

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/CS/SB 204

SPONSOR: Commerce, Economic Opportunities, and Consumer Services Committee, Banking and Insurance Committee, and Senator Miller

SUBJECT: Use of Credit Reports and Credit Scores by Insurers

DATE: March 27, 2003                      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	<u>Cibula</u>	<u>Maclure</u>	<u>CM</u>	<u>Favorable/ CS</u>
3.	_____	_____	<u>AGG</u>	_____
4.	_____	_____	<u>AP</u>	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

The committee substitute regulates and limits the use of credit reports and credit scores by insurers for underwriting and rating personal lines motor vehicle insurance and personal lines residential insurance. A rate filing that uses credit reports or credit scores must comply with the requirements of s. 627.062, F.S., or s. 627.0651, F.S., to ensure that rates are not excessive, inadequate, or unfairly discriminatory.

Insurers are required to notify an applicant or insured, in the same medium as the application was received, that a credit report was being requested for underwriting or rating purposes. An insured is prohibited from requesting a credit report based upon the race, color, religion, marital status, age, gender, income, national origin, or place of residence of the applicant or insured.

In the event an insurer makes an adverse underwriting or rating decision based upon a credit report, the insurer, or a designated third party, is required to provide a copy of the credit report to the applicant or insured. The insurer is required to include the four primary reasons, or fewer if applicable, that were the primary influences of the adverse decision. The committee substitute establishes rights and responsibilities for the insured or applicant and the insurer to address adverse underwriting or rating decisions made by the insurer and establishes an appeal process for an insured or applicant whose credit report or credit score is unduly influenced by the death of a spouse or temporary loss of employment.

The committee substitute prohibits an insurer from making an adverse decision relating to underwriting or rating solely because of the credit information contained in a credit report. An insurer is prohibited from making an adverse decision if based, in whole or in part, on any of 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) collection accounts with a medical industry code, if so identified on the consumer's credit report; 4) place of residence; or 5) any other special circumstance that the Financial Services Commission determines, by rule, lacks sufficient statistical correlation and actuarial justification as a predictor of insurance risk. A consumer with little or no credit history will be considered to have a neutral credit history for underwriting or rating purposes.

An insurer is required to reevaluate the credit history of an insured that was adversely impacted by the use of the insured's credit history, at the initial rating of the policy or at a subsequent renewal, every three years or upon the request of the insured. As an alternative, an insurer may reevaluate the insured within the first three years after the inception of the policy based on other allowable underwriting or rating factors, excluding credit information, provided that the insurer does not increase the rates or premium charged to the insured based on the exclusion of credit reports or credit scores.

The Financial Services Commission is authorized to adopt rules to administer the provisions of this act and the rules may include: 1) certain information in the filings to demonstrate compliance relating to adverse decisions by the insurer; 2) statistical information an insurer must retain and report annually to the Office of Insurance Regulation; 3) standards that ensure that the use of a credit report or credit score does not unfairly discriminate, based upon race, color, religion, marital status, age, gender, income, national origin, or place of residence; and 4) standards for reviewing methods to grade or rank credit report data.

This committee substitute creates section 626.9741, Florida Statutes.

## **II. Present Situation:**

### **Use of Credit Reports or Credit Scores**

Many insurers use "consumer reports"<sup>1</sup> 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 that there is a direct relationship between credit reports, i.e., 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.

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<sup>1</sup> The federal Fair Credit Reporting Act uses the term "consumer report," rather than the term "credit report."

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 that 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 runs 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 which 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.<sup>2</sup> 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.<sup>3</sup> 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

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<sup>2</sup> 15 U.S.C. s. 1681 et seq.

<sup>3</sup> National Conference of State Legislatures, *Credit Reports in Insurance*, September 18, 2002.

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 Department of Insurance 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.<sup>4</sup> 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.<sup>5</sup> 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.<sup>6</sup> 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.<sup>7</sup> 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 two 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.<sup>8</sup> 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 which resulted in the denial. The rule does not address the use of credit reports in rating decisions.

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<sup>4</sup> Sections 627.062(1) and 627.0651(2), F.S.

<sup>5</sup> Section 627.062(2)(e)6., F.S.

<sup>6</sup> Section 627.0651(2), F.S.

<sup>7</sup> Section 626.9541(1)(x), F.S.

<sup>8</sup> 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 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 the National Association of Insurance Commissioners (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 circumstances 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.

### III. Effect of Proposed Changes:

This committee substitute creates s. 626.9741, F.S., governing the use of credit reports and credit scores by insurers.

**Section 1.** Subsection (1) of 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 nonrenew 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 which 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. A credit score alone, as calculated by a credit reporting agency or by or for an insurer, may not be considered a credit report.
- “Credit Score” means a score, grade, or value that is derived by using any or all data from a credit report in any type of model, method, or program, whether electronically, in an algorithm, computer software or program, or any other process, for the purpose of grading or ranking credit report data.
- “Tier” means a category within a single insurer into which insureds with substantially similar risk, exposure, or expense factors are placed for purposes of determining rate or premium.

Subsection (3) of s. 626.9741, F.S., requires an insurer to inform an applicant or insured, in the same medium as the application is taken, that a credit report is being requested for underwriting or rating purposes prior to requesting a credit report. 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 insurer is required to include the four primary reasons, or fewer if applicable, that were the primary influences of the adverse decision. The reasons must be provided in sufficiently clear and specific language so that a person can identify the basis for the adverse decision. The use of generalized terms such as “poor credit history,” “poor credit rating,” or “poor insurance score” does not meet the notification requirements.

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 an insurer from requesting a credit report or credit score based upon the race, color, religion, marital status, age, gender, income, national origin, or place of residence of the applicant or insured. The insurer is prohibited 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) collection accounts with a medical industry code; 4) place of residence; or 5) any other special circumstances that the Financial Services Commission determines, by rule, lacks sufficient statistical correlation and actuarial justification as a predictor of insurance risk. A consumer with little or no credit history will be considered to have a neutral credit history for underwriting or rating purposes.

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., requires that a rate filing that uses credit reports or credit scores comply with the requirements of s. 627.062, F.S., or 627.0651, F.S., to ensure that rates are not excessive, inadequate, or unfairly discriminatory. (*See* subsection (8), below, regarding rules related to this provision.)

Subsection (6) of s. 626.9741, F.S., requires an insurer that requests or uses credit reports or credit scores in its underwriting or rating to maintain and comply with established written procedures that reflect the restrictions set forth in the federal Fair Credit Reporting Act, this committee substitute, and all related rules.

Subsection (7) of s. 626.9741, F.S., requires an insurer to establish procedures that provide that at least every 3 years, or upon the request of the insured, the insurer will 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 or subsequent renewals. The insurer is required to adjust the premium of the insured to reflect any improvement in the credit history. The insurer is prohibited from using the review of the credit report of an existing policyholder to cancel, refuse to renew, or require a change in the method of payment or payment plan.

As an alternative, an insurer may reevaluate the insured within the first 3 years after the inception of the policy based on other allowable underwriting or rating factors, excluding credit information. As the result of a review, an insurer is not permitted to increase the rates or premium charged to the insured based on other allowable underwriting or rating factors.

Subsection (8) authorizes the Financial Services Commission<sup>9</sup> to adopt rules to administer the provisions of this section. The rules may include, but need not be limited to: 1) information that must be included in filings to demonstrate compliance with subsection (3); 2) statistical detail that insurers using credit reports or scores under subsection (5) must retain and report annually to the Office of Insurance Regulation; 3) standards that ensure that rates or premiums associated with the use of a credit report or credit score are not unfairly discriminatory, based upon race, color, religion, marital status, age, gender, income, national origin, or place of residence; and 4) standards for review of models, methods, programs, or other processes by which to grade or rank credit report data.

**Section 2.** Provides that this act would take effect January 1, 2004, and would apply to policies issued or renewed on or after that date.

#### **IV. Constitutional Issues:**

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

#### **V. Economic Impact and Fiscal Note:**

A. Tax/Fee Issues:

None.

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<sup>9</sup> The Commission is composed of the Governor and Cabinet; s. 20.121(3), F.S.

**B. Private Sector Impact:**

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.

**C. Government Sector Impact:**

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

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.