Report on the Credit Scoring Data of Insurers in Maryland

Maryland Insurance

Administration

February 2004

Table of Contents

<u>Exhibits</u>:

Exhibit 1
- House Bill 521

Exhibit 2
- The Virginia Study

Exhibit 3
- The Michigan Study

Exhibit 4
- The Washington Study

Exhibit 5
- The Alaska Study

Exhibit 6
- The Missouri Study

Exhibit 7
- American Academy of Actuaries Report

Exhibit 8
- A report to the Ohio Civil Rights Commission

Exhibit 9
- The Epic Study

Exhibit 10
- The Fair Isaac Study

Exhibit 11
- P&C Bulletin 03-17

Exhibit 12
- Market Share List

Exhibit 13

- Choice Point correspondence dated December 22, 2003
- Fair Isaac correspondence dated December 19, 2003
- Allstate Indemnity Company correspondence dated January 13, 2004

Exhibit 14

- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Anne Arundel, Carroll, and Howard Counties Region.
- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Baltimore City, Baltimore and Harford Counties Region
- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Eastern Shore Region
- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Prince George's and Montgomery Counties Region
- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Southern Maryland Region
- 2003 Credit Study – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Certain Zip Code – Western Maryland Region

Exhibit 15

- 2002 Baltimore Exhibit – Comparison of the Percentage of Minority Households and Income to High Credit Scores by Zip Code

Background

Credit Scoring - House Bill 521

The use of credit scoring in the underwriting and rating of automobile and homeowners risk has emerged as a major issue in the area of property and casualty insurance over the past few years. Credit scoring is a rating tool used by insurers in an attempt to reduce their exposure to risk by (1) not writing policies for certain consumers; and/or (2) adequately pricing policies based on risk. Proponents of credit scoring maintain that an individual's credit history is highly predictive of whether the individual will be involved in an automobile accident or will sustain damage to the individual's home. Opponents of credit scoring maintain that the use of credit scores has an unfairly discriminatory impact on lower income and minority populations. According to the filings with the Administration, approximately forty (40) companies currently use credit in their rating of automobile policies.

Prior to the passage of House Bill 521 in 2002, Maryland law prohibited insurers from refusing to underwrite, cancel or nonrenew a private passenger automobile policy solely on the basis of credit history. During the 2002 legislative session, the Maryland General Assembly became one of several state legislatures to take action on the issue of credit scoring with the enactment of House Bill 521 (Chapter 580, Acts of 2002) (Exhibit 1). With respect to homeowners' insurance, HB 521 prohibits an insurer from using credit history to refuse to underwrite or rate a risk. With respect to private passenger motor vehicle insurance, HB 521 prohibits an insurer from using credit history to refuse to underwrite a risk or increase a renewal premium and restricts the manner in which an insurer may use credit history to rate a new policy. Insurers are prohibited from considering certain factors for establishing a credit score and must provide applicants and insureds with certain disclosures. HB 521 also requires the Insurance Commissioner to conduct a study on whether the use of credit scoring in the state has an adverse impact on any demographic group defined by race or socio-economic status. It is important to recognize that the provisions of HB 521 address the many concerns associated with the use of credit history by insurers.

Credit scoring is a concern to regulators, policymakers and consumers across the country because there is no obvious connection between a person's credit history and the likelihood that he or she will incur a loss. Furthermore, insurers and rating organizations that develop credit scoring models often develop their models based on varying criteria, placing greater importance on certain criteria used to develop a score, which results in a variety of formulas that may be relied upon by an insurer. These differences have created controversy, confusion, and concern for regulators and policymakers who seek to understand the practice and determine whether a person's credit score is an appropriate rating factor to be used by insurers.

While insurers and credit scoring organizations strongly advocate for the use of credit history, they are unable to explain in a clear and concise manner why the use of credit history is a reliable predictor of risk/loss. Even insurance producers have expressed concerns with the use of credit history; in part, because of the failure of insurers to educate the insurance producers on what has been characterized by insurers as an "essential and important" rating tool. Furthermore, absent regulatory and/or legislative action, insurers neglected to inform consumers that they were using credit scoring and what its potential impact was on obtaining and maintaining affordable insurance.

Maryland is one of several states studying whether the use of credit scoring by insurers has an adverse impact on certain populations. There is a concern, particularly among insurance regulators, legislators and consumers, as to whether the use of credit scoring by insurers has an adverse impact on minorities and the poor. At this time, there are conflicting studies on this issue. In addition, like Maryland, many of the individual states that have attempted to study this issue have had to do so with limited information. Some of the states that have completed such studies include Virginia, Michigan, Washington, Alaska and Missouri.

The Virginia Bureau of Insurance -- December 1999

During the 1999 legislative session, the Virginia Senate Commerce Committee requested the Virginia Bureau of Insurance ("Bureau") to study the issue of whether insurers should be permitted to use credit. As a result of this request, several insurance surveys were conducted by the Bureau for the purpose of obtaining input from insurers and insurance producers. In addition, the Bureau met with a third party vendor, Fair Isaac, to collect data regarding the development of credit scoring models used by insurers.

In Virginia, the majority of insurers using credit scoring for underwriting and rating rely on third-party vendors such as Fair Isaac. The Bureau met with Fair Isaac to discuss how factors are developed and weighed in their credit score models. Specifically, the Bureau requested information from Fair Isaac to determine if a correlation existed between credit scores and certain populations, e.g. income and race. This information was requested, in part, because of concerns expressed by the agent community regarding the potential for insurers to use credit scoring for redlining. Also, consumer groups expressed concern that the use of credit scoring might have a disparate impact on "protected classes", thus creating a barrier to insurance for certain individuals.

Fair Isaac provided the Bureau with average credit scores for certain zip codes. The Bureau examined the average credit score versus race and other demographic factors. According to the Bureau's study (Exhibit 2), nothing in their analysis led the Bureau to conclude that income or race alone is a reliable predictor of credit scores, thereby making the use of credit scoring an ineffective tool for redlining. At the time of the study, the Bureau reported that in every case where insurers have proposed to use credit scoring as a rating factor and have provided sufficient data, the use of credit scoring has been found to be statistically correlated to loss experience.

However, the Bureau was concerned about the long-term effect that the use of credit history may have on the market. Specifically, such use may result in an increase of nonrenewals, an increase in premium, or refusal to issue coverage by insurers. The Bureau has stated that it will continue to monitor credit-related consumer complaints as well as the number of companies that use credit scores in underwriting and rating. If the Bureau identifies or determines availability problems in the marketplace related to the use of credit history or credit scoring by insurers, the Bureau will consider appropriate legislation.

The Michigan Report -- December 2002

According to the Michigan Insurance Department, their study (Exhibit 3) did not reveal any “evidence of bias or illegal impact based upon constitutionality or statutorily protected criteria such as race or ethnicity, nor is there evidence of an inappropriate bias based upon geographic location of the insured.” With respect to income, the Michigan Department of Insurance did acknowledge that evidence was submitted to indicate that “persons of relatively lower socio-economic standing had better insurance credit scores on average than those of higher socio-economic standing.” However, in its study the Michigan Insurance Department states that neither their study, nor any other study at that time, has concluded that insurance credit scoring has an inappropriate or illegal disparate impact on low income or minority populations. The Michigan study concludes that additional studies on whether “impermissible bias” exists must be performed by persons without economic interests in the business of insurance in Michigan or nationally if credit scoring is ever to be fully accepted as a rating factor.

The Washington Report -- January 2003

In 2002, the Washington State legislature passed legislation (ESHB 2544) that restricted the use of credit history by insurers. The legislation also required the Insurance Commissioner to conduct a study of the effects of credit scoring. The purpose of the study (Exhibit 4) was to determine whether the use of credit scoring by insurers has “unequal impacts on specific demographic groups.” The authors of the study admit that certain limitations to the study exist; including variations among insurers as to the type of credit scoring model used, the population to which it is applied and the role credit scoring has in the underwriting and ratemaking process. In addition, the study is based on records of insurance company customers which would not include information about those persons who applied for but were refused insurance based on credit scoring.

According to the study, the most significant factor is age. "Older drivers have, on average, higher credit scores, lower credit-based rate assignments and less likelihood of lacking a valid credit score." Income is also a significant factor. As income rises, credit scores and premium rates improve. People in the lowest income categories, which was defined as less than $20,000 per year and between $20,000 and $35,000 per year, "often experienced higher premiums and lower credit scores." Although ethnicity was found to be significant in some cases, the data was insufficient to allow broad conclusions to be drawn as there were only a small number of ethnic minorities in the samples studied.

The Washington Department of Insurance has stated that "it is probable that credit scoring impacts are not equally distributed across demographic groups." While there were "considerable differences among the models", these differences "did not appear to be random variation." However, the relationship of income and ethnicity to credit scores was much less consistent than the relationship between age and credit scores. Thus, it is possible that one use of credit scoring may have a significant impact on ethnic groups while a different use of credit scoring would not. The authors of the study specifically state that that "there is a need for examination of more companies and larger samples of consumers" in order to definitively address these issues. As such, "an overall conclusion that credit scoring generally does or does not have a particular consistent, quantifiable, unequal negative effect on certain demographic groups is premature."

Alaska Division of Insurance -- February 21, 2003

The Alaska Division of Insurance ("Division") issued a report (Exhibit 5) on February 21, 2003 regarding a study they conducted on credit scoring. The purpose of the study was to determine how the use of credit impacts the insurance market and to identify issues to be reviewed in market conduct exams. The study compared the impact of credit-based insurance scoring with census information by zip code, including demographic variables such as age. All insurers writing private passenger automobile or homeowners' insurance in Alaska were surveyed by the Division regarding policyholder information before and after the use of credit scoring.

The Division asked insurers to provide data related to zip codes, age, marital status, sex, market or rating tier. In addition, the Division used census data by zip code to identify areas of high and low income and various ethnic composition. It was necessary for the Division to collect certain information from the census data because insurers do not collect such information.

The Division found that, on average, after the use of credit scoring more consumers were placed in a standard or preferred product than before the use of credit scoring. This result was consistent even in areas with higher numbers of ethnic minority and lower income consumers. For example, three zip codes with a higher percentage of non-white and lower income saw the most dramatic declines in the percentage of policyholders placed in nonstandard -- from 36% to 15%, 22% to 15%, and 29% to 16%. The results of the study are only a rough approximation for the use of credit scoring since other factors, such as age, contribute to whether a consumer is placed in preferred, standard, or non-standard tier.

The data collected by the Division for Anchorage and Fairbanks revealed that the zip code that is predominately Caucasian and has the highest income also has highest percentage of preferred policyholders and the lowest percentage of non-standard business. Zip code groups with the lowest median household income and the largest ethnic population have the smallest percentage of preferred policyholders and the largest percentage of non-standard business. According to the report, the data does seem to indicate that there is more non-standard business and less preferred business in low income/minority population zip codes before and after the use of credit history and scoring. However, the data also shows that a greater number of policyholders are eligible for the preferred tier with the use of credit scoring.

The Alaska study concludes that credit scoring has a different impact on different groups of consumers and unequal effects exist on consumers with varying income and ethnic characteristics. However, the study concluded that it was premature to determine whether the policyholder distribution is due primarily to the use of credit scoring or other rating factors. No conclusion can be drawn to definitively conclude that use of credit scoring is responsible for a shift in business. "Additional study with more detailed data would be needed to draw more definitive conclusions."

The Missouri Report -- January 2004

The most recent study on the use of credit history and its impact on minority and low-income individuals was completed last month by the Missouri Department of Insurance (Exhibit 6). The Missouri study was based on information from the twenty (20) largest automobile and homeowners insurers in the state that relied on credit scoring as a significant part of their underwriting and rating process for the period of 1999 to 2001.

According to the Missouri Department of Insurance, their study reveals that insurance companies are charging low-income and minority groups in urban and rural areas of the state higher automobile and homeowners insurance rates. The study found that residents in the lowest income areas, mainly the inner cities and rural counties, had average scores that were 12.8 points lower than the wealthiest zip codes. However, Missouri Insurance Director Scott Lakin admitted that there were some limitations to the study. For example, the study fails to explain why minorities and low-income populations have low credit scores. Furthermore, the study does not provide actual differences in premium paid by minorities and low-income residents in comparison to other Missouri residents. The insurance industry is quick to point out that neither race nor income are known by the insurers or the credit scoring models and that the study failed to address the risk of loss; that is the loss experience of the particular policyholder. Director Lakin is hopeful that these limitations will be addressed in a multi-state study to be conducted later this year.

The NAIC Study

In addition to the studies that have already been conducted, a working group of the National Association of Insurance Commissioners ("NAIC") has been considering whether to conduct a study regarding the use of credit scoring. The credit scoring working group of the NAIC is considering whether a study assessing the impact of credit scoring on certain populations should be conducted. The study has been proposed because there is some evidence that credit scoring may have a disproportionate impact on certain protected classes.

Based on a report completed by the American Academy of Actuaries (“Academy”) (Exhibit 7), "disproportionate impact" is an actuarial concept whereas "disparate impact" is a concept that suggests discriminatory use of credit history as a rating factor. The Academy’s report found that none of the reports they reviewed contained the necessary information it to evaluate whether credit-related insurance scoring results in a disproportionate impact for certain populations. For example, the most detailed analysis available to the Academy Was based on insurance data and databases that did not contain information regarding race or income.

A 1999 study conducted by Freddie Mac on consumer credit documented the unique characteristics of minorities and low-income populations. That study, based on a survey of more than 60,000 individuals, concluded that African-Americans and low-income individuals were more likely to have negative items on their credit histories in comparison to non-minorities and individuals of higher income. However, the purpose of this study was to determine whether the use of a mortgage applicant’s credit history was appropriate for determining the amount of debt that the mortgage applicant could assume. The study did not evaluate the impact of credit scoring as it relates to insurance risks.

As discussed by the Credit Scoring Working Group at the 2003 NAIC Winter National Meeting, the working group is proceeding with the development of best practices for the use of credit scoring; including adverse action, no hit/no score, scoring model submissions, sole factor and periodic review. The proposed best practices will be considered at the 2004 NAIC Spring Meeting which is scheduled for March 2004. In addition, the MIA is participating in a sub-group of the working group to specifically study whether the use of credit scoring has an adverse impact on certain consumer groups.

Consumer Advocates

In his report to the Ohio Civil Rights Commission ("Commission")(Exhibit 8), Birny Birnbaum, an economist, former insurance regulator with the State of Texas and leading consumer advocate opposing the use of credit history by insurers, reported that the use of credit scoring by insurers results in a disparate impact on poor and minority populations in Ohio. Mr. Birnbaum's opinions are shared by many opposed to the use of credit scoring by insurers for the purpose of underwriting and rating private passenger automobile and homeowners' insurance. The basis of his objections is premised on the belief that credit scoring is correlated to certain underwriting or rating factors that are prohibited by law, such as race. He believes insurers use credit scoring because it allows insurers to price based on the profitability of the consumer. "Important consumer characteristics are related to the income level of the consumer. Thus, credit scoring is, for insurers, an easy and quick method of underwriting and rating by consumer income."

It is also the opinion of Mr. Birnbaum and others that insurers' use of credit scoring for underwriting, rating, etc. "very likely" has a disparate impact on poor and minority populations in Ohio. Furthermore, insurers' use of credit scoring makes insurance less available and/or more expensive for poor and minority populations in Ohio.

Mr. Birnbaum discusses whether the use of credit history/scoring qualifies as a legitimate underwriting factor based on what he refers to as a "two-prong test". First, does the underwriting guideline violate broad public policy? And, second, does it identify a characteristic that is demonstrably and uniquely related to the risk of loss? Underwriting standards and guidelines are important for properly identifying a group of consumers for whom the expected costs of the transfer of risk are higher or lower. Rates satisfy the legal standard (to be adequate, not excessive, and not unfairly discriminatory) if (1) the rate is a sound estimate of future costs of coverage offered, and (2) consumers of the same class and essentially the same hazard are offered the same rates. To date, studies have failed to provide conclusive evidence as to the correlation of credit history/scores and loss. Those studies that suggest such a relationship exists have been conducted or sponsored by insurers or credit modeling companies with a financial interest in the issue.

Consumer advocates, including Mr. Birnbaum, have asserted that the use of credit scoring by insurers:

- Enables insurers to move away from pricing based upon risk to pricing based on what the market will bear;

- Allows insurers to revolutionize the risk classification process;

- Increases the number of non-standard drivers;

- Allows insurers to avoid rate regulation because in many states underwriting guidelines receive no scrutiny; and

- Results in redlining or the avoidance of certain types of customers.

Industry Advocates

Insurers, however, argue that credit scoring does not discriminate nor does it have a disparate impact on poor and minority populations. According to the American Insurance Association ("AIA"), insurers do not consider certain information in the calculation of an insurance score, including: income, sources of income, ethnic group, or nationality. Insurers do not look at income or race; nor do they collect such data. Because these factors are neither collected by an insurer nor considered in a credit score, there is no unfair discrimination in the use of credit history by insurers.

Credit information is gathered and entered into a computer program that generates an insurance score. Programs look at payment history, collections, credit utilization and bankruptcies. People with certain patterns of behavior in their credit history are more likely to pay higher premiums or may have trouble obtaining coverage. Credit scoring is a predictive factor of how often you are likely to file claims and how expensive those claims will be.

A study completed by the AIA concludes that credit scores are relatively constant over different income classes. However, the information relied upon by industry has not been made available for an independent review. According to representatives of insurers, the use of credit scoring benefits consumers by:

- Allowing fairer pricing for consumers;

- Enabling insurers to provide more coverage; and

- Promoting competition in the market.

Maryland, like most states, mandates that rates shall not be excessive, inadequate, or unfairly discriminatory. The use of credit scoring by insurers as a rating factor must meet the same criteria that any other classification rating factor must meet under Maryland law. Public policy requires that insurance be available and affordable to all consumers who are eligible for insurance. An insurer meets this standard of availability and affordability when rates charged by the insurer are based upon objective and uniform classifications which show that two or more risks with the same characteristics will be charged the same rates for the applicable classifications and that any rate differentials are justified.

Insurers argue that credit scoring is among the most reliable and important of the rating factors used by them. "If ever there were doubts about the importance of insurance scores in the accurate underwriting and rating of automobile insurance, those doubts were erased by the finding of this [Epic] report." The "Epic Study " (Exhibit 9) did not directly address issues concerning the impact of credit scoring on certain populations. However, according to the AIA, the EPIC actuarial study did find a “consistently strong relationship between insurance-based credit scores and future auto losses in all 50 states and Washington, D.C.” According to the EPIC actuarial study, credit scoring has consistently proven to be a strong rating factor for predicting losses in states with low minority populations as well as states with high minority populations. The relationship between credit scores and risk is consistent among states with relatively high minority populations, such as Maryland, New York, and California, and states with low minority populations, such as Utah, Idaho and Iowa.

A review of a study entitled Predictiveness of Credit History for Insurance Loss Ratio Relativities, which was conducted by Fair Isaac in 1999 (Exhibit 10), provides some insight as to the development of credit scoring models and their purpose. As stated in the 1999 Fair Isaac study, the purpose of the study was to address regulators' concerns and issues on the use of credit history and insurance bureau scores in underwriting decisions.

For many years, Fair Isaac has been developing scoring models that use data to improve business decisions. In the late 1980’s, Fair Isaac introduced scoring models to the insurance industry. According to the 1999 Fair Isaac study, these custom scoring models are developed from an insurer’s data such as application information, motor vehicle records, loss history, credit data and other sources of data to statistically predict loss ratios. The Fair Credit Reporting Act (FCRA) permits insurers to obtain a list of consumers based upon certain credit characteristics without the consumers' permission as long as the insurers provide a firm offer of insurance to the consumers on the list. Known as ”prescreening”, this activity typically is not subject to oversight by insurance regulators.

Later, in the 1990’s, Fair Isaac introduced “insurance business scores”. As reported in the 1999 Fair Isaac study, these scores are developed by analyzing very large samples of the major types of auto and home insurance policies to determine the correlation between information on consumer credit bureau reports and subsequent insurance loss ratio. The higher the score, the lower the risk. Several insurers licensed in Maryland who use credit scores for underwriting and rating private passenger auto insurance premiums rely on Fair Isaac scoring models, including Agency, Safeco Insurance Company of Illinois, Travelers Indemnity Company, Travelers Indemnity Company of America, and Travelers Indemnity Company of Illinois. Fair Isaac has stated in its 1999 study that “there are no prohibited characteristics, as defined by the ECOA or FHA, used in insurance bureau scores." Furthermore, Fair Isaac states that “insurance bureau scores provide objective evaluations that can offset underwriters' personal biases." According to Fair Isaac, this actually helps to facilitate consistent underwriting as well as remedy and control discrimination. Fair Isaac never intended for credit scores to be used/relied upon solely in underwriting and opposes such a use.

Upon its own review of Fair Isaac's credit scoring model, the Maryland Insurance Administration has not found any prohibited characteristics or factors related specifically to race or income. Insurance bureau scores are based on information obtained from consumer credit reports that insurers get from credit reporting agencies. Those agencies are Equifax, Experian and Trans Union. The information obtained from consumer credit reports that is used in credit scoring includes late payments, bankruptcies, length of credit history, outstanding debt, new applications for credit and types of credit in use. It does not include information regarding ethnic group, religion, gender, nationality, age or income.

The Maryland Study

In response to Section 3, Chapter 580, Acts 2002, the Maryland Insurance Administration (MIA) is required to conduct a study on whether the use of credit scoring in Maryland has had an adverse impact on any demographic group defined by race or socio-economic status. In order to conduct this study, the MIA issued P&C Bulletin 03-17[1] on November 25, 2003 directing those private passenger automobile insurers who utilize credit scoring in their rating methodologies to provide the MIA with certain data broken down by zip code.

A. Credit Scoring

Credit scores are numeric scores, which are generated by a computer model. The model, which varies depending on the company using it, evaluates certain credit criteria of an individual's credit history, assigns a weight to each of those credit criteria and assigns an overall numeric score for that individual. Based on that score, the insurer determines what rating factor the individual is qualified for and that factor, in turn, modifies that individual's insurance premium. Some of the credit history criteria considered by the models include the following as examples: bankruptcies, liens, late payments, number of credit cards, balances on credit cards and or other balances, car loans, credit limits, the ratio between credit limit and outstanding balance, number of trade lines open in the last twelve months, thirty-six months, etc. Some of the models will consider all of this information while some other models may consider only some of this information as well as other information or criteria. The MIA has reviewed the models being employed by insurers doing business in the State of Maryland and has been able to determine that none of the models contain or employ any prohibited credit factors; nor do they include any criteria that tracks either the race of the individual or the income of the individual.

[1] See Exhibit 11

B. Overview

Those companies that employ the use of credit in their rating methodologies for private passenger automobile insurance represent 35.47 % of those insurers who write private passenger automobile insurance in Maryland. Each of these insurers was asked to respond to the MIA's data call. Of those that responded:

- 21% of the market[2] provided data that was included in this study. These insurers were able to provide the number of policies comparable to the ChoicePoint Attract MD Standard Auto model score of equal to or greater than 700 points.

- 13% of the market[3] provided data that was not included in the study due to the format in which it was presented. These insurers were not able to provide the number of policies comparable to the ChoicePoint model score, but instead provided number of policies for each credit score range as contained in that insurer's filed rating plan. As a result, those insurers' data could not be incorporated in this study. The credit score ranges provided by those insurers vary from as many as twelve (12) rating factors to as few as four (4) rating factors.

- 0.57%[4] of the market failed to respond to the data call.

- One insurer, Allstate Indemnity Company[5], which has a market share of 0.9%, did not report insurance score data. This was due to the fact that the rating method employed by Allstate Indemnity Company determines which rating factor an individual qualifies for based on the information contained in the individual's credit history as opposed to being used to generate a numeric score. As an example, an individual could be placed in a different rating factor depending on the number of "late payments" that may appear in that individual's credit history. A scoring model, however, looks at the number of late payments that may appear in the individual's credit history, along with other credit history information, assign varying degrees of weight to that information and generate an overall numeric score. Thus, the MIA was unable to incorporate this information into the current study.

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[2] See Exhibit 12 for a listing of those insurers who provided credit data in this format.
[3] See Exhibit 12 for a listing of those insurers who provided credit data in this format.
[4] See Exhibit 12 for a listing of those insurers who failed to respond to the data call.
[5] See Exhibit 13

- Two third-party credit vendors, ChoicePoint and Fair Isaac, were sent correspondence dated November 26, 2003 and asked to contribute to the study by December 22, 2003. Both responded by correspondence[6], dated December 19, 2003 and December 22, 2003 respectively, that they would not be able to provide the requested data.

C. Compilation of Data

The insurers' zip code data was separated into six designated regions in the state of Maryland. These regions are as follows: one region consisting of Anne Arundel, Carroll, and Howard Counties; the second region consisting of Baltimore City, Baltimore County and Harford County; the third region consisting of the Eastern Shore counties; the fourth region consisting of Prince George's and Montgomery Counties; the fifth region consisting of the Southern Maryland counties; and the sixth region consisting of the Western Maryland counties. The charts[7] for the noted regions provide a comparison of the percentage of minority households and income in relation to high credit scores by certain zip codes.

D. Comparison of the 2003 Credit Scoring Data to the 2002 Baltimore Metropolitan Credit Exhibit

The 2002 Baltimore Exhibit[8] was based upon credit scoring data provided by a third party vendor, Choice Point, and was limited to eight (8) zip codes located within the Baltimore Metropolitan Area. The credit scores contained in that Exhibit were developed from a credit scoring model that used credit history factors which were subsequently prohibited from use by insurers as a result of House Bill 521 which was passed during the 2002 legislative session. The 2002 Baltimore Exhibit appears to show a correlation exists between minority population, income and credit score. Thus, it appears to support the hypothesis that as the percentage of minority population increases and the percentage of households with incomes greater than $40,000 decreases, there is a corresponding decrease in the percentage of population with high credit scores.

The 2003 data was collected from those insurers who used credit models developed for them by a third-party vendor, ChoicePoint or Fair Isaac, or who used a proprietary credit model they developed. The insurers were requested to provide data for ninety-six (96) zip codes from six different regions in the state set out above. It is important to note that the credit score data that was provided came from credit models that did <u>not</u> employ the prohibited credit history factors. These prohibited factors preclude an insurer from using a credit model that considers the following in the generation of a credit score: factors in a credit history that occurred more than five (5) years prior to the issuance of a new

[6] See Exhibit 13
[7] See Exhibit 14
[8] See Exhibit 15

policy, the number of credit inquiries found in a credit history and the absence of a credit history or the inability to determine a credit history.

In order to determine if the use of credit has an adverse impact based on race or socio-economic status, it would be necessary to show that the same correlation which was found in the 2002 Baltimore Exhibit also was found in the 2003 Zip Code Exhibits reflecting the data collected from the various regions of the state.

Conclusion and Recommendations

The MIA supported the passage of HB 521 as a means to establish reasonable regulatory oversight of the use of credit history/scoring by insurers operating in Maryland. As discussed earlier, HB 521 established important public policy protections regarding the use of credit history by insurers. HB 521 is probably one of the most comprehensive laws in the country regarding the use of credit history by insurers for underwriting and rating homeowners' and private passenger insurance policies. Many of the concerns raised by insurance regulators, legislators, consumers, and insurance producers have been addressed by HB 521. For example, under HB 521 insurers must (1) disclose to applicants and insureds that credit history is used by the insurer; (2) review an insured's credit history upon renewal at least once every 2 years or, if requested by the insured, more frequently; and (3) disclose to the applicant at the time of the issuance of a policy that the insurer is required to review the credit history of an insured who was adversely impacted by the use of the insured's credit history at the initial rating of the policy. HB 521 specifically prohibits an insurer that rates a new policy based on the credit history of the applicant from (1) using a factor that occurred more than 5 years prior to the issuance of the new policy; (2) using the absence of credit history or the inability to determine the applicant's credit history; or (3) the number of credit inquiries about an applicant's credit history. In addition, an insurer is prohibited from canceling, refusing to underwrite, or refusing to renew or increase the renewal premium based on the credit history of the insured or applicant, and may not require a particular payment plan based on the credit score of the insured or applicant. In addition, Maryland regulations prohibit an insurer from pulling a credit report due to a person's race, color, creed, sex, or blindness.

At this time, there is insufficient data to conclusively determine whether the use of credit scoring by insurers has an adverse impact on low-income or minority populations. This is due, in part, to the fact that insurers do not collect information regarding an applicant's race or income. Also, no analysis regarding the correlation between credit scoring and other rating factors exits. In addition, neither race nor income is considered in the development of credit scoring models. Insurers and/or their third party vendors have revised their credit models to bring them into compliance with the 2002 legislation. Thus, it would be difficult to determine if legislation or some other factor(s) brought about the differences seen when comparing the 2002 Baltimore Exhibit and the 2003 Zip Code Exhibits.

It should be noted that there are a number of factors that may reduce the credibility of this 2003 study. For example, in some zip codes there were only a small number of policies to be included. Additionally, there were a large percentage of insurers that could not provide their data in a format which could be incorporated into this study. To date, no study has adequately answered the question of whether the use of credit history/scoring results in rates that are higher, or lower, on average for a protected class of consumers or for consumers with lower incomes.

The MIA has neither the data nor the information needed to reach a definitive conclusion regarding the impact of the use of credit scoring by insurers on low-income and minority populations. In addition, resources for a comprehensive study regarding the use of credit history by insurers are not currently available to the MIA. The MIA will continue to monitor the market based on consumer complaints, market conduct investigations and data collection by zip code in order to determine if the use of credit history, as permitted under Maryland law, has an adverse impact on low-income or minority populations. In addition, the MIA will be participating in a multi-state study initiated by the Missouri Department of Insurance to determine the impact of credit scoring on minorities and low-income populations.

A more thorough and reliable study is recommended before any definitive conclusions are drawn regarding the use of credit scoring and its impact on certain populations. If such a study were to be completed, the MIA believes that (1) a qualified independent consultant (i.e. not an insurer's group) should conduct the study; (2) insurers should be required to participate in the study; and (3) a funding mechanism for costs associated with the study should be established.

HOUSE BILL 521

Unofficial Copy
C4

2002 Regular Session
(2lr2309)

ENROLLED BILL

-- Economic Matters/Finance --

Introduced by **Delegates Krysiak ~~and Kirk~~, Kirk, Barve, Donoghue, Fulton, and Harrison**

Read and Examined by Proofreaders:

____
Proofreader.

____
Proofreader.

Sealed with the Great Seal and presented to the Governor, for his approval this _____ day of ____________ at ____________________ o'clock, _____M.

____
Speaker.

CHAPTER_______

AN ACT concerning

Property and Casualty Insurance - ~~Discrimination in Underwriting or Premium Increase - Credit History~~ Use of Credit History ~~- Prohibition~~

FOR the purpose of ~~prohibiting an insurer from refusing to underwrite a property and casualty insurance risk or increasing the premium because of the credit history of the applicant or named insured; and generally relating to discrimination in underwriting and increasing premiums for property and casualty insurance~~ ~~altering the termination date of certain provisions of law prohibiting an insurer from refusing to underwrite a certain insurance risk solely because of an applicant's or named insured's credit history and authorizing an insurer to request a certain finding; prohibiting an insurer from using the credit history of a certain applicant or insured, in whole or in part, to cancel, refuse to renew, or refuse to underwrite a certain insurance risk; prohibiting an insurer from using the credit history of a certain applicant or insured, in whole or in part, to rate a certain insurance risk in any manner; providing for the application of this Act~~ *prohibiting an insurer, with respect to homeowner's insurance, from refusing to* *underwrite, cancel, or refuse to renew a risk based on a certain credit history; prohibiting an insurer, with respect to homeowner's insurance, from rating a risk based on a certain credit history; prohibiting an insurer, with respect to homeowner's insurance, from requiring a particular payment plan based on a certain credit history; prohibiting an insurer, with respect to private passenger motor vehicle insurance, from refusing to underwrite, cancel, refuse to renew, or increase the renewal premium based on a certain credit history; prohibiting an insurer, with respect to private passenger motor vehicle insurance, from requiring a particular payment plan based on a certain credit history; authorizing a certain insurer to use the credit history of a certain applicant in a certain manner; providing that rating includes certain practices; prohibiting an insurer, with respect to private passenger motor vehicle insurance, from using a certain factor on a certain credit history; requiring a certain insurer to advise a certain applicant about a certain credit history; prohibiting an insurer from using certain factors in rating a certain policy; requiring an insurer to disclose to a certain applicant certain information about a certain credit history; allowing a certain insurer to provide an actuarially justified discount in the rate or a surcharge in the rate; defining a certain term; requiring the Insurance Commissioner to conduct a certain study to be reported by a certain date; providing for the application of the Act; providing for the termination of certain provisions of this Act*; and generally relating to ~~prohibiting~~ the use of credit history in the underwriting or rating of personal lines property and casualty insurance.

BY repealing and reenacting, ~~with~~ *without* amendments,
Chapter 576 of the Acts of the General Assembly of 1998
Section 3

BY ~~repealing and reenacting, with amendments,~~ *adding to*
Article - Insurance
Section 27-501~~(e)~~ *(e-1)*
Annotated Code of Maryland
(1997 Volume and 2001 Supplement)
(As enacted by Chapter 576 of the Acts of the General Assembly of 1998)

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Chapter 576 of the Acts of 1998

SECTION 3. AND BE IT FURTHER ENACTED, That this Act shall take effect October 1, 1998. It shall remain effective for a period of [4] ~~3~~ years ~~AND 9 MONTHS~~ and, at the end of [September] ~~JUNE~~ 30, 2002, with no further action required by the General Assembly, this Act shall be abrogated and of no further force and effect.

Article - Insurance

27-501.

~~(e)~~ ~~(1)~~ ~~An insurer may not refuse to underwrite a private passenger motor vehicle insurance risk solely because the applicant or named insured previously obtained insurance coverage from any authorized insurer or the Maryland Automobile Insurance Fund.~~

~~(2)~~ ~~AN INSURER MAY NOT REFUSE TO UNDERWRITE A PROPERTY AND CASUALTY INSURANCE RISK OR INCREASE THE PREMIUM BECAUSE OF THE CREDIT HISTORY OF THE APPLICANT OR NAMED INSURED.~~

~~(2)~~ ~~AN INSURER MAY NOT USE THE CREDIT HISTORY OF AN APPLICANT OR INSURED, IN WHOLE OR IN PART:~~

~~(I)~~ ~~TO CANCEL, REFUSE TO RENEW, OR REFUSE TO UNDERWRITE A PERSONAL LINES PROPERTY AND CASUALTY INSURANCE RISK; OR~~

~~(II)~~ ~~TO RATE A PERSONAL LINES PROPERTY AND CASUALTY INSURANCE RISK IN ANY MANNER, INCLUDING:~~

~~1.~~ ~~THE PROVISION OR REMOVAL OF A DISCOUNT;~~

~~2.~~ ~~ASSIGNING THE INSURED OR APPLICANT TO A RATING TIER; OR~~

~~3.~~ ~~PLACING AN INSURED OR APPLICANT WITH AN AFFILIATED COMPANY.~~

(E-1) *(1)* *IN THIS SUBSECTION "CREDIT HISTORY" MEANS ANY WRITTEN, ORAL, OR OTHER COMMUNICATION OF ANY INFORMATION BY A CONSUMER REPORTING AGENCY BEARING ON A CONSUMER'S CREDITWORTHINESS, CREDIT STANDING, OR CREDIT CAPACITY THAT IS USED OR EXPECTED TO BE USED, OR COLLECTED IN WHOLE OR IN PART, FOR THE PURPOSE OF DETERMINING PERSONAL LINES INSURANCE PREMIUMS OR ELIGIBILITY FOR COVERAGE.*

(2) *WITH RESPECT TO HOMEOWNER'S INSURANCE, AN INSURER MAY NOT:*

(I) *REFUSE TO UNDERWRITE, CANCEL, OR REFUSE TO RENEW A RISK BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF AN APPLICANT OR INSURED;*

(II) *RATE A RISK BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF AN APPLICANT OR INSURED IN ANY MANNER, INCLUDING:*

1. *THE PROVISION OR REMOVAL OF A DISCOUNT;*

2. *ASSIGNING THE INSURED OR APPLICANT TO A RATING TIER; OR*

3. PLACING AN INSURED OR APPLICANT WITH AN AFFILIATED COMPANY; OR

(III) REQUIRE A PARTICULAR PAYMENT PLAN BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF THE INSURED OR APPLICANT.

(3) (I) WITH RESPECT TO PRIVATE PASSENGER MOTOR VEHICLE INSURANCE, AN INSURER MAY NOT:

1. REFUSE TO UNDERWRITE, CANCEL, REFUSE TO RENEW, OR INCREASE THE RENEWAL PREMIUM BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF THE INSURED OR APPLICANT; OR

2. REQUIRE A PARTICULAR PAYMENT PLAN BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF THE INSURED OR APPLICANT.

(II) 1. AN INSURER MAY, SUBJECT TO PARAGRAPHS (4) AND (5) OF THIS SUBSECTION, USE THE CREDIT HISTORY OF AN APPLICANT TO RATE A NEW POLICY OF PRIVATE PASSENGER MOTOR VEHICLE INSURANCE.

2. FOR PURPOSES OF THIS SUBSECTION, RATING INCLUDES:

A. THE PROVISION OR REMOVAL OF A DISCOUNT;

B. ASSIGNING THE APPLICANT TO A RATING TIER; OR

C. PLACING AN APPLICANT WITH AN AFFILIATED COMPANY.

(4) WITH RESPECT TO PRIVATE PASSENGER MOTOR VEHICLE INSURANCE, AN INSURER THAT RATES A NEW POLICY BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF THE APPLICANT:

(I) MAY NOT USE A FACTOR ON THE CREDIT HISTORY OF THE APPLICANT THAT OCCURRED MORE THAN 5 YEARS PRIOR TO THE ISSUANCE OF THE NEW POLICY;

(II) 1. SHALL ADVISE AN APPLICANT AT THE TIME OF APPLICATION THAT CREDIT HISTORY IS USED; AND

2. SHALL, ON REQUEST OF THE APPLICANT, PROVIDE A PREMIUM QUOTATION THAT SEPARATELY IDENTIFIES THE PORTION OF THE PREMIUM ATTRIBUTABLE TO THE APPLICANT'S CREDIT HISTORY;

(III) MAY NOT USE THE FOLLOWING FACTORS IN RATING THE POLICY:

1. THE ABSENCE OF CREDIT HISTORY OR THE INABILITY TO DETERMINE THE APPLICANT'S CREDIT HISTORY; OR

2. THE NUMBER OF CREDIT INQUIRIES ABOUT AN APPLICANT'S CREDIT HISTORY;

(IV) 1. SHALL REVIEW THE CREDIT HISTORY OF AN INSURED WHO WAS ADVERSELY IMPACTED BY THE USE OF THE INSURED'S CREDIT HISTORY AT THE INITIAL RATING OF THE POLICY:

A. EVERY 2 YEARS; OR

B. ON REQUEST OF THE INSURED; AND

2. SHALL ADJUST THE PREMIUM OF AN INSURED WHOSE CREDIT HISTORY WAS REVIEWED UNDER THIS SUBPARAGRAPH TO REFLECT ANY IMPROVEMENT IN THE INSURED'S CREDIT HISTORY; OR

(V) SHALL DISCLOSE TO THE APPLICANT AT THE TIME OF THE ISSUANCE OF A POLICY THAT THE INSURER IS REQUIRED TO:

1. REVIEW THE CREDIT HISTORY OF AN INSURED WHO WAS ADVERSELY IMPACTED BY THE USE OF THE INSURED'S CREDIT HISTORY AT THE INITIAL RATING OR UNDERWRITING OF THE POLICY:

A. EVERY 2 YEARS; OR

B. ON REQUEST OF THE INSURED; AND

2. ADJUST THE PREMIUM OF AN INSURED WHOSE CREDIT HISTORY WAS REVIEWED TO REFLECT ANY IMPROVEMENT IN THE INSURED'S CREDIT HISTORY.

SECTION 2. AND BE IT FURTHER ENACTED, That the Laws of Maryland read as follows:

Article - Insurance

27-501.

(E-1) (5) WITH RESPECT TO PRIVATE PASSENGER MOTOR VEHICLE INSURANCE, AN INSURER THAT RATES A NEW POLICY BASED, IN WHOLE OR IN PART, ON THE CREDIT HISTORY OF THE APPLICANT MAY, IF ACTUARIALLY JUSTIFIED, PROVIDE A DISCOUNT OF UP TO 40% OR IMPOSE A SURCHARGE OF UP TO 40%.

SECTION 3. AND BE IT FURTHER ENACTED, That the Maryland Insurance Commissioner shall conduct a study on whether the use of credit scoring in the State has an adverse impact on any demographic group defined by race or socio-economic status. In conducting the study, the Commissioner shall consult with representatives of the property and casualty insurance industry, insurance producer organizations, consumer organizations, consumer reporting agencies, and any other person that the Commissioner considers necessary to assist the Commissioner in conducting the study. The Commissioner shall also study the impact of premium rates on policies issued by the Maryland Automobile Insurance Fund on the insurance market. The Commissioner shall report on the results of these studies to the Governor and, in *accordance with § 2-1246 of the State Government Article, the General Assembly, on or before January 1, 2004.*

SECTION ~~2.~~ *4.* AND BE IT FURTHER ENACTED, That this Act shall apply to all personal lines property and casualty insurance policies and contracts issued, delivered, or renewed on or after ~~July~~ *October* 1, 2002.

SECTION 5. AND BE IT FURTHER ENACTED, That Section 2 of this Act shall take effect October 1, 2002. Section 2 of this Act shall remain effective for a period of 2 years and, at the end of September 30, 2004, with no further action required by the General Assembly, Section 2 of this Act shall be abrogated and of no further force and effect.

SECTION ~~2.~~ ~~3.~~ *6.* AND BE IT FURTHER ENACTED, That this Act shall take effect ~~October 1, 2002~~ ~~July~~ *October* 1, 2002.