters most to them while fully complying with the laws of the State of Florida. But to do so, we have to manage our risks, manage our rates, protect our capital, and make sure that we have the funds necessary to pay our customers' claims. Today's hearing is a chance for us to work together to maintain an effective tool that will allow Nationwide to responsibly manage its risk.

Credit-based insurance scoring is a factor for providing coverage at a fair price. The use of the credit mechanism has allowed Nationwide to lower rates for most customers by rewarding those with lower-anticipated claims based upon their good financial standing. In fact, credit-based scoring has allowed us to provide more than half of our Florida customers with a lower rate, our Florida auto customers.

Now, the use of credit scoring has been questioned because it's believed that the practice is unfairly discriminatory. Now, right up front, I'd like to discuss some common misunderstandings. Some believe that credit scoring makes insurance more expensive and less available. The fact is the use of credit scoring does not increase the total

premiums insurers collect, but rather appropriately allocates those premiums. Credit scoring improves premiums for policyholders with better credit scores, because research shows they are better drivers with fewer claims. As a company, we firmly believe and support the predictive nature of credit in determining propensity for loss.

Some believe credit unfairly discriminates. However, that's not true. We do not use variables such as race, color, sexual orientation, religion, income, education or national origin when assigning an insurance score. In fact, by law, we're not permitted to consider these factors.

Additionally, we have a process in place to work with our customers who suffer from extraordinary life experiences, such as loss of a job, a medical catastrophe or a natural disaster. Our policyholders are afforded the opportunity to provide this information to Nationwide. And after the verification of these facts, adjudgments are made to reflect these experiences. We like to call it "trust and verify."

In deciding so many things, our overriding objective is to is to charge the right premium for the right risk. Credit is only one factor that

Nationwide takes into account when determining an accurate rate for an individual. In addition to the credit score, we also consider factors like vehicle type, accident history and driving experience.

The combination of these factors, when taken into consideration along with the credit score, allows us to charge policyholders appropriate premiums. And as a result, some will pay more; others, less. If anything, credit scoring makes the process more accurate and reflective of each person's risk potential. Taking into consideration credit scoring, along with several other factors, this allows Nationwide to offer coverage to more people and to more accurately price policies offering lowering rates to most.

In summary, Nationwide supports the use of credit scoring in rating and underwriting instruments. With the use of credit scoring, we're able to meet the insurance needs of Floridians at a fair price while charging a premium appropriate for the risk. Our overriding objective is to simply ensure that each individual pays their fair price to protect what matters most to them.

Again, thank you for this opportunity to talk

with you in depth about this issue. At this time, my three other panel members would also like to address the issues you've raised earlier today. And I'd like to turn it over to Phil Baum.

MR. BAUM: I thought I would start by doing an overview of credit, I think as the other companies have. I would start with standard auto, and I'll turn it over to Chris and he'll get into some of our nonstandard auto, because some of the processes he uses are different.

From a standard auto perspective, we use some credit in some aspect within both underwriting and rating of the policy. The underwriting, initial up front, the insurance-based credit score is one component that's used within a broader model that's used in combination with other underwriting criteria, such accidents and violations, to determine placement in either a standard or nonstandard or eligibility for a standard auto product. Once eligibility is determined for standard auto, the insurance-based credit score is also used to determine the price, so from the

rating end of the house.
The model that's used is a proprietary model.
TransUnion provides the feed of information that's

used in the proprietary model. And the nonstandard will be a little different in the sense that we use a different model for that product.

MR. PARTON: When you say "proprietary model," is it your model?

MR. BAUM: Yes. It's not a FICO or a ChoicePoint model, but it's something that Nationwide has developed with a feed from TransUnion data.

MR. PARTON: I just want to clarify that because I think the term "proprietary" was also used for TransUnion's model or somebody's model out there. And I just want to make sure when you use it, you're talking about it's yours?

MR. BAUM: Sure. So on a high level, that gives you an idea in the standard auto framework. And I'm going to go ahead and turn it over to Chris and let him give you an explanation of the nonstandard framework.

MR. COOKSEY: Sure. The primary difference is that we've developed a credit-scoring model on a nonstandard auto database to produce a score that's specific to a nonstandard auto customer and their characteristics. So we do use a different model. It was built in-house, as was the standard auto model, and it was built by the same people using the same procedures. We also use TransUnion as the feed to get the credit report for that information.

A nonstandard auto -- and let me say this: Sooner or later, and I was introduced as specialty products, we do, in-house, call it "specialty auto," so if I say "specialty," I mean nonstandard. I will try to use the more common term. But on the nonstandard side, we do not use it in underwriting. It is not used for any kind of company eligibility. And that's really the basics of the differences between nonstandard auto and standard auto. So at this point, I will turn it over to David Bass.

MR. BASS: Good afternoon. I'm David Bass. I am the product director at Florida. I've had the opportunity to work with several members of your staff over the years and greatly appreciate that opportunity. Mr. Parton, in anticipation of some of your questions, as you suggested, I wanted to talk through a few that you have posed already today.

First, that being customer notification. Nationwide, at point of application, provides a message, a notification consistent with the Fair Credit Reporting Act, to our insureds. Every insured that makes out an application receives a copy of the notification that basically says, "Credit will be used in development of a rate and eligibility in -- at Nationwide."

One other piece of notification that we provide is if a customer receives a -- if a customer ends up -- is scored in a credit group that is worse than the median, they get an adverse action letter. And that letter clearly, and in a lot of detail, explains the right that that customer has. It also explains to the customer that the credit rating agency that we use is TransUnion and gives their, TransUnion's, contact information. In addition to that, it gives a 1-800 number that would get them to a Nationwide representative to address any further questions that they may have regarding credit.

One of the other things that I wanted to share with you --

MR. EAGELFELD: That's for people who score worse than the median?

MR. BASS: That's correct, Mr. Eagelfeld.

MR. EAGELFELD: I think the Florida Statute requires an adverse action notice for anyone who doesn't achieve the best rate. We'll check into

it.

MR. BASS: We'll be happy to work with you on that. Our interpretation is that the anchor is the median, but we will be happy to review that with you.

Extraordinary life events, as has been discussed today, there are a lot of adverse actions are being -- taking place in the market today based on the economy. We have installed, and we've had it installed for some time, a written process by which customers who are experiencing an extraordinary life event can appeal any adverse action from a rating standpoint. Those extraordinary life events at Nationwide include divorce, death of a spouse, temporary loss of income, medical emergencies, identify theft and a loss in addition to the loss that would make their home uninhabitable.

The process is as follows: We have a dedicated unit that will address customer inquiries. All we do is we ask for a minimal amount of documentation. If you have -- if you've lost your job, we want a letter. We simply for a letter that indicates that, and we ask for a brief description of how that event has impacted your

credit history. At that point, the specialized unit that I described takes the information and actually pulls out all the impacting credit. We don't go back to TransUnion, for example, for this, in this process. We'll actually make the adjustments to the credit report at that time and adjust the score accordingly.

MR. PARTON: I have to tell you, that's very, very good.

MR. BASS: Thank you. I appreciate that.

MR. PARTON: I really have a problem with consumers being told you've got to go see somebody else to get something taken care of when, in fact, I'm dealing with an insurance company. I think it is a very positive, very laudable process.

MR. BASS: Thank you. And I'd like to address the $10,000-dollar question, as Mr. Shaw stated earlier, what happens if we remove credit scoring. And what I would say is, really, the name of the game is applying the right premium to the right risk. And if the Nationwide lost the ability to utilize credit, what, in essence, that's doing is it takes away one additional component, one addition segmentation component, that we have that we use to distribute that rate among the group of

insureds. What the effect, the immediate effect, of that would be, and we did a quick calculation on that, is that 60 percent of our customers would receive a rate increase.

MR. SHAW: So it's a very large component?

MR. BASS: What's that?

MR. SHAW: So credit scoring is a very large component?

MR. BASS: I may have misspoke. The range is between 50 and 60 percent, Mr. Shaw. I apologize for that. So that would be the immediate impact that we would see. Over time, one has to assume that if, as rate may -- as experience may deteriorate, we may have to revisit our underwriting guidelines and make some adjustments at that point.
MR. PARTON: So regardless of any additional loss experience or any other matters, if you pull your credit scoring out, you're going to see 50 to 60 percent of your policyholders will receive a -- I use the term "rate increase." Is it really a rate increase or increasing their premium?
MR. BASS: It's an increase in their premium.
MR. PARTON: And in order of what magnitude?
MR. BASS: Mr. Parton, we haven't done that

particular calculation. We'd be happy to execute that and provide that to you, though.
MR. BAUM: I can give you just a general flavor.
MR. PARTON: Do you want to identify yourself, please?
MR. BAUM: Oh, Phil Baum. A general flavor, just from the range of our rating factors. I think within a range of plus or minus between 25 and 30 percent would be the extremes and then it would get -- you know, some customers would go to that

extreme and some customers would be smaller than
that.
MR. SHAW: 50 percent of your customers will
see a 25 to 30 percent increase?
MR. BAUM: No; it will be a range. But we're
saying of the 50 to 60 percent that will see an
increase, the extreme end is going to be in the
30 percent-type range. Some will see more than
that -- excuse me, some will see less of an
increase than that, but that's more of the extreme.
MR. PARTON: Do you like, I guess it was
GEICO, I have to apologize. It's been a long day.
Was there a couple of points in your policyholder's
life that you discontinue using credit scoring in

the rating factor?
MR. BAUM: No. We continue to use scoring.
We reevaluate it on an every two-year basis.
MR. PARTON: As a result of that reevaluation,
do you raise people's premiums, or is it always
just a positive? If you're better, we'll lower it,
but we won't raise it-type of situation as I think
was described by GEICO?
MR. BAUM: Yeah. The scenario is improvement
within the score. So if your credit score
improves, you would see the full amount of the
improvement. Deterioration, there is
deterioration, but deterioration is limited to what
we would call movement of one class.

MR. COOKSEY: This is Chris Cooksey. I should add that it's different in specialty auto companies, which do not allow deterioration but they do allow the full improvement if there was improvement.
MR. BASS: If I could also add, Mr. Parton -- this is David Bass. The -- every two years when we order new credit for all our customers, we re-rate the entire policy. So we reconsider all rating factors, not just credit in that evaluation.
MR. PARTON: Okay.

MR. EAGELFELD: What have you experienced in the realm of no-hits and no-scores, what kind of preponderance?
MR. BAUM: In terms of percentages of the book?
MR. EAGELFELD: Yes.
MR. BAUM: I don't have the exact percentages. I can tell you with standard auto, it's single digits, and I would say on the lower side of single digits. I don't know the Florida-specific numbers, but I'm thinking when I've seen things more corporately, they're around that level.
Now, with that being said, the way, when we score policies, we're looking at multiple individuals within the household. So if we get a hit on one of those individuals, then we'd score the policy.

MR. EAGELFELD: And if you get a no-hit or no-score, how would you rate that?
MR. BAUM: It's rated on a neutral basis.
MR. COOKSEY: This is Chris Cooksey. I should say that in our specialty auto companies, the nonstandard auto companies, the no-hit rate is -- depends on the age, as per the options that are outlined in the Florida rules.

MR. MILNES: And I take it that you, along with the other insurers that have testified here today, believe that the use of credit scores is a good predictor, that your policyholders, if they have a bad credit score, will file a claim with you?
MR. BASS: Well, I think as a group, I hate to say as an individual, but I think when we look at credit scores, the group of individuals with higher -- I'll say lower credit scores, assuming, while we're at it for simplicity, those customers are more likely to have higher future expected loss potential than those with better scores.
MR. MILNES: "Expected loss" meaning a claim?
MR. BAUM: "Expected", meaning if I look at the group of customers and I was looking, say, for example, over the next one-year time horizon, I expect that group to have a higher expected claim amount, so the combination of a claim and the claims -- the amount of the claim compared to the

group with better scores.
MR. SHAW: Why?
MR. BAUM: Why do we expect that?
MR. SHAW: Yeah.
MR. BAUM: I think it's -- there is a

correlation between credit and claims, future claims potential. I can't tell you exactly why. I can't give you the reason. But I can say we've seen the correlation; we've seen it repeatedly over time. And it's strong.
MR. SHAW: We've heard, I guess, the point is it doesn't matter why. Just the correlation exists and that's what is important to the model.
MR. BAUM: I would be concerned in the correlation was sporadic so it wasn't consistent over time. But whenever I've looked at studies with credit-based insurance scores and loss experience, it's consistent.
MR. SHAW: Do we know why these other factors -- I mean, I would assume we know why age, your driving experience; you get to be a better driver, I would assume. I guess we know by geography; maybe it's a busier area. But we don't know why credit scoring has that correlation and we don't care? Or do we not know of any other factors of why it's never important?
MR. BAUM: Well, I don't know. I think you can make suggestions as to why it might happen, but

I don't know that we can draw an actual cause-and-effect relationship. And we can even say

the same, essentially, about any factors that we use to price or underwrite for. So a type of vehicle, why would one type of vehicle have different loss experience than another? Well, you could say it's because of the value of the vehicle. But what if we see a different claim frequency by vehicles? You know, that's -- I can't explain why but we see it. So I think it's not uncommon we see differences, but we can't provide a solid kind of cause-and-effect relationship.

MR. MILNES: Can I ask you, have you conducted a study of your own book of business as to the correlation of lower credit scores and claim frequency?

MR. BAUM: You mean the relationship between claim frequency and credit scores?

MR. MILNES: Yeah. Have you guys, on your book of business, done that?

MR. BAUM: Sure.

MR. PARTON: I want to ask you a few questions about thin files. And I understand from what you're telling me is we have a thin file, no-hit, no-score or whatever you want to call it, you treat it -- or you put it in what you term a neutral category; correct? That, of course, is not the best category.

MR. BAUM: That's correct.

MR. PARTON: The thing that concerns me, I think Mr. Birnbaum probably said it better than I can, is that the potential is that there is a broad range of people that's going to fall into that category. You've got people that, for instance, because of religious beliefs, don't use credit. You're going to have a no-hit situation. You may have older people who are getting ready to retire and they've been, in anticipation of that over the years, have cut back on the use of credit, paid off things so that information just isn't there anymore or certainly has been pared down in terms of its value to a good credit score.

Have you ever done an analysis of your no-hit, your neutral, based on some of the other factors in here to see whether or not that particular group is homogenous. And the reason I say that, and this is anecdotal, but it raises the issue. We had an insurance company who we had a problem with with regards to their classification of their neutral category. And I don't know that we asked them to do it, but they did do it anyway. They did an independent analysis of factors and categories

based upon age. And what they discovered was there was a group, aged 55 to 65, I'm throwing that number out because I know it was in that sort of retirement group area, and what they discovered was their claims experience was significantly better than frankly everybody else in that group. So, obviously, it reclassified them.

And my concern is that, particularly in that no-hit category, there may be a number of categories that, in fact, fit through the profiles when you analyze it. Has there been any sort of analysis conducted on your book of business with regards to no-hits, whether it be standard or the nonstandard, to see if any of that holds true?

MR. BAUM: Yeah; I can speak to standard. We have looked at, kind of, the non-scoreable files, kind of different, I'll call them cross sections of customers. I think that portion of our book is rather small, as I mentioned before. We're talking single digits. So there is some volatility in the data just because of the small numbers. There are differences we've seen by the tenure of a customer; so the longer tenured customer versus the newer tenured customer. And we've also looked at it by age, and actually some correlation between age and

customer tenure. So we see some of the same types of effects. But it is, it's a bit more volatile just because of the size of the data and the amount of data in that class.

MR. PARTON: Nonstandard?
MR. COOKSEY: On the nonstandard side of the company, we, too, have looked at that. We have found that there is an interaction that can be found between credit and age. We have similar volatility issues. In fact, our book is simply smaller than the book of business for standard auto.
We did find one other thing that was interesting. There was, for drivers who have international driver's licenses and so they don't have a valid U.S. driver's license, we found that there was significant overlap between that and the no-hit group. And that was something that -- and I think it's filed as part of this company, we came out with what we call the, it is a mouthful, financial responsibility by license type.
In other words, we're varying the no-hit factor by the license status, specifically for people with international driver's license in order to distinguish between those who have a credit hit

and those who are credit no-hit.
MR. PARTON: I guess I'm puzzling over why you're doing it that way. Are international drivers better or worse?
MR. COOKSEY: What we found and what is common with other competitors and what we had previously was a surcharge for people with international

driver's license. The primary rationale behind it is it that we don't have the same kind of information about these people as we do with people with U.S. driver's licenses. And that was filed and approved and based primarily on a competitor analysis, as we found that there were other competitors who were doing it.

When we found this -- and actually, some -- and now we're talking about small groups within small groups, so it does get volatile here. But we found in, I believe it was 2006, just looking at some loss ratios on that group that that surcharge might be too large so we lowered it. We lowered the surcharge on that group.

What we found when we did our most recent study was that if they're a no-hit and so they're close to the average and then they're receiving the smaller surcharge, that puts them about where our

study says they should be. In other words, they're not similar to the rate of a worst credit person would be getting, but they're not at the average rate of the level either. Their risk is elevated from that. So that is what the study shows.

MR. JONES: So Chris's example here is an example of how, as a company, we're constantly reviewing our existing book of business and the Florida customer base to determine if there is a better way that we, as a company, can service these customers. Because at the end of the day, we recognize that the market here is very competitive. If we're not able to offer a solid and competitive product, someone else will. So it's to our advantage to be certain that we're offering a full-featured product at a competitive price.

MR. PARTON: Following up, I'm not sure that I asked this question but I may have. And that is, have you done an internal study or do you have any kind of study that would indicate that the availability of credit score as a rating factor has increased the availability and affordability of insurance?

MR. BAUM: We have not done specific studies on availability and affordability. I think we've

heard the discussion and the arguments about a competitive market. And if you have to price it an average price, a company may end up writing an inordinate share, for example, of a higher risk customer at an average price, which causes concern for the company and causes them to be either -- need to increase rates even further or maybe tighten up underwriting standards to control that. I think we believe in that philosophy, but we haven't done a specific study.

MR. PARTON: Finally, I want to address the issue that I have with everyone, okay, and that really is the FTC finding with regards to the impact on African Americans and certain Hispanic groups of the use of credit scoring. And again, I want you to address what it is basically saying, what the finding really is: "Credit-based insurance scores are distributed differently along racial and ethnic groups, and this difference is likely to have an effect on insurance premiums that these groups pay on average."

The most troubling aspect of this is the one we were debating with GEICO as well. "Non-Hispanic whites and Asians are distributed relatively evenly over the range of scores, while African Americans

and Hispanics are essentially overrepresented among consumers with the lowest scores and substantially underrepresented among those with the highest scores."

Given the impact of what they're describing here and given the findings of the FTC, my question to Nationwide is what have you done to address the issue? And if you haven't done anything, what can be done to address the issue?

MR. BAUM: Well, obviously, we've read the study and have seen those results. You know, there are concerns, or at least some shortcomings in the study that may mitigate to some degree some of the findings. I couldn't comment on how much it could mitigate that. Maybe it wouldn't mitigate it at all. But there are some shortcomings related to

how territory was handled that may mitigate that effect to some degree.
We haven't done anything specific. I think we continue to monitor studies such as this, because we have a vested interest to understand. But we also have a vested interest to price, and we want to price as equitably as we can based off the cost of providing the coverage.
MR. JONES: I will add to that, that as a

company, it would squarely be against our values and our morals to use a variable such as race as a factor in determining access or price regarding insurance. So to the point of whether or not the findings in the FTC study are conclusive, of course we're going to watch that to make sure that there is something there that we need to know, particularly if it turns out that we are in violation of something that is squarely against our morals and our values, and you need to know, absolutely, we would address that within our company.
MR. SHAW: So if there was a study that you found conclusive, there might come a time in which GEICO stopped using credit scoring if the right study came out? Nationwide; I'm sorry. Sorry about that.
MR. JONES: I stand by the statement I just made. I can't speak to a hypothetical, but you

need to know that we're a company with values and morals. And I, personally, would not work for a company that would violate that.
MR. SHAW: I understand that. I don't understand what "continuously monitoring" -- I mean, will there come a point that actually

determines something at a certain point?
MR. BAUM: I think what I mean by "monitor", as studies come out, we're looking at them. Are there shortcomings in the studies? What are the findings? Are they consistent? I think we're in a desire to understand more as well. That's what I meant by "continuous." As a new study comes out, is it telling us information?
MR. SHAW: In terms of a competitive market, I think if credit scoring is banned, it would be banned for everyone, so I don't know about the competitive argument. Wouldn't everyone have to deal with it in some form or fashion?
MR. BAUM: If?
MR. SHAW: Wouldn't everyone be disadvantaged to the same amount if credit scoring was banned?
MR. BAUM: Well, I think if credit had to be eliminated, then there is going to be some disruption in the market. I think that's pretty much a certainty. Exactly what happens as a result of that disruption, I think is unknown. There is there's going to be, I would say, winners and

losers in that process, from an insurance company perspective.
MR. SHAW: One disruption would be, I hear,

rates would go up for a large population of all the companies' consumers.
MR. BAUM: Certainly from a customer perspective, there's going to be that kind of, I will say, shifting of rates. Those who have been receiving kind of lower rates due to better insurance-based credit scores, those rates, the customers' rates would go up or their premiums would go up. And the reverse on the other end of the spectrum.
So certainty, there's disruption from a customer standpoint, and as a result of that, probably creates a market disruption as well. So customers are seeing premiums gyrate; they're out shopping; probably creates a stir of -- a stir of activity.
MR. PARTON: It also creates a competitive atmosphere, doesn't it?
MR. BAUM: It could create a competitive atmosphere. But it could also -- it's going to come at the disadvantages of some.
MR. PARTON: I guess I'm tying to understand -- I mean, I'm trying to figure out what it takes to get an insurance company to say, you know, that a study is conclusive. I mean, I'm

sitting here looking at Texas study, they're saying it's anywhere from 10 to 35 percent difference in the credit scores that African Americans are getting. We have Mr. Miller over here minimizing that, saying, "Well, we can't explain the difference here. Gee, it looks to be similar to the FTC score." You've got the FTC coming out and saying right off the bat African Americans are not evenly distributed while non-Hispanic whites are and Asians are, that in fact, it may very well be affecting the rates that African Americans, certain African Americans, are given.

And the question is, what does it take to be conclusive? Is it -- do you mean it has to affect 100 percent of African Americans? And then if it affects 100 percent of African Americans, does it then have to affect them at a certain level? And if it's just a little bit, that's okay even if it does affect them all. But it has to be something even bigger than that. I'm sort of looking for -- I'm puzzled. What does it take to wake up to this sort of thing and say, "Maybe we need to really take a look at what we're doing here," irrespective of the business decisions that are going on.

And, frankly, that's -- maybe it is a

legislative issue. Maybe the Legislation needs to decide that, as a public policy matter, is it good, is it right, is it reasonable, irrespective of the business consequences, to have this situation percolating under there and an insurance industry that's not really looking at it? There are no studies out there that have been taken by the industry. It's all been done by regulators or governmental entities, all of which have been criticized by the industry, but the industry has done nothing. I mean, that's troubling. Anyone care to address that?

MR. BASS: Mr. Parton, one of the -- one of the issues that we have to be aware of is that we believe that the use of credit scoring is very predictive. And as I said earlier, an important component in the whole insurance model is applying the right rate for the right risk. One of the things that the industry appreciates is that ability and credit scoring provides that ability.

Mr. Jones stated earlier that, at the point when we determine or that we are shown or we can determine ourselves that that is providing some inappropriate discrimination, we'll certainly change our -- evaluate changing our processes.

MR. JONES: Mr. Parton, I'll also add to that, the fact is at Nationwide, we don't collect certain data. So even if we were to look to initiate a certain type of study within our book of business, we don't collect data on race.

MR. PARTON: I know you don't and that's one of the arguments made by the industry. Then when we suggest that maybe you need to do that, then they all get up in arms. "Oh, my God. We don't want to collect that information. We might get sued. We might this. We might that." I mean, I guess my problem is, where does it end? Does it mean that yet again, that government is going to have to sit there and say, "I want your policyholder information. I'm going to go to every one of your customers and I'm going to find out what their race is and I'm going to run your book of business," which I find not necessarily to be an appropriate solution to this.

But there has to be a way, it seems to me, and it would be nice if the industry came up with one, to take a look at this in some meaningful way and say how can we adjust it? For instance, I mean, I've been sitting here thinking, well, if your model is sensitive enough, if you agree with the

finding of the FTC with regards to race, then frankly when you're evaluating an African American or certain Hispanic groups, maybe you need to be adjusting your model so that, for instance, credit scoring is not playing as big a role as other factors that are out there. I would hear you say, "Oh, no, no, no. Because it's predictive, we have to leave it in there." Okay. Then take it away for people who don't fit in that group. "Well, no, no, no. That's predictive. We want to make sure they get the best rate."

So there does not seem to be any adjustments that can be made to -- short of saying, "Don't use it" to -- and in a particular sense, there's no studies out there to remedy this issue; is there? My sense is you don't think it's an issue.

MR. BASS: I think what we're saying, Mr. Parton, and our -- I have not personally reviewed any of the studies that you're referring to. But I believe what we're saying as a company is that there are many studies out there. We're not sure that any of those are conclusive at this point.

MR. PARTON: I hear you. My problem with that is that that has been the attitude over the last

five years. And now, there have been four or five studies, all including the same, all of which are criticized by the industry for one reason or another or reasoned away, and yet nobody is taking, in the industry, a serious look at what is going on. I guess that's what I find kind of troubling.

Mr. Miller is always, for instance, throwing stones at studies, but we don't have one coming from the industry that deals with this issue. I understand you don't collect the data. Although, surely your agents know their policyholders, and maybe there is a way to get it through that or through driving licenses, which may or may not indicate the race of the individual, or some other way to use to then run that data against your policies to see what is going on and what the impact is with regards to these rates.

But it seems that government is the only one that's trying to think up a way that we can take a look at this. And so I urge you, given your company's sincerity, to frankly think about a way that we can look at this. I don't know what it's going to take to convince anybody, or for that matter, to dissuade what appears to be a problem and dissuade me or others, okay, that there really

isn't a problem. Any other questions?

MR. SHAW: Yeah. Your international drivers, you said there is a surcharge. Is that because -- you said that's because of a lack of information?

MR. COOKSEY: For a customer -- it's Chris Cooksey. For a customer that comes with a U.S. driver's license, we have records from the Bureau of Motor Vehicles, things like that, that are lacking if a person has an international driver's license.

MR. SHAW: It's not because of a lack of

credit information or anything like that?
MR. COOKSEY: No; not directly. But what we did find was there is an overlap in those groups of people who have not been in the country for very long, such that they still have an international driver's license also tend to not be found in the credit reporting bureaus.
MR. SHAW: All right.
MR. EAGELFELD: Would you characterize for me the geographic distribution of your auto book of business within Florida compared to the population of the state in general terms?
MR. BASS: This is David Bass. Mr. Eagelfeld, I have not specifically evaluated that, but my

sense is that it's distributed very uniformly with the distribution of population in State of Florida.
MR. EAGELFELD: You think it pretty much reflects the population by county, by demographic within the state?
MR. BASS: Yes, that's my belief.
MR. EAGELFELD: Okay.
MR. PARTON: Again, I want to really express my appreciation for you all coming in and frankly answering our questions in a very forthright manner. I think it's interesting to see the differences among companies at how credit score, in fact, is being used and I appreciate it.
MR. BAUM: Thank you.

MR. PARTON: We're going to take a 10-minute break; okay?

(Whereupon, a recess was had in the proceeding.)

MR. PARTON: We now have with us Progressive.

MR. FITTS: Thank you, members of the Panel. My name is John Fitts. I am the deputy general counsel with Progressive. Just for the record our documents are here. We've produced about 7,000 documents. Some of those are ours and I think some of those are State Farm's. Also for the record,

Mr. Parton, I want to thank you for your cooperation in working with me on the subpoena so that we could get this accomplished.

MR. PARTON: Again, I want to compliment the company, because I appreciate the reciprocal cooperation in receiving this. So I do appreciate it.

MR. FITTS: Okay. Thank you. I'm here today with, on my right, is Sanjay Vyas, who is the senior auto product manager for our Florida operations. Next to his right is Rick Crawley, who is the director of auto product research and development for Progressive. Mr. Vyas has a statement that he would like to read into the record. And I believe you wanted someone to talk about, generally, our use of credit. So he will move onto that. As you suspect, Mr. Crawley is from the home office, and he can talk more of the national credit modeling work that we've done. Between the two of them, I'm fairly confident that they can respond to all the areas of inquiry in the subpoena, and given the questions I've heard today, they'll be able to respond to those at well.

MR. PARTON: Great; thank you.

MR. VYAS: Thank you. And I'll try and make

it quick, although I've heard that promise from everyone so far. I'll try and stick to it.

Members of the Panel, my name is Sanjay Vyas, and I am here today with my colleagues to answer your questions on how the Progressive Insurance Companies use credit report data for insurance rating purposes in the State of Florida.

Progressive's business model is to offer accurately priced automobile insurance that provides the coverages consumers need along with superior policyholder and claims service. We want to be the consumer's first choice for auto insurance in Florida.

Our company is the fourth largest auto insurer in the State of Florida. We employ in our Florida offices more than 3,000 people who service our Florida customers as well as customers throughout the country. Progressive was founded over 70 years ago. 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, and have steadily grown in the State of Florida since 1996 when insurance scores based upon

credit report data were first introduced into our business model. We advertise aggressively in all parts of the state and seek to provide insurance to as many Florida consumers as we can.

We are here today to talk about some of the public policy issues related to use of credit report data in insurance rating and underwriting. Personal lines insurers have been using credit report data for many years and its use is permitted under the federal Fair Credit Reporting Act and the Florida Credit Statute. We don't use such data simply because the law allows us to. Rather, 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 Florida consumers. And without credit report data, we would have to reallocate the premium we charge across the entire book of business. This would result in substantial rate subsidization and cause rates to increase for 50 to 60 percent of our

Florida 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 overemphasized as it is absolutely critical to our business strategy. The more accurately we price, the better we can compete. Our experience is that more accurate pricing means that we were able to offer lower rates to more drivers that deserve them. 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. Each time we make a Florida rate filing in Florida, we are required to demonstrate that our use of credit report data is actuarially related to the risk of loss. The knowledgeable professionals with the OIR would not approve our filings without that demonstration. The simple fact is that 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 were among the first insurers to called for the enactment of state statutes that would provide reasonable consumer protections for the use of credit report data.

Even before these statutes were enacted, Progressive made the decision never to refuse to insure, cancel or non-renew a policy based upon information found in a credit report. We also decided not to consider any credit report data disputed by the consumer in our credit scoring models. We were one of the first companies to disclose to consumers that their credit report data would be used in the rating process, and we were the first company to file our credit models without confidentiality protection.

We educate our agents so they are able to respond to consumers' questions about the use of credit report data and established a special Credit Information Team 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 other 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 make 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 facilities communications between our customers and the 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.

Insurance companies are in the business of accurately setting rates for different risk classifications and the insurance laws in every state effectively require companies to look at different factors about drivers so long as it is not unfair. Unfair discrimination is defined by Florida law as follows: "A rate shall be deemed unfairly discriminatory to a risk or group of risks if the application of premium discounts credit or surcharges among such risks does not bear a reasonable relationship to the expected loss and expense experience among the various risks."

This process by which insurers classify risks and apply rating factors that allow them to separate drivers into different risk categories underpins the cost-based pricing system which has

been in effect through out the United States the decades.

The rating laws in all states entitle insurers to use a combination of permissible rating factors to establish rates that are not excessive, inadequate or unfairly discriminatory. Prohibiting the use of credit report data to accurately price insurance because that data may negatively affect certain groups would be a significant departure from cost-based pricing and would lead to system where low risk drivers would pay more to subsidize high risk drivers.

MR. PARTON: I'm going to interrupt just a minute. You probably need to speak up just a little bit and slow down just a little bit. I suspect her fingers are about to fall off. I haven't been yelled at by many court reporters. And we really have to respect them.

MR. VYAS: I thought I was going slowly. I was trying to speed up so I wouldn't --

MR. PARTON: Oh, no, no, no.

MR. VYAS: I'll slow down.

MR. PARTON: The point where that speeding up is in diminishing return is when we have to look at the transcript.

MR. FITTS: He's already missed one flight.

MR. PARTON: I apologize for that, but if you would just slow down and speak up a little bit, because I know she's having a little trouble over here hearing and getting it; okay? And actually, it would also be helpful, maybe you can leave your -- a copy of your prepared marks with her and that would also assist her in making sure the transcript is accurate, if you don't have a problem with that.

MR. FITTS: We don't. I think yours is scribbled up here, so why don't we get you a clean copy? If you give us your information, we'll get it to you.

MR. PARTON: Very good. Again, though, speak up a little bit and slow down.

MR. VYAS: Okay. I can even do it with a Texas accent if you'd like.

MR. PARTON: No. Although, that might be amusing.

MR. VYAS: We submit that prohibiting an actuarially justified rating factor because of concerns that it may have a negative effect on certain racial or economic groups is not consistent with principals of the American Academy of

Actuaries and would be a dangerous departure from the time tested system of risk classification and cost based pricing that has been the foundation of insurance regulatory policy for decades. We believe that with respect to the use of legally permissible rating factors, the issue is whether prices are accurate and not how prices affect certain racial or economic groups.

Today, the Florida automobile insurance market is healthy and operating efficiently. Numerous insurers offering insurance through multiple distribution channels provide consumers with many automobile insurance options. We submit that the ability of insurers to use credit report data contributes to the health of the Florida market. Our own experience bears that out.

Since introducing credit in 1996, Progressive has consistently grown and expanded its business in all geographical areas within the state. But more importantly, we believe that Florida consumers benefit the most 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.

In summary, using credit report data is about

charging Florida consumers fair and accurate rates. Today, 47 states have determined that using credit report data for that purpose is appropriate and sound public policy. We are here today to answer your questions about how Progressive uses credit report data in the hopes it will assist Florida in its public policy debate.

While we understand that the Florida Legislature has the power to modify the current policy on the use of credit report data by adding further restrictions or prohibiting its use altogether, we believe that eliminating the ability to use credit report data for insurance pricing would not be the best public policy decision and that it would disadvantage Florida drivers. Thank you.

And then I believe the next part was I was just going to spend about a page or so describing our use of credit throughout our product, because I recognize that each one has a slightly different --

MR. PARTON: I appreciate that.

MR. VYAS: I'll describe Progressive's use of credit in the rate-making process. The intent is to summarize its use. The information exists in our filing so it's not new information. It doesn't

intend to be. But it does bring together our use of credit for the purposes of this discussion.

Our credit model, which is filed with the State publically, takes credit information from the credit report and renders a score. This score is then placed in a mutual responsibility underwriting tier, FR tier. As an example, a credit score of 78 may be translated to a C1 FR tier. I mention the score just to indicate it is our proprietary credit model, different than the other ones up there, the company-specific.

The FR tier is used in approximately five places in our product. First and most importantly, we place the insured in a tier based on the interaction between credit and other underwriting information such as whether the insured currently has insurance and what bodily injury limits exists. This is called tier placement. From the tier placement, we determine the tier factor. We also use the tier placement to determine the discounts such as multi-car and paid-in-full. Customers with better credit tend to get lower discounts or smaller discounts for paid in full and multi-car than customers with worst credit, just to illustrate that relationship there.

Other variables that are mixed with credit are driver age and driver points. These are used to drive the driver matrix factor. And then other areas of product are, of course, the no-hit, thin file, paid-in-full factor, which we are a company that I think you've been referencing earlier with respect to no-incident files. We segment based on age, as well as having spoken with the office, we also distinguish between paid-in-full, so cash customers versus customers who have credit. So we've segmented the thin files and the no-hit segment in those two regards.

That's some of the -- it gives you some, to me, a very clear overly detailed perspective of the different areas of our product which use credit as an input. Thank you.

MR. SHAW: Mr. Vyas?

MR. VYAS: Yes, sir.

MR. SHAW: I want to ask you a question

because you wrote this letter back to me and I appreciate it. In number five, your answer is as follows: "Progressive has been using insurance scores in Florida for a number of years. While insurance scores are predictive, driving record and accident claims history remain the most predictive

rate variables in our program and are the most heavily relied upon." Can you reconcile how, given that statement, how, if credit scoring wasn't used, there would be a 50 percent increase or 50 percent of your customers might experience a rate increase, given the fact that accident claims history and driving record are the most predictive rating variables?

MR. VYAS: Sure; I'll take a stab at that. The question's come up a couple times, so I'm going to try perhaps a different response. And Howard, you can correct me if I'm wrong as I try to illustrate the point. If we know, for example, historically, we may know that there has been a million dollars worth of loss claims, then all they will need to collect, based on expenses and loss adjustment expenses, we might need to collect $1.5 million dollars. So that's just to illustrate the point of a million dollars in claims will result in -- require a premium of $1.5 million dollars.

So what I'm saying here is when we withdraw credit, discounts will -- the impact of credit will go away, but we'll still need to collect $1.5 million dollars so those who are benefiting

from credit can have better than average -- their rates would go up, and those, on the flip side, will see their rates go down. But all in -- the same amount of premium would be necessary to be collected to pay for the benefits.

MR. SHAW: And your response to this question seems to contradict the other companies, where credit rating seems to be the most important factor.

MR. CRAWLEY: Well, let me correct that. The -- one of the things that you might find is different for Progressive than other companies is we've historically competed in the high-risk market, which means we tend to insure people that have lots of points. So compare that to, maybe, a preferred-only writer who have very little points in their rating plan or in their book of business, points is not going to be very predictive for them. What we found when we did a study several years back is that driving record is the most predictive variable in our rating model, and that credit's still in the top five. Furthermore, when you --

MR. SHAW: I can get my head around that. That's perfectly logical. I understand it.

MR. CRAWLEY: It makes sense, right? We have a lot of people who have points, so it's going to be more predictive in our model than somebody who doesn't. It's pretty straight forward.

As Sanjay pointed out, when we build our credit models, we put them into 18 buckets or credit tiers. And the range of those 18 buckets depends on coverage. What we find is that credit is predictive across all coverages. And that range for, say, bodily injury or property damage might be a relativity of a two or a four. Some of the first-part coverages might be a relativity of a three. So if you remove credit out of our model, you're going to put everybody back to the average. And that's going to result in the majority of the drivers, even in our model where credit is maybe not the most predictive, it's still a very highly predictive method.

MR. SHAW: I don't even know if you can answer this, but what makes your model different? Why do you rely less on credit scoring than every other company that's been here?

MR. CRAWLEY: Again, because we have people in our book of business that have more points so points become more predictive. You have --

MR. VYAS: I think there's --

MR. CRAWLEY: Well, what I was going to say is the process may be a very high level of how we build our model. We build our own proprietary credit models. We do that by first adjusting for all traditional rating variables. So we'll take and adjust our expected lost costs for all traditional rating variables, and then we'll build our credit model on the residual expected loss cost.

So we effectively try to minimize the correlation of any of the other traditional rating variables. And we do that doing multi-varied analysis, the credit model is built with a generalized linear model, and that's -- so essentially we end up with a residual. By building our credit model on residuals, we can somewhat reduce the impact of credit. Would you like me to give -- I can give you more perspective on our countrywide model, if you'd like.

MR. PARTON: I'm trying to get a handle on what was described in the process. I'm not sure I understand it. You've got 18 buckets, and those 18 buckets are financial responsibility buckets?

MR. CRAWLEY: Essentially credit tiers. Very similar to what you may think of as a vehicle

rating. Another common variable is symbols. So we put -- we classify vehicles in different rating

buckets; a similar process.
MR. PARTON: Okay. So what you do is you -- first of all, I assume you're getting your information for your credit model from some source.
MR. CRAWLEY: Correct.
MR. PARTON: What source?
MR. CRAWLEY: Our primary vendor is Experian.
MR. PARTON: Okay.
MR. CRAWLEY: So we get the raw credit report from Experian and then we build our credit models based on the raw credit variables contained in those reports.
MR. PARTON: These buckets you're talking about, is that based upon financial responsibility information? What other is that based upon, that information, plus some of the other factors in order to put them in these buckets?
MR. CRAWLEY: It's primarily based on credit information. We do have some covariance in the model to try to adjust for other things that are correlated with credit, such as age, such as underwriting tier, what you might think of traditional, standard, preferred, nonstandard

criteria, prior insurance, prior limits or claims activity.
MR. PARTON: And that's all part of the analysis to sign into one of these buckets?
MR. CRAWLEY: It's all part of the analysis to

come up with the credit score that we've developed and then we've simply developed a continuous model and then we've come up with these 18 different buckets.

MR. PARTON: Okay. Now, is there a point in time, as described I think it was by GEICO -- I hope I'm right about that. Am I right? I keep using their name, and I don't want to falsely accuse them -- where you don't use credit scoring anymore.

MR. VYAS: No. We still use credit model. We don't -- unlike GEICO, I think you're right, I think it was GEICO who said they use credit only at the incept.

MR. PARTON: And for the first year.

MR. VYAS: Right; that's right. And we continue to use -- we use credit all the way through. So for Florida Statute, in two years, we'll order credit and so forth.

MR. PARTON: Okay. When you use credit after

two or three years, are you using it to -- if it adversely impacts the rate of the individual, do you raise his rate? Or is it, as GEICO was describing, when we actually look at it, we'll lower it, but we won't raise it?

MR. VYAS: We will, it if gets worse, then we'll raise the rate, and if it gets better, then we'll lower the rate, so it will go both ways. We do cap that. We cap the effect so that, per the rules, so that it doesn't swing markedly. And that's one of our five rules. We try and -- we recognize the customer has been with us and so we'll, to preserve some sort of rate stability, we'll keep that in balance.

MR. PARTON: So unlike, perhaps, Allstate and GEICO, your use of credit scoring, theoretically, could be much more sensitive to your consumer, in terms of premium during bad economic events such as what we're having now; is that correct?

MR. VYAS: Yeah. Let me address that. As I mentioned, we've had this -- we've had the Credit Information Team in place, and we let our consumers know about that at every renewal, that they have the ability to call in. We will make exceptions immediately based on loss of jobs or any other

circumstances. So we do that. So to answer your question, yes, we can change the rates. We change the rates for customers. We also let them know, at every renewal, that they can call and discuss their history with us.

MR. PARTON: You also indicated you don't use disputed data; that is, if one of your customers call and says, "Hey, you know, my credit report is wrong," or whatever data elements you happen to be looking at is wrong, do you just take it out and put them in a neutral tier, or do you take it out

and reevaluate them, period?
MR. VYAS: Correct me if I'm wrong, or do you just want to --
MR. CRAWLEY: I can just answer that one. Essentially, what we'll do is if a customer calls and says there is a disputed information, we will remove that from the effect of the model and recalculate their score and rate them appropriately and give them a premium refund back to inception.
The other piece of that would be if there is an extraordinary life event, say there is a job loss, what we will do is look at their credit report, find out where that event took place and then adjust their credit score back to that

pre-loss event condition and then rate their policy appropriately.
MR. PARTON: So if I'm understanding what you're telling me, and this is a good thing, guys, I'm just trying to figure out you're telling me. You're actually doing a little bit more. You're not just saying if you appeal and we look at this and we find that you're correct, you're not just necessarily putting them into a neutral tier. You're actually reevaluating them, period, and giving them, perhaps, even a better rate than the neutral tier, potentially?
MR. CRAWLEY: Correct. So if they were a good credit risk before the extraordinary event, we'll

put them back into a good credit tier. But that also works the other way. If they were a worse credit risk prior to that event, they'll still be a worse risk.

MR. VYAS: And you had asked earlier -- just so -- there's no cap on it. So where they -- we looked at the period for which we believe the data is accurate. If they were the best credit and they go to the best credit. They don't go to neutral; they go to the best credit. Because that was a question that had been asked earlier, so I was just

trying to clarify.

MR. PARTON: I actually think that's a good way to go. This tier business -- by the way, how big is your neutral tier versus the rest of the tiers?

MR. CRAWLEY: Actually, we looked and for quotes, we get a hit on 97 percent of our quotes and our thin file is 5 percent.

MR. PARTON: I think you indicated earlier and I was having some trouble hearing, but you actually do take a look a little bit deeper in your thin file and actually segment it based on, I think, two factors, if I heard your correctly. One was age and the other was?

MR. VYAS: If they're just cash-paid. So if they pay in full, for example, then we also give a discount associated with that.

MR. PARTON: Yeah. We've got to get you some clarification in that statute, don't we?

MR. VYAS: I'm sorry?

MR. PARTON: We have to get you some clarification in that statute, don't we?

MR. FITTS: Yes. I'm not testifying.

MR. PARTON: No; it's a point of clarification. Because I happen to agree with what

your attitude is with regards to cash payments and what our actuary's analysis is. The actuary is telling us this is the right thing to do. So I'm sort of joking about that.

Have you -- I guess if I hear you correctly, I mean typically, would you say that your market is not a standard market or traditionally has been?

MR. VYAS: We don't like to say that.

MR. CRAWLEY: Traditionally, we have been.

MR. PARTON: If another insurance company was looking at your book of business and how you began and how it proceeded, would they suggest that you -- that your book of business would be aimed at what they would consider, at least, a nonstandard market?

MR. VYAS: I think that's correct. Historically, that's definitely where we started, and we, now, our -- we sell through the internet and over the phone, so we attract all sorts of customers. But that historical initiation was with

the nonstandard or the high-risk market.
MR. PARTON: Do you segment your business, like the other insurers, that is to say, have a company that handles what they call premium business and that which is standard or substandard?

MR. VYAS: No.
MR. PARTON: Okay. So it's all one?
MR. VYAS: It's all one company.
MR. CRAWLEY: It's all one company by channel. So one of the hallmarks for us is we believe in broad distribution; we're open and available to all customers. We want to be that take-all-comers market. So one of the things we do is essentially virtually anybody in the auto insurance market can get a quote and will be accepted by Progressive. Basically, the only customers we don't write are those that have vehicles above $150 thousand dollars. So it's a very small part of the market.
MR. FITTS: You just disqualified him.
MR. PARTON: Does not disqualify me.
MR. CRAWLEY: So obviously, then, having a full-line credit to be an accurate predictor of loss helps us do that.
MR. PARTON: And I'm sorry; I know you told me when Progressive was born, but I couldn't hear.
MR. VYAS: 70 years ago, 1930s.
MR. CRAWLEY: 1937.
MR. PARTON: And you have been using credit as

one of your rating bases since the beginning?
MR. CRAWLEY: Since 1996.

MR. PARTON: Since '96.
MR. CRAWLEY: Actually before that, we used things like bankruptcies, judgment and liens in our early, very early, use of credit. So that predated that 1996. We've been using insurance scoring based on credit since 1996.
MR. PARTON: Thank you for that clarification. One of the concerns is, as I'm sure you've heard today here over and over again, but it is a pretty important issue, and there are two issues here. The one issue dealing with the current economic matters, it seems that with your business model, it -- you've provided an avenue, at least, for relief for those policyholders of yours who may have some sort of adverse event as a result of our current economic climate.
But the other issue, of course, is, and it has been a source of studies now for the last five years, is the impact of the use of credit scoring among certain racial groups. And I'm sure you're familiar with them. If you weren't familiar with them, you surely ought to be familiar with them now. My question is what is the reaction of Progressive? What is their view of this? What have they done about this? What do they think

needs to be done about this? What does it matter?
MR. VYAS: I'll give you our interpretation of the FTC study. I know we've heard numerous interpretations and I'd like to give you ours. Can you hear me?
MR. PARTON: Yeah.
MR. VYAS: Can I --
MR. PARTON: Yes. You surely can move that if that helps.
MR. VYAS: I think I'm yelling, but I don't think you're hearing me.
MR. PARTON: There you go. I can hear you now.
MR. VYAS: When we look at the FTC study, our interpretation is credit -- the different variables that we see, we see that the FTC study looked at credit and found that it was a variable, that it was an accurate predictor within each racial group.
So we've -- I'm sorry that we're repeating some of these things, but I feel it's worth bearing mention. So it is an accurate predictor within each racial group. So for an African American, those who are with good credit are benefited, and those with worst credited, are worse.
The thing that we look at in that study, we

also say that FTC looked at other variables and that includes accident history, tenure, model year. And with each of those, they drew the conclusion that there was an asymmetry with respect to the distribution of the risks. And so our assertion is that, like those other variables, credit is predictive and has value, so that's why we continue to use it.

MR. PARTON: Okay. But the FTC did find that while it may be that it's an accurate predictor within each one of those categories based upon race, when you start getting into and looking at it, it may be an accurate predictor, but in terms of the representation across the spectrum, it doesn't look the same as non-Hispanic whites, does it?

MR. CRAWLEY: We will certainly acknowledge that there is a different distribution for credit for African Americans, as there is with claims history. The FTC study clearly pointed that out as well. I don't believe you would suggest that we should remove claim history from the rate of insurance, because it is an accurate predictor of loss.

MR. PARTON: No. We didn't suggest that you

do away with claims history. I think most people, frankly, see the intuitive relationship between the two. And the question, really, that I have raised here and we have raised before is whether or not there is an aspect to credit scoring as if effects African Americans and certain Hispanic groups that is, as a result of socioeconomic disadvantages that have visited those particular ethnic groups that is ingrained and they have no control over that, is adversely impacting their credit scores, their ability to get insurance at the same rates as everybody else.

And the question of whether it is, ultimately, is a policy matter. Should we allow a methodology that has -- that is affected by a systematic socioeconomic policy that once existed and still lingers, on which to base insurance, which everybody has to have?

MR. VYAS: If I may make two comments in reaction to that. First is, we agree that accident history has the same issue that you raised as credit. That would be the point, the first I'd like to make. So that's why we associate credit history and accident history, because both of those should be, as you just described. And while one

has an intuition, we think that both of them are predictive. That's why we continue to assert that both should be used.

MR. PARTON: The problem with it is there is a fundamental difference in why that might be happening. Accidents are as a result of carelessness. Typically, you're in control of that particular aspect. So fine. If it's differently distributed, regardless of what is out there, that's one thing.

On the other hand, the question really is, is a credit score and the use of credit score something that an individual actually has control over, or is it a result of socioeconomic discrimination that continues to linger? And are we not perpetuating that by allowing this particular methodology? There is a fundamental difference between the accident history and other factors you're talking about and this other.

MR. VYAS: If I may, the FTC study also looked at income, just looked at, for example, low income, those with low income, and tried to discern whether or not credit was predictive or not. And not only whether it was predictive, whether it was equally predictive for those of that same income, so try

and control for income, so to speak, and if low income, those with good credit scores had a less propensity to have an accident than those with bad credit. So even if we control for the income variables that exist, we still look at that and conclude that credit remains predictive and is also not -- it's not --

MR. CRAWLEY: For either income or race.

MR. VYAS: -- it's not racially discriminatory.

MR. PARTON: My problem is they didn't compare it with the overall picture. Yeah, they compared it with low income and whether or not it was predictive within low income. But the bottom line with this is that, unfortunately, African Americans and Hispanics typically end up in lower income. Now, my question would have been, okay, compare it with the rest of it and let's see where the non-Hispanic whites are and where this group falls that, quote, "has this better credit score," and how underrepresented or overrepresented those factions may ultimately be.

You still can't get away from the idea that you have this group that is, indeed, substantially -- that's the word the FTC used --

substantially underrepresented in the good scores and substantially overrepresented in the bad scores. So I understand it's predictive. That's not really the issue we're talking about here. It really is what is happening with --

MR. CRAWLEY: I think the fundamental issue is whether you want to force subsidization within the rate transaction. The finding also found that roughly 40 percent of African Americans benefit from the use of credit scoring. And the question you want to say is do you want to go to that group and say, "You are, because of the removal of this tool, you need to subsidize worse-credit people of all racial groups." That's the fundamental public policy issue.

MR. PARTON: Absolutely, it is. And the answer to that would be, basically, do you want to continue to disadvantage the 60 percent that are out there for the advantage of the 40 percent below? There is an issue regarding race, from a public policy standpoint, worth the risk of, if the industry is correct, having the impact on premium, however, at this point, we don't know how big that would be, by removing that so it no longer impacts.

MR. VYAS: On a question of the size of the

credit increase, we, as I made mention, there are a number of places in our product where we use credit so I can't give you an exact figure. We do have an estimate it, if that's helpful. I mentioned the 50 to 60 percent of the people who would see a rate increase. I believe the size of that increase would be approximately 14 percent, so -- if that's helpful.

MR. PARTON: That would be helpful if you have such a -- is it a study?

MR. VYAS: It was -- in the spirit of the subpoena, I -- we took it as sort of a, I guess, for lack of a better term, a back-of-the-envelope kind of thing where I thought it would be helpful to the discussion. I don't have a proper study but I have --

MR. PARTON: Well, whatever it is, yes, that would be helpful. And frankly, a back of the envelope is better than none at all.
MR. VYAS: All right. We'll do that.
MR. EAGELFELD: We've heard a lot about the good workings of the Florida auto insurance market and the possibilities of what would happen if credit were no longer usable. You folks operate in California, I believe?

MR. VYAS: We do.
MR. CRAWLEY: We do.
MR. EAGELFELD: Is there tragedy going on in California? Do you -- do the Californians feel that there is?
MR. CRAWLEY: From our perspective, there is. We're not able to your use our countrywide auto insurance product in the State of California.
MR. EAGELFELD: What are the consequences to Californians, though?
MR. VYAS: I don't have data. In fact, when this topic came up earlier, I emailed somebody to see if we can get one estimate that would be, sort of, the size of the residual market. I think you made a point, Mr. Parton, saying that the changes might be attributable to changes within that state. But I was just trying to get a size of the assigned risk pool in each of those states: Massachusetts, Hawaii and California. I don't have numbers which

I can show you, because I was hoping to get them by this time but I don't have them. But it takes that --

MR. EAGELFELD: I'm sure it's bigger than six.

MR. VYAS: Yes. I'm sure it's bigger than six.

MR. CRAWLEY: I think, actually, the FTC study showed that for those three states that do not allow the use of credit scoring, they have a much higher percentage of people in the residual markets than those who do.

MR. EAGELFELD: Do you impose more limitations on the business? You said earlier, pretty much, accepting anything under $150 thousand dollar car. Are you writings much more constricted in California than here?

MR. VYAS: We write for two channels, both direct, which we have here, and phone. And, of course, there, there is no -- we don't impose any restrictions in that market over the phone or internet. And then we also write through independent agents, and I don't, unfortunately, I'm not aware of -- I don't have all that data about the agencies, whether there has been restrictions on the number of agents that are assigned. But with respect to the website, takes all comers.

MR. CRAWLEY: I think what we find is our ability to compete has been impaired, because we

can't put in our countrywide pricing model. And so
what we find is some adverse selection in the
channels that we operate in in the State of

California. So we are -- while in other states, we have been successful in penetrating a broad range of risks, our agent business in the State of California is relegated to the nonstandard end, non-tradition channel. And they've not been able to, sort of, penetrate the other markets within the State of California as effectively as we have in the other states.

MR. EAGELFELD: I see. So you do offer it, but it doesn't appear to have come your way?

MR. CRAWLEY: We're not as competitive.

MR. SHAW: But each company in California is disadvantaged, I'll say, to the same extent because you can't use it in the state. So that's -- in terms of a state-competitive disadvantage, not really, but nationally, you have a problem. Is that what you're saying?

MR. CRAWLEY: Correct.

MR. VYAS: I was going to speculate on why that is, because I think a reasonable followup would be why that would be, if there appears to be a level playing field, why that would -- why we would assert that? We have historically been a take-all-comers and so we continue to do that. I'm speculating that companies who use underwriting and restrict out certain risks would, in a marketplace like California, would restrict the kind of folks they take, and to do the best proxy credit, I guess, I'm speculating about their motivations so it's not really fair for me to do that, but that's what I would assume they do. And as a result of their underwriting, offer low rates to a narrower set of customers leaving, perhaps, customers with worse credit, so to speak, in the pool that we see. So I think that would be an explanation, is that they tend to use underwriting to try and restrict that.

MR. SHAW: So your business model is uniquely affected by the inability to use the credit scoring in California?

MR. VYAS: That's right.

MR. CRAWLEY: If I may, I know one of the questions was are there other examples where use of credit has helped to depopulate those high-risk plans? One of my -- my prior job before this was I was the New York State product manager and before that, worked on the State of New York. And one of the things in the early 90s, the New York assigned-risk plan was roughly 60 percent of the marketplace. So basically, one out of every six drivers was stuck in the assigned-risk plan, and that was true in downstate New York.

One of the things that the New York Insurance Department allowed was the use of -- a lot of companies, especially on the high end, to use more of their class plan, including the use of credit and tier placement or the tier and all that went in in January 1st, 1996. And one of their objectives was to depopulate the assigned-risk plans.

I'm not here to say that credit was the only thing that helped depopulate that, but over time, the New York assigned-risk plan went from a marketplace that was well over a billion dollars to, I think at its lowest point, down to about 250 million dollars. So while it wasn't the sole factor, just like credit is not the sole factor in determining the rate, it was one of the factors that helped depopulate the New York assigned-risk plan.

I think earlier, people talked about the State of New Jersey. Our ability to use credit in the State of New Jersey was also one of the determinants for us deciding to reenter that market. Again, because we could use more of our aligned pricing model, we felt comfortable going

into a new market. So I think it certainly has positive effects.

As Sanjay pointed out earlier, today, about 47 states allow the use of credit scoring as a matter of public policy. And we see that it adds value to the insurance transaction, which is something we certainly agree with.
MR. SHAW: Probably something I need to do is, and I should have done, is look at the three states who have outlawed it and see if their auto market is in total array, which -- is it?
MR. CRAWLEY: Hawaii is. Hawaii is Hawaii.
MR. SHAW: If your answer is no, it's not in total disarray, then --
MR. CRAWLEY: I would argue that California is not a well-functioning market. Consumers have been disadvantaged by overregulation in the marketplace, which is one of the challenges in, sort of, answering this is that credit, again, is not the sole predictor.
MR. SHAW: But you're saying that the market is suffering because credit is not longer allowable? Is that the regulation you're talking about?
MR. VYAS: One of them; one of the reasons. I

think that the objective that would be helping, that's in context, is whether or not there is an assigned risk -- the size of the assigned risk pool. That would mean something you could conclude only. For those, there are going to be some other factors which gives rise to your point. There should be some -- I would expect to see that there would be -- the size of the assigned risk pool there should be larger. That would be my expectation, I would think.

Also, Maryland was mentioned as a state which restricts the use of credit. And again, I'll pull that data. I think they have something called MAIF, and that's the state-run -- I believe it's the state-run assigned risk pool, and I believe that's a fairly large, in fact, one of the largest auto players there. That's only suggestive to your point. It doesn't prove --

MR. FITTS: Just to be fair, in Maryland, it's only been banned for homeowners.

MR. VYAS: But there is also, there is a restriction on the use of credit in auto.

MR. CRAWLEY: There is a collar.

MR. VYAS: There is a collar. So there is a -- but that's what I would suggest to your point,

Mr. Shaw, as you were looking for objective data which would assess whether or not the function -- the market ceases to function without it. I would think that would be one evaluation that would be helpful. And I'll try to find the data.

MR. SHAW: Great. Thanks.

MR. PARTON: Again, I appreciate your patience. I know it's been a long day. I do appreciate you coming in and cooperating with us and providing us the information you did. I do appreciate you. Thank you.

MR. RIO: Let me just say that if it meets the pleasure of the hearing officer, we'll waive our time and I'll go back to Mobile.

MR. PARTON: Well, I appreciate the offer. I do welcome you. If you would introduce the individual with you, and I'll welcome him, too.

MR. RIO: Thank you. First, for the record, I'll introduce myself and then our witness. My name is Vince Rio. I'm counsel for State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Company, which are the two companies there were subpoenaed here. I'm joined by Mr. Greg Hayward, who is our vice president and actuary with the most knowledge about our use of

credit in Florida.

And I'd like to say that Mr. Hayward would be happy to answer any questions that call for non-privileged, non-trade secret information and that we would appreciate any questions of a legal nature being addressed to me and I'll be happy to either answer them or take them under advisement and answer them later.

MR. PARTON: It sounds to me like there won't be much testimony because State Farm always claims everything is trade secret, doesn't it?

MR. RIO: No, Mr. Hearing officer, we don't, as a matter of fact. As evidence of that, I point to thousands of documents that we've produced.
MR. PARTON: But a lot of them are marked "trade secret."
MR. RIO: A lot of them are not marked "trade secret." I would say that less than 50 percent of them are marked as "trade secret."
MR. PARTON: All right. Would you raise your right hand, please? Do you solemnly swear or affirm to tell the truth, the whole truth and nothing but the truth in this hearing today?
MR. HAYWARD: Yes, I do.
MR. PARTON: I appreciate that. Thank you.

MR. RIO: Just to continue very briefly, Mr. Hayward will have only a very brief introductory statement in which he will generally describe our use of credit. We will reserve, therefore, the bulk of our time for your more-focused questions so that we can address more precisely the matters that are of most interest to you.
MR. PARTON: Thank you.
MR. HAYWARD: I do need to correct one thing on the record. I appreciate the promotion, but I'm assistant vice president. But thanks, Vince, for the thought.
MR. PARTON: Well, maybe that's an indication

of things to come.

MR. HAYWARD: Well, that would be nice. Thank you. As Vince said, we really don't have any prepared comments. We're here to address the questions that you've posed, but I'll briefly explain State Farm's use of credit, generally, and here in the State of Florida.

We have developed a proprietary underwriting model. It is a custom model built based on our book of business that we write. And it includes certain elements of credit that are on the credit

report that we have found to be very predictive of future losses. We use that in combination with loss history, so our models are not based just on credit. Our scoring models include both credit and loss history.

We use the underwriting model in several ways. One way that's beneficial to our applicants is that we only -- if someone comes to us and they have a prior incident such as a prior claim or a traffic conviction but they have a favorable score, we will overlook the claim or the violation and place them at our preferred rates. So we use it in a beneficial way to qualify people for preferred rates.

One thing that I need to mention is that we only use credit scoring for new applicants and then the effects of that scoring diminishes over time, and at the three-year mark, it's completely eliminated. So we do not use elements of credit in scoring of renewal business beyond three years. We only run a score one time, at the time of application. We also use credit in underwriting placement between the companies, and the general description would be that the more favorable your score, the more traffic incidents and claims you

could have to be eligible. So the better the score, the more likely you're going to be eligible, even if you have accidents and convictions.

We use credit also in rating. We take the underwriting score that was developed, using both credit and loss history, and we combine that with other variables to develop what we call a "customer rating index." And the customer rating index is converted to a rate factor, as you've heard, using multi-varied analysis to match the rating factor to the propensity of loss in the rating plan, taking into consideration all the other rating factors that we use. The rating factor would be 1.00 for neutral, so the rating factor has no effect on the rate.

About 60 percent of your new applicants would have a rating less than one and about 40 percent would have a rating factor greater than one. So about 60 percent benefit; about 40 percent have a higher new business rate because of the

consideration of the credit element. That's basically it, a description of how we use credit.
I wanted to address a couple of the other questions that you've asked. And one of the them was the question that -- what has the industry

done? And I'd like to tell you that we've done a lot since we started using credit. We've made a lot of changes in how we use credit, just in the examples of the types of inquiries that we count in the use of credit. We were very supportive of the changes that were made to the law in Florida. And in 2004, as well as the incoil changes that were put into the incoil draft legislation that a majority of states have adopted.
And we've even gone further than that in the way we look at inquiries. But such things as only counting one inquiry for people that are shopping for an auto loan or only counting one inquiry for people that are shopping for mortgages. We certainly want to encourage shopping for the best rate they can get, and we're very supportive of that. We've made the changes to do those types of things. They're not counting elements that are automatically reported. Those are all things that we very much support. Excuse me for getting too close to the mic. But we've made a number of changes.
Mr. Eagelfeld, the filing that we made in

October -- it was expected in October; we actually made it in well before that -- but made a number of

changes to our model that we think really addresses a lot of the concerns. We had seen, for example, that the average scores did vary by age, and we had made some age adjustment factors in our rating plan because of the multi-varied analysis because of that. But in the most recent filing, we made our scoring models basically age neutral, which we think takes away a lot of the criticisms of different scores by different age groups. We've adjusted that out of our models now.

We've also developed a specific model for dealing with the unable-to-scores, the thin files and the no-hits. We know that was a criticism. We talked to the different groups that have had criticisms over the use of credit, and we know that was one of the things that bothered them about the use of credit. And we specifically looked at our business with thin files, developed a scoring model specific for them that will give many of them very preferred rates even though they have a thin file. We filed that in Florida. It's now effective. It became effective in October. We think that addresses the criticisms.

The idea that we haven't tried to address this question, we have participated in study after study. Being the largest auto insurer, everyone wants our data to participate in these studies. And we volunteered up our data to do these studies. We've participated in the Insurance Department studies that have been done. We've talked a lot of the Texas study. We've participated in the Federal Trade Commission study. We've provided our data. And I can attest to you that we did not do anything to try to distort that data or bias that data. As Mr. Miller testified earlier today, I would have no idea how to bias it to begin with, because we don't collect any information on race or income, so I would have no idea which ones to pick and which ones not to pick even if there was any way we would have wanted to bias it. But I'm here to tell you that we've participated. It was a random sample. There was no bias in any way in the way we selected that data. So I think we have done a lot to address concerns about the use of credit. We have made changes.

We have done a lot to try to do a better job of explanation. I will admit to you when the industry first started using credit, it was not very well explained. We have worked a lot to try to figure out the best way to explain it to

customers. We provide all the notices that I've heard other companies talk about. We've worked hard to try to make sure that we explain that well, that our agents are trained well on how to explain why are we using credit, what's the purpose and why is it good for our policyholders. So I think we have done a lot. Maybe there's additional things we're doing and we're certainly willing to consider those, but I think we have worked hard to try to make this a factor that is for the good of our policyholders.

MR. SHAW: You discontinue the use of credit scoring after three years? You don't use it anymore?

MR. HAYWARD: That's correct.

MR. SHAW: Why not?

MR. HAYWARD: Well, for a couple of reasons. One is we know a lot more about the customers at the end of three years. We have them insured for three years, would know their driving history, we know their payment history with us. So there's a lot of other things we have that we can use in rating. But there is also issues of systems cost to develop a system to order scores on renewal business, all of the notices that we have to send

to that, all the explanations. And at this point, we think it makes a lot of sense for us to do that on new applicants, but we have not done so on renewal applicants.

MR. SHAW: I'm just kind of confused by every company uses it in a different way. Some don't use it after a year; some don't use it after three years; some, it's not that important. But all the companies say it's vital and we need it and if we don't have it, everyone will pay more or 50 percent of our consumers will pay more. So I don't understand. I'm having a hard time reconciling that. It may be a rhetorical statement.

MR. HAYWARD: Oh, sure. Let me address that. I don't think I did address that question, how many would pay more with State Farm if credit was banned? In a sense, we do not use it on renewals; it would not affect our renewal customers. So that's the vast majority of our customers. Depending on how the legislation was crafted, it may or may not affect those in that three-year period.

If the legislation said you can't use credit reports after a certain date, you can't order reports after a certain date, I think you could say

that that doesn't affect the ones that are already used. But at most, it would affect business that we've written in the last three years. And for us, the effect of credit diminishes over time. We rescore business every renewal with a renewal model, and we waive that with the credit model through the first three years, and at the end of three years, it's completely removed as a factor.

MR. SHAW: And as you get more information on the driver, you lessen the amount that credit means, I guess, the weight you put on it.

MR. HAYWARD: Yes; that's correct.

MR. SHAW: Why? I mean, I guess because you have more information on that driver and their tendencies? You said paying your bills and paying your premiums and that kind of thing?

MR. HAYWARD: That's correct. You have much more information about them, their time of being insured --

MR. SHAW: Hypothetically, if you had that information when you first signed them up, you wouldn't need that credit score.

MR. HAYWARD: It would be less important; yes. All of the loss history information, motor vehicle records, those things are -- you don't necessarily

have complete information on them like you do when you've insured someone for three years.

MR. SHAW: Yeah. Explain to me what you have after three years that you don't have at the very beginning.

MR. HAYWARD: Well, we know we have the accurate loss history, because we're the one, we're the insurance company that provided that. We know that they have been paying their premiums with us. We know much better the drivers in the household, the cars that we're insuring, all those things that might be uncertain when somebody just walks in the door of an agent's office and says, "I'd like to buy insurance."

MR. SHAW: Okay. I mean, if credit scoring was outlawed, it would -- you would just have a problem, from what I hear, that first three years when you're using it to kind of get enough history on the person. That's really when it's the most important to State Farm.

MR. HAYWARD: Yes, that's when it's the most important to State Farm. But it would mean that more new applicants would have higher rates than lower rates. That is consistent with -- like I said, about 60 percent would get a lower new

business rate because of the use of credit.

MR. SHAW: Did you -- and you might have said it. What would be the increase that you would estimate?

MR. HAYWARD: It could be as much as 40 percent for some business. Really, that's about the maximum. Our lowest rating factor is about -- it would be about a 40 percent lower rate. So to remove that, you'd end up with about a 40 percent increase.

MR. SHAW: Okay. Thank you.

MR. PARTON: Well, I really appreciate you clarifying that. I was having a real difficult time, sort of, reconciling what I was hearing from some of the other insurers. But, of course, everybody has a different model. I mean, you've got a model where you're not going to use credit score within three; GEICO has one that would be less effective, potentially, in terms of its renewal business, because it stops using credit scoring after one year. But then you have other people like Progressive that may be very much affected all the way across the board because they don't ever stop using it. But that's helpful. And the information that -- how everybody else is using

it and how they treat it on an ongoing basis is also very helpful in looking at this.

Is there any difference -- well, do you just use credit score to decide -- well, you do it for many reasons, one of which is rating. But in terms of initially doing it, you don't use a separate scoring model for your fire and hazard than you use for mutual; am I correct?

MR. HAYWARD: That's correct; same model.

MR. PARTON: You just use that same model. And however it turns out, one may go here, one may go there, then you further use it with other factors in determining what rate or do you use tiers within those companies?

MR. HAYWARD: It would be a rate.

MR. PARTON: Okay. I'm going to -- at the risk of -- I'm sure your answer is very similar to what I've already heard -- ask you about the effects on minority groups that have been documented by the FTC and how you view that? What, if anything, State Farm has done to look at that?

And by the way, one thing I will compliment you again on is -- see, I can be very complimentary, Mr. Rio -- I really appreciate the initiative of taking a look at that thin file group

and coming up with a way to further rate them, is the way I would put it, to assure that you don't have a bunch of people that just really shouldn't be in it. One of my concerns has always been -- well, two. First of all, older people; second -- people, if they're going to be impacted and going to be going in there, and while it's a neutral tier, it's not the best, necessarily, that they otherwise will offer. So it's very encouraging to hear that somebody's kind of looking at that and ratings and getting the best price.

But again, I would ask you to address the issue of the disparate impact or disproportionate impact or overrepresentation, if you will, of certain minority groups in the worst tiers in terms of credit scores.

MR. HAYWARD: Sure. I'd be glad to. One of the things that I mentioned that we did with our October filing is the age neutral adjustments. To

the extent there are different age distributions
within different demographic -- for example, income
is probably pretty obvious that younger people are
probably, on average, lower income, at least young
adults that are out on their own are most likely
lower income than older age groups. So the age

adjustment that we made to our models I think
addresses that difference and, at least, was one of
the criticisms that people have had about models.
     Now, that adjustment is -- took quite a bit of
work for us to do, but it was something we could do
because we know age. We can't really make a race
adjustment or an income adjustment, because we
don't know that. But we were able to make the age
adjustment.
     I think the -- and I think there's maybe three
things that I can add to the discussion that,
rather just repeat what others have said. And one
of those is the Texas Commissioner's conclusions
after having reviewed the study results. And the
Texas Commissioner, they did what I think is a
pretty reasonable study. They did it on an
individual level. They looked at credit, and they
did see a difference. But after having seen that
difference and looked at the totality of all the
study, the Commissioner concluded that the use of
credit was not unfairly discriminatory.
     And he looked at really three different

definitions in his -- as he talks about it in his summary of that. In his letter to the governor and the speaker of the legislature, he said that

there's something that would be intentional discrimination. And clearly, that is absolutely wrong, prohibitive. And their look at the models is that there is not. The fact or the prohibitive factors are not part of the scoring models. They've looked at the models, just as you've looked at the models, and you know that we don't use any of the prohibitive factors overtly in any way in the models. So he said that would clearly be outlawed.

Then he said there's unfairly discriminatory. Unfairly discriminatory, he said is, is there an actual basis for the model? Is it predictive? Does it match the risk potential with the losses that are produced? And their conclusion, after looking at all these models and studying them in great detail, was yes, they are actuarially sound; they're not unfairly discriminatory.

And the third one, he said there is this whole question of disproportionate effect. And he said that, by its very nature -- and I'm paraphrasing. You can read the actual language to see exactly what he said, but I'm kind of paraphrasing here. He said by the very nature of risk-based pricing, it's going to have distributional differences.

Races are not all exactly the same across different segments. They're not all the same distributions by age. They're not all the same distributions by geography. They're not all the same distributions in the way they use their credit. And he said there are going to be distributional differences. And he found that there were distributional differences, but he said that's not the test. That's not the test under Texas law. And so he said that is not something that would cause him to want to ban the use of credit. So I kind of agree with the way he looked at it, and that's kind of the way that we have looked at it as we examine these studies.

MR. PARTON: And I appreciate that. I don't necessarily agree with the former commissioner from Texas, and I'm not sure that our law is necessarily the same here as the one he was dealing with there. He was dealing with -- he didn't have a law that was allowing him to make rule that governs unfair discrimination that was -- as that term is not used. Because unfair discrimination is both an actuarial term, but it's also one that deals with other realms, not necessarily actuarial.

And I agree with him, while he didn't have a choice to elect this, as opposed to the unfair discrimination as it is defined actuarial, I don't think that necessarily is true in the State of Florida. Mr. Rio, I'm sure would argue differently and others have. They've lost that argument.

MR. RIO: We disagree as to whether the law said it, but we don't need to debate that.

MR. PARTON: But I have to get you on that, Mr. Rio. But my first comment that has to deal with the idea is that its unintentional. Certainly, I agree with you. I don't think the law was built to add credit scoring to intentionally discriminate against anybody. But at the end of the day and it's determined that that is, in fact, going on, and you know about it and you keep using it, isn't that intentional?

MR. HAYWARD: I've got two other things I'd like to draw your attention to. One is in Louisiana, we had a plan challenge to our use of scoring models. Mr. Birnbaum was the Plaintiff attorney's witness. The case went before the Louisiana Insurance Rating Commission, and Mr. Birnbaum pretty much gave the same arguments that he gave today. You can read the transcript to see exactly.

But the conclusion of the Louisiana Insurance Rating Commission was also that the credit-based models that State Farm was using were in compliance with the statute, which is pretty much incoil statute. I know Florida's is a little different. Some -- a lot of similarities, but there are some differences. But they ruled that the models were in compliance with the statute and also concluded that the models were not unfairly discriminatory. So that's the second thing that you might want to look at, as far as the transcript of that hearing.

MR. PARTON: Again, so you can keep clarity for me, when they said "unfairly discriminatory," were they talking about in the sense of civil rights or were they talking about it in the sense of actuarial soundness?

MR. HAYWARD: I believe it was actuarial soundness, the way they were looking at it. Although the -- I will say that the Louisiana law does have similar language about the models can't be unfairly discriminatory by race, income, a list of other things. So it does have fairly similar language in that regard.

The third one, the third study, you might want to pay attention to is a companion study to the

Federal Trade Commission study. The Congress, when they passed the Fact Act, they instructed the Federal Trade Commission to do a study on the use of credit in the insurance business, and then they asked the Federal Reserve Board to do a similar study, kind of a companion study, on the use of credit in banking and lending business.

I think that study also lends some things that you might want to look at. They came to the conclusion that race and income -- the use of credit and credit variables are not a proxy for those -- for those prohibited factors. But they even went further than that and --

MR. EAGELFELD: At the risk of being a little impertinent, I think the administration that was in charge of the FTC at the time was not notable for its civil rights enforcement priority.

MR. HAYWARD: The Federal Reserve Board also did a look at this disproportionate effect. And they concluded with a -- with the exception of maybe age and new immigrants to the country, that race was not disproportionately affected in the lending side.

Now, it's -- granted, lending is different than insurance, but they're both using credit

reports. And it's hard, at least for me, to rationalize how it could be a disproportionate effect for using credit reports in the insurance industry but not be so in the banking and lending side.

MR. SHAW: Let me ask a legal question. Has there ever been a court challenge based on the disparate impact of the use of credit scoring that

you're aware of?
MR. RIO: In the realm of insurance?
MR. SHAW: Yes.
MR. RIO: There's never been a successful court challenge that I'm aware of to the use of -- there's never been a court case that's held that disparate impact is the test. And if we're talking about matters of law, where disparate impact is a test, it is not the test. In certain arenas where disparate impact is a factor of consideration, the law goes beyond that and inquires as to whether there is an independent business reason for the factor that's under examination. And in virtually all of those cases, they have found that if there is an independent business reason, as there is with insurance, then there is no unfair discrimination based -- or there is no discrimination based on

race.
MR. SHAW: And the independent business reason is the actuarial correlation between --
MR. RIO: Yes, sir.
MR. SHAW: Okay. Thanks.
MR. PARTON: Well, that's not what they found. That's what he is asserting independent business reason is. I think it's a little bit more than just a business reason, but we'll debate that some other time.
MR. RIO: I'm sure we will.

MR. PARTON: Which is why, by the way, we use "disproportionate effect" and not "disproportionate impact." There are different consequences and tests to each one of those. And you're correct; in the civil rights arena and the business arena and typically in hiring cases, that's the sort of weighing that goes on.

And I've read the other study by -- I've got to go back and refresh my memory, but I do recall that there were some substantial differences in, really, what the Federal Reserve was actually saying in that particular report and the issues that they were. And there was imprecision, if you will, in looking at what they're saying versus what

the FTC was saying, which frankly, I would expect. They were looking at different things.

And the biggest problem between both of those studies is the failure to define certain terms. For instance, in the FTC, it uses the term "proxy." It never does really define what it means by a "proxy." I don't, today, know what it means by a "proxy," and it always helps when you do these reports that you actually do those things. So I understand and I agree. I'm going to go back and read that before -- I have read it once -- and refresh my memory about it. But I appreciate you bringing that up. I do remember that. And, in fact, now there is a getting through report or an attempt, if you will, in examining this, as I recall. I don't know who is doing it. They just made this huge data call --

MR. HAYWARD: The Federal Trade Commission, yes.

MR. PARTON: -- sent the insurance companies a twitter in terms of the policies and things like that that it was asking for, as I recall.

MR. HAYWARD: Yeah. And that is the point. Being the largest, we are subject to pretty much all of those types of things. And I can tell you

that I have a high number of staff people working on the response to the Federal Trade Commission, which unfortunately distracts us from being able to do our normal business, but it is something that we have to do and we are working very hard to be able to to try to response to that.

MR. EAGELFELD: Are you a participant in CLUE?

MR. HAYWARD: Yes, we are.

MR. EAGELFELD: Do you -- CLUE is the Comprehensive Loss Underwriting Exchange. It does give accident history on people, new business applicants, you can get something out of it. Do you believe the information on there is fairly reliable?

MR. HAYWARD: It's fairly reliable. It's not 100 percent, obviously, because not all companies report to it.

MR. EAGELFELD: Well, not as good as having the insured on your own books, certainly, but you're not flying completely blind or have to rely only, other than on the insured's own statement, so you have something to rely on that you believe, perhaps, is more reliable than motor vehicle reports?
MR. HAYWARD: I would say it is more reliable

than motor vehicle reports, which we know are fairly incomplete.
MR. EAGELFELD: So you believe the other participating companies -- you know that you, the nature of your reporting, but you believe that the other participating companies are also fairly thorough in their reporting?
MR. HAYWARD: Yes, I believe so. You always have the issue of are we ordering the reports on the right drivers? You also have those kind of questions when you're writing a new applicant: Did they actual disclose all the drivers of the vehicle, are we actually looking at the right loss history reports? But, whereas, if you insure the business for three years, you know that much better than for somebody just walking in the door.
MR. EAGELFELD: Okay. As far as the current financial crisis the country is involved in, how have you been monitoring it and its potential effects on your new business rating, or premium

volume, credit scores, et cetera?
MR. HAYWARD: We have monitored the credit scores very closely. That's been a question -- I know that you wanted to ask us that question as well as several others. So we have looked at it

very closely. Of course, we only order scores on new business, so it doesn't affect our renewal book at all one way or the other. But our average scores, and this is in that boxes of documents over there. We've provided you our average scores, both company-wide and in the State of Florida.
But interestingly enough, and I don't know that I have a real good explanation for this, but the average scores have actually increased. I don't know that I can explain why. Maybe Mr. Miller had a few thoughts today as to why that might be true. But it could be that people are being more cautious in their spending, and that, in effect, is actually helping their credit scores. They're taking out less new credit, they're being very careful about the way they're managing things because they're worried about the economy.
But that, you know, that, as I heard the actuary from Allstate say, that doesn't mean there won't be an individual. But on average, we've actually seen the credit scores increase, which would run counter to what your initial suspicions would be.

MR. EAGELFELD: Your average scores -- you
don't really have a separate insurance credit

score. Your score is a compounding of credit
elements and underwriting elements?
MR. HAYWARD: That is true.
MR. EAGELFELD: So is that the kind of score
that you found is increasing?
MR. HAYWARD: It is. That's the score we're
monitoring, yeah. So to the extent there is some
lower frequency, that could have some effect as
well.
MR. EAGELFELD: Right. There has been quite a
dramatic decline or unusual decline in driving in
the United States over the last year or so,
vehicles miles traveled.
MR. HAYWARD: So that could be a possible
explanation as well.
You had also asked about the writing. We have
definitely, as new cars -- a lot of insurance sales
go with car sales. And as car sales decline, so do
new insurance sales. So we have seen that effect.
We had a good year in policy growth last year as a
company and pretty good year solid growth here in
the State of Florida. In the last five years,
we've added about 200,000 vehicles here in the
State of Florida, insureds.
So we've been consistently growing, but with

the downturn in the economy, that growth has slowed. And we expect it to continue to be that way with people not buying cars. Until they're able to get back out and start buying cars again, our sales will suffer as well. I think that was it. Was there a another part to your question?

MR. EAGELFELD: No, I don't think so. How does your appeals process for extraordinary life events work?

MR. HAYWARD: Oh, good. Yeah, I'm glad you asked that too. It sounded very similar to the way the other insurers described it. We do go a little bit beyond what the law requires as well. But it includes all the items in the Florida Statute, but it would also include things like identity theft and it includes -- I think the statute may just say "death of spouse." But we say if you have the death of a spouse or a child or even a parent, a death in the family, and you can demonstrate that's had an adverse effect on your score, then we will treat -- we treat it as neutral is what we would do in that appeals process. But it sounded very similar to what the other companies have described.

The question about if someone finds an error in their report or they dispute something, would

you go back and do refunds? Yes, we do. We follow those same kind of procedures.

MR. EAGELFELD: If an item is in dispute, actively in dispute, would you use that item within your scoring?

MR. HAYWARD: No, we do not use items in dispute.

MR. EAGELFELD: But that kind of dispute would have to be a dispute that's actually reported to the credit bureau --

MR. HAYWARD: That's correct.

MR. EAGELFELD: -- under the Fair Credit Reporting Act. They reserve their rights.

MR. HAYWARD: Yeah. Items that are shown in dispute on a credit report, we would not use.

MR. EAGELFELD: All right. Okay. Have you done any in-house research on what your company's response might be if credit use were curtailed in one more state.

MR. HAYWARD: Yes, we have. And we saw that was one of the items in the subpoena and we have supplied documents from research that we have done. I would support the statements that Mike Miller gave, that we have worked long and hard to try to find substitutes for credit. Is there something

better that we can use? And we haven't found an adequate substitute. So I don't think we can just come up with a new factor that's going to replace it.

There are some other factors that we would try to use and file with the Department to say we think these are some things that we could use, and we've done some research on those, but we don't think they would adequately replace the predictiveness that credit has.

MR. EAGELFELD: It might be a partial replacement?

MR. HAYWARD: There would be maybe some partial replacement, but not nearly the power that we have seen with the use of credit.

MR. EAGELFELD: Is it possible that such an event might spur you to find and research some currently non-used variable that might equal credit, not necessarily replace it, but might rival it for predictive value?

MR. HAYWARD: Well, the obvious one that is a lot in the literature is actually monitoring the driving with a device.

MR. EAGELFELD: Actually, that was in the back of my mind, at least the mileage aspect of that.

How far you go with it --

MR. HAYWARD: I mean, part of what all these different risk assessments are trying to do is trying to identify the high-risk versus low-risk drivers. And if you have a device in the car that actually monitors how they drive the vehicle, that could potentially be a replacement.

Trying to do that in a cost-effective way and in a way that customers accept from a privacy standpoint and all those things raise new issues. But there probably are other ways to identify high-risk and low-risk drivers.

MR. EAGELFELD: It raises many issues and clearly credit is cheaper and more convenient to use.

MR. HAYWARD: Yes. Definitely, a device isn't -- and we have done research on this. But you compare the cost of ordering a credit report versus the cost of having and installing a device on a vehicle and monitoring, that is still a pretty high-cost option to try to assess driving.

MR. EAGELFELD: And likely, you'll have anyone proclaiming it doesn't have any relationship to losses.

MR. PARTON: Real quickly, I just want to

follow up with some of the things that Mr. Eagelfeld was asking you, really, about what happens in that three-year period from the first time you order credit scoring. Is the customer able, in that three-year period, to ask you to rerun it and rewrite it?

MR. HAYWARD: Yes, in accordance with the statute.

MR. PARTON: Okay. And again, in dealing with the appeals process, let's assume for the moment that first of all, I'm with State Farm Mutual and I haven't had a very good year. I lose my job; I'm not able to pay my credit cards, okay? This probably wouldn't even apply, because what you say is at some point, you're not really using that.

MR. HAYWARD: It would only apply it they come to us as a new applicant.

MR. PARTON: Right. So that's when I would have an issue. That would not be something, or would it be something that could be addressed in your appeals process; that is, you know, I come to you, I've come from another company. I've heard you have a better deal, even though I had a pretty good deal over here. How would you deal with me? My house is being foreclosed, I've lost my job, et

cetera, et cetera. How would you deal with that?

MR. HAYWARD: They would do the appeal process, provide the documentation that they have lost their job and this has affected their credit standing, and we would rate them as a neutral.

MR. PARTON: As a neutral? Okay. All right. Thank you. Any other questions?

MR. EAGELFELD: What's your experience with the proportion of no-hits? I guess you don't really have a no-score, because you have a special model. What can you say further on that?

MR. HAYWARD: Yeah. I had looked at ours and we were in the five, six percent range. It's actually come down quite a bit. We have worked very hard with our vendor to do a better job of identifying credit reports. So we have, from what we traditionally -- where we started anyway, we've been able to reduce that number considerably.

MR. EAGELFELD: Who is your vendor?

MR. HAYWARD: We go through ChoicePoint and we go through Experian.

MR. PARTON: Do you all track your appeals as it regards credit score, such that if we wanted to get an idea of roughly what percentage of appeals are granted or not, we could take a look at that?

MR. HAYWARD: I thought you would ask that question, since I heard Allstate give their percentage. I don't know for sure. We can try to get an answer to that, but I've never tried to find an answer to that. But I'll see if we have a way of tracking that.

MR. PARTON: And again, I don't know whether it measures the effectiveness of the process or not, but I think it would be another data element that we can look at. I would appreciate it.

I want to thank you very much for coming, and you, too, Mr. Rio. I also want to thank those who have been here and participated in this hearing. It's been a long day; actually, a little bit longer than I thought it would be. I won't say why, but I am glad it's over. And I am now adjourning this hearing. Thank you.

(Whereupon, the proceeding was concluded at 5:12 p.m.)

* * *

CERTIFICATE OF REPORTER

I, LISA A. BABCOCK, do hereby certify that I was authorized to and did report the foregoing proceedings, and that the transcript, pages 134 through 329, is a true and correct record of my stenographic notes.

Dated this 4th day of March, 2009 at Tallahassee, Leon County, Florida.

____

LISA A. BABCOCK

Court Reporter