

Where NY Regulator's Insurance Investigation Is Headed

By **Matthew Gaul and Maxfield Fey** (March 24, 2022)

The use of credit scoring information in insurance underwriting and rating processes has been controversial for many years.

Regulators and consumer advocates frequently raise concerns about the fairness of using credit reporting information to assess insurance risk and the potential negative impact on lower-income people and members of racial and ethnic minorities.

Insurers, on the other hand, cite the predictive value of credit information, its availability and the importance of including it in a mix of ratings factors to accurately assess risk.

Over the years, a number of states, including New York, have placed statutory and regulatory limits on the use of credit information. Now it looks like the New York Department of Financial Services has decided to wade into these issues once again.

March 2 DFS Section 308 Letter

On March 2, the DFS issued a letter addressed to major insurers authorized to write property and casualty insurance in New York, requiring each insurer to submit a special report pursuant to New York Insurance Law, Section 308.

The recipients must respond to a series of questions about the use of personal credit scores in underwriting and rating processes in the private passenger automobile, commercial automobile and homeowners insurance markets. The 60 questions in the letter are divided into four sections: (1) credit scoring and initial tier placement; (2) consumer notifications and interactions; (3) data analysis; and (4) general views and observations.

New York's law on using credit information permits and regulates the use of credit information, and some of the Section 308 letter questions appear targeted at examining compliance with existing law and getting a better understanding of the actuarial role credit scoring plays in underwriting and tiering, the weight it is given, and whether credit information leads to positive or negative rate impacts for policyholders.

The questions in the Section 308 letter also indicate, however, that the DFS is skeptical of the use of credit information generally even within the confines of current statutory law. For example, the DFS challenges insurers to defend the validity of credit information as a predictor of loss:

54. Data aside, after taking into consideration all other elements of the company's class plan, why does the company feel that an insured's credit score is such a valuable predictor of future losses, both in general, as well as in comparison to an insured's actual past driving history?

The DFS also questions the fluctuating nature of credit scores and demands a response to a



Matthew Gaul



Maxfield Fey

hypothetical where the prudent management of credit by a consumer could lead to a lower credit score and higher insurance premiums:

55. How does the company reconcile the validity of an insured's credit score as a rating consideration when a credit score, unlike many other rating variables that are considered "static," can frequently fluctuate and be negatively influenced by one or more reasonable proactive actions on the part of the insured? For example, an insured who has a longstanding credit card with a high available limit that they rarely, if ever, use may choose to close that account to protect themselves from identify theft. This has a dual negative impact on the insured's credit score, as not only does the insured's average age of accounts decrease, but the insured's ratio of outstanding balances to available credit goes up.

56. Why should the insured in this example now be subject to a potentially higher insurance premium when it appears that their credit decision was made in a reasonable, prudent and responsible manner?

The DFS is also concerned about the impact of the use of credit scores on lower-income individuals:

59. Arguments have been made that lower income individuals may not have the same access to credit as, or be able to manage their finances as well as, higher income individuals, thus leading to lower average credit scores, or even the absence of a credit score. Similar arguments have been made that higher income individuals have higher deductibles and/or may elect not to report claims, choosing instead to pay smaller claims out of pocket rather than see their insurance premiums increase, a luxury that is not afforded to a lower income individual. How does the company respond to each of these arguments?

60. In addition, has the company performed any independent or other analysis to ensure that the use of credit scores for initial tier placement is not a proxy for any other prohibited variables, such as income?

In the section on consumer notifications and interactions, the DFS also asks whether the insurer automatically updates credit scores for all insureds, which is not required by law. Additionally, if a company only updates credit scores at the request of the insured, the insurer must indicate how often it permits insureds to request updates, how many requests the company has received in the last four years, and how these credit score updates have affected insureds.

Finally, the Section 308 letter also asks a series of questions on whether the recipient insurer encourages insureds to check their credit reports regularly and report any errors not just to the credit reporting agency but also to the insurer.

New York Article 28

New York Insurance Law, Article 28, on the use of credit information,[1] creates a comprehensive regulatory scheme for managing the use of credit scores by insurers issuing personal lines property and casualty coverage in New York.

Article 28 prohibits using credit information as the sole basis to deny issuing a policy, using credit information to cancel or not renew a policy, or using credit information to increase an insured's premium. Additionally, Article 28 bans insurers from taking adverse action against

consumers with no credit, and only permits insurers to use reports issued or calculated within 90 days of when the policy was first written.

Article 28 also requires insurers to allow policyholders to request to be rereated with a new credit pull at least once every three years. However, absent a policyholder request, there is no requirement for insurers to pull new credit information or rerate policies automatically.

Article 28 also requires insurers to reunderwrite and rerate policies if it is determined through the federal Fair Credit Reporting Act that the credit information of a current insured is incorrect or incomplete. Insurers have 30 days to reunderwrite and rerate policies upon receiving notice of such determination, in addition to refunding any overpaid premiums to the insured.

Current U.S. Regulatory Climate

While some states remain silent on the issue, most states have taken at least some action to ban or manage the use of personal credit scores in insurance rating. According to the National Association of Insurance Commissioners, most states do not allow credit-based insurance scores to be used as the sole basis for raising rates, or denying, canceling or not renewing a policy.[2]

California, Hawaii, Maryland, Massachusetts and Michigan have completely banned the use of personal credit scores when determining policy rates for at least some lines of insurance.[3]

Oregon and Utah prohibit insurance companies from canceling a policy or not renewing a policy based on personal credit scores. Additionally, in Utah, personal credit scores can only be used to offer potential insureds discounts on premiums, and cannot be used to adversely affect a premium offer. Furthermore, if a discount is offered it cannot be revoked once the policy is in effect based on a change in credit.[4]

In Washington, State Insurance Commissioner Mike Kreidler recently issued an order banning the use of personal credit scores in policy rate-setting for the next three years in automobile, homeowners and renters insurance.

In a written statement following the issuance of the order, Kreidler stated, "We know that now, more than ever, credit reporting is unreliable" and that "[i]t is unfair to base how much someone pays for frequently mandatory insurance on an unreliable and fluctuating factor like a credit score." [5]

Likely Direction of the DFS Inquiry

It is impossible to predict with certainty where the new DFS inquiry will lead, but the Section 308 letter does provide clues on the actions the DFS might take. The DFS could conclude based on the data it receives from the industry that no action is necessary, but that result seems unlikely.

The DFS could work with the New York Legislature to amend and/or expand the statutory limitations on the use of credit information in Article 28.

In recent years, however, the DFS has rarely taken a legislative path on major initiatives, choosing instead to issue regulations within its interpretation of existing statutory authority or to issue guidance in the form of circular letters setting forth DFS expectations for

industry conduct. This has been true even recently when the state executive branch, Senate and Assembly have been controlled by a single political party.

It may be difficult for the DFS to impose an outright ban on the use of credit scores in underwriting and rating on its own, given New York's statutory scheme detailing permissible uses of credit scores, but there are a number of actions the DFS may take that would have a dramatic impact on current practices relating to the use of credit scores.

First, the DFS may impose fines and remedial actions through consent orders if it determines that certain insurers are not complying with the existing requirements of Article 28.

Second, the DFS has asked about the use of credit information in commercial auto insurance, a line of business that has thus far rarely been subject to restrictions on the use of credit information either in New York or elsewhere. The DFS could issue guidance indicating that underwriting and rating for commercial auto policies — particularly policies issued to sole proprietorships or partnerships with a single driver — should be subject to restrictions similar to those set forth in Article 28, or others.

Third, like Kreidler, the DFS is concerned about the fluctuating nature of credit scores and whether insurers refresh the credit information they use over time.

It may be difficult for the DFS to mandate that insurers update credit information more often than the standard set forth in Article 28 — every 3 years at the request of the insured — without inviting legal challenge. The DFS could, however, via regulation or guidance require insurers to notify their policyholders of their right to request an updated credit pull and re-rating of their policy pursuant to New York Insurance Law, Section 2302(g).

Fourth, the DFS could also mandate that insurers encourage their policyholders to review their credit reports, challenge any errors through established procedures and report errors to the insurer.

Finally, given the emphasis on actuarial analysis in the Section 308 letter, the DFS may issue detailed guidance on the appropriate role of credit information in underwriting and tiering and what weight credit information should be given.

The DFS could also require that insurers that use credit information in New York be prepared to demonstrate that such use does not result in unfair results for lower-income people or other disadvantaged groups. The DFS took this approach in Circular Letter 1 in 2019[6] relating to the use of external data and algorithmic underwriting in life insurance, which led to most insurers abandoning algorithmic underwriting in New York.

Conclusion

Responses to the Section 308 letter are due on May 2, although some insurers may seek extensions given the volume of information requested and the difficult public policy-related questions presented. It may be some time after that before the DFS digests the information received and decides what action to take.

Matthew J. Gaul is a partner at Willkie Farr & Gallagher LLP. He formerly served as deputy superintendent for life insurance in the New York State Insurance Department, now part of

the DFS, and chief of the Investor Protection Bureau at New York State Attorney General's Office.

Maxfield Fey is a law clerk in at Willkie Farr.

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[1] N.Y. Ins. Law §§ 2801–2809 (McKinney).

[2] National Association of Insurance Commissioners, Credit-Based Insurance Scores. Available at <https://content.naic.org/cipr-topics/credit-based-insurance-scores> (last updated February 22, 2022).

[3] Id.

[4] Louis DeNicola, Which States Restrict the Use of Credit Scores in Determining Insurance Rates?. Experian. Available at <https://www.experian.com/blogs/ask-experian/which-states-prohibit-or-restrict-the-use-of-credit-based-insurance-scores/> (last updated September 23, 2020).

[5] Rachel La Corte, Washington insurance commissioner adopts credit scoring ban. Oregon Public Broadcasting. Available at <https://www.opb.org/article/2022/02/01/washington-insurance-commissioner-adopts-credit-scoring-ban/> (last updated February 1, 2022).

[6] https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2019_01.