

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 987 Use of Credit Reports by Insurers
SPONSOR(S): Rivera, Bullard and others
TIED BILLS: **IDEN./SIM. BILLS:**

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR |
|---------------------------------|--------|---------|----------------|
| 1) Insurance Regulation | | Cheek | Schulte |
| 2) Insurance | | | |
| 3) Commerce | | | |
| 4) Finance & Tax | | | |
| 5) Commerce&Local Affairs (sub) | | | |
| 6) Appropriations | | | |

SUMMARY ANALYSIS

Many insurers use "consumer reports" or credit reports, as they are commonly known, as a tool for underwriting or rating automobile and homeowner's insurance. Insurers believe that the use of credit reports, combined with traditional underwriting tools, can improve the insurers' ability to predict future losses and claims. The insurance industry believes there is a direct relationship between credit reports (e.g., financial stability) and risk. Other financial services industries, such as credit card issuers and financial institutions, use consumer credit information in an attempt to ascertain a person's ability to repay a loan. The bill creates s. 626.9741, F.S., governing the use of credit reports and credit scores by insurers. Specifically, the bill does the following:

- Regulates and limits the use of credit reports and credit scores by insurers for underwriting and rating purposes for personal lines motor vehicle insurance and personal lines residential insurance.
- Requires an insurer to inform an applicant or insured, in writing, prior to a credit report being requested for underwriting or rating purposes, that a credit report may be used for underwriting purposes; prohibits the insurer from requesting a credit report based upon race, color, creed, marital status, gender, or national origin of the applicant or insured; prohibits an insurer from requesting a credit report based as an underwriting or rating factor unless the insurer provides the Office of Insurance Regulation sufficient information.
- Requires an insurer to provide a means of appeal for an applicant or insured whose credit report or credit score is unduly influenced by the death of a spouse or temporary loss of employment.
- Prohibits an insurer from refusing to renew a policy or imposing a premium increase due to credit information contained in a credit report until the insured has had an opportunity to correct any error in the credit report; authorizes the Financial Services Commission to adopt rules and the Office of Insurance Regulation to conduct a study of the use of credit information as an underwriting rating factor.

The bill does not appear to have a substantial fiscal impact on state or local government

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h0987.in.doc
DATE: April 11, 2003

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. DOES THE BILL:

- | | | | |
|--------------------------------------|------------------------------|--|------------------------------|
| 1. Reduce government? | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. Lower taxes? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. Expand individual freedom? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 5. Empower families? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |

For any principle that received a “no” above, please explain:

Authorizes Office of Insurance Regulation to conduct a study of the use of credit information as an underwriting rating factor.

B. EFFECT OF PROPOSED CHANGES:

Use of Credit Reports or Credit Scores

Many insurers use “consumer reports” or credit reports, as they are commonly known, as a tool for underwriting or rating automobile and homeowner’s insurance. Insurers believe that the use of credit reports, combined with traditional underwriting tools, can improve the insurers’ ability to predict future losses and claims. The insurance industry believes there is a direct relationship between credit reports (e.g., financial stability) and risk. Other financial services industries, such as credit card issuers and financial institutions, use consumer credit information in an attempt to ascertain a person’s ability to repay a loan.

Although some insurers may evaluate an actual credit report, many companies that use credit information are using a credit score. A credit score is an evaluation of a person’s credit at one point in time. Credit scores are calculated from formulas that are based on specific factors in a person’s credit history or report. Factors used to calculate a person’s credit score generally include such things as bankruptcy, payment history, late payments, number of open accounts, length of credit history, home ownership, type of credit in use, and debt-to-credit ratio. The methods and formulas used for credit scores are frequently considered proprietary information. Some insurers develop their own scoring model and formula; others use independent credit scoring companies, such as Fair Issac or ChoicePoint.

Insurers contend that people with better credit scores tend to file fewer and less expensive claims than people with lower credit scores. Consumer advocates argue that credit has nothing to do with insurance underwriting and rating and the use of credit scores by insurers disproportionately harms women, minorities, and those with low income. Many consumer advocates have also questioned the use of inquiries or new applications for credit for credit scoring, since a person might still be making timely payments. In addition, consumer advocates have expressed concerns that the use of credit reports by insurers may lead to unfair discriminatory practices against minorities and persons with low incomes. For example, many minorities and low-income people may pay their bills on time, but possibly not through financial institutions or credit cards, and could be harmed if a person’s lack of credit is used as a factor for calculating credit scores. Concerns have also been raised regarding sharp premium increases after a change in a person’s credit due to illness, loss of employment, or the death of a spouse, despite payment of premiums on a timely basis.

Consumer advocates have expressed concerns regarding how credit reports or credit scores are used by insurers. If the methods or formulas are considered proprietary information, it is difficult for consumers to know exactly what factors might cause a good or bad insurance credit score, thereby

making it impossible for a consumer to improve or challenge a bad score. Concerns have also been raised regarding the accuracy and methodology used in the credit scoring and reporting. Many studies have been issued addressing these issues.

On November 15, 2002, the American Academy of Actuaries issued a report titled *The Use of Credit History for Personal Lines of Insurance; Report to the National Association of Insurance Commissioners*. The purpose of the report was to review and critique four papers that have been published concerning the use of credit history for underwriting and rating decisions. Strengths and weaknesses were noted for all of the papers. The first paper, titled *The Impact of Personal Credit History on Loss Performance in Personal Lines* (2000), by James Monaghan, demonstrates that a large number of credit characteristics add predictive power. The second paper evaluated, titled *Insurance Scoring In Personal Automobile Insurance-Breaking the Silence* (2001), by Conning and Company, concludes the use of credit information has merit because it appears to have a correlation to loss ratio performance. The third paper, titled *Predictiveness of Credit History for Insurance Loss Ratio Relativities* (1999), by Fair Isaac, demonstrates how loss ratios are related to credit variables and credit scores. The fourth paper, titled *Use of Credit Reports in Underwriting* (1999), by the Virginia Bureau of Insurance, drew significant conclusions regarding the use of credit history in underwriting; however, the paper includes only a limited amount of data to allow an assessment of the validity of the conclusions.

In December 2002, the Consumer Federation of America released a report titled *Credit Score Accuracy and Implications for Consumers*. The report noted that a consumer's credit history and credit score can determine access and pricing for fundamental financial services. The report provided the following findings:

1. Credit scores and the information in credit reports vary significantly among repositories, regardless of whether the consumer generally has good or bad credit histories. Errors frequently occurred regarding information about late payments, the balance and credit limit of revolving accounts, and the status of accounts.
2. Many consumers are unharmed by the variations, and the report concluded that some consumers might benefit from the variations.
3. The report estimated that tens of millions of consumers are at risk of being penalized in the form of increased costs and decreased access to credit due to the inaccurate credit report and credit score information.
4. The report estimated that one in 10 consumers run the risk of being excluded from the credit marketplace due to duplicate reports, incomplete records, and mixed files.
5. Generic explanations provided in credit reports do not provide adequate information to consumers to address inconsistencies or errors.
6. Consumers outside of California do not have an affirmative right to know their credit scores.
7. No public entity is guaranteeing the validity and fairness of credit scoring systems.
8. Certain medical information held by credit reporting agencies has the potential to cause breaches of consumers' medical privacy.

Federal Fair Credit Reporting Act

The purpose of the federal Fair Credit Reporting Act (FCRA) is to require consumer reporting agencies to adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner that is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information in accordance with the provisions of the act. The FCRA provides that consumer reports (or credit reports) may include information relating to a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living. The FCRA authorizes the use of credit reports as a factor in establishing a consumer's eligibility for: 1) a credit transaction, 2) insurance underwriting, 3) employment purposes, 4) a license, or 5) a legitimate business purpose. The FCRA provides that if a person is denied insurance due to information provided by a consumer-reporting agency, the insurer is required to provide the person with the name, address, and telephone number of

the consumer-reporting agency. The FCRA establishes a procedure for resolving disputed credit information in a timely manner.

State Laws Regulating the Use of Credit Reports; Florida Department of Insurance Rules

Only a few states, Maryland and Hawaii, have adopted laws significantly restricting the use of credit reports, according to a report issued by the National Conference of State Legislatures. Maryland became the first state to forbid the use of credit to rate or refuse to renew homeowner's insurance. Hawaii prohibits the use of credit in rating plans for both automobile and homeowner's insurance. Idaho prohibits an insurer from charging a higher rate or canceling coverage based primarily on a credit rating or credit history. Washington prohibits insurers from denying, canceling, or refusing to renew coverage for all lines of personal insurance due to credit history. Louisiana prohibits an insurer from refusing to insure or renew coverage because the insured has declared bankruptcy. Illinois, Oklahoma, and Wisconsin prohibit insurers from refusing to insure *solely* on credit history. Kentucky prohibits an insurer from refusing to issue or renew auto insurance solely because of credit history or lack of credit history of an applicant. New Hampshire provides that the use of credit reports for auto, fire, and certain casualty policies must be based on objective and measurable standards with appropriate consumer protections. Other states have laws similar to the Florida rule, described below, requiring notice to the applicant of the use of the credit report, the reasons for denial of coverage, and how the consumer can obtain a copy of the credit report.

Florida insurance laws prohibit "unfair" discrimination. The Florida Insurance Code provides that the rates for homeowner's and automobile insurance cannot be excessive, inadequate, or unfairly discriminatory. A rate for property and casualty insurance (including homeowner's insurance) is deemed unfairly discriminatory as to a risk or group of risk if the application of premium discounts, credits, or surcharges among such risks does not bear a reasonable loss and expense experience among the various risks. For private auto rates, a rate is deemed unfairly discriminatory if the rate clearly fails to reflect equitably the difference in expected losses and expenses. Under Florida law, an insurer may not refuse to insure someone solely because of race, color, creed, marital status, sex, or national origin, regardless of whether such factors are statistical indicators of risk of loss. Currently, the Office of Insurance Regulation requests an insurer to submit information to demonstrate the validity and predictability of using credit scores or credit reports for purposing of underwriting or rating. Although the law does not address the use of credit reports, the law does place the burden on the insurer to demonstrate that the rate is not excessive, inadequate, or unfairly discriminatory. As a means to ensure that rates are not excessive, insurers have agreed with the office to provide a periodic reevaluation of the credit history of an insured that is adversely affected by the use of a credit report or credit score. An insurer that currently uses credit reports or credit scores, for purposes of underwriting or rating, reviews every 2 years, or upon the request of an insured, the credit history of the insured who was adversely impacted by use of the insured's credit history at the initial rating of the policy.

There is no Florida statute that directly addresses the use of credit reports in insurance underwriting, but the Department of Insurance adopted a rule on this subject in 1996, Rule 4-125.004, F.A.C.¹ The rule applies only to personal lines automobile and homeowner's insurance and requires that any insurer that uses credit reports in reviewing applications must maintain and adhere to written procedures specifying how the reports will or may be used in underwriting decisions. The insurer must notify the applicant in writing prior to requesting a credit report. If an insurer denies an application based on information in a credit report, the reasons accompanying the notice of denial must indicate how the applicant can obtain a copy of the credit report and how the applicant can identify the specific items in the credit report that resulted in the denial. The rule does not address the use of credit reports in rating decisions.

¹ Effective January 7, 2003, the rules of the Department of Insurance became rules of the Department of Financial Services or the Financial Services Commission, as is appropriate to the corresponding regulatory function. The Legislature created the Office of Insurance Regulation, under the Financial Services Commission. The office is responsible for all activities concerning insurers, including rates (and other specified activities). Sections 2 and 4, ch. 2002-404, L.O.F.

Task Force on the Use of Credit Reports in Underwriting Automobile and Homeowner's Insurance

In 2001, the Florida Treasurer and Commissioner of Insurance established a task force to examine insurers' use of credit reports and issue recommendations. On January 23, 2002, the Task Force on the Use of Credit Reports in Underwriting Automobile and Homeowner's Insurance issued its final report and included the following recommendations regarding the use of credit reports:

1. Prohibit the use of credit reports as the sole basis for making underwriting and rating decisions;
2. Require insurers to provide the Department of Insurance with sufficient information for the department to independently verify insurers' use of credit reports;
3. Require insurers to send consumers, whose adverse insurance decision is a result of their consumer credit information, a copy of their credit report and a plain-language explanation of the specific credit characteristics causing the adverse determination;
4. Prohibit insurers from drawing a negative inference from a bad credit score that is due to medical bills, little or no credit information, or other special circumstances;
5. Require insurers to offer premium payment plans to consumers and prohibit the denial or conditioning of such payment plans on anything other than the consumer's payment history with that insurer group;
6. Mitigate the impact of credit reports by imposing limits on the amount of weight insurers can give to them in the decision to write or not write a policy, and limit premium increases due to credit information;
7. Conduct an independent and comprehensive investigation of the relationship between insurers' use of credit information and risk of loss, including the impact by race, income, geographic location, and age;
8. Conform Rule 4-125.004, F.A.C., regarding the definition of "adverse decision" to the Federal Fair Credit Reporting Act definition; and
9. Continue departmental inquiry into the effects of the use of credit reports by the insurance industry, and initiate consumer education programs to inform consumers of the use of credit scoring by insurers.

National Association of Insurance Commissioners' Credit Scoring Regulatory Options

Recently, the Credit Scoring Working Group of the National Association of Insurance Commissioners (NAIC) adopted a report titled *Credit-Based Insurance Scoring: Regulatory Options*, in January 2003. The report will be considered for adoption by the full membership of NAIC in June 2003. At this time, the NAIC is not pursuing a model act addressing the use of credit-based insurance scoring. Some of the regulatory options include:

1. Ban underwriting based solely on credit history;
2. Require insurers to offer reasonable underwriting exceptions if an extraordinary personal circumstance adversely impacts a consumer's credit history;
3. Prohibit insurers from offering less favorable payment plans based on credit history;
4. Take no action to address the use of credit reports in underwriting;
5. Prohibit the use of credit history for rating;
6. Prohibit insurers from increasing premiums for existing customers based on credit history;
7. Cap the amount of premium surcharge or discount that results due to credit history;
8. Require insurers to actuarially support rating differentials based on credit history;
9. Require insurers to recalculate a credit score at renewal if the insurer has previously taken an adverse action and the insured requests the recalculation; or
10. Take no action to address the use of credit reports in rating.

Major Changes to Current Law

The bill creates s. 626.9741, F.S., governing the use of credit reports and credit scores by insurers.

Subsection (1) of the new s. 626.9741, F.S., provides that it is the purpose of this section to regulate and limit the use of credit reports and credit scores by insurers for underwriting and rating purposes. This section applies to personal lines motor vehicle insurance and personal lines residential insurance, which includes homeowners, mobile homeowners dwelling, tenants, condominium unit owners, cooperative unit owners, and similar types of insurance.

Subsection (2) of s. 626.9741, F.S., defines the following terms, as used in this section:

- “Adverse decision” means a decision to deny or non-renew a policy of insurance, to issue a policy with exclusions or restrictions, to increase the rates or premium charged for the policy of insurance, to place an insured or applicant in a rating tier that does not have the lowest available rates for which the applicant or insured is otherwise eligible; or to place an applicant or insured with a company operating under common management, control, or ownership that does not offer the lowest rates available within the affiliate group of insurance companies, for which the insured or applicant is otherwise eligible.
- “Credit report” means any written, oral, or other communication of any information by a consumer reporting agency, as defined in the federal Fair Credit Reporting Act, bearing on a consumer’s credit worthiness, credit standing, or credit capacity, which is used or expected to be used as a factor to establish a person’s eligibility for credit or insurance or any other purpose authorized under the provisions of the Fair Credit Reporting Act.

Subsection (3) of s. 626.9741, F.S., requires an insurer to inform an applicant or insured, in writing, prior to a credit report being requested for underwriting or rating purposes, that a credit report may be used for underwriting purposes. If an insurer makes an adverse decision based upon a credit report, the insurer, or a third party designated by the insurer, must provide a copy of the credit report to the applicant or insured.

The federal Fair Credit Reporting Act requires an insurer that denies coverage because of information supplied by a consumer reporting agency to provide the applicant or insured with the name, address, and telephone number of the consumer reporting agency. If the applicant or insured requests a copy of the credit report within 60 days of receiving the denial notice, the credit report is free.

Subsection (4) of s. 626.9741, F.S., prohibits the insurer from requesting a credit report based upon race, color, creed, marital status, gender, or national origin of the applicant or insured. The bill also prohibits the insurer from making an adverse decision solely because of information contained in a credit report or credit score. An insurer is also prohibited from making an adverse decision based on the following factors: (1) the absence of, or an insufficient, credit history (2) the number of credit reports or credit inquiries requested or made regarding the applicant or insured; (3) credit problems resulting from medical bills; or (4) other special circumstances that the Financial Services Commission determines, by rule, does not pose an increased insurance risk.

The subsection also requires an insurer to provide a means of appeal for an applicant or insured whose credit report or credit score is unduly influenced by the death of a spouse or temporary loss of employment. An insurer must complete a review of an adverse decision upon request of an applicant or insured who supplies an insurer with reasonable documentation of a temporary loss of employment or death of a spouse. If an insurer determines that a credit report or credit score was unduly influenced by either of such factors, it shall either exclude the credit information or treat the credit information as neutral, whichever is more favorable to the applicant or insured.

Subsection (5) of s. 626.9741, F.S., prohibits an insurer from requesting a credit report based as an underwriting or rating factor unless the insurer provides the Office of Insurance Regulation sufficient information for the office to determine that the methodology used by the insurer reasonably predicts the insurance risk posed by the applicant or the insured and that the weight given to the credit information

reasonably predicts the insurance risk posed by the applicant or insured. The weight given to the credit information must be reasonable compared to other factors affecting insurance risk. The bill also provides that any premium increase imposed by an insurer based on credit information contained in a credit report must be consistent with the rates filed with and approved by the Office of Insurance Regulation pursuant to the applicable insurance rating laws and rules.

Subsection (6) of s. 626.9741, F.S., prohibits an insurer from refusing to renew a policy or imposing a premium increase due to credit information contained in a credit report until the insured has had an opportunity to correct any error in the credit report. The insurer must notify the insured that he or she may correct or question the accuracy of the information on which the nonrenewal or premium increase is based within 10 days after receiving a copy of the credit report. If, within such period, the insured notifies the insurer or a third party designated by the insurer, in writing, that the insured questions the accuracy of the credit information on which the renewal or premium increase was based, the nonrenewal or premium increase may not take effect until 30 days after the accuracy of the credit information has been verified and communicated to the insured. An insurer must cooperate in any such investigation. The insurer may nonrenew the policy or impose the premium increase if the insured fails to respond to relevant questions regarding the investigation within 15 days after written notice to the insured.

Subsection (7) authorizes the Financial Services Commission to adopt rules to administer the provisions of this section.

Reporting Requirements

The Office of Insurance Regulation is required to conduct a study of the use of credit information as an underwriting rating factor. The study shall evaluate and determine the increased risk of insurance loss posed by an individual's credit worthiness, credit standing, or credit capacity, and the appropriate weight that should be given to such factors in determining insurability in conjunction with other risk factors.

C. SECTION DIRECTORY:

Section 1: Creates s. 626.9741, F.S. – *Use of Credit reports and credit scores by insurers.*

Section 2: Directs the Office of Insurance Regulation to conduct a study.

Section 3: Provides that the act takes effect January 1, 2004, and applies to policies issued or renewed on or after the date.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The costs of additional duties imposed on the Office of Insurance Regulation and the Financial Services Commission are indeterminate, but are expected to be handled within existing resources.

2. Expenditures:

See above.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Applicants or insureds previously denied coverage or offered coverage at a higher premium solely based on an insurer using information contained in credit report could no longer be denied or charged a higher premium solely based on information contained in a credit report or credit score.

To the extent that an insurer may not deny coverage or charge a higher premium, for example, due to the lack of a credit history, additional costs would be spread among all of the insurer's policyholders.

Insurers would incur additional costs associated with providing adverse action notifications and copies of credit reports to all insureds and applicants that were denied coverage due to an adverse determination based on a credit report or credit score.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill authorizes the Financial Services Commission to adopt rules.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.