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PART II: Compounding The Confusion And Exculpating The Confused: Adverse Action Notices Under FCRA: *Safeco Insurance Co. Of America V. Burr*

On June 4, 2007, the United States Supreme Court ruled on a case much-anticipated by both the insurance industry and the consumer credit industry. The case is significant from a compliance perspective because on one hand the Court clarifies some aspects of “adverse action” notice requirements, but on the other hand, the ruling may cause more confusion about when such notices are required. The holding also resolved a conflict among several Circuit Courts of Appeal as to the proper standard to be applied in determining whether a violation of the FCRA is “willful.” For further analysis on the Court’s ruling from a litigation perspective, refer to a companion Client Alert, also issued today, issued by a Lord, Bissell & Brook class action litigation team.

Safeco addresses FCRA requirements for an insurer to notify a consumer if the premium rate class offered such consumer is higher following the insurer’s review of the consumer’s credit report (just one type of consumer report) compared to what rate the consumer would have received if the report had not been considered by the insurance company. This notice obligation applies to applicants seeking a new policy as well as to customers renewing policies who receive higher rates based on their credit reports.

The decision is a mixed bag for insurers. The Supreme Court ruled clearly:

- ♦ An “adverse action” can occur at the time of the initial application for insurance, not just at the time of renewal of an existing policy, which may surprise some insurers, as it apparently did *Safeco*;
- ♦ The failure to offer the consumer the insurer’s best premium rate, even if that decision is based on a consumer report, is not necessarily an “adverse action” triggering the need to provide an adverse action notice;
- ♦ At renewal time, only an increase over the prior premium rate class, not an increase over

the neutral score, would trigger the adverse action notice requirement; and

- ♦ While *Safeco* failed to comply with the adverse action notice requirements, such failure was not “willful” and thus *Safeco* is not liable for statutory damages to the consumers involved, given the lack of clarity in FCRA.

NOTE: For further discussion of these four rulings from a litigation perspective, see the companion Client Alert, also issued today, issued by a Lord, Bissell & Brook class action litigation team.

In contrast, the ruling is not clear on what the benchmark rate is for determining whether the rate actually offered to the consumer adversely affects the consumer. Rather than comparing what the consumer was offered to the insurer’s best premium rate class to determine whether the consumer is adversely affected, the ruling directs insurers to compare what was offered to what the premium rate class would be if the consumer had had a “neutral score” or what the “baseline” rate would be in the absence of consumer reports used to rate the consumer.

According to the Court, the drafters of FCRA intended to “require notice and prompt a challenge by the consumer only when the consumer would gain something if the challenge succeeded.” The Court disagreed with the Ninth Circuit’s decision that notification was required if the consumer would have received a lower rate if his or her credit report was more favorable. Instead, it agreed with GEICO’s approach, which first determined the consumer’s “neutral score” rate by determining the applicable rate without considering the consumer’s credit report. Next, GEICO would consider the consumer’s credit report and if the resulting rate given to the consumer was higher than the “neutral score” rate, the consumer would be sent an adverse action notice.

The Court insisted on this approach both in connection with applicants who have no prior dealing with the insurance company and current customers renewing a policy who receive a higher rate after the insurer's review of a less favorable credit report. The Court held that for renewal customers, the baseline for the "increase" is the previous rate charged to the customer, not the "neutral" baseline reasoning that once a consumer has learned that the insurer charged more based on the credit report, there is no need to provide an additional notification to the consumer.

Thus, the benchmark to determine whether a consumer is adversely affected by the insurer's use of a consumer report in the underwriting process is what the premium rate class would be if either:

- ◆ A consumer report with a neutral score had been received; or
- ◆ No consumer report had been received.

Developing the "neutral score" or "baseline" rate to then use as the benchmark to determine if the consumer is adversely affected by the insurer's reference to a consumer report may present challenges to insurers. This approach, according to Justice Stevens, writing separately on this point, will enable companies to "adopt whatever 'neutral' credit scores they want." It would be possible for an insurer to select low "neutral" credit scores so as to reduce the likelihood that notification will be required.

Insurers may be encouraged to:

- ◆ Develop for each type of consumer report used in the underwriting process a "neutral score"; and/or
- ◆ Determine a baseline premium class rate based on not referring to any consumer reports.

As did the lower courts, the Court also reviewed whether the insurers willfully vio-

lated FCRA by not sending adverse action notices on initial policy offers. Because the Court adopted GEICO's "neutral score" approach, it was not found to have violated FCRA and therefore the "willfulness" analysis is irrelevant with respect to GEICO. The Court agreed with the Ninth Circuit's determination that the "reckless disregard of a requirement of FCRA would qualify as a willful violation within the meaning of §1681n(a)" of FCRA. Although *Safeco's* interpreted FCRA to only require notification to customers, not applicants, regarding an adverse action based on the customer's credit report, the Court held that "*Safeco's* reading was not objectively unreasonable, and so falls well short of raising the 'unjustifiably high risk' of violating the statute necessary for reckless liability." *Safeco's* incorrect interpretation of FCRA was reasonable given the lack of guidance available, but future insurers will not likely be afforded such leniency from the courts.

As a reminder, "consumer reports" are not just credit reports or credit scores. Rather, "consumer reports" may include driving histories (also known as MVR's), MIB reports, certain background or "investigative consumer reports", and other information obtained from third parties offering a wide range of data on consumers such as certain pharmaceutical reports.

The ruling offers little guidance on how insurers are to develop what a "neutral score" is. Thus, the Court compounds the confusion of what the benchmark is to determine whether the consumer is adversely affected, other than we know the benchmark is not necessarily the best rate the company offers.

With respect to what the premium rate would be in the absence of any of the consumer reports some insurers may use in the underwriting process, such rate is likely to be extremely high because it is through such reports that insurers may verify what the consumers are reporting in the application for insurance. Consequently, taking this

approach could result in very few adverse action notices to consumers, which may be exactly what the Court intends. Influencing the Court's decision that best rate the company offers should not be the benchmark is the concern with "hypernotification", referring to the idea that such commonplace notices would mean little and be perceived as junk mail.

Further, if an insurer issues a policy with a premium class initially applied for by the consumer, but that premium class is not the best class (meaning lowest premium) or is not the premium class based on the "neutral score" or "baseline" rate, must the insurer send an adverse action notice? The consumer received what he or she sought, perhaps aware of the negative information in the consumer reports, but because of the information in the consumer reports, the carrier did not provide the better premium class. The Court's opinion provides very little guidance on this point. Granted, in many circumstances, the consumer may not actually apply for a specific rate class, so this issue may not apply to many insurers.

Summary Of Prior Decisions

Safeco, which was consolidated with *GEICO General Insurance Co. v. Edo* (formerly known in the Ninth Circuit as *Reynolds v. Hartford Financial Servs. Group, Inc.*) involved the issue of determining which circumstances trigger an insurer's duty under FCRA to issue notices of adverse actions to consumers. FCRA provides that an insurer must provide a consumer with an adverse action notice when the insurer takes an "adverse action" against the consumer that is based on information contained in a consumer report. At the heart of the prior decisions is the determination of what constitutes an "adverse action." FCRA was enacted in order to provide consumers with fair and accurate credit reporting, promote greater efficiency in the banking industry and protect the privacy of consumers.

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FCRA defines an “adverse action” as “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.” In *Reynolds*, the Ninth Circuit was faced with a claim by consumers that they should have received an adverse action notice when, due to information contained in their consumer reports, they were initially offered insurance at rates less than the best rates available. The insurers, however, argued that a prior rate needs to be offered before an insurer can be said to have “increased” the rate charged to a particular insured. In *Safeco*, the insurer did not deliver notices to applicants because it reasoned that since it had no prior dealings with the applicant, it could not “increase” the rate as there was no historical rate to compare it with. GEICO would deliver notices to applicants if the rate given was higher than the rate that the applicant would have received had the consumer’s credit report not been reviewed.

The Ninth Circuit, however, disagreed with the assertions of the insurers in both *Reynolds* and *Safeco*. Instead, it held that whenever an insurer charges a higher initial rate than it otherwise would have charged had the consumer report been more favorable, it has increased the charge within the meaning of FCRA. Therefore, the court noted, the fact that a policy is an initial one is of no con-

sequence, and an insurer is required to send adverse action notices whenever a consumer pays a higher rate because the consumer’s credit rating is less than the top potential score.

The Supreme Court reversed the Ninth Circuit and remanded both *Reynolds* and *Safeco* for further proceedings consistent with its opinion. GEICO was found not to have violated FCRA and although *Safeco* violated FCRA, its violation was not reckless.

Safeco may have the effect of influencing regulators’ interpretations of the adverse underwriting decision notice requirements of insurers under the various state versions of the NAIC Insurance Information and Privacy Protection Model Act. In addition, the Supreme Court’s interpretation of what constitutes a “willful violation” will most certainly impact pending class actions relating to the Fair and Accurate Credit Transactions Act (“FACTA”), which amended FCRA. In these class actions, significant liability hinges on whether certain retailers willfully violated FACTA in failing to remove their customers’ credit card expiration dates from receipts.

For further information on consumer notification requirements imposed on consumers by FCRA, please see <http://www.lockelord.com/newsstand/289>.

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