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# Adverse Underwriting Decisions: Recent Developments and a Framework for Simplifying Compliance

Insurers must notify consumers if the insurer takes an “adverse action” regarding the consumer's application for insurance. The required content of the notice varies, based on how the decision to take such action was made. These laws apply to life, health and property and casualty lines of business. Recent events suggest that insurers should re-evaluate compliance with these requirements. This article summarizes these laws and suggests a framework for evaluating and improving compliance.

## RECENT EVENTS

### *New Focus of Federal Trade Commission*

Insurers' use of consumer reports in the underwriting process is a topic of great interest among state insurance commissioners and the Federal Trade Commission (“FTC”). At the December 2002 meeting of the National Association of Insurance Commissioners (“NAIC”), a representative from the FTC stated that it will begin investigating aggressively insurers' compliance with the adverse underwriting decision notice requirements under the Fair Credit Reporting Act (“FCRA”).

### *State Law Changes*

California recently amended its version of FCRA. Effective September 28, 2002, the law requires insurers to provide consumers with notice of the right to receive any investigative consumer reports ordered by the insurer (investigative consumer reports are discussed in more detail below). This option must be provided to the consumer by means of a box to check on either a disclosure form or a separate consent form. Previously, insurers were required to provide consumers with copies of investigative consumer reports within seven days of receiving the report or at the time of the initial meeting between the consumer and the

person requesting the report, whichever was earlier. Insurers should review their forms to ensure that they are complying with the new California requirement.

## FAIR CREDIT REPORTING ACT

Under FCRA, an insurer taking certain adverse actions with respect to any consumer's application for insurance must provide a specific notice to that consumer. Adverse actions based in whole or in part on any information contained in a consumer report trigger the notice requirement. For such actions, the insurer must notify the consumer of the adverse action, the contact information of the consumer reporting agency that furnished the consumer report to the insurer, and other specified disclosures<sup>1</sup>. Key to understanding when the FCRA notice requirements are triggered is determining:

1. whether an “adverse action” has occurred;
2. whether a “consumer report” was used, in whole or in part, as the basis for the adverse action
3. what information must be in the notice to the consumer; and
4. who is entitled to receive the notice<sup>2</sup>.

### *“Adverse Actions”*

An “adverse action” under FCRA is “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.” This is interpreted very broadly to mean any action taken that is adverse to the interests of the consumer<sup>3</sup>. Thus, not only would a decline to issue decision be considered an “adverse action,” but charging a higher premium than applied for,

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or issuing coverage with additional exclusions would be “adverse actions” as well.

### *“Consumer Report”- More Than Just Credit Reports*

The “adverse action” described above does not, by itself, trigger the notice requirements under FCRA. The adverse action must be based, in whole or in part, on information contained in a “consumer report.” A “consumer report” is information from a consumer reporting agency bearing on a consumer’s creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living. The term includes more than traditional consumer credit reports. “Consumer reports” also include reports prepared by the Medical Information Bureau (“MIB”),<sup>4</sup> and driving records provided by state departments of motor vehicles (regardless of whether provided by a third party vendor) because these reports concern the “character, general reputation, personal characteristics, or mode of living” of the consumer.

### *Contents of the Notice*

If an insurer receives a consumer report, and information in that report forms the basis, at least in part, for an adverse action, then that insurer is required by FCRA to send notice of the adverse action to the consumer who was the subject of the consumer report. FCRA sets forth the information that must be contained in these notices<sup>5</sup>. Thus, it is essential to develop protocols to track the usage and sources of consumer reports.

In addition, FCRA requires that insurers provide certain notices if the insurer orders investigative consumer reports to aid in underwriting. An investigative consumer report is “a consumer report or portion thereof in

which information on a consumer’s character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom [the consumer] is acquainted or who may have knowledge concerning such items of information.” If an insurer orders an investigative consumer report, it is required under FCRA to disclose (1) to the consumer, not later than three days after such report was requested, that an investigative consumer report has been requested, and (2) that the consumer has the right to request from the insurer information concerning the nature and scope of the investigation ordered and a written summary of the consumer’s rights under FCRA regarding such report.

### *Notice Goes to the Subject of the Consumer Report*

FCRA requires that the consumer who is subject of the consumer report receive the required notice. Therefore, an insurer must take care to ensure that the notice is sent to the proper individual, who may or may not be the consumer who applied for coverage, as in the case of life insurance when the insured is not necessarily the policy owner.

### *State Mini-FCRA’s*

A number of states, such as California, have statutes similar to FCRA. While many of these statutes do not impose additional obligations on insurers, some states require notice of information that FCRA does not. For example, Massachusetts requires

that the notice of an adverse action provide additional disclosures to those required by FCRA. In addition, as noted above, the California notice requirements regarding the use of investigative consumer reports differ significantly from FCRA’s.

Unlike FCRA, California requires that an insurer provide most of its investigative consumer report disclosures regardless of whether the consumer requests such information.

Thus, not only would a decline to issue decision be considered an adverse action, but charging a higher premium than applied for, or issuing coverage with additional exclusions would be adverse actions as well.

Under California law, the insurer must disclose the name and address of the investigative consumer reporting agency conducting an investigation as well as a summary notice of the consumer’s right to inspect the files of the investigative consumer reporting

agency. In addition, the insurer must provide a means by which the consumer may indicate that he or she wishes to receive a copy of any report that is prepared. If the consumer requests a copy, then the insurer must send the copy within three business days of the insurer’s receipt of the report.

### **NAIC MODEL ACT**

Nearly twenty states have adopted all or part of the NAIC’s Insurance Information and Privacy Protection Model Act (“NAIC Model Act”) in some form<sup>6</sup>. Like FCRA, the NAIC Model Act also requires that insurers provide a notice when an adverse underwriting decision has been made. Unlike FCRA, which requires the notice to be sent to the consumer who is the subject of the consumer report, the NAIC Model Act requires that an

“applicant, policyholder or individual proposed for coverage” be provided with the specific reason for an adverse underwriting decision (“AUD”) or advise that person that a written request may be made to receive the specific reason for the AUD. Under the NAIC Model Act, the applicant, policyholder or individual proposed for coverage must be provided a summary of these rights. Many of the states that have adopted the NAIC Model Act, however, have varied the requirements imposed upon insurers in significant ways, and it is important for insurers to note that an analysis of each state’s law should be undertaken before that insurer can properly evaluate its compliance with the various state laws.

### *“Adverse Underwriting Decisions”*

An AUD is “a declination of insurance coverage; a termination of insurance coverage; failure of an agent to apply for insurance coverage with a specific insurance institution which the agent represents and which is requested by an applicant; for property and casualty insurance coverage, (1) placement by an insurance institution or agent of a risk with a residual market mechanism, an unauthorized insurer or an insurance institution which specializes in substandard risks, or (2) the charging of a higher rate on the basis of information which differs from that which the applicant of policyholder furnished; or, in the case of a life, health or disability coverage, an offer to insure at higher than standard rates.”<sup>77</sup> While this definition is not as comprehensive as that of “adverse action” under FCRA, actions beyond

declinations are also considered AUD’s under the NAIC Model Act.

The major difference between the NAIC Model Act and FCRA is the absence of a need for a consumer report to trigger the provisions of the NAIC Model Act. Under the NAIC Model Act, any time that an AUD is made by an insurer, that insurer is obligated to provide the notice previously described. Developing universal forms of notice that may be used in various scenarios can ease the burden of compliance with the nuances of each law.

### FRAMEWORK

Insurers should re-evaluate their procedures for ordering and using consumer reports to determine whether they are properly notifying applicants and existing insureds of adverse actions in light of developments since their last comprehensive review. We also suggest that insurers determine whether they are doing business in states that have adopted the NAIC Model Act, and ensure that their adverse underwriting decision notices comply with the nuances of the state laws adopting the NAIC Model Act. The notices and the procedures that insurers are required to undertake by FCRA, the NAIC Model Act, and the state “mini-FCRA’s” are complex and often require extensive analysis, but, with the right framework in place, the task of complying with these laws can be streamlined. Following is a suggested framework for analyzing compliance:

1. For each product line, categorize information obtained from third parties in the underwriting process into one of the following:

- (i) consumer report
- (ii) investigative consumer report
- (iii) MIB report (also a consumer report)<sup>8</sup>
- (iv) none of the above

2. For purposes of the FCRA and mini-FCRA’s, for each product line, determine the process for tracking when an “adverse action” has been made and was influenced by each categories (i)-(iii) above.
3. For purposes of the NAIC Model Act, determine the process for tracking when an “adverse underwriting decision” has occurred.
4. Identify the relevant state deviations under the NAIC Model Act and the state mini-FCRA’s.
5. For each product line, determine the consumer (the owner of the policy or the insured) entitled to the notices under FCRA, the mini-FCRA’s and the NAIC Model Act.
6. Assemble and review current forms of letter sent to consumers following adverse underwriting decisions for compliance.
7. Develop a matrix of the nature of the adverse underwriting decision (such as declines, issuing less than the consumer applied for, etc.) against the basis of the adverse underwriting decision (whether the decision was influenced by categories 1 (i)-(iv) above). From the matrix, it will be clearer what content is required for the notice in a particular circumstance (such as where a consumer report was the basis for declining to issue a policy to a consumer resident in a state that has adopted the NAIC Model Act, but which has not adopted a mini-FCRA). Combining letters in this fashion can reduce the overall

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number of form letters, as well as reduce the number of letters sent to the consumers, while at the same time improving compliance with these disparate laws.

For additional information on this topic, including the NAIC Model Act adopted by various states, the mini-FCRA's and a sample form which combines into a single letter the content required under more than one of the laws described above, please contact one of the authors or your Lord, Bissell & Brook attorney.

<sup>7</sup> See NAIC Model Act § 2.

<sup>8</sup> MIB reports differ from tradition consumer reports because they are generated by the Medical Information Bureau, which has its own rules regarding adverse action notices. The MIB rules and FCRA's rules must be read in conjunction with each other.

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*Endnotes*

<sup>1</sup> This is an obligation on the insurer using the consumer report - not the consumer reporting agency, which has other obligations under the FCRA.

<sup>2</sup> Life insurance differs from certain lines of property and casualty insurance and health insurance in that the consumer applying for insurance is oftentimes not the consumer about whom consumer reports are gathered. For example, life insurance is often purchased by a person insuring the life of another. The consumer reports are typically obtained on the insured life, not the policy holder.

<sup>3</sup> See Ball-Stires FTC Staff Opinion Letter dated March 1, 2000.

<sup>4</sup> MIB has its own rules regarding notices.

<sup>5</sup> FCRA requires that the consumer be provided with: notice that an adverse action has occurred, the name and contact information of the consumer reporting agency that furnished the consumer report, a statement that the consumer reporting agency did not make the decision to take the adverse action, and notice of the consumer's right to obtain a free copy of the consumer report and dispute information on the report.

<sup>6</sup> For a listing and copies of the actual versions adopted by these states please contact the authors.