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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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April 27, 1981

The Honorable Jack Brooks
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

Reference is made to your letter of March 6, 1981, requesting our comments on H.R. 2161, a bill to improve information practices in the insurance industry, to amend the Privacy Act of 1974, and for other purposes.

Title I of the bill--Records Subject to the Privacy Act--adds a new subsection to the Privacy Act of 1974 which excludes its applicability to insurance records maintained by Federal agencies or their contractors if the maintenance and disclosure of such insurance records are subject to the provisions of the Fair Insurance Information Practices Act. The remainder of the bill is cited as the Fair Insurance Information Practices Act. The coverage extended by the act to insurance records is similar in most respects to that presently provided by the Privacy Act for systems of records maintained by Federal agencies.

The underlying purpose of the Privacy Act, assuring a degree of personal privacy and fairness in determining matters affecting individuals served by the Federal Government, is adopted in the provisions of this act for the benefit of consumers in the insurance industry. In the bill, this is provided in provisions addressing conditions of disclosure (Title IV), notification of insurance information practices (Title II), information collection practices (Title III), individual access to personal information (Title V), and correction, amendment, or deletion of recorded personal information (Title VI).

GAO STUDY OF STATE REGULATION OF THE INSURANCE BUSINESS

In our report "Issues and Needed Improvements in State Regulation of the Insurance Business" (PAD-79-72, October 9, 1979), we confirmed some of the findings concerning the absence of adequate State regulations reported earlier by the Privacy Protection Study Commission. The Commission was established by the Privacy Act of 1974 and tasked, among other things, to conduct a study broadly assessing practices in both the public and private sectors. The Commission's report "Personal Privacy In An Information Society" made extensive recommendations for

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improvements in privacy and fair information handling by the insurance industry--areas of data collection and use which the States were not actively regulating. One large company, however, was identified in the report as voluntarily adopting a broad range of fair information practices advocated by the Commission and adopted in this bill.

Adverse underwriting decisions

Title II, Part B of the bill generally requires that when an individual is subject to an adverse underwriting decision insurers must inform the individual of the fact and of the individual's rights under the law. It requires that upon request the insurer provide the basis for the decision and names of organizations supplying information leading to the decision.

In our 1979 report on State regulation of the insurance business, we presented information on automobile insurance that is especially relevant to Title II, Part B. We found that most States already required that consumers be notified of the reason for cancellation of an automobile insurance policy. However, only 29 States required that companies provide the reasons for nonrenewal, and 14 of those 29 States required disclosure only at the request of the customer. Apparently, very few States required that consumers be provided the reasons for the rejection of an initial application for insurance. We did an onsite evaluation in a sample of 17 States. Only 3 of these 17 States required insurance companies to provide the reasons for rejection, and then only on written request of the consumer.

We found that rejection led to adverse consequences such as limited coverage and higher rates in either the residual market, i.e., assigned risk plan, or with so-called substandard companies. We also found that there were apparent problems of consumer informaton regarding the availability of the assigned risk plan. Since substandard rates were far higher than assigned risk plan rates in some States, we concluded that consumers were not adequately informed by agents, companies, and insurance departments about their options in the assigned risk plan.

We believe that Title II, Part B of the bill is consistent with our assessment that consumers should be informed of the reasons behind adverse underwriting decisions. We believe that the reason for the rejection should accompany the notice of rejection on new applications as well as renewals. This requirement may have the effect of requiring insurers to rationalize highly subjective underwriting practices that may be unfairly prejudicial to particular classes of persons. Since insurers presumably have specific reasons for denying insurance to an individual, they should not incur any substantial burden by being systematically

required to state those reasons to the individual at the time the decision is communicated. Moreover, the prospective insurer may be in a position to correct erroneous information used for such adverse decisions to the benefit of both the consumer and the company.

Section 225, requiring that individuals must be informed when an agent submits their application to the residual market or a substandard insurer, is a remedy to the problems we discussed above with regard to consumer information about these matters. The section, however, may need to be clarified. Presumably, the phrase, "whenever the other provisions of this part do not apply," means that the section only applies when an individual is not first subject to an adverse underwriting decision. However, it is unlikely that individuals would be placed in the residual market plan unless their applications for insurance first were rejected. It is precisely the people who are first rejected who need the protection of section 225. Moreover, the protection most needed is not information on where the agent is applying but information about the availability of the residual market plan as an alternative to substandard insurers. We suggest, therefore, that section 225 be changed to apply to all situations where agents make application to the residual market or substandard companies and that it be broadened to also require agents to supply information about the residual market mechanism together with notice of the adverse underwriting decision.

The cost of complying with regulations did not impose any significant burden on insurers according to our 1979 discussions with leading insurance companies. We believe that compliance with the requirements in this legislation also would not incur costs which are significant in relation to the general administrative and claims costs of insurers.

ENFORCEMENT, PENALTIES AND THE IMMUNITY PROVISION

As the principal enforcement mechanism, the bill provides civil and criminal penalties for improperly disclosing or obtaining personal information and further provides civil penalties in actual damages and equitable relief for enforcing the fair information practices provisions of the bill. The bill also contains an immunity provision which limits the applicability of penalties; however, the scope of immunity is unclear.

Additionally, the bill provides criminal penalties of a fine up to $100,000 and imprisonment for not more than 5 years for (1) anyone improperly obtaining personal information from an insurance institution (subsection 703(a)) or (2) the insurance institution's officers or employees providing personal information to a person not authorized to receive it (subsection 703(c)).

Aside from these damages for improperly obtaining or disclosing personal information, an aggrieved individual may be awarded not less than $1,000 in addition to actual damages under subsection 702(c) when the fair information provisions of the bill are intentionally violated. These fair information provisions include areas of information collection practices, individual access to personal information, correction or amendment of information, and adverse underwriting decisions (Titles IIB through VI).

Section 802 provides general immunity to insurance institutions and their employees for damages except as a result of a disclosure of or receipt of information required by the bill that is false and intentionally disclosed. Since the immunity provision applies "except as otherwise provided," it is not clear how the other provisions of the bill would be affected. The intended effect of the immunity provision on these penalty provisions should be clarified.

FEDERAL OVERSIGHT

Section 701(c) of the bill provides that the Secretary of the Treasury may enter into agreements with State insurance officials for enforcement of the provisions of the bill or similar State privacy legislation. The Secretary may also allocate funds to the States which have made such agreements. However, no provisions are made in the bill for assessing the effectiveness of its procedures and monitoring its implementation. Notwithstanding GAO's oversight and reporting responsibility, we believe specific executive branch responsibility for monitoring the act should be assigned. This responsibility could be placed in the Department of the Treasury in which the bill places other responsibilities. Another alternative would be the Office of Management and Budget which is responsible for overseeing the Privacy Act of 1974.

Sincerely yours,

Butcher 4/14/81

J M 4/14/81

Jones 4.14.81

Acting Comptroller General
of the United States