Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Financial Institutions & Insurance Committee

HB 2544

Brief Description: Using credit history for insurance purposes.

Sponsors: Representatives Cooper, Benson, Santos, Clements, Simpson, McIntire, Armstrong, Hunt, Romero, Dickerson, Upthegrove, Chase, Ogden, Haigh, Conway, Kenney, Campbell and Linville; by request of Governor Locke, Insurance Commissioner and Attorney General.

Brief Summary of Bill

- Prohibits insurers from denying, cancelling, or refusing to renew a personal insurance policy due to a person's credit history.
- Regulates an insurer's use of credit history in the process of premium rate setting for personal insurance.

Hearing Date: 1/30/02

Staff: Thamas Osborn (786-7129).

Background:

Though credit reports have been used for many years by the insurance industry in making property and casualty underwriting decisions, the practice has recently begun to generate considerable public attention. The attention is largely the result of two developments; namely, the increasing use of credit history information in the setting of insurance rates and the development of "credit scoring" models for underwriting and rate setting purposes.

The credit reporting industry consists of over 600 credit bureaus that accumulate credit data on a local or regional basis. These bureaus, in turn, provide data to the three national credit reporting companies: TRW, Trans Union, and Equifax. It is these companies that generate the credit reports most often used by financial institutions, insurance companies and other commercial entities.

Both the federal Fair Credit Reporting Act (15 USC, Section1681) and the state Fair Credit

Reporting Act (Chapter 19.182 RCW) explicitly allow consumer reporting agencies to release credit reports to insurance companies for insurance underwriting purposes. Accordingly, insurance companies have utilized these reports for many years as a factor to be considered in determining which individuals are eligible for coverage and/or what the terms of such coverage will be. The weight given to credit reports, in conjunction with other factors, varies widely within the industry, thus there is no one practice that can be ascribed to the industry as a whole.

In recent years, the review of an individual's credit report in the insurance underwriting process has given way to the consideration of the individual's "credit score". A credit score is a number generated via a computer program that analyzes the data in an individual's credit report. The computer program uses an algorithm to reduce credit report data to a single numerical score, ranging from 300 to 850. According to the proponents of credit scoring, an individual with a higher score poses a lower risk of loss to the insurance company than does an individual with a lower score.

Generally, credit scores are calculated either by the insurance company using its own computer model or by third party vendors such as Fair Isaac Company or Choice Point, who contract with insurers to do credit score calculations. Many different modeling programs are used throughout the industry, thus there is no uniformity between companies with respect to the criteria used in generating the score.

At present, there is no explicit state regulation of the insurance industry's use of either consumer credit information or credit scoring. However, the Office of the Insurance Commissioner (OIC) does have general legal authority to regulate the rate setting practices of those insurance companies doing business in Washington state. This authority is quite broad and provides a basis for regulatory action whenever a rate setting practice can be proved to be "...excessive, inadequate, or unfairly discriminatory." Furthermore, pursuant to administrative rule, the OIC requires that any rate setting process be "actuarially sound", which means that there must be a demonstrable statistical correlation between the premium rate and the actual risk of loss.

Summary of Bill:

<u>Insurance underwriting decisions</u>: An insurer is prohibited from considering a person's credit history with respect to the decision to deny, cancel, or renew a policy of personal insurance. However, in the consideration of an applicant during the initial underwriting process, it is permissible for an insurer to place the applicant with an affiliated company based in whole or in part on the applicant's credit history.

<u>Premium rate setting</u>: An insurer may adjust premium rates for personal insurance based on an insurance score, provided the following conditions are met:

· Other objective criteria are considered in conjunction with credit history in the calculation of the insurance score;

· The insurance score reflects substantiated statistical differences in risk or exposure; and

- In the case of a premium that is increased as the result of the insured's credit history, the total premium charged to the insured is not more than 20 percent above that charged to an insured with the most favorable credit history.

Definition of personal insurance: "Personal insurance" means property and casualty insurance used for personal, family, or household purposes.

Rule-making: The insurance commissioner is authorized to promulgate the rules necessary to implement the rate-setting provisions of the bill.

Appropriation: None.

Fiscal Note: Not Requested.

Effective Date: Section one of the bill takes effect on July 1, 2002. Section two of the bill takes effect on January 1, 2003.