Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 300 (as enacted) **PUBLIC ACT 165 of 2012**
House Bills 4593 through 4596 (as enacted) **PUBLIC ACTS 205 through 208 of 2012**
Sponsor: Senator John J. Gleason (S.B. 300)
Representative Ben Glardon (H.B. 4593)
Representative Paul Opsommer (H.B. 4594)
Representative Deb Shaughnessy (H.B. 4595)
Representative Lisa Howze (H.B. 4596)
Senate Committee: Insurance
House Committee: Insurance

Date Completed: 8-28-12

CONTENT

The bills add Chapter 21A (Credit Information and Credit Scores) to the Insurance Code to regulate the use of credit information and insurance scores with regard to personal insurance policies (such as automobile and home insurance).

Senate Bill 300 defines terms used throughout Chapter 21A.

House Bill 4593 requires an insurer to indemnify a producer against liability related to the producer's use of credit information or insurance scores for the insurer; and provides that nothing in Chapter 21A may be construed to provide an insured or applicant for insurance with a cause of action that does not exist in the absence of the chapter.

House Bill 4594 does the following:

-- Prohibits an insurer from using credit information or an insurance score as part of a decision to deny, cancel, or not renew a personal insurance policy.
-- Allows an insurer to use credit information or a credit-based insurance score to determine premium installment payment options and availability.
-- Provides that an insurer may not apply credit information or a credit-based insurance score that the Code otherwise permits unless certain criteria are met.
-- Requires an insurer to notify an insured or applicant against whom the insurer takes an adverse action based on credit information, and provide the reasons for the action.

House Bill 4595 requires an insurer to provide reasonable exceptions to the use of credit information upon the request of an insured or applicant, under specific circumstances.

House Bill 4596 requires an insurer to reevaluate an insured if a dispute resolution process determines that the initial evaluation was based on incorrect or incomplete credit information, and make any necessary adjustments.

All of the bills were tie-barred to each other. The bills will take effect on the 91st day after adjournment of the 2012 legislative session. A detailed description of the House bills follows. The definitions contained in Senate Bill 300 are described where applicable.

House Bill 4593

The bill provides that nothing in Chapter 21A may be construed to provide an insured or applicant for insurance with a cause of action that does not exist in the absence of the chapter.

The bill requires an insurer to indemnify and defend producers and hold them harmless from and against all liability, fees, and costs arising out of or relating to the actions, errors, or omissions of a producer resulting from the use of credit information or insurance scores for the insurer, if the producer follows the procedures and instructions established by the insurer and complies with all applicable laws and regulations.

Senate Bill 300 defines "credit information" as any credit-related information derived from a credit report, found in a credit report itself, or provided in an application for personal insurance. Information that is not credit-related may not be considered credit information, regardless of whether it is contained in a credit report or in an application, or is used to calculate an insurance score.

Senate Bill 300 defines "insurance score" as a number or rating derived from an algorithm, computer application, model, or other process based on credit information for the purposes of predicting the future insurance loss exposure of an individual applicant or insured.

The bill defines "personal insurance" as property/casualty insurance written for personal, family, or household use, including automobile, home, motorcycle, mobile home, noncommercial dwelling fire, boat, personal watercraft, snowmobile, and recreational vehicle, whether written on an individual, group, franchise, blanket policy, or similar basis.

House Bill 4594

Use of Credit Information/Insurance Score

The bill prohibits an insurer from using credit information or an insurance score as any part of a decision to deny, cancel, or not renew a personal insurance policy under Chapters 21 (Automobile Insurance and Home Insurance), 24 (Casualty Insurance Rates), and 26 (Fire and Inland Marine Rates). Credit information and an insurance score may be used, however, to determine premium installment payment options and availability.

The bill also prohibits an insurer from applying credit information or a credit-based insurance score that is otherwise permitted under the Code unless all of the following conditions are met:

-- The insurer or its producer discloses, either on the insurance application or when the application is taken, that it may obtain credit information in connection with the application.
-- The insurer or a third party on the insurer's behalf does not use the insured's or applicant's income, gender, address, zip code, ethnic group, religion, marital status, or nationality in calculating an insurance score.
-- The insurer does not take adverse action against a consumer because he or she does not have a credit card account, unless the action is based on any other applicable factor that is independent of that fact.
-- The insurer or a third party on its behalf does not consider an absence of credit information or an inability to calculate an insurance score in the rating of personal insurance unless any resulting rate differential is filed with and not disapproved by the Office of Financial and Insurance Regulation (OFIR).
-- The insurer or a third party on its behalf uses a credit report issued within 90 days before an insurance score based on that report is first applied to the insured.
-- Upon the request of the insured or, with his or her permission, the producer at annual renewal, or upon the insured's request during the course of the policy, an insurer or a third party on its behalf will obtain a new credit report or insurance score and rerate the insured.

With regard to an absence of credit information, OFIR may not disapprove a filing if it is reasonably justified by differences in losses and/or expenses, or provides the insured or insurance applicant with a discount that is not less, on average, than the average credit-based discount received by the insurer's insureds in Michigan.

In addition, an insurer may not apply credit information or a credit-based insurance score that is otherwise permitted unless, for scores calculated or recalculated on or after the bill's effective date, the insurer or a third party on its behalf does not use the following as a negative factor in any insurance score or in reviewing credit information:

-- Credit inquiries not initiated by the consumer or requested by the consumer for his or her own credit information.
-- Credit inquiries relating to insurance coverage, if so identified on an insured's or insurance applicant's credit report.
-- Multiple lender inquiries, if coded by the consumer reporting agency on the credit report as being from the home mortgage industry or automobile lending industry and made within 30 days of one another, unless only one inquiry is considered.
-- Collection accounts with a medical industry code, if so identified on the consumer's credit report.

Senate Bill 300 defines "adverse action" as an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any personal insurance, existing or applied for. "Consumer reporting agency" means any person who, for monetary fees or dues or on a cooperative nonprofit basis, engages regularly in the practice of assembling or evaluating consumer credit information or other consumer information for the purpose of furnishing consumer reports to third parties.

Adverse Action

Under House Bill 4594, if an insurer takes an adverse action based upon credit information, the insurer must notify the insured or applicant in accordance with 15 USC 1681m(a). The insurer must give notice in clear and specific language of the reasons for the adverse action, including a description of all factors that were the primary or most significant influences for the action and the insured's or applicant's insurance score if not otherwise provided. The insurer, however, does not have to give more than four factors for the adverse action. The use of generalized terms such as "poor credit history", "poor credit rating", or "poor insurance score" do not meet the bill's description requirements. Standardized credit explanations provided by consumer reporting agencies or other third party vendors do meet those requirements.

(Under 15 USC 1681m(a), a person who takes any adverse action against a consumer based on information contained in a consumer report must notify the consumer orally, electronically, or in writing. In addition, the person must give the consumer the name and contact information of the consumer reporting agency that furnished the report, as well as a statement that the agency did not make the decision to take the adverse action and is unable to provide the reasons for it. The person also must give the consumer a notice of the consumer's right to obtain a free copy of his or her consumer report and to dispute with the consumer reporting agency the accuracy or completeness of information in the report.)

House Bill 4595

Under the bill, notwithstanding any other law, rule, or regulation, upon written request from an insured or insurance applicant, an insurer that uses credit information must provide reasonable exceptions to the application of that information on the insurer's rates, rating classifications, or company or tier placement for a person who has experienced and whose credit information has been influenced directly by any of the following events:

-- A catastrophic event, as declared by the Federal or State government.
-- Serious illness or injury, or serious illness or injury to an immediate family member.
-- Death of a spouse, child, or parent.
-- Divorce or involuntary interruption of legally owed alimony or support payments.
-- Identity theft.
-- Temporary loss of employment for at least three months, if it results from involuntary termination.
-- Military deployment overseas.
-- Predatory lending resulting in the foreclosure of, or commencement of proceedings or an action to foreclose, a mortgage of real property owned by the insured or insurance applicant.

-- Other events, as determined by the insurer.

If an insured or applicant submits a request for an exception, an insurer is permitted, but not required, to do any of the following:

-- Require a reasonable written and independently verifiable documentation of the event.
-- Require the person to demonstrate that the event had direct and meaningful impact on his or her credit information.
-- Require a request to be made within 60 days from the date of the application for insurance or the policy renewal.
-- Grant an exception even if the person did not provide an initial request in writing.
-- Grant an exception when the insured or applicant asks for consideration of repeated events, or the insurer has considered this event previously.

An insurer must notify insureds and applicants that reasonable exceptions are available, and provide information about how to inquire further.

Within 30 days after an insurer receives sufficient documentation of an event, it must inform the insured or applicant of the outcome of his or her request for an exception. This communication must be in writing or provided in the same medium as the request.

The bill provides that an insurer will not violate a law, rule, or regulation relating to underwriting, rating, or rate filing as a result of granting an exception.

House Bill 4596

The bill requires an insurer to reevaluate a current insured if it is determined through the dispute resolution process set forth in 15 USC 1681i(a) that the credit information of the insured was incorrect or incomplete, and if the insurer receives notice of this determination from the consumer reporting agency or the insured. The insurer must reevaluate the insured within 30 days of receiving the notice.

After reevaluating, the insurer must make any necessary adjustments, consistent with the Code and the insurer's underwriting, rating guidelines, and premium discount plan. If an insurer determines that the insured has overpaid premium, the insurer must refund the amount of overpayment calculated back to the shorter of the last 12 months of coverage or the actual policy period.

(Under 15 USC 1681i(a), if a consumer notifies a consumer reporting agency that he or she disputes the completeness or accuracy of any item of information contained in his or her file at the agency, within 30 days the agency must conduct a reasonable reinvestigation to determine whether the disputed information is inaccurate. If the information is found to be inaccurate or incomplete, or cannot be verified, the agency promptly must delete it from the consumer's file or modify that item as appropriate.)

MCL 500.2151 (S.B. 300)
500.2159 & 500.2161 (H.B. 4593)
500.2153 & 500.2156 (H.B. 4594)
500.2154 (H.B. 4595)
500.2157 (H.B. 4596)

BACKGROUND

Legislation enacted in 1997 allowed insurance companies to establish premium discount plans. Under this legislation, some insurers began considering policyholders' credit scores in setting rates, citing data indicating a correlation between a person's credit score and the likelihood that the person will file a claim.

Several years later, in response to concerns regarding the accuracy of credit reports and questions about the fairness of the practice, then-Governor Jennifer Granholm called for a total ban on the use of credit scores in setting individual insurance premiums. The Office of Financial and Insurance Regulation (then called the Office of Financial and Insurance Services, or OFIS) proposed administrative rules to that end in 2004. The rules took effect in 2005, prompting several insurance industry associations and private insurers to file a lawsuit seeking declaratory and injunctive relief. The complaint was based on the assertion that the rules were in conflict with the Insurance Code, and that the OFIS Commissioner had exceeded her rule-making authority.

In April 2005, the trial court permanently enjoined the Commissioner from enforcing the rules, stating that she had exceeded her rule-making authority by ordering an industry-wide reduction in rates rather than using the Insurance Code's contested case hearing process to challenge rates on an individual basis. The court also concluded that evidence established a correlation between insurance scores and risk of loss; thus, the use of those scores met standards set forth in the Code.

The Commissioner appealed to the Court of Appeals, which did not agree on a rationale but vacated the trial court's order. Subsequently, although applications for leave to appeal were pending before the Michigan Supreme Court, OFIS began to issue notices that disapproved new rate filings. Some of the notices acknowledged the trial court's order but stated that the disapproval was based on the conclusion that insurance scoring was directly prohibited by the Insurance Code because rates based on insurance scoring were unfairly discriminatory. As a result, the plaintiffs moved in the trial court to enforce its April 2005 order. In April 2009, the court issued an order preventing the Commissioner from "challenging or denying rate filings on the basis that the rate filing uses insurance scores as a rating factor" and ordering her to "refrain from taking further actions based on a blanket prohibition on the use of insurance scores".

The Michigan Supreme Court granted leave to appeal in May 2009. In a July 2010 decision, the Supreme Court concluded that the OFIS rules were contrary to the Insurance Code, and reinstated the trial court's order (*Insurance Institute of Michigan* v *Commissioner, Financial and Insurance Services*, 486 Mich 370). The Supreme Court applied the following three-pronged test established by case law to determine the validity of the OFIS rules: (1) whether the rule is within the matter covered by the enabling statute; (2) if so, whether it complies with the underlying legislative intent; and (3) if it meets the first two requirements, whether it is arbitrary or capricious.

Noting that the Insurance Code permits the use of insurance scoring through the provisions allowing premium discount plans and the use of rating factors, the Court determined that the OFIS rules prohibiting the practice were not "within the matter covered by the enabling statute".

The OFIS Commissioner claimed the use of credit scoring went against the Code's stated purpose that insurance should be available and affordable for everyone, because insurers did not expect a reduction in *overall* losses or expenses to be associated with offering discounts for insurance scores. The Court, however, rejected this argument, as the Code "expressly permits '*an* insurer' to establish '*a plan*' 'if *the plan*…reflects reasonably anticipated reductions in losses or expenses" (emphasis in original). The Court acknowledged the plaintiffs' assertion that credit-based discounts actually contribute to the continuing affordability and availability of insurance, as well as evidence that the prohibition against insurance scoring would lead to a rate increase for the majority of Michigan residents.

Next, the Court examined the Commissioner's argument that insurance scoring produces rates that are "unfairly discriminatory" in violation of the Insurance Code. The Code allows insurers to sort their customers according to a reasonable classification system to justify rate differentials. According to OFIS rules, a "reasonable classification system" is a system designed to group individuals or risks with similar characteristics into rating classifications that are likely to identify significant differences in mean anticipated losses and/or expenses between the groups, as determined by sound actuarial principles and by actual and credible loss and expense statistics or, in the case of new coverages or classifications, by reasonably anticipated loss and expense experience. The Commissioner claimed that insurance scoring was not a reasonable classification system because the information contained in credit reports can be inaccurate, leading some customers to be classified incorrectly.

The Court, however, dismissed this line of reasoning, pointing out that the Commissioner had not moved to curb the use of credit scores in the banking and finance industries, which also are regulated by OFIS. In addition, the Court found that most credit report errors are too minor to affect the actual score and, therefore, do not result in rates that are unfairly discriminatory.

In conclusion, the Supreme Court reaffirmed that the use of credit scores is permitted under the Insurance Code, and that the Commissioner exceeded her statutory authority in promulgating rules to ban the practice. The Court reinstated the trial court's order declaring the rules invalid and permanently enjoining their enforcement.

Legislative Analyst: Julie Cassidy

FISCAL IMPACT

The bills will have no fiscal impact on State or local government.

Fiscal Analyst: Josh Sefton