Ohio Department of Insurance Regulatory Report

State of Insurer Compliance with the Credit History and Credit Score Rule

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Issued July 2005

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Background

In 2003, the Ohio Department of Insurance ("Department") promulgated a rule to establish standards for the use of credit history and credit scores in connection with the underwriting and rating of personal lines insurance. The rule, Section 3901-1-55 of the Ohio Administrative Code, applies to all personal lines coverage (personal automobile insurance and homeowners insurance). Insurance companies were required to be in compliance with the rule on September 10, 2003. The rule was preceded by a bulletin issued by the Department on November 22, 2002 (Bulletin 2002-2).

Under the rule, a "credit score" is defined as a "number or rating that is derived from an algorithm, computer application, model or other process that is based in whole or in part on credit history for the purpose of predicting the future loss experience of an individual applicant or insured." A credit score is different from and has a more restrictive meaning than credit history. "Credit history" is defined in the rule as "…any written, oral or other communication of any information bearing on a consumer's creditworthiness, credit standing or credit capacity…"

The Department initiated an examination of all insurance companies that write auto and homeowners coverage for individuals – known as personal lines insurance – to determine whether the companies were prepared to comply with the rule and related bulletin. The companies' policies and procedures were reviewed to determine whether they conformed to the requirements of the rule and the bulletin. The review had two purposes. The first was to determine whether the insurance companies that write personal lines insurance in Ohio were aware of the rule and had developed appropriate procedures to comply with the rule. The second purpose was to identify and correct any deficiencies in those procedures.

The review was not intended to establish actual compliance or non-compliance with the credit scoring rule. Policy files were not tested for compliance. The review was not intended to and this report does not address the merits of using credit scores or credit history in insurance underwriting and rating, nor whether the use of credit information in insurance underwriting and rating is beneficial to consumers.

Executive Summary

The personal lines insurance industry was well prepared to comply with Ohio's rule on the use of credit scores and credit history. The Department of Insurance ("Department) found that approximately 67% of the personal lines market in Ohio uses credit scores or credit information.

The Department initially identified four areas of concern with respect to compliance with the rule: (1) failure to have procedures to re-underwrite or re-rate a consumer or adjust a premium when the company learns that a credit score or history is inaccurate; (2) failure to provide the reasons for an adverse action to the consumer; (3) the use of a credit score as a sole factor in determining eligibility for coverage; and (4) the delivery of adverse action notices to agents instead of to insureds.

The review also covered some topics that are not addressed specifically in the rule. For example, the Department discovered that companies vary in how they use credit scores when there are multiple credit scores within a single household. All companies use a single score for the household, but use different methods to select the score.

Companies were also asked to explain whether they offer consumers any information about how to influence or improve credit scores. A majority of the companies provide some amount of information to consumers about the factors that may affect a credit score. This information is generally provided in the form of brochures or a company web site.

Companies also provided information about the credit scoring models and vendors that they use. Eighty-five percent of the companies use one of four credit scoring models offered by a commercial vendor. Fifteen percent of the companies developed their own model or modified a commercial model.

Scope and Methodology

A total of 266 insurance companies were originally included in the review and represented approximately 99.8% of the personal lines market in Ohio. Each insurer or group of insurers that had more than $1,000,000 of written premiums in Ohio in either personal automobile or homeowners insurance was included. If a group of related insurance companies collectively had more than $1,000,000 in premiums, then all insurance companies in that group that write insurance in Ohio were included. Twenty-seven companies reported that they were no longer writing personal lines insurance in Ohio and were excluded from the review.

The Department requested detailed responses to specific questions, copies of agent rating and underwriting manuals, company rating and underwriting manuals, marketing materials and all directives, instructions, memoranda, bulletins, and any other written materials provided to company agents or employees concerning the use of credit scores or credit history. The companies also had to provide copies of their standards for the manner in which credit history or credit scores affect underwriting and rating decisions, copies of all notices and disclosures that are provided to consumers and copies of written information provided to consumers about ways to improve credit scores. Companies that indicated they used credit scores received a subsequent request for detailed information about credit scoring models and algorithms, mathematical calculations used to underwrite risk.

In the few cases in which the Department identified policies or procedures that seemed inadequate or otherwise presented a risk of non-compliance, the Department addressed those concerns directly with the respective companies.

General Use of Credit Scores and Credit History in Ohio

The Department's review revealed that credit scores or credit history is used by approximately 67% of the companies that write personal lines insurance in Ohio. All of the companies that use credit scores or credit history reported that they use those factors in underwriting new business, and 92% of the companies that use credit scores or history reported that they also use credit information on renewals.

Report Results

Overall Findings

The Department initially found that 91% of the companies that use credit scores or credit histories have policies and procedures reasonably designed to achieve compliance with the credit scoring rule. Four areas of potential concern were identified during the initial review:

- Failure to have procedures to re-underwrite or re-rate a consumer or adjust a premium when the company receives notice that a credit score or history is inaccurate.

- Failure to provide reasons for an adverse action or a lack of procedures for handling adverse action situations.

- Apparent use of a credit score as a sole factor to determine eligibility.

- The delivery of adverse action letters to agents instead of insureds.

At the conclusion of the Department's review, the few companies that had been identified early in the process (as described below) as having potential compliance problems had provided additional and satisfactory information or had changed certain practices in order to address the Department's concerns.

Inaccurate or Incomplete Credit Information

Under the rule, when an insurance company is notified by a consumer or a consumer reporting agency that a consumer's credit history or credit score is inaccurate or incomplete, the company has 30 days in which to re-underwrite the consumer, re-rate the consumer and adjust the premium. Also, an insurer must recheck an insured's credit history or credit score upon written request of the insured. The companies appeared to have appropriate policies and procedures to comply with this requirement.

Adverse Actions

The rule requires insurers to provide consumers with certain notices during the application process and when an adverse action is taken as a result of a credit score or credit history. Adverse actions include a denial or cancellation of coverage, an increase in the charge for insurance or an unfavorable change in the terms or amount of coverage.

Applicants for insurance must be notified that credit history or a credit score may be obtained and used in connection with underwriting or rating a policy. All companies provided information that suggested that their policies and procedures satisfy this requirement. Although various methods of disclosure were reported, many companies use an ACORD application form that contains the required disclosures.

If an adverse action is taken as the result of a credit history or a credit score, the insurance company must provide certain information to the consumer within 30 days of the date the adverse action is taken. All companies appeared to identify adverse actions in accordance with the definition of "adverse action" in the rule. All companies had appropriate procedures for issuing required notices upon taking an adverse action as a result of credit information. In a couple of situations, companies indicated that they provide the required notice only to the agent who is expected to deliver the notice to the consumer. These companies were asked to change their practice.

The notice forms that were initially submitted by 4% of the companies did not provide the consumer with the significant factors of the credit score or credit history that resulted in the adverse action. However, most of those companies were already in the process of correcting the deficiency when they responded to the Department.

Sole Factor

The rule provides that credit history or a credit score may not be used in any underwriting decision, premium determination or in any adverse action as that term is defined in the rule unless other factors are also considered. Generally, the sole factor prohibition means that an insurer must review and consider other underwriting and rating factors in addition to the credit information. The Department identified a few instances in which companies appeared to be using a credit score as a sole factor for eligibility. The companies either provided additional, satisfactory information or changed their practices.

Prohibited Underwriting, Rating and Credit Scoring Factors

In underwriting or rating a policy of personal lines insurance, no insurance company may use any of the following as a negative factor:

- Credit inquiries that are not initiated by the consumer;
- Credit inquiries relating to insurance coverage;
- Disputed information that is currently under investigation by the consumer reporting agency, if so identified on the records of such agency;
- Collection accounts with a medical industry code;
- Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within 30 days of one another, unless only one inquiry is considered; or
- Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within 30 days of one another, unless only one inquiry is considered.

Most companies rely upon a vendor, generally a consumer reporting agency, to ensure compliance with this provision of the rule. The Department reviewed the credit scoring models that are reported to be in use in Ohio and found that none of the prohibited factors are used to develop a credit score in any of the models. The Department also determined that the models do not consider race, creed, color, national origin, minority status or income in developing credit scores.

No Hit/No Score

On occasion, an applicant for insurance may have insufficient credit history to develop a credit score ("no score"), or may have no credit history ("no hit"). When such a situation occurs, insurers are required to underwrite and rate the consumer in accordance with actuarial principles and standards of practice. Most companies (86%) place the "no hit/no score" consumer in a "neutral" (base rate) tier unless the consumer has a credit or surcharge for some other reason. Others use a discount off the base rate.

Multiple Scores Within a Single Household

Companies were asked to explain the underwriting process in situations in which a husband and wife in the same household have different credit scores. All of the companies reported that they assign a single credit score to the household. However, they use various means to choose that score. The most common method, as reported by 71% of the companies, is to use the score of the "first named insured", the "head of household", or the "applicant." Twenty-six percent of the companies use the highest score of the two. The remaining companies average the two scores.

Internal Audits

The Department requested information about procedures for verifying or auditing the accuracy of credit scores. Only 13% performed any internal audits to determine the accuracy of credit scores. Most companies rely upon the vendor to do so.

Information Provided To Consumers

The Department wanted to know whether insurance companies provide consumers with information about what a consumer can do to influence or improve a credit score. Sixty-three percent of the companies reported that they provide some information to consumers about the factors that may affect credit scores and ways that consumers can improve credit scores. The information is disseminated in brochures, pamphlets, or, in some cases, a referral to a company website.

Credit Score Models

Four commercial credit score models are in use in Ohio along with several models that were developed by or for insurance companies:

Vendor or Source	**Companies Using**
Choice Point	37%
Trans Union	27%
Equifax	6%
Experian	15%
Company developed model	15%

Conclusion

Overall, the insurance companies writing personal lines insurance in Ohio seemed well-prepared to comply with the regulatory restrictions on the use of credit history and credit scores, as promulgated in section 3901-1-55 of the Ohio Administrative Code, and had policies and procedures that were reasonably designed to achieve compliance.

The Department intends to continue to monitor compliance with section 3901-1-55 on a periodic basis. Currently, the Department is one of five state insurance departments selected to provide technical advice to the Federal Trade Commission on its review of the use of credit scoring. The Department will continue to review any research published on credit scoring to ensure that consumers are treated fairly.