F I S C A L   I M P A C T   R E P O R T

SPONSOR: Stewart DATE TYPED: 2/16/03 HB 598

SHORT TITLE: Prohibit Certain Actions by Insurers SB

ANALYST: Maloy

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY03	**FY04**	**FY03**	**FY04**		
	NFI		NFI		

Relationship to SB 325, which regulates credit scoring rather than prohibiting it.

SOURCES OF INFORMATION

Responses Received From
Office of the Attorney General
Public Regulatory Commission

SUMMARY

Synopsis of Bill

This bill prohibits insurers from either canceling or raising premiums on automobile policies due to unsatisfactory credit reports.

Significant Issues

1. A credit score is the interpretation of credit reports and/or histories and other data about an individual using a predictive scoring model or formula known as an algorithm. Insurance companies use credit scores in underwriting personal lines of insurance and in determining the rating tier for individual applicants. Credit scores are one of the factors that assist an insurance company in determining whether to provide or renew coverage to an applicant and in deciding what premium an applicant should pay.

2. HB 598 proposes to enact a law similar to those adopted by other states. Twenty-three states have legislation pending or have passed legislation that addresses the use of credit scoring in underwriting. A sampling of the existing statutes and regulations nationwide shows that most of the existing state laws focus on regulating the use of credit reports /

histories, not credit scores, and that there is no overriding uniform approach being taken by states to regulate credit scoring.

However, most of the legislation limits companies from canceling, denying or non-renewing insurance based in whole or in part on credit rating or history.

- See for Examples, IDAHO § 41-1843 and Idaho Insurance Code § 18.01.19 (prohibits an insurer from charging a higher premium or canceling a policy based primarily on an individual's credit rating or credit history); ILLINOIS § 5/155.38 (Insurer may not refuse to issue or renew insurance solely on basis of credit report); MINNESOTA § 72A.20 (Subd. 36. *Limitations on the use of credit information.* No insurer(s) may reject, cancel, or non-renew personal lines of insurance for any person in whole or in part on the basis of credit information, including a credit report without considering other applicable underwriting factors); MARYLAND § 27-501(e)(2)(i) and (3)(i)(prohibits an insurer from refusing to underwrite auto or homeowner's insurance solely on the basis of credit history); MISSOURI § 375.918 (insurer shall not take adverse action based solely on credit report or insurance credit score); MONTANA § 333-18-210 (prohibit an insurer from denying coverage solely on the basis of an applicant's credit report and/or credit score); KENTUCKY § 304.20-040 and 042 (No insurer shall decline, refuse to renew, or cancel insurance due to credit history); RHODE ISLAND § 27-6-53 (Insurer cannot cancel, nonrenew or increase premium rate solely on credit history); WASHINGTON § 48.18.545(places underwriting restrictions that apply to personal insurance, prohibits specific factors from being considered such as, number of credit inquiries and credit histories).

3. Proponents of the use of credit scores contend that the use of credit scores is beneficial to consumers in the marketplace. The insurance industry views credit scores as an objective and efficient way to provide consistent, accurate and more complete underwriting and pricing. Insurance companies contend that credit scores provide a fair pricing structure by matching rates with the risk of loss. Since most customers have good credit, insurance companies assert that they are able to offer the majority of policyholders lower premiums.

4. Critics of the use of credit scores assert that the use of credit scores disproportionately discriminate against poor and minority consumers, who have little or no credit history, by placing them in higher rating tiers and requiring them to pay higher rates. Critics further contend that these same consumers are also forced to pay their entire premium in one payment since their credit scores do not allow them to qualify for installment payments. Insurance companies also are criticized for setting credit score ranges determining the premiums that consumer have to pay. The ranges of acceptable credit scores can be increased or decreased, depending on whether the insurance company wants to increase or decrease the amount of policies it issues. Thus, an insured can maintain the same credit score over a number of years, but still receive a premium increase or non-renewal notice because of the insurance company's business decision.

According to the PRC's Insurance Division:

5. This is a complex and highly charged actuarial issue, which has been studied in detail by the Insurance Superintendent's Credit Scoring Task Force, as well as by most parties in New Mexico's insurance community.

6. There is an undeniable correlation between insurance credit score and personal auto and homeowners claim costs. Although the causes of this correlation are subject to speculation, insurers are nonetheless permitted by actuarial principles to include insurance credit score as a rating element, just as they are with age, gender and other rating factors with known predictive value. Furthermore, the federal Fair Credit Reporting Act explicitly allows insurers to use credit report information in underwriting and rating.

7. However, perceived abuses have arisen in its application, and many states believe they have the authority to curb these abuses through legislation and/or regulation. Such perceived abuses include:

   - Canceling, non-renewing or otherwise denying coverage to customers solely because of an adverse credit score;
   - Penalizing customers and applicants who do not have a credit history;
   - Making no exceptions for the credit-damaging effects of job layoffs, catastrophic illnesses and other extraordinary life events;
   - Failing to recalculate credit scores after errors in the underlying credit reports are corrected;
   - Overstating the appropriate amount of premium increases or decreases justified by credit scores.

8. Furthermore, there is concern that certain demographic groups in New Mexico (such as the poor and the young) may have worse credit scores, which may produce "unfairly discriminatory" high rates and would act to increase the number of uninsured drivers. The Insurance Division has commissioned the University of New Mexico to conduct a study to determine if such demographic correlations exist in New Mexico. If they do, the Superintendent of Insurance is likely to consider whether to prohibit or restrict credit scoring.

9. This bill will have a major impact on the personal auto and homeowners insurance marketplace in New Mexico. The vast majority of personal auto and homeowners policies issued in New Mexico include credit score as a rating element. Removing this element would raise rates for the approximately two-thirds of policyholders who have "good" credit scores and would lower rates for the remaining third who have "bad" credit scores.

10. Most insurers would have to refile their rating plans with the Insurance Division, removing the credit-scoring element.

FISCAL IMPLICATIONS

Legal defense costs are likely to be incurred to defend the state when sued by the insurance industry.

TECHNICAL ISSUES

1. Terms should likely be defined.

2. As currently written, the bill applies to commercial auto policies (where insurance credit scoring is not used). Is this an intended affect?

ALTERNATIVES

Regulate, instead of prohibit, the use of credit scoring in rating personal auto and homeowners insurance. See SB 325 for an example. Also, such regulation can include requiring insurers to:

- File and obtain the Insurance Division's review and approval of all credit-scoring models, rating factors, and underwriting guidelines prior to their use;
- Treat customers who have little or no credit history as if they had an average or above-average credit score;
- Disclose to all policyholders the use of their credit information as well as the key elements of their credit history that have affected their credit score;
- Recalculate credit scores when errors in the underlying credit reports are corrected.

SJM/prr/njw