



The Federal Fair Credit Reporting Act & State Regulation of Credit Scoring: Chartered & Unchartered Territory for Insurance Companies Post *Safeco V. Burr*

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Introduction

Two summers ago, in June 2007, the United States Supreme Court issued *Safeco Ins. Co. et al. v. Burr*, 551 U.S. 47, 127 S.Ct. 2201 (2007). Two years later, *Safeco v. Burr*, remains a watershed event for insurance companies using credit scoring (or insurance scoring) to assist in underwriting and rating personal insurance policies. As insurance companies re-tool their insurance scoring models or newly enter the field of insurance scoring, they face newly defined obligations under the Fair Credit Reporting Act (“FCRA”), 15 U.S.C. §§ 1681 et seq. because of *Safeco v. Burr*.

In *Safeco v. Burr*, the Supreme Court held that: (a) FCRA’s “adverse action” notifications apply to the initial rate offered for new personal insurance, and (b) the trigger for such notification rests *not* on the failure of the consumer to obtain the “best rate,” but rather, on the insurer’s determination of a “neutral” benchmark.

This article explores several ramifications of the *Safeco v. Burr* decision that may require future clarification in the courts. For example, while *Safeco v. Burr* sets forth a “neutral” benchmark as the standard for determining when an insurance company should issue a notice of “adverse action,” it is unclear how much leeway insurance companies have in determining that “neutral” benchmark. In addition, several state statutes contain definitions of “adverse action” that expressly require an insurance company to issue notice of “adverse action” in circumstances when the consumer fails to receive the “best rate.” These statutes which potentially conflict with FCRA as interpreted by *Safeco v. Burr* may be preempted. Finally, although *Safeco v. Burr* involved a credit-based consumer report, the holdings in this

case could be applied to non credit based consumer reports. If so, insurance companies may be saddled with issuing “adverse action” notices when using C.L.U.E. reports or MVRs when they rate new customers for personal insurance.

FCRA & Users of Consumer Reports

Federal regulation of the consumer reporting industry began over 30 years ago with the enactment of the Fair Credit Reporting Act (“FCRA”), 15 U.S.C., §§ 1681 et seq. With respect to insurance companies, FCRA regulates “users” of “consumer reports.” If, in connection with the use of a “consumer report,” an insurance company takes an “adverse action” against the consumer, it must issue a particular notice. 15 U.S.C., § 1681m(a). An “adverse action” means: “a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance.” 15 U.S.C. § 1681a(K)(1)(B). The goal of the notice requirement is to ensure that consumers adversely impacted by a “consumer report” have the opportunity to request and review their report for accuracy and make any necessary corrections. 15 U.S.C., § 1681m.

Prior to *Safeco v. Burr*, many insurance companies interpreted the “adverse action” notice requirements to apply to renewal policies and not new policies. In *Safeco v. Burr*, the insurance company contended that the statute did not apply to new policies because it was impossible to “increase” charges to customers with whom they had no prior dealings. *Safeco, supra* at 2211. The Court disagreed and read the statute to reach “initial rates for new applicants” that were higher than they would have been but for their credit

reports. *Id.* The Court pointed out that “notice in the context of an initially offered rate may be of greater significance than notice in the context of a renewal rate; if, for instance, insurance is offered on the basis of a single, long-term guaranteed rate, a consumer who is not given notice during the initial application process may never have an opportunity to learn of any adverse treatment. *Safeco, supra* at 2212, n. 12. However, the Court conceded that the company’s interpretation of “increase” had “a foundation in the statutory text,” and thus did not find it’s reading “objectively unreasonable.” *Id.* at 2215.

The second significant ruling in *Safeco v. Burr* involved the Court’s pronouncement of the standard to be used by insurance companies in determining when notice of an “adverse action” is triggered. The Court made clear that Congress was not concerned with whether an individual failed to receive the “best rate.” The Court explained that adopting such a view “would require insurers to send slews of adverse action notices; every young applicant who had yet to establish a gilt-edged credit report, for example, would get a notice that his charge had been ‘increased’ based on his credit report.” *Safeco, supra* at 2214. This would result in “hypernotification” and would “undercut the obvious policy behind the notice requirement, for notices as common as these would take on the character of formalities, and formalities tend to be ignored. It would get around that new insurance usually comes with an adverse action notice, owing to some legal quirk, and instead of piquing an applicant’s interest about the accuracy of his credit record, the commonplace notices would mean just about nothing and go the way of junk mail.” *Id.*

Instead, the Court adopted a “neutral” credit score benchmark to determine the trigger. This translates into “what the applicant would have paid if the company had not taken his credit score into account.” *Safeco, supra* at 2214. The Court placed no additional requirements on how an insurance company determines the “neutral” score in connection with that company’s use of credit history or its insurance scoring model. In short, under *Safeco v. Burr*, insurance companies are free to determine the “neutral” benchmark in connection with their particular insurance scoring models.

Justice Stevens, who concurred in part in the decision, strongly disagreed on this point.

“ . . . As a matter of federal law, companies are free to adopt whatever ‘neutral’ credit scores they want. That score need not (and probably will not) reflect the median consumer credit score. More likely, it will reflect a company’s assessment of the creditworthiness of a run-of-the-mill applicant who lacks a credit report. Because those who have yet to develop a credit history are unlikely to be good credit risks, ‘neutral’ credit scores will in many cases be quite low. Yet, under the Court’s reasoning, only those consumers with credit scores even lower than what may already be a very low ‘neutral’ score will ever receive adverse action notices.” *Safeco, supra* at 2217, Stevens concurring in part, dissenting in part.

How insurance companies determine their “neutral” credit score may become the subject of future clarification, particularly where “neutral” scores do not reflect a median or average credit score but a much lower score. In other words, under Justice Stevens’ observations, the lower the “neutral” score, the less notices that will be sent to consumers and the less opportunities for consumers to correct inaccurate credit information.

Safeco v. Burr’s Application to State Statute’s Governing Credit Use & Scoring

Most states have adopted statutes governing the use of credit information and credit scoring in insurance. Of these states, the majority have adopted the National Conference of Insurance Legislators Model Act Regarding Use of Credit Information in Personal Insurance (“NCOIL Model Act”). The NCOIL Model Act defines “adverse action” consistently with FCRA. In this regard, the “neutral” benchmark standard set forth in *Safeco v. Burr* should govern “adverse action” notices issued in these states.

For example, following *Safeco v. Burr*, North Dakota, which adopted the NCOIL Model Act, issued a bulletin explaining to insurers that “adverse actions” occur not when the new customer fails to receive the best rate, “but rather only when the new

customer's rate is worse than what they would have received from a neutral rate (without the use of credit information)." ND. Ins. Bulletin, June 29, 2007.

However, some states define "adverse action" differently. For example, Kansas defines an "adverse action" to include "*anything other than the best possible rate.*" Kan. Stat. Ann., § 40-5103(a)(2) (emphasis added). The key questions that have yet to be addressed in these states concern whether the state statutes conflict with FCRA, as interpreted by *Safeco v. Burr*, and if so, whether FCRA preempts them. Under its general preemption provisions, FCRA does not preempt state laws regarding the use of consumer reports *except* when state and federal law conflict and only to the extent of the conflict. 15 U.S.C., § 1681t(a). Stated differently, an insurance company is not exempt from complying with *consistent* state laws on this topic, but would be exempt from complying with *inconsistent* state laws but only to the extent of the inconsistency.

Safeco v. Burr's Application to Non-Credit Consumer Reports

Most people think of "consumer reports" under FCRA as those reports prepared by consumer reporting agencies bearing on a consumer's "credit worthiness, credit standing or credit capacity." 15 U.S.C.A. § 1681a(d)(1). However, Congress drafted the statute more broadly to include non-credit consumer reports. These include reports by a consumer reporting agency "bearing on a consumer's . . . character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for-- credit or insurance to be used primarily for personal, family, or household purposes . . ." *Id.*

Given the breadth of the definition, an unresolved issue for insurance companies concerns whether non credit consumer reports such as loss history or claims history reports (C.L.U.E. reports) as well as Motor Vehicle Reports ("MVRs") fall within the scope of FCRA's notification requirements. Federal Trade Commission ("FTC") Commentary suggests that MVRs should be considered "consumer reports" and

subject to FCRA's "adverse action" notification requirements. The FTC notes: "[m]otor vehicle reports are distributed by state motor vehicle departments, generally to insurance companies upon request, and usually reveal a consumer's entire driving record, including arrests for driving offenses. Such reports are consumer reports when they are sold by a Department Motor Vehicles for insurance underwriting purposes and contain information bearing on the consumer's 'personal characteristics,' such as arrest information." 16 C.F.R. Pt. 603(c), App. The FTC further notes that: "[a]n insurer that refuses to issue a policy, or charges a higher than normal premium, based on a motor vehicle report is required to comply with subsection (a) [i.e., notice of adverse action]." 16 C.F.R. Pt. 615 App. The FTC Commentary, however, serves as guidance only, and is non-binding as the courts are free to reject these interpretations. 16 C.F.R. Pt. 600, App. Introduction, 1.

In *Safeco v. Burr*, the U.S. Supreme Court acknowledged it was dealing only with the *credit* based "consumer reports" under the broad FCRA definition. *Safeco, supra* at 2206, n. 1. However, the opinion does not limit itself to credit based consumer reports and could be read to apply to non credit consumer reports as well. If so, application of *Safeco v. Burr* to non credit "consumer reports" would require insurance companies to issue "adverse action" notices when using C.L.U.E reports and MVRs in rating new policies.

In conclusion, while *Safeco v. Burr* helped clarify the FCRA obligations imposed upon insurance companies, the decision raises multiple issues such as how to determine the "neutral" benchmark, what to do with potentially conflicting state statutes and whether non credit consumer reports such as C.L.U.E. and MVR fall within its holding. These issues await further clarification in the courts.

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