INSURANCE ETHICS

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CHAPTER 1 – ETHICS AND AGENCY

Introduction

Although the public sometimes views the insurance industry as an impersonal entity, dedicated insurance professionals will likely denounce that image as a major misconception and proclaim that the insurance business involves much more than working with claim forms and actuarial data. Veterans in their field have probably learned that much of an insurance producer's job pertains to the development of relationships with the public and that countless professionals nurture such relationships every day by assisting individuals, families, businesses and various groups in the procurement of coverage for personal, commercial and industrial needs. Most of those professionals should agree that without those solid relationships, consumers have little incentive to trust an insurer to protect them, their loved ones or their businesses from financial risks and that one of the most reliable ways for an insurance producer to earn trust is to behave in an ethical manner toward every customer. Besides the personal satisfaction that can come from treating others ethically, this sort of behavior often translates to success at work. An employer wants to trust employees and is likely to favor workers who do their jobs without being swayed by self-interest. And the average person, particularly in regard to such an essential product as insurance, is more likely to do business with an outwardly ethical organization than with a company that seems to disregard ethical conduct.

Perhaps the most visible members from the insurance world and the ones most capable of shaping the average person's perception of the insurance industry are insurance agents and brokers. The terms "agent" and "broker" are common in various parts of the professional world. One can hear those words in conversations related to real estate and investments, to name only two examples. It must be noted, however, that the definitions of the terms can vary from one field to the next and that, contrary to popular belief, agents and brokers do not have identical job duties. In fact, they perform importantly distinct functions with differing ultimate goals. In terms of insurance, both agents and brokers examine a consumer's requests and serve as intermediaries who set up prospective insureds with coverage from an insurance company. The important difference between the two professionals involves the people who they ultimately represent in an insurance transaction. Whereas a broker is ultimately a representative of the insured, an agent's ultimate responsibility is generally to a specific insurer. Simply put, a broker is paid to act in the consumer's best interest, while the agent is paid to act in the insurer's best interest.

Despite those important differences, ethical insurance producers do not simply devote themselves to the people who pay them and ignore potential responsibilities to other parties in an insurance transaction. The majority of brokers do not lick their lips in anticipation of deceiving insurers so that their clients can reap benefits, and most agents do not take predatory stances toward consumers in the hopes of selling deficient or unnecessary policies. It is perhaps best to view agents and brokers as one might view any responsible employee of a legitimate business. For example, a consumer cannot expect a decent appliance salesperson to encourage customers to visit a competitor's store for a better deal on a television, but the consumer can still expect knowledgeable, honest and friendly service.

Like other true professionals, insurance agents and brokers endorse good-hearted attributes such as honesty and integrity. They generally agree that ethical professionals serve people other than themselves, take great care when trusted with other people's money and avoid (or at least disclose) conflicts of interest. And yet, a deep examination of modern insurance issues and practices indicates that even though insurance producers have a common base for ethical standards, they have not necessarily had opportunities to apply ethics to many concrete aspects of their jobs. Perhaps, understandably, they become distracted by the many other issues affecting the healthful maintenance of their business and are therefore unable to act as ethically as we would otherwise expect.

Professional insurance producers know their business and are more than likely aware of the fact that more and more consumers have purchased coverage to protect themselves from lawsuits concerning fiduciary duties (activities related to upholding trust, including careful handling of funds). With consumers willing to fight in court against businesses that ignore such duties, many agents and brokers have worried about their own liability when customers or clients have sour insurance experiences. When insureds suffer losses that their policies do not cover, they sometimes cite their agents or brokers as the primary sources of fault. An increasing prevalence of suits against insurance producers has left many agents and brokers in legal and ethical dire straits. They certainly want to provide excellent service to consumers, but sometimes it seems as if purposely avoiding certain aspects of ethical service is a necessary way of fending off litigation. Various court rulings have affected producers' pursuit of ultimate ethical goals, and not simply because judges have been too hard on the industry. The problem for insurance producers is that there is no indisputable precedent set by a court that clearly spells out what insurance producers must do in order to fulfill their fiduciary obligations to policyholders and insurance companies.

Although many courts have viewed producers as specialists with a wide range of responsibilities to customers and clients, the perceived legal duties of agents and brokers have not always been so extensive. Insurance agents (who serve the interests of insurers) probably frowned at the New York Supreme Court's ruling in the 1939 case *Recht v. Graves*, in which life insurance agents claimed that, as professionals, they did not need to adhere to certain state laws regarding business taxes. But the court's decision that agents were "engaged in the practice of a business or occupation and not in the practice of a profession" perhaps inadvertently gave agents great legal protection. As business practitioners, their obligations to their customers were no more complex than those expected from a general business. Like other businesspeople, insurance agents could not lie or steal from their clientele, but they did not need to do much more than give the people what they requested or ordered. Based on this business designation, agents presumably would not have been liable for selling a person an inferior or unnecessary form of insurance as long as the person had requested it.

In a duty-specific case before the Wisconsin Supreme Court in 1990, the plaintiffs in *Nelson v. Davidson* alleged that their State Farm agent had an obligation to inform them that they could have purchased underinsured motorists coverage. They based their case on the fact that courts in other states had held agents responsible for advising consumers of available insurance products. In its ruling for the defense, the court wrote that the plaintiffs did not present any relevant examples of Wisconsin courts agreeing with those other decisions and stated that "the vast majority of other jurisdictions hold that the general duty of care which an insurance agent owes a client does not include the obligation to advise of available coverages." So, if an agent was insuring a building in a neighborhood with a history of arson, that agent might have chosen to disclose the area's history to the property owner for ethical reasons or to entice the owner to buy more coverage, but it is unlikely that the mentioned court would have held the agent responsible for fire damages if he or she had kept quiet about the risk.

A 2001 appellate division case in New York, *Chase's Cigar Store, Inc. v. Stam Agency, Inc*., materialized when a cigar store employee stole money from the company and the loss was not covered by the owner's insurance policy. Allegedly, the policyholder allowed the agent to craft the details of the policy himself and did not ask for protection against employment dishonesty. The business owner filed suit against the agent for not securing the coverage, but the matter was dismissed on the grounds that the agent followed the customer's instructions, had no obligation to include employment dishonesty protection within the policy and allowed the business owner to review the policy terms, which clearly excluded employment theft and dishonesty.

Another real-life case, *Hardt v. Brink*, involves a somewhat similar situation but one in which the judicial system placed greater responsibilities upon insurance producers. In this example, a plaintiff had secured insurance through the defendant agent since 1947 and had purchased, among other products, a comprehensive liability policy from the man. In 1956, the plaintiff told the agent that he had entered into a lease agreement for a building. A year later, the building suffered severe fire damage, but the losses were not covered by the liability policy because of an exemption for rented property. The plaintiff sued the agent for not alerting him to a major liability gap and won his case in a U.S. district court in the state of Washington in 1961. Instances such as this one show that some courts reason that an insurance producer must not only help clients obtain what they ask for, but also must take on the greater duties of understanding and pointing out a customer's or client's insurance needs.

Unfortunately for those insurance producers who want clear legal guidance regarding how to serve the public, even courts that have agreed that agents and brokers have advisory duties to customers and clients have not arrived at exactly the same conclusions. Some courts have determined that the way insurance producers present themselves to the public dictates their professional obligations. For a simple example, let us focus on job titles. Some people believe that individuals who identify themselves as insurance salespersons or agents are merely that; company representatives who offer coverage and take applications, but who are under no obligation to advise anyone. Conversely, people who call themselves investment advisers or risk managers have, in many cases, been expected to perform many service-oriented tasks because those job titles are commonly associated with expertise.

Many courts, when determining an insurance producer's duties, have based rulings on the existence of what is generally referred to as a "special relationship" between the agent or broker and the customer or client. If a special relationship exists, the insurance producer's obligations (not to mention potential liability) increase. If no such relationship exists, the producer is generally exempt from having to advise people or pursue anything more than what a consumer requests. However, different courts have considered different factors when judging the presence of a special relationship.

In some situations, an insurance professional's job title and the qualifications implied by that title are enough to substantiate an insured's special relationship claim. At other times, courts have intricately examined details of a case in order to determine whether or not agents or brokers have committed themselves to special relationships and to all the work-related and legal-related issues that these arrangements entail. In the 1988 case

Durham v. McFarland, Gay & Clay, Inc., the Court of Appeal of Louisiana, Fourth Circuit ruled an agent was liable for hurricane damages because he did not do enough to insure the plaintiff against residential flood risks. The court based parts of its decision on the fact that the plaintiff had been a customer of the defendant for roughly 15 years and the fact that the defendant (who was repeatedly instructed to transfer coverage to the residence) knew for an extended period of time that the property was not adequately covered for flood risks.

Other courts seem to have ignored circumstantial special relationships and used broad brushes to paint all insurance agents and brokers as mandatory providers of advice and various fiduciary services. In *Saylab v. Don Juan Restaurant, Inc*., a 2004 case heard by the U.S. District Court for the District of Columbia, a broker (a professional serving the interests of consumers) obtained a general liability policy for a dining establishment. When drunk drivers who had become intoxicated at the restaurant killed two people, families sued. Once the general liability policyholders realized liquor liability was excluded from their coverage, they took legal action against the broker for not addressing their potential need for such insurance. In the opinion of the court, insurance brokers, regardless of any special relationship, were more than just average insurance representatives. They were professionals with expertise who should not be easily let off the hook for failing to advise clients of insurance needs or gaps in policies.

Additional courts have had similar views on the obligations of insurance agents. In *Riddle-Duckworth, Inc. v. Sullivan*, the Supreme Court of South Carolina stated in 1969, “[T]he respective duties and obligations arising from the relationship of a principal and his agent in the procurement of insurance must be determined in the light of the fact that the agent was an expert dealing in a highly specialized business, with knowledge and means of knowledge not possessed by the average applicant for insurance.”

In the 1995 case *Southwest Auto Painting and Body Repair, Inc. v. Binsfeld*, heard by the Court of Appeals of Arizona, an agent did not bring up the subject of employee theft and dishonesty coverage. In its ruling against the agent, the court referred to the testimony of an insurance expert:

“The expert testified that the standard of care in the community for professional insurance agents requires agents to advise clients about the relevant types of coverage that are available and the cost of the coverage, either in a written confirmation of information given orally or in a written proposal handcrafted to the individual needs of the prospective insurer.”

A Case for a Legal and Ethical Balance

Because insurance producers have important business obligations, it is fair, up to a point, to apply the concept of “caveat emptor” (a Latin phrase that means, “Let the buyer beware”) to disputes between consumers and insurance producers. It is logical to expect intelligent prospective policyholders to take the time to educate themselves about their insurance needs and about the products that might best suit those needs. But it is also logical for intelligent prospective policyholders to view an insurance agent or broker as the best educator for them. After all, the insurance agent or broker has specialized, professional experience, can better answer to consumer questions than written research materials and is probably the most accessible source of insurance information available to the average person.

Obviously, this is an ethics course, and opinions concerning which acts are ethical and which acts are unethical can differ from generation to generation, from culture to culture and from person to person. Studies of ethics are generally not structured around set-in-stone rules that firmly and universally state what is right and what is wrong. The study of ethics endures through the centuries because it involves choices that can often be debated as being both right or wrong depending on a person's values and one's life philosophies. A writer could fill the following pages with summaries of numerous ethical theories and examples of how each of those theories could apply to the duties of insurance agents and brokers. But the insurance community might not yet have reached a time when that sort of text should be written or studied, at least not as long as insurance producers have to worry about how an inconsistent judiciary will view their actions. Rather than an abstract examination of philosophy, today's insurance producers deserve and need something practical that will instruct them on how to protect themselves from lawsuits without compromising customer service. Yet, due to the subjectivity of ethical beliefs and the differing opinions of various courts, we will struggle to decipher truly practical guidance unless we allow ourselves to make two assumptions in regard to this topic: one about ethics and one about laws.

From an ethical standpoint, let us assume, for the next few pages, that insurance producers collectively subscribe to the "golden rule," a theological concept that has gained tremendous acceptance in secular society and instructs, "Do unto others as you would have them do unto you." For insurance producers, morally subscribing to the golden rule requires agents and brokers to put themselves into the policyholder's shoes. When the producer shops for an important item, he or she probably wants to be served by helpful professionals who go out of their way to understand a customer's needs, who do their best to set the customer up with products that best address those needs and who offer crucial advice (solicited or otherwise) that pertains to potential risks and overall customer satisfaction.

From a legal standpoint, let us assume that any court is capable of interpreting an insurance producer's duties in the broadest manner possible. This would mean that agents and brokers, in every jurisdiction, could be obligated to advise the public, alert consumers to their insurance gaps, do what they can to turn customers' ultimate insurance decisions into realities, handle other people's money in a responsible fashion and perform various other fiduciary functions. Let us also pay close attention to the fact that agents and brokers ultimately serve one master: the insurer in the agent's case and the insured in the broker's case.

The information that follows makes those assumptions and respects that fact. It is intended to help the insurance producer find a balance of ethical principles and safe, legal practices. It is for insurance agents and brokers who do not want to allow their desire to stay out of court to overpower their desire to perform excellent, ethical services and who do not want their service-oriented ambitions to overpower their attention to liability risks. We have prepared this material in the hope that it can make the insurance producer firmly believe that legal concerns need not jeopardize one's devotion to ethics. There is a legal world and an ethical world, and it is indeed possible to do business in both places at once.

Insurance Premiums

Although courts and insurance professionals have had many differing opinions about what insurance producers must do in order to fulfill the requirements of their jobs, it is inarguable that an agent or broker must act with care when entrusted with insurance premiums. In many cases, a policyholder pays for coverage through the insurance producer, who must pass the funds along to an insurer and receives a specified commission. Obviously, the producer's role as a conveyer of funds requires trust from the insurer and the insured. Insurance companies want the money that they are entitled to receive in a timely fashion, and policyholders rely on the producer's speedy delivery of those funds to ensure that payments are not marked as late or nonexistent.

As is the case in avoiding most of the potential conflicts mentioned in this text, documentation can often shield agents and brokers from allegations of illegal and unethical acts involving premiums. It is ethical for producers to take their agreed-upon commissions from premium payments, but producers should be able to quickly prove their right to commissions and should confirm in writing that the insurance companies and policyholders understand that right. Examples of documentation that might serve insurance producers in this regard include copies of contracts that set forth commission obligations, bank deposit records, correspondence and notes taken during meetings and telephone conversations.

In the interim period between receiving premiums from the insured and sending the money to the appropriate insurer, producers sometimes have the opportunity to invest the funds in short-term accounts. These investments, when properly executed, allow the insurance company to obtain interest on the payments, which is typically applied to a producer's commission as well. (Some insurers allow producers to hold onto premiums for extended periods of time in order to accumulate more interest.) Because the producer's commission is usually affected by these investments, an agent or broker might face the temptation to put the money in ventures that have the potential for high rewards in exchange for high risks. Ethical insurance producers resist this desire and follow what has become known as the "prudent man rule" or "prudent investor rule." Highly self-explanatory in name, this rule dictates that an insurance producer must invest premium payments in a smart, fiscally conservative fashion. Producers should treat the premium dollars obtained from the insured and owed to the insurance company as carefully as they would treat their own life savings. Putting the money into the stock market is a serious ethical offense because of the risks involved. Bank accounts are a safe, responsible investment vehicle for premium dollars. Other modes of investment can be deemed ethical as well, under the condition that they are not likely to deprive the insurance company of premiums it deserves.

Ethical Duties to the Insured

Agents and brokers have different bottom-line responsibilities, but it can be argued that both types of professional insurance producers have ethical obligations to current and prospective policyholders. At some point in every transaction with the public, insurance producers must at least try to pursue what clients and customers want. If someone decides that he or she must have a term life insurance policy that costs a particular amount, the broker should search for a provider who can accommodate the client, and agents should return to their company and do what they can to obtain the requested policy for the customer. The insurance producer should not allow personal feelings to override a consumer's decisions.

That does not mean that insurance producers must never use their experience and personal instincts to influence a consumer's thought process. In fact, doing so is ethically encouraged, as long as the producer has the person's welfare in mind. The responsible insurance producer listens to the consumer and tries to decipher what the person needs, which may or may not be exactly the same as what the consumer requests. What the prospective insured needs will differ from one individual to the next. A heart surgeon is undoubtedly susceptible to risk factors that differ from those faced by a bakery owner. If a business is being insured, producers should use their own experiences, the experiences of colleagues and the statements of the insured to learn about the risks involved with that type of venture. They should study and ask about the kinds of people with whom the insured does business as well as any agreements that the insured has made with third parties that may require specific coverage.

It is then the producer's ethical (and, in some jurisdictions, legal) responsibility to make clients and customers understand their insurance needs. If the producer believes, based on a consumer's situation, that a whole life policy would serve the person better than a term life policy, the agent or broker should say so and explain why. If the insurance producer recognizes risks that would not be covered based on the consumer's stated requests, the agent or broker should disclose the insurance gap. Specifically for agents, this might mean making the consumer aware of insurance gaps that cannot be filled by their own companies.

Upon being made aware of these various pieces of information, the consumer must ultimately be the one to decide on the type of coverage for the agent or broker to procure. But the obligation to track down what the consumer requests should still not be viewed by the producer as an act of blind obedience that puts the broker, agent or insurer at a financial disadvantage. Even if a consumer hopes to obtain the cheapest coverage available, the producer can make a strong ethical case for the purchase of a more expensive policy. A producer should present a consumer with the policy that is the best value, and value is not measured in dollars and cents alone. Instead, it is measured by the quality of the coverage relative to the price. A cheap policy with big insurance gaps is not the best value for the consumer compared to a slightly more expensive policy with fewer or no gaps.

When discussing individual policies, insurance producers should make no assumptions about the consumer's knowledge of what a policy will cover and what it excludes. Even though exclusions are documented within the policies themselves, agents and brokers should discuss these exclusions in a detailed manner with their customers and clients so that potential policyholders understand what they are buying, what risks they are managing through insurance and what risks they are still financially exposed to.

This ethical duty relates to a broader issue of knowledge and competence among insurance producers. Insurance agents should be well-schooled about the products they sell. Brokers, who will lack the in-house training that an agent might receive, should also make themselves as informed as possible of the various policies that they can provide from various companies. Of course, no insurance producer knows the answer to every question that a consumer might have about every policy. Competent, ethical insurance professionals admit when they do not have an answer for a consumer and then attempt to follow up on the query by diligently consulting a more knowledgeable source. Yet, it is not enough for the producer to give a reliable source's answer alone. Assuming the agent or broker finds the answer to the question, he or she must clearly understand the answer and anticipate any further questions that the answer might produce in the mind of the client or customer. This is not, however, an absolute ethical obligation. Sometimes, as in many life situations, it is best to admit that you do not know the answer to a question and to advise the other person to ask a more specialized individual instead. It should go without saying that a consumer will appreciate honesty more than factually shaky advice that could lead to serious trouble in the future.

An ethical insurance producer also informs clients and customers of facts relating to their insurance status as soon as possible. If consumers apply for insurance and are denied by the provider, the agent or broker must quickly inform them of the rejected application so that alternative coverage might be secured in a timely manner. The producer should never allow anyone to assume they have been approved for coverage. In a similar fashion, agents and brokers should keep a keen eye on a consumer's policy expiration dates and renewal deadlines. Although a producer should not renew or apply for an alternate policy on a consumer's behalf without authorization, the agent or broker is ethically bound to inform people of upcoming periods of potential insurance gaps so that consumers can act to avoid those periods.

Insurance producers can do their jobs ethically and legally by giving the prospective policyholders a brief description of specific insurers. Agents and brokers should mention an insurer's rating, which relates to its ability to absorb risks and pay claims. The person paying for a prospective policy might also want to know if the insurer is well-established in the industry or if it is a relatively new organization. It will be important for the person to know how closely the company scrutinizes claims and how quickly it pays legitimate ones. Because a company's financial health and claims procedures can vary during a policy's lifespan, agents and brokers should convey this information to consumers not just at the application stage but periodically afterward, too, as circumstances change.

These ethical disclosures are undoubtedly more challenging for insurance agents than for brokers. After all, agents represent the insurer in a transaction and are obviously expected to paint a positive image of their respective employers for the public to see. To do otherwise could jeopardize sales, endanger employment and potentially violate the concept of agency. And yet, it is not impossible to make these ethical disclosures and still uphold one's responsibility to an employer. Agents might mention that their company is a new kid on the block while emphasizing the lower costs and comprehensive benefits of the company's policies; or they might admit that their company takes its time when paying claims but emphasize that the company is a financially healthy institution that has professionally served the public for decades. Through such sales presentations, the road to agency commissions can still be paved with honesty.

Ethical Duties to the Insurer

Once the consumer has considered all relevant information and chosen a preferred policy, producers have an ethical duty to provide insurance companies with applications that are as extensive and accurate as possible so that the respective insurer can fairly assess risk and price the policy accordingly. It is unethical for agents and brokers to deceptively burden an insurer with prospective customers, regardless of their insurability, all in the name of commissions.

As one can expect, the agent has many more ethical duties than the broker in regard to an insurance company. Sometimes the dos and don'ts for an agent are clearly spelled out in an agency contract, but that is not always true. Generally, though, there are several ethical practices in which an agent should engage regardless of the specifics of the contract.

As a representative of the insurance company, the agent becomes the face of the organization for the customer. The impression that a person forms of an agent is likely to represent that person's impression of the entire company. As a result, the agent must practice acceptable etiquette when interacting with the public. Though speaking with a customer should not entail tremendous anxiety, agents might want to behave as they would when going out on a job interview. The producer's appearance, manner of speech and general attitude should all be relative to the appropriateness of the occasion.

Insurers expect their agents to be loyal to their company, to keep the insurer apprised of customer-related situations and to perform their jobs in an ethical and financially responsible way. On a more specific level, agents are generally not allowed to sell similar forms of insurance for competing companies while in the employment of a particular insurer. Some insurance producers, known as independent agents, are not permanently employed by one insurer and are allowed to sell policies from various companies at the same time. Independent agents, however, must disclose any existing or potential conflicts of interest before representing any insurer.

Ethical agents should also become well-versed in the internal procedures of their companies and should not overstep the boundaries of their job descriptions. Unless authorized by employers, agents do not have the power to make deals with customers. They cannot negotiate premiums, redefine the terms of a policy or unilaterally approve a person for coverage. They must understand that they are part of an organization and that performing the duties of another employee without company approval can, at worst, lead to legal trouble, or, at best, produce role confusion among co-workers and procedural disorder in the workplace.

Conclusions

This text stresses the many ethical and legal responsibilities of insurance producers. And yet, even though these responsibilities can make the producer's job mentally, emotionally and physically challenging, those reading this material should understand that not all responsibilities are on their shoulders. Despite ethical duties owed to consumers, insurance producers need not handle every aspect of a transaction. As stated previously, the insurance producer is an advisor, not a decision maker. It is the insured who must choose whether or not to purchase a particular policy. It is the insured who must pay premiums. It is the insured who must provide producers with any needed documents for coverage, and it is the insured who must read and acknowledge an understanding of a policy's terms.

Of course, no professional is immune to accusations pertaining to illegality. But insurance producers can reasonably protect themselves from liability by disclosing, at an early stage of a transaction, what they will do for a consumer and what they will not do. Smart, ethical agents and brokers do not allow the public to guess as to whether or not they represent the insurer or the insured. They document this disclosure, as well as every other act and discussion they have with a consumer, be it about a person's wants or needs, policy exclusions, the financial stability of an insurer or any other matter.

In a perfect world, the producer would and could act in the best interests of everyone, including the consumer and the insurer. That, though, can be a difficult goal to attain, particularly when a person is confronted with the daily grind of doing business, with the emphasis on profits and the reality that producers need to earn a living. But even for those producers who struggle with this approach due to the pressures of making money and staying out of legal trouble, there are serious incentives to behaving ethically.

Adherence to ethics improves public relations, which can only help business. Such adherence should also lessen a producer's legal concerns in a time when few agents and brokers are absolutely certain of their court-imposed duties. The more people feel as if they have been treated fairly, the less likely they are to take legal action against someone. And even in those situations in which litigation becomes unavoidable, demonstrations of documented ethical conduct can be an insurance producer's best defense.

CHAPTER 2 – ETHICS AND DISCRIMINATION

Introduction

As people become more aware of neighbors with differing backgrounds, we may want to believe that they would become more understanding and tolerant of each other's differences; however, instead of fading away, discrimination seems to evolve with the times and continues to be a relevant ethical concern for insurance producers. When companies or entire industries do not offer equal professional services to all groups of consumers based upon their geographic location, they engage in a discriminatory practice called "redlining." Whereas traditional cases of redlining usually involved blatant discrimination against a few groups (particularly racial minorities), today's insurers who redline tend to do so subtly, even unintentionally on some occasions, and often affect minorities who would not have needed to worry about these issues 40 years ago.

As consumers, courts and various regulators refine their definitions of discrimination and redlining in order to combat unacceptable inequality, insurers must periodically perform a self-check to ensure that their business practices do not nurture discrimination. It is very possible that some well-meaning professionals have been illegally discriminating without even realizing it. This material alerts insurance producers to potential seeds of redlining and discrimination within their sales practices and offers suggestions on how to attack the root of the problem before it becomes an ugly and seemingly unmanageable issue.

Redlining: Yesterday and Today

Though the discriminatory practice of redlining has affected multiple classes and groups of people over the years, it will probably be forever linked to unfortunate instances of blatant racial inequality. The term got its name from the exclusionary business dealings of real estate agents, lenders and others who literally drew red lines on maps in order to highlight parts of cities and states where a significant portion of blacks resided and where businesses would not offer service. The U.S. government acted to outlaw and curb redlining in various industries through the Fair Housing Act (one of many major pieces of civil rights legislation passed in 1968), the Home Mortgage Disclosure Act and the Community Reinvestment Act. The latter two acts mainly pertain to lenders and not to the underwriting community. But in 1992, the U.S. Court of Appeals for the 7th Circuit ruled, in the *National Association for the Advancement of Colored People, et al. v. American Family Mutual Insurance Company*, that the Fair Housing Act applies to insurers, as well as to real estate agents and lenders. In its decision, the court focused on the plaintiffs' arguments, which highlighted the link between housing and insurance and how fairness in the lending and real estate professions cannot exist without fairness in the insurance industry:

"Lenders require their borrowers to secure property insurance. No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable."

Within an insurance context, redlining is most commonly an issue for companies that sell homeowners and personal auto coverage, and the unlawful discrimination can occur on many levels. Insurers might deny coverage outright or charge the discriminated party higher rates than they would charge a desired customer. Redlining might also occur in more subtle situations, such as when an insurer does not tell members of a particular group about policies that could save them money or when an insurer's marketing campaign unjustly ignores certain segments of the population.

Today, nearly 40 years after the Fair Housing Act became law, few, if any, insurers publicly condone redlining. But the issue has not ceased to exist, due in large part to wide-ranging opinions about what truly is redlining and what is merely smart, selective and analytical business by insurance companies. An article published in the insurance trade publication CPCU Journal in 1996 focused on people's varying interpretations of the term and listed 11 distinct definitions that ranged from very specific to very vague, and there are probably at least 11 additional definitions in use today. Many insurers tend to view redlining in a traditional way, claiming that it involves concerted efforts to discriminate against particular groups without basing the discrimination on substantiated risk factors. These insurers would almost certainly agree that providing unequal service to people based on race or ethnicity is indeed an example of redlining.

Many consumer advocates, though, say redlining occurs whenever an insurer's underwriting criteria discriminate against people, either directly or indirectly and regardless of risk factors. For example, some insurers have been accused of redlining because they used a building's age as a factor in offering and pricing homeowners policies. In these situations, insurers might have had statistical proof that older homes represented high risks and might have felt as though they were underwriting responsibly. Yet, disagreement about redlining materialized because homes in such traditionally non-white areas as inner cities are generally older than those in predominately white communities.

Although disputes related to insurance and redlining were not exactly non-existent before the 1990s, historical events beginning in and continuing after that decade have made geographically based discrimination a hot topic in professional, legal and legislative circles over the past 15 years or so. The 1992 riots in Los Angeles, which stemmed from the acquittal of white police officials who were tried for the beating of black man Rodney King, drew attention to redlining that occurred in the area. As politicians and the public tried literally and figuratively to rebuild that community, they realized the tough task was being made even more difficult by some insurers. Prior to the riots, many property owners in the area, generally non-white and working-class, struggled to find affordable coverage from major insurance companies, and some chose to purchase policies from questionable overseas providers who operated outside of state regulatory boundaries. After the riots, policyholders discovered that some of these so-called insurers ran bogus operations, and many riot victims found themselves stuck with significant uninsured damage to their properties. Meanwhile, the riots cost legitimate insurers $775 million, and at least two insurers became insolvent due, in large part, to the destruction. Many underwriters who financially survived the riots viewed the violence as a warning sign instructing them to either limit coverage in and around South Central Los Angeles even more or else to not do business in the area at all.

Natural disasters like Hurricane Andrew influenced some insurers' decision to limit or not sell property insurance for structures on both coasts as well as buildings near fault lines in the West, much to the displeasure of local homeowners and businesses. Similar dismay occurred among property owners in cities after September 11, 2001. Initially, most states allowed insurers to exclude coverage for terrorist attacks, but in places like New York City, where risk was obviously high and where regulators did not permit terrorism exclusions, some people suggested that insurers were essentially redlining by either denying property coverage or charging outrageously high rates for it.

Despite its roots in racist behavior, redlining has affected a wide variety of social groups that includes but is not limited to skin color. Some insurers have used people's occupations against them in insurance transactions. Liability insurers have been known to steer clear of lawyers and doctors, who are presumably more apt to be sued than the average person. When AIDS first came to the public's attention, some health insurers allegedly tried to distance themselves from HIV-positive customers by making coverage pricey and elusive for people in stereotypically homosexual lines of work such as interior decorating and for people who lived in San Francisco and other parts of the country with relatively high gay populations.

Discrimination based on occupation does occur, according to consumer advocates and insurance agents, but grouping that behavior in with redlining is a stretch for those people who still envision shaded maps when they think of the redlining prohibited by the Fair Housing Act. The allegations related to insurers and San Francisco, on the other hand, are an example of “territorial rating,” the most common situation in which insurers run the risk of modern-day redlining. Usually done on a zip-code level, territorial rating occurs when insurers price policies or offer different coverage to consumers based on geography. The practice is legal in many states and is rooted in the assumption that different locations present different risks for insurers. If, for instance, two zip codes feature vastly different crime rates, insurers might have the right to charge a homeowner in an unsafe neighborhood more for coverage than they would charge a homeowner in a comparatively safe neighborhood.

Whether through territorial rating or through underwriting on a case-by-case basis, property insurers have also faced redlining issues when they have exercised their otherwise legal right to base premiums and product availability on a building's value and age. In many cases, insurers have shied away from offering replacement cost coverage to homeowners whose property boasts little market value. This practice is most common in inner cities and is sometimes dictated by an insurer's fear that replacement cost policyholders with lowly valued properties might commit arson and sacrifice their homes in order to pocket more money from an insurance company than they could obtain in the real estate market. A building's age comes into play during the underwriting process because older properties present a sizeable risk to an insurance company if owners do not maintain them through the years, as wear and tear accumulate and as things fall apart. Many insurers have set age limits on the properties they will cover, usually somewhere in the neighborhood of 50 to 60 years.

The Realities of Insurance

Sometimes lost amid accusations of discriminatory behavior by insurers is the fact that insurance is not an open-door business that can thrive by treating every potential customer equally in every way. In its simplest form, insurance is a gamble for companies that write policies, a bet based on actuarial analysis that the people buying coverage will pay more to insurers in premium dollars than they will take away through valid claims. Agents and underwriters have an obligation to their employers to carefully examine the risk potential of insureds in order to ensure financial survival for the company, and that inevitably means they cannot always grant potential customers the rates and coverage they request. Risk managers who absorb every risk that presents itself to them do not engage in much management at all and instead make their employers vulnerable to financial collapse.

Insurers should realize, however, that they walk a legal and ethical tightrope whenever their underwriting decisions seem to involve moral judgments or when their decisions benefit one person while penalizing another. When insurers deny coverage, it is not instinctively wrong for affected applicants to feel judged. After all, denial of insurance signifies that the person is a high risk, and being deemed a high risk can mean many things with varying degrees of insult attached to them. It can mean people are perceived as unlikely to care for their own physical health, drive safely, or properly maintain their possessions. In some cases, it can also mean people are perceived as likely to engage in illegal activity.

Consider those insurers who admit they worry about providing replacement cost coverage to someone because the person might set fire to a home for financial gain. Given the underwriting principles of those insurers, how are decent, law-abiding citizens supposed to react when they cannot secure replacement cost policies? Whether an insurer denies service for valid reasons or not, rejected individuals will likely feel as if a moral judgment has been made about them, not to mention other people who share their racial, ethnic, socio-economic or other types of characteristics? Even if consumers who are denied insurance do not notice a potential moral judgment on the insurer's part, they will still realize that the insurer's business practices penalize them while benefiting others. When situations such as this occur, the public cannot help but speculate about insurers' commitment to fair, ethical customer relations.

And yet, consumers must be made to understand, and insurers must not back down from the fact, that some risks are real and demand ethical and legal, yet ultimately discriminatory actions. In terms of territorial rating, insurers have decided to stick to this reality most consistently when choosing how to serve drivers and homeowners in inner cities. When supporting their decisions to limit or charge more for coverage in these areas, they often cite statistics that back up their high-risk assessments. Insurers generally do not look to cover many old buildings, and a high number of those structures tend to exist in inner cities because builders have few incentives to modernize the neighborhoods. Likewise, insurers do not jump at opportunities to provide coverage where much crime occurs, and cities have generally faced steeper levels of vandalism and theft than rural and suburban communities.

A general yet substantiated crime defense is perhaps the least controversial one insurers have made when asked why their industry limits its business with inner-city residents. Not only can crime be shown by reasonably reputable numbers via a comparison of crime rates; it can also be represented in a manner that does not necessarily judge consumers. The insurer and the customer can mutually understand that poor economic circumstances and other factors often force good people to live in areas with high crime rates. Denying coverage or demanding high premiums on this basis might protect the insurer's financial interest while not pointing an accusatory finger at the applicant and suggesting that the person is irresponsible or negligent. With such risks and explanations in mind, insurers have repeatedly insisted their dealings in inner cities represent lawful, necessary discrimination in its most ethical form, as opposed to illegal, prejudicial redlining.

Is Redlining Real?

Although insurers deserve some leeway so they do not need to face redlining allegations whenever they work toward careful risk management, it is sad to realize how many insurers have abused that leeway by refusing to address the longtime civil rights violations committed by redlining colleagues. Within the past few decades, many insurers seem to have engaged in a cycle of inadequate responses to the problem. At one point in the cycle, insurers deny outright that redlining occurs. Then, as people begin whispering about unlawful and unethical discrimination by so-called professionals, these insurers declare they have only heard anecdotes involving wrongdoing and demand to see some concrete evidence before taking action. When the judicial system, the media or whistleblowers at last expose one insurance company as a guilty redlining proponent, some people finally concede that ethical misconduct does, in fact, exist. But they still do not go so far as to examine their own actions and solve any potential problems in their organization. They neither dare to acknowledge that they were aware of any misdeeds by their peers nor admit any personal mistakes when they, themselves, get caught giving their profession a bad name.

Many real-life cases, as well as studies, suggest redlining is far from a non-issue for the insurance community. The landmark case that resulted in the application of the Fair Housing Act to insurers, *NAACP v. American Family Mutual Insurance Co*., centered on the discriminatory business practiced by Wisconsin's third-biggest insurer at the time. The smoking gun in the case, which alleged redlining against minorities in pursuit of homeowners coverage, was a memo written by an American Family manager, which instructed agents to, "Quit writing all of those blacks." Perhaps not so coincidentally, the suit also called the insurer's hiring methods into question, particularly its employment of black agents or lack thereof. In the end, American Family settled with the NAACP for a package worth $16 million that included agreements by the insurer to open offices in racially diverse neighborhoods and to market its products and services more prominently in black communities. The settlement did not require the company to admit any wrongdoing.

In a separate case, state regulators charged the California Insurance Group with a tremendous amount of redlining in San Francisco that turned away several minority groups, including gays, blacks and Latinos. In its examination, the California Department of Insurance obtained statements from company employees who painted a disturbing picture of blatant, unethical discrimination. According to people who cooperated with the state's investigation, the insurance company made it clear to agents that, "We don't want to write homosexuals or queers." Regulators said California Insurance Group committed 252 violations, and the insurer wound up settling the case (without admitting any wrongdoing) by paying a $500,000 fine, the highest amount in state history up to that time for redlining and the third highest insurance fine paid to the state for any reason.

The American Family and California Insurance Group cases were, in a way, exceptions to the rule, in that the two insurers' alleged attitudes toward minorities came across as harsh and clear. Presumably, most insurers who practice redlining are a bit craftier when communicating their discriminatory desires to employees than those executives quoted in these two cases. In deciding *Nationwide Mutual Insurance Company, et al. v. Housing Opportunities Made Equal, Inc*., the Supreme Court of Virginia in 2000 quoted an employee, who said about an employer's alleged redlining that discriminated against people in black neighborhoods, "They didn't tell you … not to write in those sections, but the way the rules were written up, it seems like we could not do it."

Many alleged incidents involving racially motivated redlining have been exposed via "matched-pair studies." Traditionally in this method of checking for redlining, testers with differing racial backgrounds call insurers and inquire about homeowners policies for similar properties. General results from some matched-pair studies have allowed consumer groups to conclude the following:

- Blacks receive fewer callbacks from insurers than whites.
- Blacks receive fewer quotes for replacement cost homeowners insurance than whites.
- Some insurers require blacks, but not whites, to provide them with a Social Security number before getting a quote.
- Some insurers inform blacks, but not whites, about company policy that restricts coverage for old buildings.
- Some insurers require more inspections for black-owned properties than for white ones.

Matched-pair studies played a significant role in the Virginia Nationwide Mutual case. In that case, out of the 15 studies conducted by Housing Opportunities Made Equal (HOME) in the mid-1990s to test for redlining at Nationwide, seven provided evidence of supposed racial discrimination. A jury ruled in HOME's favor in the amount of $100.5 million, an award that, according to the New York Times, allowed the case to overtake the American Family settlement as the costliest discrimination example in the history of property insurance. The Supreme Court of Virginia overruled on appeal but not because evidence failed to establish redlining. Instead, the court threw the case out because, in its opinion, HOME was not an injured party in the dispute. In a surprise development, the court later reconsidered its stance and planned to rehear the case. That plan never came to fruition because HOME accepted a $17.5 million peace offering from Nationwide.

In some situations, insurance agents have bravely put their job security and professional esteem at risk in order to expose unethical and illegal behavior at their workplaces. Some have gone on the record about company policies regarding agent performance that effectively discourage them from doing business in inner cities. When an insurer evaluates its agents based on the number of claims that their sold policies produce, employees might think twice before offering coverage to an inner-city dweller who owns an old house, lives in a bad neighborhood or exhibits other characteristics that could hint at future filings. On other occasions, agents have said the area where they live or intend to do business can affect their chances of being hired by an insurer, with agents who aim to serve urban communities suffering negative consequences.

These factors leave some consumers not only susceptible to denial of coverage but also physically distant from insurance agents in the first place. In 1995, the Massachusetts Affordable Housing Alliance reported that 14 of the top 20 insurers in the state did not have a presence in inner-city Boston, despite an insurer-funded study (conducted by Stanford Research Institute and detailed in the Los Angeles Times) that found a mere 7 percent link between a person's geography and loss potential.

Among other studies that give credence to redlining's presence in insurance, the St. Louis Post-Dispatch reported in 1993 that people in the city's poor, black neighborhoods paid 31 percent more for homeowners insurance than other customers, often regardless of their claims history. An American Insurance Association study found blacks were three times as likely as whites to turn to a state-sponsored insurance program, highlighting the racial inequality in the open market. Back in the mid-1980s, California drivers outside Los Angeles could get 10 times the coverage available to South Central residents at one-third the cost.

These facts and examples should help insurance producers realize that redlining is, indeed, a real problem that they ought not dismiss or ignore. However, the presented information should not be read as a condemnation of most insurers. Passionate statements that seem to equate redlining to a myth are misguided, but people who make those statements do have several sources at their disposal to at least prove redlining does not occur in every insurance office. A matched-pair study conducted by the Urban Institute revealed no firm evidence of redlining affecting blacks in parts of New York state or Latinos in Phoenix. During the early 1980s, the American Insurance Association looked into redlining and reported, based on work by R.L. Associates, that 92 percent of black homeowners had comprehensive property coverage. According to National Underwriter, a state-authored report, “Status of Homeowners Insurance in Illinois,” revealed that of 13,290 complaints made to Illinois’ insurance department in 1993, only four involved property insurance redlining. In September 1994, the trade publication Best’s Review questioned 1,000 blacks and Hispanics about their insurance experiences, and 95.7 percent said no insurer had ever denied them coverage. It should also be noted that despite the disturbing results of the paired studies that probed for discrimination at insurers such as Nationwide, the number of samples in those studies (15 in Nationwide’s case) are sometimes too small to produce concretely scientific results. In order for these studies to exhibit a relatively low margin of error, they must incorporate many samples instead of single-digit or even double-digit amounts.

Redlining Laws and Regulation

Redlining is illegal in America, but the states’ individual jurisdiction over the insurance industry has left the country without a uniform way of regulating the underwriting community in order to prevent discrimination. Many citizens have responded to perceived inequality in places such as South Central in Los Angeles with calls for the federal government to become more involved in the matter. Perhaps the closest the country came to seeing a federal law dealing exclusively with redlining was back in the early 1990s, when the L.A. riots and their aftermath were still a part of public and political consciousness. At that time, the main question for legislators did not concern whether or not the country would wind up with a federal redlining law. Instead, the uncertainty seemed to center on exactly what the contents of that law would be. The era’s two main, competing House bills did not address how an insurer should conduct business, but they aimed to give the federal government access to company data that might have allowed people to recognize and rectify potential redlining more consistently.

The Insurance Disclosure Act, sponsored by Massachusetts Democrat Joseph P. Kennedy II, called for insurers to present the Secretary of Housing and Urban Development (HUD) with annual data related to their customers, employees and underwriting decisions. Under the act, insurers operating in 150 parts of the country would have disclosed to HUD the total number of policies they wrote, the premiums they earned, the total policies they either cancelled or did not renew and the number of agents they employed or let go during the year, all grouped by geography. Applicants, customers, dismissed insurance representatives and current agents would have also been categorized based on their races.

Cardiss Collins, D-Ill., sponsored the competing Anti Redlining in Insurance Disclosure Act, which also instructed insurers to reveal policy, premium, cancellation, non-renewal, and employee data in geographical groupings to HUD but did not specify racial disclosures and applied to 25 metropolitan areas instead of the other bill’s 150.

For the most part, insurers criticized the Kennedy bill, calling it too burdensome for the industry. Professionally maintaining data costs money, and although a person might argue that federal legislation requires mortgage lenders to collect data about consumers for anti-discriminatory purposes and that insurers should be held to the same standard, insurance professionals do not see absolute parallels between the two occupations. After all, applications for insurance annually outnumber applications for mortgage loans. Perhaps believing some form of redlining legislation was bound to pass through Congress with or without their endorsement, insurers begrudgingly got behind the Collins bill, the lesser of the two evils due to its more limited demands, which the House passed and sent to the Senate in July 1994.

Redlining legislation's fate changed four months later thanks, in part, to Election Day returns. Politically speaking, 1994 was the year of the Republican revolution, the year Newt Gingrich and his conservative colleagues reclaimed control of Congress after years of Democratic rule. Among other things, Republicans campaigned that year on a platform of ending an era of alleged big government. The newly elected Congress seemed to apply that stance to the redlining issue, preferring that data collection and other regulatory responsibilities be left up to the states. With big government as one of its foes, it made little sense for the new majority to pass redlining laws when some states already had such laws in their own books.

With every shift in federal power, there is not only a change in the "yea" or "nay" tallies in congressional chambers but also a change in the government's attention to issues. Despite hanging onto their seats, Collins and Kennedy lost power in committees, which play a major role in deciding which bills come up for a vote and which ones remain stuck in political purgatory, seemingly never to be considered again. The Anti Redlining in Insurance Disclosure Act never made it to the Senate floor for a vote, and the only redlining bill to come from that Senate was read twice and then eternally referred to the body's Committee on Banking.

Within the executive branch, HUD Secretary Henry Cisneros, who placed redlining near the top of his concerns, was not ready to concede defeat just because the legislative system had worked against his goals.

"This must stop," Cisneros had said about redlining, as quoted in National Underwriter before the massive Washington shakeup. "Insurance is not a luxury. It is a necessity of life, and we can't have insurance companies …pulling out when they feel like it because the numbers don't work."

Insurers and declared advocates for the separation of powers in government spoke out against HUD as it worked toward exposing redliners and developing a federal regulatory plan. HUD, they said, should keep its nose out of insurance issues and should not use its funds—American tax dollars allocated to the department by Congress—in ways that contradicted the legislature's decisions. Over the years, HUD has given millions of dollars in grant money to consumer organizations, including $1.5 million to plaintiffs in the Nationwide case, for them to conduct redlining studies. HUD's continued push for redlining reform with or without Congress's approval provoked comments published by National Underwriter in 1995 from Rep. Earl Pomeroy, D-ND, who half-jokingly referred to HUD workers as "pointy-headed SOBs who didn't get the message of the last election." Unable to cool down insurers' boiling blood, and doing its best not to invite litigation, HUD eventually backed off from the issue, at least in its campaign to regulate parts of the industry.

State redlining laws have placed varying demands on insurers. Some states do not force insurers to submit any documents to regulatory departments for anti-redlining purposes. Other states require information about service in certain zip codes. Some states only release cumulative data for all area insurers put together. Others make individual companies' data available upon public request. Insurers in some states must disclose their underwriting guidelines to regulatory departments, while insurers in other states need not do so. In the early 1990s, when the redlining debate was arguably at its hottest, only a few states took a watchdog approach to redlining and required insurers to provide them with geographically categorized sales data.

Changes in statewide political power can affect how governments approach redlining prevention. This seems to have occurred in California, generally known as one of the strictest states in the country when it comes to insurance discrimination. During some regimes, the state's insurance department stressed a need for extensive disclosures from insurers. Under other people's control, however, the department did not want to require disclosure from some insurers if they presented the state with plans on how to serve highly urban communities. The state has also gone back and forth throughout political changes on the issue of auto insurance. California's auto insurers have sometimes had a legal right to use zip codes as factors when offering and pricing coverage. At other times, they have had orders from above to base underwriting decisions on nothing more than consumers' driving records, how long they have been behind the wheel and how many miles they drive.

Insurers have refused to embrace proposed and existing federal and state laws for valid reasons that go beyond the financial problems they foresaw in the previously mentioned Kennedy and Collins bills that failed to become law. The opposition to any federal redlining law is easily summed up by the introduction to the McCarran-Ferguson Act, which states, "Congress hereby declares that the continued regulation by the several states of the business of insurance is in the public interest." Simply put, the authority for insurance regulation rests with the states and not with Washington D.C. In this sense, insurers are not necessarily claiming proposed federal legislation lacks benefits for consumers and the industry. They are merely pointing out that the government allocated certain powers to certain bodies long ago for a reason and that the federal government might overstep its boundaries if it takes power away from the states.

Regardless of where an anti-redlining proposal comes from, insurers have reason to wonder how legislation might affect their risk management. Any potential law could represent a slippery slope that might eventually cause insurance companies to falter if they no longer have the right to stay away from some risks. People who have trouble sympathizing with insurance companies ought to consider that if the government orders insurers to insure people and properties perceived as high risks against the insurers' better judgment, less risky consumers will almost certainly encounter higher premiums and deductibles in order to keep the companies in stable financial condition.

On behalf of policyholders and themselves, insurers frequently point out privacy issues that come out of anti-redlining laws and regulations. Prospective laws and regulations that aim to eradicate redlining on a racial basis usually require an insurer to collect data about consumers' racial backgrounds. Yet, even if a law demands such an action, there is an ethical conflict in that situation because many people do not want to reveal personal information. America's long, sometimes unsatisfactory record on discrimination, particularly from a racial perspective, has made it difficult for many minorities to believe that any information they give to an insurer will go toward anti-discriminatory endeavors. Insurers who understand the pain of prejudice and the reluctance of people to disclose personal information must ask themselves a question: Is personal privacy a reasonable sacrifice for an ultimate goal of supremely fair insurance services?

Privacy is particularly a worry for insurers when states require them to disclose their underwriting guidelines. For many people in the industry, such demands border on too much to ask because companies' underwriting guidelines are often viewed as their secret recipes for success in a fierce market. If too many trade secrets come out of legally imposed disclosures, a business might lose its competitive edge. From a more positive perspective though, increased disclosure by insurers might win faith from consumers who want to make certain that the industry does not engage in shady business. When used effectively by the states, these disclosures perform a priceless purpose, making legislation like the Fair Housing Act more enforceable and assuring the public that insurers uphold all applicable laws.

Sometimes courts have allowed insurers and regulators to withhold data from the public because the data reveals trade secrets, and at other times, courts have ruled the public has the right to access these alleged trade secrets. The St. Louis Post-Dispatch went to court hoping to obtain insurers' zip-code information from the Missouri Department of Insurance. In this particular case, a judge ruled the data constituted trade secrets, and the state did not need to make the information public. But when the California Department of Insurance released zip-code data that State Farm said contained trade secrets, the Supreme Court of California ruled against the insurer.

A Bigger Ethical Picture

Regardless of whether or not they practice illegal redlining, legal territorial rating or any other form of discrimination that intentionally or unintentionally produces negative consequences for minorities, every professional in the industry must understand how overpriced or unavailable insurance coverage contributes negatively to society. A combination of high prices, poor availability, and redlining undoubtedly affected the numbers in 1995 when the California Department of Insurance found that nearly 30 percent of state drivers lacked auto coverage. Granted, a fraction of the population will never care to obtain insurance. But is that fraction truly equal to an astounding 30 percent? Let us assume at least some people within the 30 percent wanted to purchase coverage, uphold the law and compensate innocent victims who they might have hurt on the road. If it is true that territorial rating occurred, some of these consumers, such as those in inner-city Los Angeles, might have been denied coverage or only offered it at an astronomical price. Maybe the denied customers turned next to a state insurance program, which typically charges more than your average insurer and seemed unaffordable. Perhaps at some point, people who got quotes from traditional and non-traditional insurers noted the high cost, realized they had rent to pay and kids to feed and decided auto insurance simply did not fit within their extremely tight budgets. Pricing and availability problems risk the consequence of people breaking the law in order to continue driving their cars and have money for other necessities. The remaining 70 percent of the population are left to wonder what will happen if they are involved in an accident with a car driven by someone from someone in the uninsured 30 percent.

Some people have dismissed the existence of racially discriminatory redlining by citing studies that claim 98 or 99 percent of black homeowners have property insurance. Yet it must be remembered that people from every walk of life who own homes are bound to have property insurance for the simple reason that lenders rarely provide mortgage loans without proof of insurance. As a result, writer, professor and sociologist Gregory D. Squires has said these studies must be inverted: Instead of focusing on how difficult it is for black homeowners to get insurance, they should focus on how many blacks could not become homeowners because they could not obtain proper insurance.

America touts itself as the land of opportunity, where hard work and good citizenship produce results. Due to redlining, territorial rating or other factors, many Americans do work and behave like good citizens, only to never experience the great American dream of home ownership. Senate Bank Committee member John Kerry, D-Mass., had similar thoughts on redlining in 1994, which appeared in National Underwriter:

"When companies not only adopt the bad public policy, but the bad business policy of not doing business in whole sectors of our country, they are writing out the whole American dream. They are just writing it off. I think it's disgusting."

Let us return to our discussion of the inner city and explore the long-term effects that redlining and unethical territorial rating can produce there. Poor people in these areas cannot afford what insurance they can get, which means they will not buy the houses of people who have left the neighborhood, which in turn means the properties will not sell and continue to drop in value. When a local homeowner dares to consider opening a business in the community, these low-valued homes are most times not worth enough in collateral to earn the person a commercial loan. Without businesses, there are no jobs. Without jobs, there are no new homeowners or any money to pay for high insurance premiums. As Lyndon Johnson's Kerner Commission famously said in 1968, "Communities without insurance are communities without hope."

Insurance is not what's wrong with inner cities, but insurers must understand that their decisions can, in some ways, either help to continue vicious cycles in these areas or aid in some life-changing solutions.

Some Words on the Web

The internet has influenced countless aspects of modern society, and the redlining debate is no exception. Although some insurers might still find a way to practice redlining on the Web, particularly when they request an address from the computer-linked consumer before providing quotes, many people believe online insurance sales limit chances for unethical discrimination. Unlike face-to-face meetings and telephone conversations, Web communication does not allow an unethical insurer to determine a consumer's race with relative ease and practice discrimination on that basis. Also, online insurance offers can counteract the absence of agents and brokers within some geographic areas, including inner cities. Even if people in South Central cannot physically find a respectable agent to do business with them, they are potentially only a few clicks away from discovering the coverage they desire.

Still, the technological gap between the rich and the poor can be applied to insurance and used to support claims that internet-based sales actually nurture discrimination under some conditions. If an insurance company uses the internet as a prime venue for advertising, the company might ignore members of minority groups and communities who are less likely than the typical white male in suburbia to have computer skills or disposable income for internet access. This is especially an ethical concern when insurers offer unique deals to online consumers, while leaving the rest of the population out of the loop and paying higher premiums.

An insurer need not sacrifice ethics in order to become a major force on the Web. In fact, online advertising and an appealing, user-friendly Web site are fundamental elements of any smart modern business strategy. A professional should, however, consider the consequences of any internet campaign and think about those consequences within the context of fair service to all people.

How Agents Can Fix the Problem

No insurer wants to be accused of redlining, lose business and have to cope with a public relations nightmare. Also, no agent wants to jeopardize a company by binding policies that present tremendous risk. After facing their accusers in redlining disputes, some insurance companies have loosened up a bit and taken on more types of customers than they would have in the past. But an insurance company's standards need not drop in order to prevent potential redlining. Insurers can protect themselves and serve a variety of customers as long as they apply the same standards to all customers, remain as honest as possible, and think openly and analytically.

Sure, statistics tell us inner cities are generally high risks for insurers. But does that mean there are literally no customers in those areas for insurance companies to serve? Some people within the industry have taken tours that show agents less stereotypical parts of cities that they might find attractive in a business sense. Examples of such tours include ones in St. Louis created by the NHS Missouri Insurance Initiative. Some insurers hire minority agents and people familiar with inner cities so the company has a knowledgeable presence in underserved areas as well as representatives who can relate to local consumers and thus educate them about the importance of insurance.

If an insurance company must deny coverage or can only offer it at a high price, agents must do everything in their power to make the consumer understand exactly why the company responded that way. The public must know why insurers cannot accept all customers, why non-prejudicial discrimination is necessary and what risks insurers are generally unlikely to absorb. The more consumers understand about why insurers deny coverage at certain rates and about the insurance business in general, the less likely they are to view themselves as victims of illegal discrimination.

The open minded, analytical agent rarely shuts the door completely on a customer. It may be necessary to deny coverage to someone or to only offer someone high rates, but an agent who is trying to prevent redlining will inform a consumer about any potential solutions to the insurance problem. If a certain part of a house is too old and beat up to insure, the agent should say so and offer to take a second look at the place pending improvements. If property owners can get a better rate once they install a sprinkler system, a burglar alarm or smoke detectors, the insurance company should let them know and give those potential customers an opportunity to make those changes.

If nothing else, insurers must treat each customer fairly during the application process. This means not making time for white customers who come in from the street while telling black ones on the phone that they need an appointment. It means having the same philosophy on old houses in white neighborhoods and old houses in Hispanic neighborhoods. It means taking the time and spending the money to inspect a home instead of instinctively denying coverage for it over the phone. For the truly ethical agent, it can also ultimately mean raising one's voice, publicly if necessary, when colleagues and superiors refuse to recognize or alter their discriminatory ways.

Following this advice and consciously recognizing the consequences of redlining, territorial rating and other discriminatory insurance practices could create major long-term benefits for insurers and the public. As insurers grow more knowledgeable and therefore more willing to carefully venture into underserved communities, they might find many new customers who will remain loyal to them for all of their insurance needs. Over time, insurers might even change the culture within the business world and, through their presence and support, convince other professionals to reinvest money, time and energy into poor communities. At the very least, they might change outsiders' opinions of insurers and nurture a trust between the industry and the public that is never shaken by the unethical acts of the occasional bad egg.

CHAPTER 3 – ETHICS AND CREDIT INFORMATION

Introduction

Anyone who has applied for a mortgage or any other kind of loan has probably had their credit history and credit score examined by a lender. Credit card companies, whether they receive actual applications for accounts or simply solicit the public via a steady flow of pre-approved offers, do credit checks on all potential customers. Even many landlords and some employers take the time to investigate the financial pasts of prospective tenants and employees. Credit reports and accompanying credit scores (typically three-digit numbers based on the contents of a credit report) can greatly affect the feasibility and conditions of a business relationship and can therefore serve as either an attractive, positive feature or a negative one for the applicant. Sometimes, these reports and scores are the ultimate factors that determine whether or not a person obtains that mortgage loan, credit card, apartment or job. At other times, a person is generally assured of obtaining a mortgage loan or a line of credit, but these reports and scores dictate such important details as interest rates and credit limits for the applicants. Applicants with impressive credit reports and scores have a good chance of obtaining the money or other items that they wish to secure through loans or credit transactions, and they can expect to obtain them on favorable terms. Conversely, individuals who compile a substandard credit history are often at the mercy of a businessperson who has a professional duty to guard the lender or creditor against potential financial losses.

Over the past decade or so, insurers have been increasing their use of credit reports and credit scores to assist in flagging high-risk customers among a large number of applicants for coverage. As we will explain later, this use has increased as some insurers believe that an individual who does a poor job of managing credit will also do a poor job of managing other tasks and therefore pose a greater insurance risk. Both the general public and industry professionals have begun to realize, however, that when insurers choose to base policy rates on credit histories, they are making a decision that may or may not be ethical, notwithstanding any practical benefits. Few insurance professionals are opposed to the overall concepts involving credit reports and credit scores. Most of them do not doubt that these sources of data are quite useful within the confines of certain businesses, particularly the lending industry. But many consumers, agents, brokers and other industry executives have pointed out that there are big differences between lending money to someone and insuring that person. Insurance is not a loan that is paid off with interest over time. Instead, insurance is a product, cancelable upon nonpayment, that transfers risk from one party to another. Whereas a lender’s main concern is that a risky customer will not make proper payments, an insurance producer’s main concern is that a risky customer will have some sort of costly accident, become seriously ill, sustain damage to a home or become involved in some other type of situation that will require an insurer to pay for claims. Based on these differences and the negative consequences that credit-based underwriting has produced for some consumers, many people believe that an individual’s financial history should not play a significant role in the availability of affordable, quality insurance coverage.

The information that follows addresses how credit scoring factors into an insurance producer’s ethical obligations to employers, consumers and the industry as a whole and notes that credit-based decisions may be perceived as ethical, unethical or both depending on one’s values and the details of a given situation. As is the case with many ethics topics, two well-meaning people can examine this issue and come to very different conclusions regarding what is “right,” “wrong,” “just” or “unjust.” The information presented here allows readers to come to their own conclusions about the use of credit reports and credit scoring in insurance but encourages insurance producers to value ethical considerations whenever making those determinations.

Understanding Credit Reports, Credit Bureaus and Credit Scores

A lender, creditor or any other person with a legitimate reason to investigate an individual’s credit history can obtain a credit report from any of the three major credit bureaus in the United States: Equifax, Experian and TransUnion. Although credit reports from each of these bureaus might differ from one to the next, they all intend to contain the same basic data. For identification purposes, a credit report will include a person’s name, address, phone number, Social Security number and other general information that may be applicable and available to the bureau. An up-to-date credit report lists existing and cancelled accounts that the person has been authorized to use, credit limits, outstanding and repaid debts, bankruptcies, tax information, overdue child-support payments and more, depending on the individual’s financial obligations. The identities of parties who have investigated the person’s credit history through that particular bureau, such as banks and credit card companies, will also appear. Some communities have even begun informing credit bureaus of people’s unpaid small fines, such as overdue library charges and parking tickets. Equifax, though, has thus far declined to include these minor blemishes on their reports, claiming, according to a January 2006 article in the Wall Street Journal, that it wishes to avoid penalizing people who live in parts of the country where local ordinances are enforced more strictly than in other areas and where laws and enforcement differ.

Extensive as they can sometimes be, credit reports do not include information that relates to a person’s medical history, criminal background, ethnicity, race or gender. Payments and delinquencies on rental agreements and utility bills also do not appear, though Experian has considered including such data.

A creditor or lender is free to report unpaid bills to the credit bureaus when 30 days past a due date, but the creditor or lender does not always report every debt to every bureau. Therefore, a credit report from Experian, for example, might feature delinquencies and payments that a TransUnion credit report does not mention and vice versa. Because the consumer rarely knows which of the three bureaus a creditor, lender or other party will contact for a report, informed individuals periodically scrutinize their credit reports available from each bureau, keeping an eye out for outdated material and obvious errors.

Unfortunately, not all obvious errors are honest mistakes made by the creditor, lender or bureau. Instead, some are instances of the increasingly common crime known as identity theft. Carelessness or security flaws related to one’s personal information can often assist total strangers, or even people in positions of trust, in opening accounts, taking out loans and running up bills in an unsuspecting, innocent person’s name. Needless to say, bogus information on a credit report can make a financially responsible, desired client seem like someone with a deplorable credit history who creditors will either reject or only serve under the condition of high interest rates.

If consumers believe that something on one of their credit reports is incorrect, they may challenge the validity of the information by contacting the bureau that published the report. Credit bureaus are required to make contact with the party who submitted the disputed information and must attempt to verify the accuracy of the report’s contents. If, after that process has run its course, the consumer still contests the information, he or she may explain the alleged discrepancies in a personal statement that is added to the credit report for all inquirers to view and consider.

Despite the threat of identity theft and the heavy traffic of personal information that travels through the World Wide Web, U.S. residents might not need to be as concerned about unauthorized credit activity as they were at the beginning of the new millennium. The passage of the Fair and Accurate Credit Transactions Act of 2003 made the task of monitoring one's personal credit information relatively simple and inexpensive. Consumers are now legally entitled to a free copy of their credit reports from each of the three credit bureaus every year, via either the internet or mail. Because the act does not force people to order their reports by a specific date, consumers can space out the arrivals of the three reports and give themselves a relatively frequent opportunity to monitor their records for any suspicious activity affecting their credit history. All three credit bureaus offer additional fee-based access to the reports as well.

Credit scores serve as reliable summaries of credit reports and are perhaps most popular as a way for banks and other lenders to initially screen applicants for home loans. Calculators of credit scores typically assign a three-digit value to a person's credit history based on the types of accounts that the individual is authorized to use, the consistency with which the person pays bills and the existence and quantity of debts. Generally speaking, someone who has used a lot of credit and has paid off debts in a timely fashion will have a high, favorable score. In contrast, someone with minimal credit history, large debts and a pattern of late payments will generally have a low, unfavorable score.

Since lenders and creditors began utilizing the numbers as financial evaluation tools, Fair Isaac and Co. has been the consistent leader in the field of credit scoring and is particularly dominant in the mortgage lending industry. Through the use of data compiled from the three credit bureaus, Fair Isaac formulates what is commonly known as a FICO score, which assesses the credit risk of a person through a "higher the better" point system. A FICO score can range from a value of 300 to 850. People with scores above 660 are generally considered low-risk applicants for loans and credit and are more likely than other applicants to secure low interest rates if and when they are approved by a lender or creditor. Those individuals with scores ranging from 620 to 660 are generally thought to possess an increased risk of financial delinquency. An applicant with a FICO score below 620 tends to represent a high risk to creditors and lenders and may face high interest rates or a flat denial of financial assistance.

As the importance of credit scores increased in this country, the individual credit bureaus began expanding their product lines beyond reports by offering their own scores. Equifax has used a system known as Score Power, which calculates a three-digit score in a manner similar to that of Fair Isaac and Co. Experian's scoring product, known as PLUS Score, resembles true FICO scoring to a certain degree but deviates somewhat in the data it considers and in the way it manipulates that data. Furthermore, a person's PLUS Score can range from 330 to 830, a slightly tighter group of numbers than the one employed by FICO. TransUnion has formulated a different scoring system that is based on somewhat different criteria than the FICO approach.

FICO's dominance in the credit-scoring business is understandable, given its position as the first to enter the market. In addition, a FICO score is, in many ways, a number derived from a composite of information from all of the bureaus and is, therefore, arguably a more reliable representation of a person's creditworthiness than the contrasting scoring systems that Experian, Equifax and TransUnion have used independently of one another. The credit bureaus recently addressed the discrepancies within their scoring systems and waged a competitive campaign against FICO in order to increase their market shares. In 2006, the bureaus unveiled VantageScore, a credit-scoring method that uniformly analyzes credit report data for all three organizations. As a result of the collaborative venture, a person can receive a credit score from Experian, Equifax or TransUnion and know that the selected bureau is analyzing the same financial factors in the same way as the other bureaus. The range for scores under the VantageScore system is identical among the three bureaus, but scores might still differ if a lender or creditor reports to one bureau and not the others. Even though all three bureaus would apply the same calculation formula, the differences between the data reported to each bureau would cause different score results.

VantageScore also provides people with a letter grade that relates to their creditworthiness. The inclusion of a letter grade to go along with the score might not serve much of a purpose for experienced lenders and creditors who know how to interpret the numbers, but the presence of an A, B, C, D or F (reminiscent of school grades) should cater to members of the general public who want to know not only their credit score but also what their credit score means to business professionals. The rating and grading scale for VantageScore is as follows:

- 901-990 = A
- 801-900 = B
- 701-800 = C
- 601-700 = D
- 501-600 = F

Although the Fair and Accurate Credit Transactions Act of 2003 allowed Americans to gain free, periodic access to their credit reports, the legislation only stipulated that a person must be given access to a credit score for a "fair and reasonable fee." As a result, the credit bureaus and FICO usually do not disclose these scores without payment. These numbers can be purchased directly from any of those organizations. Loan applicants, however, are entitled to a credit score upon request.

Insurers and Credit Histories

Insurers have used credit reports and scores for many years when offering coverage to businesses, but it has only been within the last decade or so that credit history has played a major role in the availability and pricing of personal-line policies. For the prospective insured who wants to keep credit data out of the underwriting process, coverage options are becoming increasingly limited. In 1996, Best's Review reported, through a source at FICO, that approximately 200 insurance companies were looking into applicants' credit information. In roughly two years, according to Money magazine, that number rose by 50 percent. Despite the passage of various laws in various states that limit insurers' use of credit histories, most property and casualty insurers at least glance at this information in one form or another.

There are few guarantees, however, that any two insurers will utilize credit scores in the same way. Since consideration of credit began, some insurers have based decisions outright on an applicant's credit score. Others have used credit scores in a slightly less strict manner, as alerts to underwriters that an applicant might represent a considerable risk but not as grounds for immediate disqualification for coverage. Other insurers have gone a step further in their analysis of credit statistics. Instead of focusing primarily on credit information, they incorporate the scores and reports into a more wide-ranging formula to create an "insurance score," which is influenced by one's credit history to a lesser degree. In other cases, which will be featured more prominently elsewhere in these pages, state governments have weighed in on the issue and passed legislation that limits the industry's use of credit history when approving applicants for coverage and when setting premium rates. Some states, for example, reserve the use of credit histories solely for auto insurance companies.

Managing Insurance Risks Through Credit Reports and Credit Scores

Whether they work as agents or brokers, insurance producers are ethically required to avoid burdening insurance companies with an overabundance of risks. To many professionals, credit histories are an excellent tool that aids them in this responsibility. Ideally, facts found in people's credit reports allow underwriters to gauge the behavior of prospective insureds and to assess the likelihood of those applicants filing certain claims. In a simple, concise statement printed in an article from the Boston Globe in February 1994, Gerald Fels, executive vice president and chief financial officer of Commerce Insurance Co., summarized the way in which applicants' credit histories inform insurers.

"They're basically going to give us the information on whether this is a good customer or a bad customer."

Within that generality, however, insurers rely on several different theories that link people's behavior to their credit history. Many insurance professionals assert that a credit report or credit score reflects a person's concept of responsibility and, therefore, the person's risk potential. Under this rationale, someone who makes regular payments on a car loan has a good chance of being a responsible driver. Perhaps the driver makes the regular payments because he or she recognizes a moral responsibility to repay a lender. In that case, it is thought that the same sense of morality might extend to the person's driving habits and produce fewer insurance claims than someone with bad credit because the driver does not want to hurt another person or damage another person's property. Or perhaps the person making regular payments on the car loan is emotionally attached to the vehicle and does not wish to damage it in an accident or through a mechanical failure. In this more materialistic situation, according to some industry veterans, the person is not only less likely to drive recklessly but also more apt to keep the automobile in good, sturdy and safe condition. Similar theories exist in regard to the credit histories of homeowners. Supposedly, people with good credit are responsible consumers who keep their household in a sturdy, safe condition and represent reduced risks for insurers. Granted, an insurance producer might not buy into the logic of all of these psychological theories related to risk potential, but as long as the producer buys into at least one of them, the credit-worthy applicant is still viewed as someone who is relatively unlikely to hurt an insurance company by filing excessive claims.

The financial difficulties associated with bad credit serve as another incentive for insurers to investigate someone's credit report or credit score. If a person struggles with credit, that might mean that money problems prevent proper maintenance of cars and homes, regardless of the owners' responsible intentions, and could lead to excessive claims. Plus, whereas monetarily secure policyholders might opt to pay for some insured damages out of their own pockets in order to prevent increases in their policy premiums, people in unfavorable financial situations might have no other choice but to file even the smallest of claims.

A few of the arguments supporting insurers' probes into credit histories seem to treat low-income applicants in a seriously cynical manner. For example, some insurance professionals say an extremely low credit score or a heavily soiled credit report could hint at an applicant's deviance and susceptibility to the temptations of insurance fraud. This theory applies, of course, to the few applicants who see absolutely nothing wrong in committing fraud under any circumstances. But it also applies to morally conflicted applicants who would not normally deceive insurers but who find themselves drowning in such a deep pool of pressure from creditors that they feel as though they must engage in fraud to remain financially afloat.

Aiding Consumers Through Credit Reports and Credit Scores

All of these arguments make credit reports and credit scores seem like weapons that insurers use to penalize the public. But the underwriting community's use of credit histories does create potential benefits for many insurance customers, particularly those who have struggled to obtain affordable auto and home coverage in the past. Some motorists with imperfect driving records have been rewarded with lower premiums because of their impressive credit histories. Many homeowners who reside in geographic areas associated with high risk now have better insurance benefits because they pay their debts quickly and fully.

A popular criticism of the insurance community is that underwriting lacks enough objectivity. This accusation becomes weaker thanks to the use of credit scores and, to a greater degree, insurance scores. Although many people have angrily argued that credit scores jeopardize fairness in insurance, proponents of credit-based decisions point out that credit reports allow the industry to be more reliant upon facts when underwriting and less reliant on the biased personal and preconceived opinions of human beings. Many insurance professionals on this side of the argument are also quick to point out that credit scores have a foundation in relative objectivity because they do not take such personal attributes as one's gender, race or ethnicity into account.

Possible Discrimination Based on Credit Reports and Credit Scores

Despite the positive effects that credit histories have produced for many insurance customers, greater media attention seems to have been given to the vocal segment of the population that views credit-based underwriting as a despicable extension of redlining, an outlawed practice that has typically involved lenders and insurers denying service to various minority groups based on geographic location. Even though some professionals defend their preference for credit-based underwriting by pointing out that credit reports and scores do not contain information about race or ethnicity, critics argue that demographic data connects enough dots to prove discrimination and that insurance producers who ignore such evidence should not be let off the hook for their allegedly unethical and possibly illegal behavior.

No modern insurance company publicly admits to restricting business based on race, but some studies strongly suggest that the use of credit reports and credit scores in underwriting has indirectly made racial discrimination a greater reality. A December 30, 2004 report by the Texas Department of Insurance that counted drivers with the "best" credit by racial group found that 90 percent of the drivers with these high scores were white. Hispanics, meanwhile, accounted for 5 percent of those drivers, and blacks, a mere 2 percent. In stark contrast, blacks and Hispanics accounted for 61 percent of drivers with the “worst” credit reports and credit scores.

To some critics, insurance discrimination based on credit is an issue that transcends race. Immigrants, for example, tend to have limited or non-existent credit histories and might have to settle for expensive auto and home insurance, assuming that the coverage is offered to them in the first place. Other immigrants who do not fit that profile could still encounter similar problems if they speak little or no English and cannot decipher the contents of their credit reports in order to check for outdated information, honest instances of inaccuracy or potential identity theft. The federal government does not require credit bureaus to make reports available in foreign languages, and reports from Experian and Equifax are only available in English. A company communications executive said TransUnion limits language options to English and Spanish.

One might also make the case that insurers’ use of credit histories results in age discrimination. Most young people have not lived long enough to establish much of a credit history, unless one counts the mounds of pre-approved credit card offers that have traditionally flooded the mailrooms of dormitories on college campuses and the hefty student loans that affect people’s finances well into adulthood. The use of credit reports and scores could also work against elderly people who, based on conservative tradition and habit, avoid purchasing many items on credit and have low credit scores as a result.

The use of credit reports and scoring also leaves the door open, inadvertently or otherwise, for gender discrimination in insurance. Granted, financial independence among women in the United States seems to become more common with the passage of each generation, but the country clearly has not yet achieved a goal of true equality between the sexes. The passage of the Equal Credit Opportunity Act three decades ago disallowed any denial of credit based on a person’s gender, and yet, some women might still have less impressive credit histories than men, particularly in the case of a recent divorcee who was not legally connected to all of an ex-husband’s accounts.

Other Negative Consequences of Credit-Based Underwriting

The multi-faceted issue of discrimination is not alone on consumer advocates’ lists of complaints regarding credit-based insurance decisions. Even wealthy, middle-aged, American-born, white males, seemingly safe from most obvious forms of alleged discrimination by insurers, could fail to obtain the coverage they deserve due to omissions and errors in credit reports. At the time of this writing, the degree of similarity among the three bureaus’ credit scores under the VantageScore system is still unknown. But insurance insiders have confirmed that, even though the bureaus will be analyzing and scoring data in the same way, the data itself might still differ from one bureau to the next. Most times, the differences among an individual’s respective reports from Equifax, Experian and TransUnion do not jeopardize a person’s quest for credit at a reasonable interest rate, but sometimes they do. A 2002 study by the Consumer Federation of America concluded that of 1545 combined files from the credit bureaus, 31 percent of them exhibited differences that could have potentially knocked down a person’s credit score by at least 50 points.

Critics further contend that underwriters might not give enough consideration to unique circumstances when examining credit histories. Even if prospective or existing customers admit to having bad credit, the reasons for their financial blemishes might not fit neatly into a theory that equates a good credit history with a strong sense of responsibility. Consider, for example, the monetary demands that come with major health scares or the loss of a job at a downsized company. Such factors can lead to personal and family crises and have the ability to spoil years of respectable credit if they remain a part of one's life for an extended period of time. If the insurance company is unfamiliar with these private matters or does not wish to make exceptions for them, a person can be thought of as a high risk for auto and home coverage all because of temporary personal misfortune.

In other cases, a person might be in the uncomfortable position of being legally responsible for someone else's accumulation of bad credit and might need to pay the price for the other party's actions in the form of overly expensive insurance. Think again about the credit predicament of the recently divorced woman but, this time, imagine that the former husband had run up major debts on accounts that he had access to but that were in her name. Until those debts are paid off or the matter is settled in some other way, the woman's credit score will remain much lower than it probably should be, and she could face steep insurance premiums to cover her home and car.

In order to justify their use of people's credit histories, some insurance professionals cite studies like the one conducted by Tillinghast-Towers Perrin, which found that there is at least a 92 percent chance of a relationship between a person's credit history and future losses. Despite that high number, however, some consumers cannot help but wonder what such studies actually prove, and to an extent, some insurers feel the same way. Supporters of the studies point to the numbers and insist that a relationship exists between creditworthiness and insurability. They theorize about responsibility, maintenance of belongings and so forth, all of which are interesting conclusions worthy of greater study. These possible links do not yet have universal acceptance behind them to support the use of credit scores, in contrast, for example, to the various medical findings that have linked smoking, drinking and stress to assorted health consequences and that have allowed health insurers to price policies based on an individual's personal habits. Many Americans who drive impeccably despite their bad credit and who are now paying high auto insurance premiums because of debts believe that the limited existing studies must be flawed, and that insurers have unwisely decided that safe driving does not mean as much to them as it once did.

Defending Credit Reports and Scores in Insurance

Perhaps insurers need to provide stronger proof to the rest of the world that the correlation between credit and future losses is not merely a general link. Or perhaps it is the critics of credit scoring in the business who need to rethink their positions. The previously mentioned study by Tillinghast Towers-Perrin that found no less than a 92 percent chance of a link between credit history and loss was, in fact, an examination of eight different insurance companies' data and found correlations in some cases as high as 99 percent.

Although credit has influenced the availability and pricing of homeowner's insurance, the majority of credit-related complaints that insurers receive from customers seem to come from motorists who claim that an insurer has unfairly raised their auto premiums due to personal financial issues. Auto insurers, though, have responded on the contrary, saying that their use of credit histories actually promotes fairness; fairness to the industry, which must carefully absorb risk, and fairness to customers, whose premiums should be measured against the rest of a company's risk portfolio and priced accordingly. Auto insurance underwriters are already at somewhat of a disadvantage because so many accidents go unreported, leaving people's driving records incomplete and potentially allowing unsafe drivers to obtain cheap coverage. If auto insurers want to compensate for such instances of unfairness against themselves and other policyholders, they must consider additional variables that might help them assess insurability. In the eyes of some insurance professionals, credit reports and credit scores serve this very purpose.

Many people are indeed willing to accept the validity of the mentioned studies and are not opposed to some instances of credit-based underwriting, but they still criticize the industry for not putting forth enough effort to address potential discrimination. As their defense, some insurance producers have claimed that a major study of discrimination would involve analyzing data that they do not have at their disposal. In keeping with various privacy and equal protection laws, insurers cannot require applicants to disclose such personal information as race and ethnicity. So, by upholding laws and professional standards designed to prevent direct discrimination, insurers have found themselves without the data that they would need to examine indirect discrimination.

When countering attacks from people who accuse the industry of discriminating against low-income applicants, some insurance professionals preach about the purpose and formulation of credit reports and credit scores. In simplified terms, the reports and scores are not meant to show lenders, creditors and other parties how much money applicants make. Instead, they work toward a more analytical goal, helping inquirers interpret how well applicants manage the money that they earn, no matter the amount. Income is not even listed on a credit report. Nor is it a component of one's credit score. Significant wealth does not disqualify someone from being assessed a low credit score and does not guarantee a person a high score.

Many pro-credit insurance producers have responded to criticism with a legal defense. Credit scoring is permitted under the Fair Credit Reporting Act, and this law does not make an exception for insurance producers. Also, perhaps recognizing insurers' pursuit of overall fairness, regulators, lawmakers and members of the judiciary have allowed the industry to engage in some forms of legal discrimination when the discrimination was related to risk management. For example, younger drivers (who tend to be involved in more accidents than other types of drivers) can be charged more for auto insurance than middle-aged adults, and women (who have a higher life expectancy than males) can be charged less for life insurance than men. From a purely legal perspective, many insurers contend that discrimination that results from the use of credit reports and credit scores is permissible, either because the discrimination is unintentional or because the correlation between credit and future losses is scientifically powerful enough to make discrimination acceptable.

Credit-Based Underwriting in Practice

Some consumers and insurance professionals do not necessarily have a problem with credit being a factor in insurance rates, but they wish the industry would use the information contained in credit reports in a uniform manner or, at the very least, disclose the different ways that they use the data. Some insurers have used credit scores obtained from Fair Isaac or one of the three credit bureaus to judge insurability. Some have used only portions of the bureaus' credit reports. Others have relied on a combination of credit information and other factors of their own choosing and have formulated a customized insurance score. But the general methods used and the elements that make up each insurer's scoring formula have often been difficult to understand. This was especially the case back in the 1990s, when credit was still emerging as an underwriting tool for auto and property insurers.

Even among insurers who use credit in the same numerical way to determine insurability, companies often apply their numbers differently when dealing with consumers. One company might use credit data when setting policy rates, while a company across the street might use the same data strictly as a guide when making more general underwriting decisions. The industry has debated within itself about which customers should be credit-checked. One camp has supported credit inquiries solely for new customers, while another has said credit considerations should apply to existing customers, too, and should give insurers opportunities to cancel or refuse to renew a policy.

The insurers' secrecy regarding their use of people's credit histories has left some consumers confused, not understanding, for example, why they obtained a mortgage loan with a relatively limited amount of hassle but are paying a bundle to insure the family station wagon. The sometimes tight-lipped approach to use of credit information can also make it difficult for prospective insureds to shop around in search of an insurer whose views on credit will best benefit their situation.

Independent insurance agents have also expressed frustration over some insurers' credit-related practices. These agents complain about being left in the dark about how credit considerations might specifically apply to each individual customer, and some have lost potential business because they could not soothe the minds of people who worried about how their finances would affect their chances of obtaining preferred coverage. Even agents who have been generally informed about an insurer's underwriting guidelines have stated that the industry's use of credit histories has made their jobs harder. When customers are confused about why an insurance company accesses their credit information, they expect the agent to explain the complex issue and the practices of various companies in an accurate, trustworthy manner. Furthermore, some agents say the money they earn by selling credit-based policies does not compensate them enough for the administrative and legal headaches they might encounter on the job. It should be noted, however, that these internal criticisms seem to have died down in recent years as insurance companies have increased communication with independent agents regarding reasons for implementing credit-based underwriting.

Despite claims that the industry's credit practices are legally permissible, history has validated agents' fears in regard to lawsuits. Housing groups sued Citigroup's Travelers Property Casualty Insurance, claiming that the company's access to credit histories assisted the insurer in discriminating against people in poor communities. In a separate matter, a class action suit was filed against auto insurance giant Allstate for alleged unlawful racial discrimination when the company increased a Hispanic individual's premiums by 25 percent, even though his insurance records contained only one claim and his only credit blemishes, as reported by Business Week, were two late payments to a gas station and hospital that added up to $131. No matter how an agent or broker feels about the use of credit information in the underwriting of insurance, these lawsuits suggest that insurers must carefully monitor how they incorporate information from credit bureaus into their underwriting guidelines. Perhaps, they also suggest that regulators must help insurers by clearly differentiating legally acceptable credit-based underwriting from illegal credit-based underwriting.

Government Responses to Credit Reports and Credit Scores in Insurance

Insurance regulation is generally a state issue, and many states have utilized their right to independence by making laws and adapting guidelines regarding credit-based insurance that significantly differ from laws and guidelines in other parts of the country. A few states prohibit insurers from considering an applicant's credit history under all circumstances. Other states have decided to walk on a middle ground between total prohibition and the acceptance of credit. Some states have enforced, and many more have discussed, caps on rate increases that insurers may impose on policyholders based on creditworthiness.

Perhaps the closest the country has come to developing a uniform position on credit-based insurance practices has been the adoption of the Model Act Regarding Use of Credit Information in Personal Insurance by more than half of the states. This model was developed by the National Conference of Insurance Legislators (NCOIL), and it states that insurers cannot cancel, deny or refuse to renew coverage because of credit without considering other underwriting factors that do not relate to credit. Insurers who wish to raise rates must adhere to those same standards. Any adverse action taken by an insurer because of credit issues must be accompanied by a documented, clear explanation of the insurer's reasoning. The model specifically states that vague explanations, including "poor credit rating," "poor credit history" and "poor insurance score" do not suffice. If an insurer utilizes an insurance scoring system, that system must not assign numerical values to applicants' income, sex, religion, nationality or geography. Penalizing people based on the number of times their credit has been checked is also prohibited in most cases. The model recognizes the possibility of errors on credit reports and requires insurers who base rates on credit to reevaluate any wronged consumers, no later than 30 days after disputes are settled under provisions in the Fair Credit Reporting Act. Insurers must also reevaluate policyholders' rates whenever coverage is up for renewal. Perhaps most significantly, the NCOIL model orders all insurers to disclose the ways in which they use credit information to state insurance departments. Insurance companies do not need to give this information to applicants, but they must inform consumers, at the application stage, that credit history may affect their coverage options.

The following is a copy of the NCOIL model for your review:

Model Act Regarding Use Of Credit Information In Personal Insurance

NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

MODEL ACT REGARDING USE OF CREDIT INFORMATION IN PERSONAL INSURANCE

Adopted by the NCOIL Property-Casualty Insurance and Executive Committees on November 22, 2002.

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SECTION 1. SHORT TITLE

This Act may be called the *Model Act Regarding Use of Credit Information in Personal Insurance*.

SECTION 2. PURPOSE

The purpose of this Act is to regulate the use of credit information for personal insurance, so that consumers are afforded certain protections with respect to the use of such information.

SECTION 3. SCOPE

THIS ACT APPLIES TO PERSONAL INSURANCE AND NOT TO COMMERCIAL INSURANCE. FOR PURPOSES OF THIS ACT, "PERSONAL INSURANCE" MEANS PRIVATE PASSENGER AUTOMOBILE, HOMEOWNERS, MOTORCYCLE, MOBILE-HOMEOWNERS AND NON-COMMERCIAL DWELLING FIRE INSURANCE POLICIES [AND BOAT, PERSONAL WATERCRAFT, SNOWMOBILE AND RECREATIONAL VEHICLE POLICES]. SUCH POLICIES MUST BE INDIVIDUALLY UNDERWRITTEN

FOR PERSONAL, FAMILY OR HOUSEHOLD USE. NO OTHER TYPE OF INSURANCE SHALL BE INCLUDED AS PERSONAL INSURANCE FOR THE PURPOSE OF THIS ACT.

SECTION 4. DEFINITIONS

For the purposes of this Act, these defined words have the following meaning:

A. Adverse Action—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 personal insurance.

B. Affiliate—Any company that controls, is controlled by, or is under common control with another company.

C. Applicant—An individual who has applied to be covered by a personal insurance policy with an insurer.

D. Consumer—An insured whose credit information is used or whose insurance score is calculated in the underwriting or rating of a personal insurance policy or an applicant for such a policy.

E. Consumer Reporting Agency—Any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

F. Credit Information—Any credit-related information derived from a credit report, found on a credit report itself, or provided on an application for personal insurance. Information that is not credit-related shall 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.

G. Credit Report—Any written, oral, or other communication of information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing or credit capacity which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor to determine personal insurance premiums, eligibility for coverage, or tier placement.

H. Insurance Score—A number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of an individual applicant or insured.

SECTION 5. USE OF CREDIT INFORMATION

An insurer authorized to do business in *[insert State]* that uses credit information to underwrite or rate risks, shall not:

A. Use an insurance score that is calculated using income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the consumer as a factor.

B. Deny, cancel or nonrenew a policy of personal insurance solely on the basis of credit information, without consideration of any other applicable underwriting factor independent of credit information and not expressly prohibited by Section 5(A).

C. Base an insured’s renewal rates for personal insurance solely upon credit information, without consideration of any other applicable factor independent of credit information.

D. Take an adverse action against a consumer solely because he or she does not have a credit card account, without consideration of any other applicable factor independent of credit information.

E. Consider an absence of credit information or an inability to calculate an insurance score in underwriting or rating personal insurance, unless the insurer does one of the following:

    1. Treat the consumer as otherwise approved by the Insurance Commissioner/ Supervisor/Director, if the insurer presents information that such an absence or inability relates to the risk for the insurer.

    2. Treat the consumer as if the applicant or insured had neutral credit information, as defined by the insurer.

    3. Exclude the use of credit information as a factor and use only other underwriting criteria.

F. Take an adverse action against a consumer based on credit information, unless an insurer obtains and uses a credit report issued or an insurance score calculated within 90 days from the date the policy is first written or renewal is issued.

G. Use credit information unless not later than every 36 months following the last time that the insurer obtained current credit information for the insured, the insurer recalculates the insurance score or obtains an updated credit report. Regardless of the requirements of this subsection:

    1. At annual renewal, upon the request of a consumer or the consumer's agent, the insurer shall re-underwrite and re-rate the policy based upon a current credit report or insurance score. An insurer need not recalculate the insurance score or obtain the updated credit report of a consumer more frequently than once in a twelve-month period.

    2. The insurer shall have the discretion to obtain current credit information upon any renewal before the 36 months, if consistent with its underwriting guidelines.

    3. No insurer need obtain current credit information for an insured, despite the requirements of subsection (G)(1), if one of the following applies:

(a) The insurer is treating the consumer as otherwise approved by the Commissioner.

(b) The insured is in the most favorably-priced tier of the insurer, within a group of affiliated insurers. However, the insurer shall have the discretion to order such report, if consistent with its underwriting guidelines.

(c) Credit was not used for underwriting or rating such insured when the policy was initially written. However, the insurer shall have the discretion to use credit for underwriting or rating such insured upon renewal, if consistent with its underwriting guidelines.

(d) The insurer re-evaluates the insured beginning no later than 36 months after inception and thereafter based upon other underwriting or rating factors, excluding credit information.

H. Use the following as a negative factor in any insurance scoring methodology or in reviewing credit information for the purpose of underwriting or rating a policy of personal insurance:

1. Credit inquiries not initiated by the consumer or inquiries requested by the consumer for his or her own credit information.

2. Inquiries relating to insurance coverage, if so identified on a consumer's credit report.

3. Collection accounts with a medical industry code, if so identified on the consumer's credit report.

4. Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within 30 days of one another, unless only one inquiry is considered.

5. Multiple lender inquiries, if coded by the consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within 30 days of one another, unless only one inquiry is considered.

Section 6. Dispute Resolution and Error Correction

If it is determined through the dispute resolution process set forth in the federal Fair Credit Reporting Act, 15 USC 1681i(a)(5), that the credit information of a current insured was incorrect or incomplete and if the insurer receives notice of such determination from either the consumer reporting agency or from the insured, the insurer shall re-underwrite and re-rate the consumer within 30 days of receiving the notice. After re-underwriting or re-rating the insured, the insurer shall make any adjustments necessary, consistent with its underwriting and rating guidelines. If an insurer determines that the insured has overpaid premium, the insurer shall refund to the insured the amount of overpayment calculated back to the shorter of either the last 12 months of coverage or the actual policy period.

Section 7. Initial Notification

A. If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or its agent shall disclose, either on the insurance application or at the time the insurance application is taken, that it may obtain credit information in connection with such application. Such disclosure shall be either written or provided to an applicant in the same medium as the application for insurance. The insurer need not provide the disclosure statement required under this section to any insured on a renewal policy, if such consumer has previously been provided a disclosure statement.

B. Use of the following example disclosure statement constitutes compliance with this section: "In connection with this application for insurance, we may review your credit report or obtain or use a credit-based insurance score based on the information contained in that credit report. We may use a third party in connection with the development of your insurance score."

SECTION 8. ADVERSE ACTION NOTIFICATION

If an insurer takes an adverse action based upon credit information, the insurer must meet the notice requirements of both (A) and (B) of this subsection. Such insurer shall:

A. Provide notification to the consumer that an adverse action has been taken, in accordance with the requirements of the federal Fair Credit Reporting Act, 15 USC 1681m(a).

B. Provide notification to the consumer explaining the reason for the adverse action. The reasons must be provided in sufficiently clear and specific language so that a person can identify the basis for the insurer's decision to take an adverse action. Such notification shall include a description of up to four factors that were the primary influences of the adverse action. The use of generalized terms such as "poor credit history," "poor credit rating," or "poor insurance score" does not meet the explanation requirements of this subsection. Standardized credit explanations provided by consumer reporting agencies or other third party vendors are deemed to comply with this section.

SECTION 9. FILING

A. Insurers that use insurance scores to underwrite and rate risks must file their scoring models (or other scoring processes) with the Department of Insurance. A third party may file scoring models on behalf of insurers. A filing that includes insurance scoring may include loss experience justifying the use of credit information.

B. Any filing relating to credit information is considered trade secret under *[cite to the appropriate state law]*.

Section 10. Indemnification

An insurer shall indemnify, defend, and hold agents harmless from and against all liability, fees, and costs arising out of or relating to the actions, errors, or omissions of [an agent / a producer] who obtains or uses credit information and/or insurance scores for an insurer, provided the [agent / producer] follows the instructions of or procedures established by the insurer and complies with any applicable law or regulation. Nothing in this section shall be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this section.

Section 11. Sale of Policy Term Information by Consumer Reporting Agency

A. No consumer reporting agency shall provide or sell data or lists that include any information that in whole or in part was submitted in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. Such information includes, but is not limited to, the expiration dates of an insurance policy or any other information that may identify time periods during which a consumer's insurance may expire and the terms and conditions of the consumer's insurance coverage.

B. The restrictions provided in subsection (A) of this section do not apply to data or lists the consumer reporting agency supplies to the insurance [agent / producer] from whom information was received, the insurer on who's behalf such [agent / producer] acted, or such insurer's affiliates or holding companies.

C. Nothing in this section shall be construed to restrict any insurer from being able to obtain a claims history report or a motor vehicle report.

Section 12. Severability

If any section, paragraph, sentence, clause, phrase, or any part of this Act passed is declared invalid due to an interpretation of or a future change in the federal Fair Credit Reporting Act, the remaining sections, paragraphs, sentences, clauses, phrases, or parts thereof shall be in no manner affected thereby but shall remain in full force and effect.

Section 13. Effective Date

This Act shall take effect on *[insert date]*, applying to personal insurance policies either written to be effective or renewed on or after 9 months from the effective date of the bill.

Coming to Ethical Conclusions About Credit Reports and Credit Scores in Insurance

All insurance professionals need to be aware of the laws that dictate proper conduct in their respective states, as well as the general contents of federal laws pertaining to credit reporting. For some people, in fact, laws are the only things to consider when determining the ethical nature of an act. People who subscribe to this general line of moral reasoning can be divided into at least two additional categories. One group believes that acting ethically involves strictly upholding all laws and that acting unethically involves breaking any law in any way. People who base their decisions on this ethical philosophy are inclined to follow rules and laws even if they feel that the rules and laws are unjust. The second legalistic group believes that anything prohibited by law is unethical in all cases, and that all things allowed by law are deemed ethical. Within the context of this course material, the second group would argue that as long as the law allows credit-conscious insurers to discriminate against some minorities (intentionally or otherwise), then engaging in that discrimination is ethical and justified. This philosophy coincides with some insurers' defense that, because the Fair Credit Reporting Act permits credit scoring and does not make an exception for insurers, they can use credit scores with a clear conscience without worrying about any negative consequences for some consumers.

Ethical choices can also be made based on a hierarchy of responsibilities. Insurance producers serve the interests of clients and also the interests of insurance companies, but serving both parties equally is almost certainly impractical. If an agent or broker decides that relationships with customers are more important than what might be best for an insurance company, thereby subscribing to a "customer is always right" philosophy, that agent or broker might be inclined to oppose credit scoring in the industry when a client's premiums would go up as a result of the practice. If an agent or broker ultimately feels responsible to the insurance company, he or she is likely to support the industry's use of credit histories because it aids the insurer in the risk-assessment process and promotes solvency and profits. Other insurance producers might look beyond business and believe that they have an overall responsibility to society at large. In that case, they are likely to believe that all kinds of discrimination are wrong and that insurance should be affordable for people from all walks of life, regardless of credit history.

Sometimes a person's perception of what is ethical relates to the negative consequences that are involved with a particular act. Within this ethical framework, people base their decisions on their desire to avoid the least favored outcome. A major negative consequence of using credit history in insurance is that some applicants are bound to be displeased about having to pay more for coverage and might develop bitterness toward the industry. If credit histories are not considered, the major negative consequence is that insurers will lack valuable tools that could assist them in their underwriting.

On other occasions, people's views on what is ethical and what is unethical relate to the number of people who will benefit from an act or the amount of overall good that an act might produce. Because some studies have determined that more consumers actually benefit from credit being a factor in insurance than are harmed by it, an ethical choice might be to promote the use of credit information. If an insurance professional feels that ethical choices must benefit as many people as possible but not necessarily satisfy the ultimate desires of a majority, he or she might determine that some sort of compromise that permits credit-based decision-making on a limited basis is the most ethical solution.

There are obviously many ways to approach and interpret the ethics involved with the use of credit scores by insurers. Yet, although a person might have firm opinions about the most ethical way to deal with the issue, a reasonable professional should be able to recognize that both sides of the debate have some valid concerns and points. Unlike other debates that have gone on among insurance professionals, lawmakers and consumers, this topic and the conflicts related to it do not pit the "good guys" against the "bad guys" or lend themselves to an obvious resolution. With that in mind, agents and brokers might be tempted to merely throw up their arms in a sign of frustrated resignation and convince themselves that the abundant ethical gray areas will never allow the insurance industry to discover a uniformly acceptable approach to credit-based underwriting.

It may still be premature to jump to such an open-ended conclusion. No matter which side of the credit scoring issue an agent or broker is on, it is perhaps helpful to remember that one reason why professional insurance producers care about ethics in the first place is that they want their industry to reach certain ideal heights. Of course, these great expectations for their business relate, in some ways, to financial gain. But for the true professional, they also involve gaining public trust and improving people's sometimes unfavorable perceptions of the typical agent, broker and insurance company. With these ideals in mind, the industry owes it to itself and to its customers to recognize those situations in which discrimination disguised as credit-based underwriting is clearly evident. Over time, observant professionals might notice patterns that could strongly support, refute or refine the results of today's limited, controversial studies. Insurers could then incorporate these patterns into their business practices and perform the immeasurably important task of educating the public about how the industry treats credit information, and about how insurance professionals base that treatment on their ethical obligations.

APPENDIX A – FINAL EXAMINATION

Below is the Final Examination for this course. You may enroll in this course and complete an online version of this exam at our website:

www.BookmarkEducation.com

Your certificate will be issued immediately upon successful completion of the course.

Insurance Ethics

1. Many pro-credit insurance producers have responded to criticism with a ________ defense.

A. financial
B. logical
C. legal
D. ethical

2. The agent has many more ethical duties than the broker in regard to the ________.

A. insurance company
B. consumer
C. insured
D. legal process

3. Consumers are now legally entitled to a copy of their credit report from each of the three credit bureaus every year. The fee a bureau may charge for these reports is ________.

A. $0.00
B. $5.00
C. $10.00
D. $15.00

4. The credit bureaus recently addressed the discrepancies within their scoring systems and waged a competitive campaign against ________ in order to increase their market shares.

A. the government
B. NAIC
C. the press
D. FICO

5. Insurance is a product, ________ upon nonpayment, that transfers risk from one party to another.

A. cancelable
B. refundable
C. irreversible
D. deductible

6. The most common situation in which insurers run the risk of modern day redlining is________.

A. group rating
B. individual rating
C. territorial rating
D. credit rating

7. A producer should present a consumer with the policy that is the ________.
 A. least expensive
 B. most expensive
 C. fastest to pay claims
 D. best value

8. ________ can often shield agents and brokers from allegations of illegal and unethical acts involving premiums.
 A. Documentation
 B. Bankers
 C. Planning
 D. Insurers

9. Matched-pair studies have allowed consumer groups to conclude ________.
 A. whites receive fewer callbacks from insurers than blacks
 B. blacks receive fewer callbacks from insurers than whites
 C. blacks receive more callbacks from insurers than whites
 D. matched-pair studies are inconclusive and cost too much

10. If the insurance producer recognizes risks that would not be covered based on the consumer's stated requests, the agent or broker should ________.
 A. refuse to sell the policy
 B. disclose the insurance gap
 C. ignore the insurance gap
 D. purchase E & O insurance

11. A popular criticism of the insurance community is that underwriting lacks enough ________.
 A. sensitivity
 B. information
 C. diversity
 D. objectivity

12. Insurers in some states must disclose their ________ guidelines to regulatory departments.
 A. financial
 B. underwriting
 C. racial
 D. ethical

13. The Fair and Accurate Credit Transactions Act of 2003 stipulated that a person must be given access to a credit score for "a ________ fee."
 A. $5.00
 B. fair and reasonable
 C. $25.00
 D. non refundable

14. When insureds suffer losses that their policies do not cover, they sometimes cite ________ as the primary sources of fault.

A. their friends and relatives
B. their agents or brokers
C. themselves
D. attorneys

15. Many alleged incidents involving ________ motivated redlining have been exposed via " matched-pair studies."

A. commercially
B. financially
C. circumstantially
D. racially

