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Fair Credit Reporting Act (FCRA)
What Insurers Need to Know

The Fair Credit Reporting Act ("FCRA" or the "Act")[1] is a federal consumer protection statute that is designed to promote accuracy and fairness in the dissemination of personal information by "consumer reporting agencies" ("CRA"). To that end, FCRA imposes various obligations on businesses that furnish, distribute, and use consumer reports. The Act also affords rights to consumers who have been adversely affected by the use of information in their consumer report.

Insurers often obtain consumer reports for a variety of reasons, and companies that do so should be familiar with FCRA and varying interpretations of the Act. Courts have not interpreted FCRA's broad language consistently, and, in gray areas of the law like these, it is important for companies to understand the circumstances that could lead to noncompliance. A better understanding of the law will help minimize the threat of consumer-initiated litigation and FCRA related compliance issues. After analyzing the United States Supreme Court opinion in *Safeco Insurance Co. of America, et al v. Burr, et al*, which was released on June 4, 2007, this paper briefly discusses the obligations of insurers when they use credit reports in their underwriting and rating processes.

I. *Safeco Insurance Co. v. Burr* (U.S. Supreme Court June 2007)

The main issue of interest to insurers in *Safeco Insurance Co. v. Burr*[2] is whether insurers must give consumers an adverse action[3] notice under FCRA when the consumer initially applies for a policy and the rates offered by the insurer, based at least in part on a consumer report, are not the best rates or terms that the insurer has to offer. The insurers argued that there can be no "increase" in rate on an initial policy requiring an adverse action notice because there is no previous rate to use for comparison. The Federal Government argued that insurers are required to give adverse action notices on initial policies whenever the applicant receives a rate that is more than the insurer's best possible rate based at least in part on a consumer report.

[1] 15 U.S.C. §§ 1681 et seq.

[2] This decision is a consolidation of two cases, *Safeco v. Burr* and *GEICO General Insurance Co., et al. v. Edo.* The issues presented in both were identical, although the different facts resulted in different outcomes for the insurers.

[3] 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." 15 U.S.C. §1681a(k)(1)(B)(i).

The U.S. Supreme Court held that the FCRA, indeed, requires insurers to give adverse action notices on initial policies when an adverse action is taken based in part on a consumer report.[4] However, the Court did not adopt the Government's position that the benchmark for making this determination is the insurer's best possible rate. Rather, the Court adopted the position argued by GEICO. First, for an adverse action notice to be required, the consumer report must be a necessary condition of the rate increase. If the rate would have been the same regardless of the consumer report, then the insurer has taken no adverse action based on a consumer report and no adverse action notice is necessary.[5] Second, the Court held that the benchmark for determining whether the insurer took an adverse action is not the insurer's best possible rate but rather the rate that the applicant would have received had the insurer not taken into account the applicant's consumer report. The court called this the "neutral score."[6] Finally, after the initial policy period, the benchmark for determining whether there has been an "increase" in the rate is the rate for the previous policy period and not the "neutral score" baseline of the initial policy period.[7]

Secondarily, the Court held that FCRA's "willful" standard includes an insurer's reckless disregard of FCRA requirements and can result in additional damages under FCRA. However, the Court held that "a company subject to FCRA does not act in reckless disregard of [FCRA] unless the action is not only a violation under a reasonable reading of the statute's terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless."[8] That is, the insurer's reading of the statute would need to be objectively unreasonable to meet the reckless disregard standard.[9]

To sum up the Court's holdings in *Safeco*:

1. Initial policies are subject to adverse action notices if an adverse decision is made based in whole or in part on a consumer report.

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[4] *Safeco*, Slip Op. at 11-12.

[5] *Safeco*, Slip Op. at 13.

[6] *Safeco*, Slip Op. at 15.

[7] *Safeco*, Slip Op. at 17.

[8] *Safeco*, Slip Op. at 19.

[9] The Court held that Safeco did not act in reckless disregard in interpreting the FCRA requirements not to give an adverse action notice on initial policies. The court found that it was reasonable to assume that an "increase" presupposes prior dealing, and where no prior dealing occurred, no adverse action notice was required. The Court also indicated that the company did not have the benefit of guidance from the Federal Trade Commission or from the courts on the issue and that the FCRA was "less than pellucid." All of this combined made Safeco's reading of the statute not objectively unreasonable accounting to the Court, falling "well short of raising the 'unjustifiably high risk' of violating the statute necessary for reckless liability.'" *Safeco*, Slip Opinion at 20-21.

2. For there to be an adverse action on an initial policy, the consumer report must be a necessary condition to the increase in rate.

3. The benchmark for determining whether there has been an increase in rate is the applicant's "neutral score," i.e., the rate that the applicant would have been charged if the insurer had not taken his/her credit score or consumer report into consideration.

4. On renewal, the benchmark for determining whether there has been an increase in rate is the rate that was in effect for the previous policy, not the "neutral score."

5. Reckless disregard falls within FCRA's "willful" action standard and may subject the insurer to statutory damages ranging from $100 to $1,000 and punitive damages.

6. The test for determining reckless disregard is whether the insurer's action was "objectively unreasonable." If there is reasonable rationale for the insurers interpretation of the statute and there is no FTC or court guidance contrary to the insurer's interpretation, then the insurer's interpretation is not "objectively unreasonable."

II. Insurer Obligations Under Existing Fcra Law And Interpretation

A. FCRA'S SCOPE — UNDER WHAT CIRCUMSTANCES DOES FCRA APPLY?

FCRA generally applies to "consumers," "consumer reports," and CRAs. Thus, understanding what these terms mean is fundamental to understanding when the Act applies. For example, because FCRA defines "consumer" to mean "an individual,"[10] courts generally agree that the Act protects consumers only in their capacity as individuals — it does not protect individuals in their business or professional capacity, nor does it protect businesses or artificial entities.[11]

"Consumer reports" are made up of certain types of information about consumers,[12] and CRAs are persons or businesses that regularly collect and furnish consumer reports to third parties for a fee.[13] Based on the interdependent definitions of consumer, consumer report, and CRA, the answer to any FCRA applicability question generally turns on whether information about a consumer meets the definition of a consumer report. If it does, and if it was obtained from a

[10] 15 U.S.C. 1681a(c).

[11] National Consumer Law Center, *Fair Credit Reporting* § 2.3.6.5.2, p. 31 (5th ed. 2002) (hereinafter *Fair Credit Reporting*) (citing, *e.g., Mende v. Dun & Bradstreet*, 670 F.2d 129 (9th Cir. 1982); *Cambridge Title Co. v. Transamerica Title Ins. Co.*, 817 F. Supp. 1263 (D. MD 1992) *aff'd*, 989 F.2d 491 (4th Cir. 1993); *Wrigley v. Dun & Bradstreet*, 375 F. Supp. 969 (N.D. Ga. 1974) *aff'd*, 500 F.2d 1183 (5th Cir. 1974); *Sizemore v. Bambi Leasing Credit Crop.*, 349 F. Supp. 252 (N.D. Ga. 1973)).

[12] 15 U.S.C. § 1681a(d)(1).

[13] 15 U.S.C. § 1681a(f). State and local government subdivisions and their agencies are "persons" under FCRA and could meet the definition of a CRA under certain circumstances. *See* 15 U.S.C. § 1681a(b).

company that collects and provides such information to third parties for a fee, then FCRA probably applies.

Under FCRA, a "consumer report" means:

> [A]ny written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for (A) credit or insurance to be used primarily for personal, family, or household purposes; (B) employment purposes; or (C) any other purpose authorized under [FCRA].[14]

This definition is broad and, essentially, has two prongs. The first prong requires the personal information at issue to be obtained from a CRA and bear "on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living." Many are surprised to learn that information need not relate to an individual's credit history in order for FCRA to apply. However, this prong clearly states that information need bear on only *one* of the seven characteristics in order to be a consumer report, and four of the seven — character, general reputation, personal characteristics, and mode of living — have no obvious relationship to credit history.[15]

Assuming information about a consumer satisfies the first prong, the second prong requires the information to be "used or expected to be used or collected" to serve as a factor in determining the consumer's eligibility for personal credit, personal insurance, employment, or another purpose covered by the Act, in order to be a consumer report. Unfortunately, courts have not interpreted this prong consistently.

For example, a majority of courts interpreting this prong have held that information obtained from a CRA about a consumer is a consumer report whenever it is or was: (a) used; (b) expected by the CRA to be used; or (c) collected by the CRA to serve as a factor in establishing the consumer's eligibility for a purpose covered by FCRA.[16] This interpretation tracks the actual

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[14] 15 U.S.C. § 1681a(d)(1).

[15] If an individual's driving record contains arrest information, for example, it likely meets the definition of a consumer report because such information tends to bear on a person's character, general reputation, and mode of living. FTC Official Staff Commentary § 603(d) item 4C, § 603(f) item 10. On the other hand, credit header reports that contain basic information about consumers (*i.e.*, name, address, etc.) often do not constitute consumer reports because they do not bear on any of the seven characteristics. *See, e.g., Dotzler v. Perot*, 914 F.Supp. 328 (E.D. Mo. 1996).

[16] *Fair Credit Reporting*, § 2.3.5.1, p. 23 (citing, *e.g., Comeaux v. Brown & Williamson Tobacco Co.*, 915 F.2d 1264 (9th Cir. 1990); *St. Paul Guardian Ins. Co. v. Johnson*, 884 F.2d 881 (5th Cir. 1989); *Ippolito v. WNS, Inc.*, 864 F.2d 440 (7th Cir. 1998); *Heath v. Credit Bureau of Sheridan, Inc.*, 618 F.2d 693 (10th Cir. 1980); *Hansen v. Morgan*, 582 F.2d 1214 (9th Cir. 1978)).

language of the definition, and it is supported by the Federal Trade Commission ("FTC").[17] In addition, two observations follow from this interpretation, and each calls for broad application of FCRA:

1. ***Actual use of information can be irrelevant***. First, even if information about a consumer was obtained or used for a purpose not covered by FCRA, the information is a consumer report and FCRA applies if: (a) the information originally was collected by a CRA in connection with a covered purpose; or (b) the ordinarily expected use of such information relates to a covered purpose.[18] Thus, even if an insurer intends to use information about a consumer for a purpose that is not covered by FCRA (*e.g.*, underwriting commercial insurance), the Act will apply if the information originally was collected or expected to be used in connection with a covered purpose (*e.g.*, underwriting personal credit or insurance).

2. ***Partial use of prior consumer report in a subsequent report can trigger application of FCRA*.** Second, if a CRA collects information about a consumer for a covered purpose, then any subsequent report incorporating that information is a consumer report regardless of how the subsequent report was used or expected to be used.[19] In other words, a report that is used or expected to be used for a purpose that FCRA does not cover can still be a consumer report if information included in the report was obtained from a prior report and originally was collected for a covered purpose.

Some courts, largely in *dicta*, have stated that FCRA does not apply if a report was obtained and used solely for business or commercial purposes not covered by the Act.[20] These statements generally appear to underscore the fact that FCRA is not designed to protect businesses or individuals in their business or professional capacities. However, they also appear to be shorthand for the real reason these courts found that FCRA did not apply — because the information at issue was collected, used, *and* expected to be used solely in connection with the consumer in his or her business or professional capacity, not in his or her personal capacity.

Taken together, one can expect FCRA to apply in a given situation if the information at issue:

- Was obtained from a CRA;

[17] *Fair Credit Reporting* § 2.3.5.1, p. 23 (citations to numerous FTC Informal Staff Opinion Letters omitted). While various federal agencies have some level of enforcement power under FCRA, the FTC has primary enforcement responsibility. 15 U.S.C. § 1681s. Thus, its interpretation of the Act is entitled to a significant amount of deference. *See generally Udall v. Tallman*, 380 U.S. 1, 16 (1965).

[18] *See* note 8, *supra* p. 2.

[19] *Fair Credit Reporting* § 2.3.5.2, p. 25 (citing FTC Official Staff Commentary § 603(d) item 5C.

[20] *Fair Credit Reporting* § 2.3.6.5.5, p.32 (citing, *e.g.*, *Boothe v. TRW Credit Data*, 523 F. Supp. 631 (S.D.N.Y 1981), *modified*, 557 F. Supp. 66 (S.D.N.Y. 1982); *Matthews v. Worthen Bank & Trust Co.*, 741 F.2d 217 (8th Cir. 1984); *Mende v. Dun & Bradstreet*, *supra* n. 3; *Wrigley v. Dun & Bradstreet*, *supra* n. 3).

- Pertains to the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living; *and*
- Was collected, used, *or* expected to be used in connection with determining the consumer's eligibility for personal credit, personal insurance, employment, or any other purpose covered by the Act.

B. FCRA'S PERMISSIBLE PURPOSES – WHY MAY INSURERS OBTAIN CONSUMER REPORTS?

If consumer information obtained from a CRA meets the definition of a "consumer report," then insurers must be able to show that they had a permissible purpose to obtain the information. Under FCRA, three permissible purposes might justify an insurer's request for a consumer report. Specifically, a CRA may furnish a consumer report to an insurer if the CRA has reason to believe the insurer: (a) intends to use the information in connection with the underwriting of insurance involving the consumer;[21] or (b) has a legitimate business need for the information in connection with a transaction initiated by the consumer.[22] In addition, insurers may be able to obtain a consumer report in order to make firm offers of coverage to every individual included on a prescreened list.[23]

The permissible purpose for which insurers most often obtain consumer reports is in connection with the underwriting of insurance involving the consumer. Insurance involving the consumer has been interpreted to mean coverage obtained primarily for personal, family, or household reasons (*i.e.*, personal lines coverage).[24] Underwriting activities generally include the issuance, renewal or cancellation of a policy, establishing the amount, terms, or duration of coverage, and establishing the rates or fees to be charged,[25] but they do not include marketing activities,[26] nor do they include the investigation of insurance claims.[27] Thus, consumer reports may not be obtained for purposes of marketing, claims administration or investigation.

Although FCRA allows insurers to obtain consumer reports if they have a legitimate business need for the information in connection with a transaction initiated by the consumer, this provision has been interpreted in a way that does little to expand on the permissible purpose of personal lines underwriting. Specifically, FCRA's reference to consumer-initiated transactions as a permissible purpose in the insurance context is limited to transactions initiated by consumers

[21] 15 U.S.C. § 1681b(a)(3)(C).

[22] 15 U.S.C. § 1681b(a)(3)(F)(i).

[23] 15 U.S.C. §§ 1681b(c).

[24] FTC Official Staff Commentary § 604 item 1B.

[25] FTC Official Staff Commentary § 604(3)(C) item 1.

[26] Buchman, FTC Informal Staff Opinion Letter, Mar. 2, 1998.

[27] FTC Official Staff Commentary § 604(3)(C) item 2. For citations to FTC informal opinion letters, *see Fair Credit Reporting* p. 126 note 258.

for personal, family, or household purposes.[28] Thus, a transaction initiated for business or commercial reasons would not justify an insurer's request for a consumer report on the individual who initiated the transaction.[29]

Prescreening is the other purpose for which insurers may obtain consumer reports. The term prescreening generally refers to a process by which CRAs compile and provide lists of information to insurers on consumers who meet specific insuring criteria.[30] These lists are considered a series of consumer reports on each individual consumer, and, although insurers may obtain such lists from CRAs, they may do so only under certain circumstances. First, consumers on prescreened lists must not have elected to be excluded from such lists.[31] In addition, insurers must make each consumer on a prescreened list a firm offer of coverage.[32] Finally, when making a firm offer of coverage, insurers must inform consumers that they may contact the CRA that compiled the list and elect to be excluded from any such lists created by the CRA in the future.[33]

Because credit reports on businesses, artificial entities, or individuals in their business or professional capacities are not consumer reports, insurers need not have a permissible purpose in order to obtain such reports. Insurers often obtain business or non-consumer reports about a company or its owners in order to underwrite commercial policies covering sole proprietorships, partnerships, or other small business entities. In these situations, however, insurers should not obtain a consumer report on the principals or owners from a CRA without that person's advance consent. To reiterate, insurers must have a permissible purpose in order to obtain consumer reports, and underwriting commercial lines coverage is *not* a permissible purpose. Thus, while insurers are free to obtain business or non-consumer reports in order to underwrite commercial coverage, they should not obtain a consumer report for this purpose without the individual's consent.

C. ADVERSE ACTION NOTICES – WHEN AND WHY MUST AN INSURER PROVIDE THEM TO CONSUMERS?

FCRA requires insurers to deliver a prescribed notice to any consumer against whom adverse action is taken based, at least in part, on information in a consumer report.[34] In the insurance context, "adverse actions" that trigger the adverse action notice requirement include:

> [A] denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of

[28] FTC Official Staff Commentary § 604(3)(E) item 2. For citations to FTC informal opinion letters, *see Fair Credit Reporting* p. 119 note 185.

[29] *Id*. For citations to FTC informal opinion letters, *see Fair Credit Reporting* p. 119 note 185-186.

[30] FTC Official Staff Commentary § 604(3)(A) item 6.

[31] 15 U.S.C. §§ 1681b(c).

[32] *Id.*

[33] *Id.*; *see also* 15 U.S.C. 1681m(d).

[34] 15 U.S.C. § 1681m.

> coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance.[35]

As noted under Section I above, the U.S. Supreme Court's recent decision in *Safeco* holds that insurers must give an adverse action notice even on initial policies if the rate the insurer charges the applicant is more than what the insurer would have charged the applicant in the absence of a consumer report.

When insurers take adverse action against a consumer based on information in a consumer report, the actual notice they must provide to the consumer is relatively straightforward. The notice can be made orally, electronically, or in writing, and it must include the following information:

- The name, address and telephone number of the CRA that furnished the report;
- A statement that the CRA did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the action was taken;
- A statement that the consumer has the right to obtain a free copy of his or her consumer report from the CRA within 60 days of the notice; and
- A statement that the consumer has the right to dispute the accuracy or completeness of any information in his or her consumer report with the CRA.[36]

D. WHAT ARE THE PENALTIES FOR VIOLATING FCRA?

Penalties for violating FCRA depend on whether the violation was negligent or willful:

- **Negligent violations**. Consumers damaged by negligent violations of FCRA may receive the actual damages sustained as well as the costs and reasonable attorney's fees necessary to enforce liability.[37]
- **Willful violations**. Consumers damaged by willful violations (which includes reckless disregard) of FCRA may receive the actual damages sustained or statutory damages between $100 to $1,000, the costs and reasonable attorney's fees necessary to enforce liability, and any punitive damages the court may allow.[38]

A separate penalty provision subjects any natural person who obtains a consumer report under false pretenses or knowingly without a permissible purpose to statutory fines, imprisonment for up to two years, or both.[39]

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[35] 15 U.S.C. § 1681a(k)(1)(B)(i).

[36] *Id*.

[37] 15 U.S.C. § 1681o.

[38] 15 U.S.C. § 1681n.

[39] 15 U.S.C. § 1681q.

CONCLUSION

Before requesting any information about a consumer from a CRA, insurers need a basic understanding of FCRA's scope and the purposes for which consumer reports may be obtained under the Act. Insurers also should understand when consumers are entitled to an adverse action notice and the potential penalties for noncompliance with FCRA.

This update provides a general overview of the provisions in FCRA that commonly apply to insurance companies. It is general information only and is not intended to be legal advice. If you have additional questions or concerns after reading this update or would like to discuss FCRA in more detail, please contact Noreen Parrett, (608) 251-1967, nparrett@parrettoconnell.com.

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