**Docket G2002-15**
**Proposed 211 C.M.R. 100.00**
**The Use of Credit Information in Rating Personal Lines Insurance**

**Testimony of Birny Birnbaum**
**On Behalf of the Center for Economic Justice[1]**

**July 11, 2003**

The Center for Economic Justice objects to the proposed regulation. The proposed regulation does little, if anything, to protect consumers from the unfair and arbitrary practice of insurance credit scoring. Rather, we urge the Commissioner to prohibit insurers' use of insurance credit scoring because the practice violates the unfair discrimination rate standard. In addition, we urge the Commissioner to reject insurers' use of credit scoring because it:

- is inherently unfair;
- has a disproportionate impact on consumers in poor and minority communities;
- penalizes consumers for rational behavior and sound financial management practices;
- violates actuarial standards for risk classification;
- undermines rate regulation; and
- undermines the basic insurance mechanism and public policy goals for insurance.

Let me preface my remarks by saying that there are hundreds of agents who want to come before you and tell you why they are opposed to credit scoring, why credit scoring has worsened insurance availability and how credit scoring has a disproportionate impact on poor and minority consumers. But they won't be here today because of their fear of reprisal by the insurance companies they represent. If you want to hear from these agents, you need to give them protection against these reprisals. To give you a sense of who these agents are, the following agent organizations have come out against credit scoring – National Association of State Farm Agents, National Association of Professional Allstate Agents and the United Farmers Agents Association.

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[1] CEJ is a Texas 501(c)3 non profit organization that advocates on behalf of low income consumers on insurance, credit and utility matters. CEJ seeks to improve the availability and affordability of basic goods and services to low income consumers. Birny Birnbaum, CEJ's Executive Director, has extensive experience with credit scoring, having worked on the issues for 12 years as an insurance regulator (Associate Commissioner for Policy and Research and Chief Economist at the Texas Department of Insurance) and as a consulting economist to consumer organizations and public agencies. A more detailed description of his experience is attached.

**Problems with Insurance Credit Scoring Warrant a Prohibition**

Credit scoring is inherently unfair because it penalizes consumers who are the victims of economic or medical catastrophes, such as job loss, divorce, dread disease or terrorist attack. For example, in the aftermath of the September 11 attack, hundreds of thousands of people working in the travel-related industry lost their jobs. Out of this group, thousands had to increase borrowing to offset loss of income or loss of health insurance. Many filed for bankruptcy. It is unfair for insurance companies to further penalize these victims by raising their homeowners and auto insurance rates.

Credit scoring is inherently unfair because a good credit history does not equal a good credit score or favorable insurance treatment. This occurs because insurance credit scores are based not just on bankruptcies and delinquencies, but also on other factors unrelated to credit management. For example, credit scores are often based on the type of credit (consumer finance loans are less favorable than bank loans), the number of credit cards (there is a magic number that is optimal, even if the consumer only uses the retail store cards once to get the first time 10% purchase discount), length of time credit has been established (which is another way of charging younger people more), length of time since last account opened (which penalizes families that have just moved or refinanced their mortgage) and the number of inquiries (which penalizes consumers who shop around for the best rate – behavior that should be rewarded and not punished with higher insurance rates.) While the insurance industry offers a rationale for each of these factors, the fact is that credit scoring casts too wide a net and penalizes people engaged in behavior we would all consider good financial management.

Credit scoring is unfairly discriminatory and violates actuarial standards for risk classification because it is an arbitrary process. For example, your score can vary from very bad ("high risk") to very good ("low risk") depending on which credit reporting agency provides the credit information to the insurer because a consumer's information varies among the big three bureaus. A representative from ChoicePoint admitted this in a hearing before the Georgia Insurance Commissioner in 2001. I recently ordered my three-bureau credit report and found different inquiries in each of the three bureaus – not one single inquiry was reported by more than one bureau.

Credit scoring is arbitrary because a score can change dramatically over a short time frame for no apparent reason. My auto credit score in November 2002 (obtained from www.choicetrust.com) was very low – around the 17th percentile. When I check my score again in May 2003, I was now in the 82nd percentile. In six months (or perhaps a shorter period), my score went from very high risk to very low risk. No other insurance risk factor is so arbitrary.

In addition to being arbitrary, credit scoring also has a systematic bias against consumers in poor and minority communities, described further below. It is important to state clearly that the claim that credit scoring has a disproportionate impact on consumers in poor and minority communities is NOT an argument that poor people are poor financial managers. The two arguments are unrelated because good financial management / good

credit history does NOT equate to a good insurance credit score. It is the structure of insurance credit scoring models – and not the financial management habits of low-income consumers – that creates the bias against consumers in poor and minority communities. Further, it is unclear how anyone who has actually examined the factors and structure of credit scoring models could legitimately assert that the claim of systematic bias against consumers in poor and minority communities is a critique of the financial management habits of low-income consumers.

Credit scoring undermines the basic insurance mechanism and thwarts insurance public policy. Insurance is fundamentally a social mechanism designed to protect consumers from catastrophic loss – either as victims of a catastrophic event, such as a home fire or being hit by another driver, or as citizens who are responsible for causing an automobile accident. Insurance is essential for protecting consumers' most valuable assets and health. Consequently, insurance public policy goals include universal coverage and loss prevention. The public policy of universal coverage is reflected in automobile financial responsibility laws that seek to ensure that all drivers, through insurance, can make whole the victims of an accident. And insurance is a de facto requirement for all homeowners borrowing money to pay for the home. As a society, we have an interest in insurance availability and affordability – and also in loss prevention. It is through the insurance mechanism that consumers are presented economic incentives to pursue less risky behavior (such as discounts installing theft prevention devices and taking driver training courses) and economic disincentives for risky behavior (such as surcharges for speeding or poorly maintained properties).

Credit scoring undermines the basic insurance public policy goals because it worsens insurance availability and affordability for those consumers who already have a difficult time with insurance costs. As described further below, credit scoring has a disproportionate impact on poor consumers and raises costs for all consumers. Credit scoring has no loss prevention capability. Since credit scoring does not result in any reduction in claims – unlike an anti-theft device which reduces theft claims – insurers must pay for discounts to some consumers with surcharges for other consumers. Good insurance public policy should require insurers to use risk classification factors that promote loss prevention and should prohibit risk factors that ignore loss prevention and/or create insurance availability problems. Credit scoring is the poster child for the type of risk classification factor that should be prohibited as contrary to public policy.

Credit scoring undermines the basic insurance risk spreading mechanism because it enables insurers to develop virtually unlimited market segmentation. For example, a recent Progressive filing in Florida introduces a 'continuous underwriting model'. Instead of 7 final price points or market levels, this model uses a finer segmentation of credit score to arrive at 126 different rate levels. This represents a market failure. While rational from the insurer perspective, market forces do not produce – via the invisible hand – the core public policy goals sought by the Legislature and the public.

## Inherently Unfair

### Penalizes Victims of Economic, Medical or Other Catastrophes

- Majority of bankruptcies caused by economic or medical catastrophe or divorce.
- Penalize victims of job loss, catastrophic illness, terrorist attack, identify theft
- Unrelated to financial responsibility

### Arbitrary Results for Consumers

- Variation by Credit Bureau
- Timing of Credit Report
- Data Quality
- Illogical Factors
- Score Manipulation
- Variations by Geographic Regions
- Unrelated to Financial Responsibility

### Penalizes Consumers for Lenders' Business Decisions

- Abusive Marketing to College Students
- Growth in Card Offers, Available Credit, Teaser Rates
- Selective Reporting of Credit Transaction Information
- Unrelated to Financial Responsibility

## Biased Against Consumers in Poor and Minority Communities

Admission by McCorkell of Fair, Isaac

Freddie Mac Study of Credit by Race

*Statistical Abstract* Data

University of Texas BBR Study

Nature of Information in Credit History and Information Omitted

Agents' Experience

Penalizes Consumers for Good Financial Management and Rational Behavior

Penalties for Debt Consolidation

Penalties for 10% Initial Use Discount

Penalties for Using 0% Rates

Penalties Using One Card

Penalties for Not Borrowing

Penalties for Shopping Around for Best Rates

Undermines Regulatory Oversight of Insurers

Use Underwriting and Multiple Tiers to Avoid Rate Oversight

Growing Use of Third Party Black Boxes

Undermines the Fundamental Insurance Mechanism, Insurance Public Policy Goals

Moves from Risk Spreading to Pay-As-You-Go

Creates Availability and Affordability Problems

Negates the Critical Loss Prevention Role of Insurance

**Bottom Line:** Problems with credit scoring are apparent and even acknowledged by the industry, as evidenced by their "compromise" proposal with a variety of purported restrictions and regulatory oversight. But what are the great benefits to consumers that warrant the use of this problematic factor and intense regulatory resources? Ultimately, there are none. Moreover, all the benefits alleged by the insurance industry come down to one claim – the purported statistical relationship between credit scores and loss ratios.

**Insurer Misinformation about Credit Scoring**

Insurers have provided a tremendous amount of misinformation in the credit scoring debate.

*"The majority of consumers benefit from credit scoring."*

This is perhaps the most insidious argument because it contains an implied threat to regulators and legislators – don't mess with credit scoring or insurers will raise rates and blame regulators and legislators. However, the facts show that the majority of consumers do not benefit and that all consumers lose. First, my own research shows that 50% or fewer consumers actually get a discount. Attached please find a good example of how one insurer – Farmers had to double the base rates to pay for credit scoring discounts and that even consumers who got a 40% "discount" paid more after credit scoring than before. Because credit scoring has no ability to reduce claim costs, there is no free lunch. Beware of proposals to allow insurers to offer only discounts – consumers are not protected from credit-based rate increases.

Second, there is no guarantee that today's beneficiaries will be tomorrow's beneficiaries. An insurer can change the cutoff score for a discount and change the percentages of who benefits.

Third, why is this argument relevant? The issue is whether credit scoring is an unfair practice and counter to insurance public policy goals. It is profoundly un-American to justify an unfair practice because the (alleged) majority benefits.

Fourth, insurance credit scoring raises the costs for everyone. There is no reduction in insurance claims, but there is an increase in insurance administrative costs to pay for developing or licensing the scoring model, for obtaining the credit history and for complying with the Fair Credit Reporting Act adverse action notice requirements. Further, because credit scoring has such major rate impacts, particularly on poor consumers, the number of uninsured grows with credit scoring. Consumers pay more with greater numbers of uninsured drivers – higher uninsured motorist rates and higher taxes to pay for emergency room services for uninsured drivers.

*"We can write more business with credit scoring."*

If this were the case, why are major agents groups opposed to credit scoring? Groups like the National Association of State Farm Agents, the National Association of Professional Allstate Agents and, the United Farmers Agents Association have called for a prohibition on credit scoring. My research has shown an increase in auto insurance residual markets in the past few years.

*"There is a statistical correlation between credit scores and loss ratios."*

Since at least 1995, when the National Association of Insurance Commissioners (NAIC) started examining credit scoring, the key issue has not been whether there is a simple correlation between credit scores and loss ratios, but whether credit scores are a proxy for other factors already used by insurers or a proxy for prohibited factors such as race and income.

Interestingly, the industry has started to cite a study by the University of Texas Bureau of Business Research as providing "definitive" evidence on the correlation of credit to loss. I am well acquainted with this UT report and can provide the following facts. First, the study failed to effectively address the question of correlation to loss because the authors relied upon a methodology that the NAIC working group dismissed in 1996 as being "counterproductive and misleading." Second, the study did show that credit is a proxy for other factors already used by insurers. This study looked at policies issued before insurers started using credit and found that the average score in the standard and preferred (low risk) market were much higher than the average score in the nonstandard (high risk market). Because the policies examined were from a period before insurers used credit, the difference in average scores shows that credit replicates other underwriting factors already used by insurers. Third, my own research shows that the likelihood of being placed in the nonstandard market is very highly correlated with race and income, indicating that credit scores are, in turn, biased against poor and minority consumers.

Beyond the technical problems with the correlation argument is the bigger policy issue – why should a simple correlation be sufficient justification for the use of a consumer characteristic as a rating factor? From the insurers' perspective, anything that allows them to further segment the market is good. But from a public policy perspective, why would we want insurers to use your check writing habits as the basis for pricing your insurance? If insurers found a correlation between eye color and risk of loss, should that be allowed?

The Big Lie: "Credit Scoring Rewards Financially Responsible Consumers"

"There is a Statistical Relationship Between Credit History and Risk of Loss"

"Most Consumers Benefit"

"More Accurate Pricing Means More Insurance Sold"

"Assessment of Risk is Essence of Insurance. Eliminating scoring will create unfair subsidies."

"Ban will make it more difficult to assess risk and therefore make insurance more expensive and difficult to get."

"Ban Will Harm the Market"

"Models are Color Blind"

"NCOIL Model is a balanced Compromise"

"We only offer Discounts"

"Use of Credit Promotes Competition"

"A Ban on Credit Scoring Puts Independent Agency Companies at a Competitive Disadvantage."

**The Commissioner Should Prohibit Insurance Credit Scoring Because It Violates the Unfair Discrimination Rate Standard**

The Commissioner is required to disapprove rates that excessive, inadequate or unfairly discriminatory. A rate is unfairly discriminatory if consumers with the same expected risk of loss are treated differently. Stated in another way, different treatment for two similarly situated consumers is unfair discrimination.

For the sake of argument and demonstration that insurance credit scoring is unfairly discriminatory, we will assume consumers with identical credit characteristics and otherwise identical underwriting rating characteristics have the same expected risk of loss. So if consumers with otherwise identical risk characteristics have identical credit characteristics, we will assume that these two consumers have the same expected risk of loss. This assumption is consistent with insurer claims of a statistical relationship between credit scores and risk of loss.

Credit scoring is unfairly discriminatory because these two consumers can be treated differently – differences in offers of insurance and/or rates – for many reasons related to the nature of credit scoring:

1. Because of differences in credit information across the three main credit reporting agencies, the two consumers could be assigned significantly different credit scores – and consequently be treated differently – depending upon which credit reporting agency the consumers' credit reports are obtained from.
2. Because of differences in credit information at different points in time, including differences of a few days or a few weeks, the consumers could be treated differently depending upon when their credit reports were obtained.
3. Because the same medically-related delinquencies may show up with a medical code or may show up without a medical code (e.g., as a credit card delinquency), the consumers may be treated differently depending upon how their medically-related bankruptcy or delinquency appears in the credit report.

These are just three examples of how the arbitrary nature of credit scoring leads to unfair discrimination. Even if we assume the insurer clam of an overall correlation between credit and risk of loss, the fact that a broad correlation exists does not eliminate the possibility of unfair discrimination because of arbitrary application of the rating factor. The arbitrary nature of credit scoring, as described above, violates actuarial standards for risk classification and violates the unfair discrimination rate standard.

**Statutory Authority for Proposed Regulations**

The statutory authority cited for the proposed regulations does not provide authority for the proposed regulation. The cited statutes provide the Commissioner with authority to promulgate statistical plans for the collection of data related to review of rates. The proposed regulation does not even include any provision for amending statistical plans for credit scoring data elements. The Commissioner does not have the statutory authority, at least pursuant to the cited statutes, to promulgate the proposed regulation. Rather, the Commissioner has the authority to completely prohibit the use of credit scoring because it is an unfairly discriminatory practice and, therefore, violative of the rate standards the Commissioner must enforce.

**The Proposed Regulation Fails to Provide Meaningful Consumer Protections**

Any effort to provide meaningful consumer protections must include the following provisions, all of which are missing from the proposed regulation. This list is not exhaustive.

1. <u>The use of credit scoring is prohibited for conditioning payment plan eligibility.</u> Payments plans are an essential tool for making insurance available to consumers by making insurance affordable to consumers. Insurers who require full policy payment up front are denying coverage to large numbers of insurers. Payment plan eligibility should be conditioned only a consumers' payment history with the insurer offering the policy. There is no reason to use credit scores for payment plan eligibility. Insurance scores, in theory, predict risk of loss and not likelihood of making a payment. Insurers stress this repeatedly in their efforts to distinguish lending credit scoring from insurance credit scoring. Further, even a lending credit score is irrelevant for insurance because the insurer is never in a position to provide coverage without payment. The proposed regulation does not address the use of credit information to condition payment plan eligibility.

2. <u>An adverse action should be defined as any underwriting, tier placement or rating activity that results in an insurer failing to offer the most favorable terms of coverage and premium to a existing policyholder or new applicant who, if he or she had a more favorable consumer credit report, would have been eligible for the more favorable treatment.</u> The proposed regulation fails to address insurer's abuse of the FCRA's adverse action language – the failure to provide adverse action notices to most or all new business applicants who failed to receive more favorable terms of

coverage and rates because of the insurers' consideration of the consumer credit report. Insurers have mistakenly and inappropriately relied upon the "increase in any charge" language of the FCRA to argue that new customers cannot suffer an adverse action because there can be no increase in a charge for that consumer.

For purposes of this regulation an "adverse determination" includes, but is not limited to, the following situations:

a. An offer of insurance in an insurance company that is affiliated with an insurance company with lower rates, if the consumer does not qualify for coverage in the lower-rated insurance company because of the consumer's credit score. The lower-rated insurance company has taken an adverse action.

b. An offer of insurance in an insurance company by an independent agent who also represents an insurance company with lower rates, if the consumer does not qualify for coverage in the lower-rated insurance company because of the consumer's credit score. The lower-rated insurance company has taken an adverse action.

c. An offer of insurance at a premium or rate that is higher than the premium or rate the consumer would pay if the consumer had the best possible credit score, all other factors being the same. The company charging the higher premium or rate has taken an adverse action.

3. Insurance scores should be defined as numerical or categorical designations because some insurers simply develop assign credit tiers or categories instead of an actual credit score.

4. The scoring models should be filed with the Division of Insurance and be public information. In this way, credit scoring would be treated like any other rating factor used by insurers – the factor is part of a rate filing and the filing is public information. Allowing insurers to keep credit scoring models secret would be like allowing the Insurance Services Office to hide both the derivation of its loss costs and the loss costs themselves because ISO claimed the analytic model and output as a trade secret. No insurance regulator would permit such an action by ISO, yet the proposed regulation contemplates the same type of secrecy for credit scoring models. Further, the trade secret claim made insurers and vendors for the various credit scoring models is without merit. In some states, insurers and vendors file credit scoring models and the models are public information. Yet, the insurers and vendors file the models and use them in those states, demonstrating that public availability of the models does not put one insurer at a competitive disadvantage to other insurers. In addition, by not making the models public information, the only people who don't know what is in the models are consumers. Any insurer who has worked with or used credit scoring models – and certainly the insurers who have

developed their own models – knows what credit characteristics go into the models. There will be no great revelation among insurers by making the models public information – only enlightenment of consumers.

5. The relevant statistical plans should be amended to capture credit scoring information. The statistical plans based on transaction-detail reporting should add two data fields – one for the raw credit score for the consumer and another for the credit score category or tier assigned to the consumer based on the raw score. The collection of statistical data that includes credit scoring information is necessary for the Commissioner to fulfill her responsibility of enforcing rate standards and is both authorized and required by the statistical plan statutes cited as authority for the proposed regulation. Further, the Commissioner should collect and analyze statistical data that includes credit scoring data elements prior to approving insurers' use of credit scoring. It is only in this manner that the Commissioner can perform an independent analysis of the statistical relationship of credit scoring to risk of loss that fully accounts for interrelationship of credit scoring with all other rating factors. See attachment for discussion of statistical plans.

6. The statistical justification for the use of credit scoring should specify that a simple loss ratio analysis is not acceptable and that a multivariate analysis that analyzes credit simultaneous and explicitly with all other known rating factors be required. See attached detailed discussion in the review of the University of Texas Bureau of Business Research Study.

7. Consideration in credit scoring models of the following types of credit information should be prohibited: inquiries, length of time credit has been established, type of lender, vehicle service accounts, the number of credit cards. The use of inquiries should be prohibited because the number of inquiries can be unrelated to efforts by a consumer to increase his or her credit amounts. For example, inquiries occur when a consumer sets up new telephone, cell phone or utility service. Inquires occur when a consumer gets a new credit card with a 0% teaser rate to transfer current debt. Inquiries occur when a consumer shops around for the best auto loan rate, the best insurance rate, the best mortgage refinancing rate. A statistical relationship between inquiries and risk of loss is insufficient justification for the use of inquiries because of how unrelated an inquiry can be to expanding a consumer's debt load. Length of time credit has been established should be prohibited because it is a proxy for age. Type of lender should be prohibited because it discriminates against consumers who live in neighborhood where the primary financial institution is a consumer finance company and not a bank branch. Vehicle service accounts – consumers are penalized if they have, say, a credit card for a tire store – should be prohibited because a consumer should not be penalized for having an account with a tire store. The number of credit cards should be prohibited because the credit evaluation should focus on management of actual debt, not on the fact that a consumer has a large number of cards that were used once and never again. As the models are made available to the public, this list may grow.

8. Insurers should be required to obtain and use a three-bureau merged credit report in developing credit scores. Consumers should not be penalized because of differences in credit information maintained by the different bureaus.

9. Insurers should be required to confirm the consumer's credit score two weeks after the initial credit score. Consumers should not be penalized because credit scores can depend upon the point in the credit card cycle that the credit report is generated.

10. Consumers should be provided with their credit score, the list of factors included in the credit score, the consumers' value for each of the factors and optimal value for each of the factors. It is only through the provision of this information that a consumer can meaningfully understand the insurer's credit evaluation and check the credit report for errors of commission and omission. The provision of reason codes is simply inadequate information for a consumer to understand an adverse action and review the credit report for errors and omissions.

11. Insurers should be prohibited from penalizing a consumer for a collection account or delinquency report resulting from a catastrophic or life event and should be required to establish a procedure for consumers to inform the insurer of such events. There must be greater consumer protection that a prohibition against consideration of collection accounts or delinquency reports identified with a medical industry code. This is insufficient protection for consumers who are the victims of a medical catastrophe because most medically-related delinquencies or collection accounts are not coded as medical industry. Rather, a consumer will likely pay medical bills with either a credit card or other form of credit and the collection or delinquency will show up on these other types of credit. The proposed regulation should prohibit insurers from considering collection accounts or delinquency reports resulting from a catastrophic event and provide the consumer with a procedure to inform the insurer about such events. For example, something along the lines of:

    EFFECT OF EXTRAORDINARY EVENTS.

    (a) Notwithstanding any other law, an insurer shall, on written request from an applicant for insurance coverage or an insured, provide reasonable exceptions to the insurer's rates, rating classifications, or underwriting rules for a consumer whose credit information has been directly influenced by a catastrophic illness or injury, by the death of a spouse, child, or parent, by temporary loss of employment, by divorce, or by identity theft. In such a case, the insurer may consider only credit information not affected by the event or shall assign a neutral credit score.

    (b) An insurer may require reasonable written and independently verifiable documentation of the event and the effect of the event on the person's credit before granting an exception. An insurer is not required to consider repeated events or events the insurer reconsidered previously as an extraordinary event.

(c) An insurer may also consider granting an exception to an applicant for insurance coverage or an insured for an extraordinary event not listed in this section.

12. There should be a collar on the rate impact of credit scoring. There should be a maximum percentage differential of 25%, for example, between the rates (including consideration of rating tiers) for two consumers with, respectively, the best and the worst credit scores and with otherwise identical underwriting and rating characteristics. Credit scoring should not have greater impact on premiums than factors providing loss prevention incentives to consumers.

13. Insurers who use credit scoring should be required to file the following information with their credit scoring underwriting and rating plan:

    a. Any underwriting guidelines or tier placement guidelines based in whole or in part on consumer credit information;

    b. A complete description of any rating factor based in whole or in part on consumer credit information;

    c. A multivariate analysis of the relationship between credit and expected losses and which simultaneously considers the impact of all other rating, tier placement and underwriting factors on expected losses.

    d. An analysis of the expected impact on consumers of the insurer's use of consumer credit information, including the number of consumers paying less and the number of consumers paying more for insurance when consumer credit information is used compared to when consumer credit information is not used by the insurer. The analysis shall also include the number of consumers moving from one rating tier to another because of the insurer's use of consumer credit information.

    e. A report of the number of consumers in each credit score category used by the insurer by ZIP Code.

    With this information, the Commissioner and the public will be able to analyze the impact of credit scoring on insurance markets.

**Qualifications of Birny Birnbaum**

Birny Birnbaum is a consulting economist whose work focuses on community development, economic development and insurance issues. Birny has served as an expert witness on a variety of economic and actuarial insurance issues in California, New York, Texas and other states. Birny serves as an economic adviser to and Executive Director for the Center for Economic Justice, a Texas non-profit organization, whose mission is to advocate on behalf on low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance. Birny has authored reports on insurance markets, insurance credit scoring, insurance redlining and credit insurance abuses for CEJ and other organizations. Birny serves on the NAIC Consumer Board of Trustees.

Birny has worked on insurance credit scoring issues for 12 years as both an insurance regulator and consumer advocate. Birny has recently authored a report on insurance credit scoring for the Ohio Civil Rights Commission and served on the Florida Insurance Commissioner's Task Force on Credit Scoring.

Birny served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Birny provided technical and policy advice to the Commissioner of Insurance and performed policy research and analysis for the Department on a variety of topics. His particular areas of insurance expertise include:

- Homeowners and Automobile Insurance Availability and Affordability
- Evaluation of Underwriting and Rating Factors, including Credit Scoring
- Data Strategy, Collection and Analysis
- Analysis of Insurance Markets and Availability
- Review of Rate Filings and Rate Analysis
- Loss Prevention/Cost Drivers
- Regulatory Policy and Implementation

Prior to coming to the Department, Birny was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issues. OPIC is a Texas State agency whose mission is to advocate on behalf of insurance consumers. Prior to OPIC, Birny was a consulting economist working on community and economic development projects. Birny also worked as business and financial analyst for the Port Authority of New York and New Jersey. Birny was educated at Bowdoin College and the Massachusetts Institute of Technology.

**Actual Impact of Credit Scoring -- Farmers in Ohio**

| Code | Policies | Factor | Discount | Rate Before Credit Scoring | Rate After Credit Scoring | Rate Increase After Base Rate Change | | |
|---|---|---|---|---|---|---|---|---|
| E, N | 3,054 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| Z | 661 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| Y | 594 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| X | 740 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| W | 1,038 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| V | 1,326 | 1 | 0% | $100 | $200.50 | Yes | | 100.5% |
| U | 1,652 | 0.75 | 25% | $100 | $150.38 | Yes | | 50.4% |
| T | 1,992 | 0.75 | 25% | $100 | $150.38 | Yes | | 50.4% |
| S | 2,385 | 0.75 | 25% | $100 | $150.38 | Yes | | 50.4% |
| R | 2,635 | 0.75 | 25% | $100 | $150.38 | Yes | | 50.4% |
| Q | 2,884 | 0.75 | 25% | $100 | $150.38 | Yes | | 50.4% |
| P | 3,186 | 0.6 | 40% | $100 | $120.30 | Yes | | 20.3% |
| O | 3,852 | 0.6 | 40% | $100 | $120.30 | Yes | | 20.3% |
| L | 4,236 | 0.6 | 40% | $100 | $120.30 | Yes | | 20.3% |
| K | 5,196 | 0.6 | 40% | $100 | $120.30 | Yes | | 20.3% |
| J | 6,030 | 0.6 | 40% | $100 | $120.30 | Yes | 41,461 | 20.3% |
| I | 1,545 | 0.4 | 60% | $100 | $80.20 | | | -19.8% |
| H | 7,086 | 0.4 | 60% | $100 | $80.20 | 49.2% | Overall Rate Increase | -19.8% |
| G | 9,506 | 0.4 | 60% | $100 | $80.20 | | | -19.8% |
| F | 7,822 | 0.29 | 71% | $100 | $58.15 | 50.8% | Overall Rate Decrease | -41.9% |
| D | 8,221 | 0.29 | 71% | $100 | $58.15 | | | -41.9% |
| C | 6,063 | 0.29 | 71% | $100 | $58.15 | | | -41.9% |
| B | 2,617 | 0.29 | 71% | $100 | $58.15 | | | -41.9% |
| A | 8 | 0.29 | 71% | $100 | $58.15 | | | -41.9% |
| Total | 84,329 | | | | | | | |

New Rate Calculated by Multiply $100 Old Rate time 2.005 (to reflect 100.5% increase

Exhibit 3

# Farmers Insurance Company of Columbus / Farmers Insurance Exchange

## Ohio Fire (Excluding Mobile Homes)

### Derivation of FPRA Code Discount Factors

| FPRA Score | FPRA Code | Current PIF | Total Premium | Total Loss | Loss Ratio | Loss Ratio Relativity | Rebased Loss Ratio Relativity | Proposed Discount Factor | Premium Spread by Group |
|---|---|---|---|---|---|---|---|---|---|
| NA | E & N | 3,054 | 4,544,004 | 1,996,307 | 43.9% | 0.724 | 0.264 | 1.000 | 0.040 |
| 226-375 | Z | 661 | 596,468 | 993,183 | 166.5% | 2.742 | 1.000 | 1.000 | 0.005 |
| 376-400 | Y | 594 | 533,863 | 860,884 | 161.3% | 2.656 | 0.968 | 1.000 | 0.005 |
| 401-425 | X | 740 | 734,950 | 902,181 | 122.8% | 2.022 | 0.737 | 1.000 | 0.006 |
| 426-450 | W | 1,038 | 1,029,330 | 1,332,899 | 129.5% | 2.133 | 0.778 | 1.000 | 0.009 |
| 451-475 | V | 1,326 | 1,321,730 | 1,568,696 | 118.7% | 1.955 | 0.713 | 1.000 | 0.012 |
| 476-500 | U | 1,652 | 1,723,258 | 1,631,864 | 94.7% | 1.560 | 0.569 | 0.750 | 0.015 |
| 501-525 | T | 1,992 | 2,108,336 | 2,392,179 | 113.5% | 1.869 | 0.681 | 0.750 | 0.019 |
| 526-550 | S | 2,385 | 2,490,593 | 2,393,096 | 96.1% | 1.583 | 0.577 | 0.750 | 0.022 |
| 551-575 | R | 2,635 | 2,908,825 | 2,792,033 | 96.0% | 1.581 | 0.576 | 0.750 | 0.026 |
| 576-600 | Q | 2,884 | 3,126,207 | 2,941,839 | 94.1% | 1.550 | 0.565 | 0.750 | 0.028 |
| 601-625 | P | 3,186 | 3,727,179 | 2,438,888 | 65.4% | 1.078 | 0.393 | 0.600 | 0.033 |
| 626-650 | O | 3,852 | 4,470,625 | 3,355,325 | 75.1% | 1.236 | 0.451 | 0.600 | 0.039 |
| 651-675 | L | 4,236 | 5,224,379 | 4,617,989 | 88.4% | 1.456 | 0.531 | 0.600 | 0.046 |
| 676-700 | K | 5,196 | 6,484,066 | 5,204,246 | 80.3% | 1.322 | 0.482 | 0.600 | 0.057 |
| 701-725 | J | 6,030 | 7,774,172 | 5,511,778 | 70.9% | 1.168 | 0.426 | 0.600 | 0.069 |
| NA | I | 1,545 | 1,795,786 | 943,923 | 52.6% | 0.866 | 0.316 | 0.400 | 0.016 |
| 726-750 | H | 7,086 | 9,638,670 | 5,531,973 | 57.4% | 0.945 | 0.345 | 0.400 | 0.085 |
| 751-775 | G | 9,506 | 13,675,321 | 6,775,538 | 49.5% | 0.816 | 0.298 | 0.400 | 0.121 |
| 776-800 | F | 7,822 | 12,074,421 | 5,002,925 | 41.4% | 0.682 | 0.249 | 0.290 | 0.107 |
| 801-825 | D | 8,221 | 13,112,538 | 4,898,344 | 37.4% | 0.615 | 0.224 | 0.290 | 0.116 |
| 826-850 | C | 6,063 | 9,986,690 | 3,447,613 | 34.5% | 0.569 | 0.207 | 0.290 | 0.088 |
| 851-875 | B | 2,617 | 4,259,923 | 1,293,453 | 30.4% | 0.500 | 0.182 | 0.290 | 0.038 |
| 876-900 | A | 8 | 17,775 | 1,617 | 9.1% | 0.150 | 0.055 | 0.290 | 0.000 |
| Total | Total | 84,325 | 113,359,109 | 68,828,774 | 60.7% | 1.000 | 0.365 |  | 1.000 |

Notes:
1) Total Premium and Total Loss are from IMPACT 1996 to February 2001 YTD data.
2) Base rate will be increased uniformly by 100.5% to achieve revenue neutrality.

# Farmers Insurance Company of Columbus
## Ohio Homeowners and Landlords Protector
### Summary of Premium Effects -- Effective September 16, 2001

| Type of Change | Special/Protector Plus | Renters/Condos | HO Total |
|---|---|---|---|
| Base Rate Changes by Territory | 19.3% | 11.4% | 19.0% |
| FPRA Discount | -50.1% | -50.1% | -50.1% |
| Required FPRA Base Rate Offset | 100.5% | 100.5% | 100.5% |
| Crossover correction | 0.0% | 0.0% | 0.0% |
| Sewer & Drain Rate Change | 2.6% | 0.1% | 2.5% |
| Overall Rate Change Effect | 22.5% | 11.5% | 22.1% |
| Annual 2000 Premium | $ 25,108,816 | $ 940,929 | $26,049,745 |
| Annual Dollar Effect | $ 5,646,465 | $ 108,225 | $ 5,754,689 |
| Indicated Change | 21.7% | 11.4% | 20.2% |

# HOMEOWNERS PACKAGE
# FARMERS INSURANCE COMPANY
# FARMERS INSURANCE EXCHANGE

## RATING RULES (cont.)

### ★ FIRE REVISED PRICING MECHANISM DISCOUNT

Insureds may be eligible for a discount based on their **Farmers Property Risk Assessment (FPRA) code**. The FPRA code for the head of the household will apply to all Property policies in the household. The discount will apply to all policy types except Mobile Home.

| FPRA CODE | FACTOR |
|---|---|
| A | 0.29 |
| B | 0.29 |
| C | 0.29 |
| D | 0.29 |
| E | 1.00 |
| F | 0.29 |
| G | 0.40 |
| H | 0.40 |
| I | 0.40 |
| J | 0.60 |
| K | 0.60 |
| L | 0.60 |
| M | 1.00 |
| N | 1.00 |
| O | 0.60 |
| P | 0.60 |
| Q | 0.75 |
| R | 0.75 |
| S | 0.75 |
| T | 0.75 |
| U | 0.75 |
| V | 1.00 |
| W | 1.00 |
| X | 1.00 |
| Y | 1.00 |
| Z | 1.00 |