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February 13, 2001

Roseanne Mead
Chair, Suitability Working Group

Carolyn Johnson
Senior Counsel
National Association of Insurance Commissioners

By Electronic Mail

Re: Comments on Proposed Suitability Regulation

Dear Ms. Mead and Ms. Johnson:

I apologize for these late written comments. I had planned on attending today's interim meeting, but my flight was cancelled and I am unable to obtain another timely flight.

I will limit my comments to the need for the suitability regulation to apply to credit life and credit disability insurance. The following comes from a New York credit insurance regulation.

> *In the marketing of credit insurance, the inferior bargaining position of the debtor creates a "captive market" in which, without appropriate regulation of such insurance, the creditor can dictate the choice of coverages, premium rates, insurer and agent, with such undesirable consequences as: excessive coverage (both as to amount and duration); excessive charges (including payment for nonessential items concealed as unidentifiable extra charges under the heading of insurance); failure to inform debtors of the existence and character of their credit insurance and the charges therefor, and consequent avoidance of the protection provided the debtor by such coverage.*
>
> *In the absence of regulation, premium rates and compensation for credit insurance tend to be set at levels determined by the rate of return desired by the creditor in the form of dividends or retrospective rate refunds, commissions, fee or other allowances, instead of on the basis of reasonable cost. Such "reverse competition," unless properly controlled, results in insurance charges to debtors that are unreasonably high in relation to the benefits provided to them.* (New York State Insurance Department Regulation 27A -- 11NYCCR 185)

These statements describe the most important characteristic of credit insurance markets – reverse competition.

- Credit insurance is sold to a lender who, in turn, sells the credit insurance to borrowers.
- Credit insurers rely upon lenders to present and sell credit insurance to borrowers.
- Credit insurers compete for the lenders' business by offering more compensation and commission to the lenders.
- Credit insurance is typically sold as a package of products, or coverages.
- The lender selects the package of coverages to be offered to the consumer

In addition:

- Credit insurance primarily benefits the lender, not the borrower
- The massive profit for lenders from the sale of credit insurance has led to unfair and coercive sales practices. Please see an extensive report on credit insurance on our web site: http://www.cej-online.org/report.pdf.

As described in previous comments, the use of single premium gross indebtedness credit life and credit disability products has been a key tool of predatory lenders. Most credit insurance, as measured by premium volume, is sold as a single premium product. Single premium gross reducing term credit life and credit disability insurance premiums are calculated on the basis of the total (gross) indebtedness – the total of principal and interest payments. On longer-term loans, including car loans and home equity loans, the credit insurance premiums are substantial and are typically financed.

The role of single premium credit insurance in **predatory lending** has been highlighted by recent events. In recent months, both Freddie Mac and Fannie Mae have announced new guidelines to prevent predatory lending. The refusal to purchase or securitize loans with single premium *credit life insurance* was the first item on both organizations' lists.

Why is single premium gross indebtedness reducing term credit life insurance so harmful to consumers? Gross indebtedness refers to the sum of all principal and unearned interest payments. With a gross indebtedness premium calculation, the credit life insurance premium is based not on the amount borrowed, but on the amount borrowed plus all the interest payments over the term of the loan. In the typical gross indebtedness credit insurance premium calculation, the insurance premium is typically financed and the premium is then based on the total of loan principal, loan interest, credit insurance premium, and credit insurance premium loan interest. To illustrate, consider an auto loan of $15,000 for 60 months at 12% interest with credit life and credit disability insurance in Kentucky.

	Example: Auto Loan, $15,000 for 60 months at 12% **KY Credit Life @ $0.60 / 100 / year, Dis @ $5.68**		
1	Loan Principal	$15,000.00	
2	Credit Insurance Premium	$1,965.43	
	Life		***$679.30***
	Disability		***$1,286.13***
3	Amount Financed	$16,965.43	
4	Finance Charges:	$5,677.77	
	a. On Principal	$5,020.00	
	b. On Credit Insurance	$657.76	
5	Gross Indebtedness (3 + 4)	$22,643.20	
	Ratio of 5 to 1	151%	
	Monthly Payment Before CI	$333.67	
	Monthly Payment After CI	$377.39	

As can be seen from the auto loan example, the lender's use of the single premium credit insurance causes the consumer to purchase an amount of insurance 51% greater than the amount necessary to pay off the loan.

The harm to consumers increases dramatically as the term of the loan and the interest rate on the loan increase. The table below shows the calculations for single interest credit insurance sold with a 10-year home equity loan with a principal amount (before credit life insurance) of $40,000 and a sub-prime interest rate of 17%. The example is for single life coverage. Now, the amount of coverage – gross indebtedness – has jumped to over $92,000 and the upfront premium is $4,142 , which is financed. The purchase of the credit insurance also adds another $4,500 in finance charges over the term of the loan. If the consumer had been able to pay for the credit insurance on a monthly basis on the outstanding principal amount, the *total* of premiums paid would be $2,114.91 or about half of the single premium. And the consumer would have had the benefit of interest income on the money until it was paid out over the term of the loan. Further, with a premium of $4,142 for single premium credit insurance, annually renewable term life insurance becomes a reasonable, if not desirable, alternative. The single premium credit insurance requires the consumer to purchase far more coverage than necessary to pay off the loan, thereby refuting credit industry claims that credit insurance amounts are related exactly to the loan amount.

Example: Home Equity, $40,000 for 120 months at 17% IA Single Premium Credit Life, Single Life @ $0.45 /$100/yr		
1 Loan Principal	$40,000.00	
2 Credit Insurance Premium	$4,142.84	
Life		***$4,142.84***
3 Amount Financed	$44,142.84	
4 Finance Charges:	$47,920.22	
a. On Principal	$43,422.87	
b. On Credit Insurance	$4,497.35	
5 Gross Indebtedness (3 + 4)	$92,063.06	
Ratio of 5 to 1	230%	
Monthly Payment Before CI	$695.19	
Monthly Payment After CI	$767.19	
Sum of MOB Payments		$2,114.91

As is evident from this example, predatory lenders use single premium credit life insurance to massively increase the amounts borrowed by consumers and, because the lenders take a security interest in the real estate securing the loan, lead consumers put their homes at risk. If credit disability insurance were included, the amount of the premium would be significantly higher. The following example shows the same loan, but with joint life coverage – which is often seen in predatory loans.

In the joint life example, below, the premium jumps to over $7,000. And Iowa has relatively low credit life insurance rates! In states like Oklahoma or Louisiana, the premiums would be 50% to 100% higher.

Lenders choose gross indebtedness credit insurance coverages and that choice provides substantial benefits to lenders – not to consumers. Recall that it is the lender who chooses the credit insurance products that will be offered to the consumer. The consumer is offered only to take it or leave it. The credit insurer gets the entire premium up front and the producer gets the entire commission up front. By getting the entire premium up front, the credit insurer gains significant investment income that the consumer would have gained under a monthly outstanding balance coverage. The credit insurer further benefits because the credit insurance premium is based upon an amount *50% greater* than the original loan amount. The lender benefits because the amount lent is increased by the total of insurance premium and interest on that premium.

Example: Home Equity, $40,000 for 120 months at 17% **IA SP Credit Life, Joint Life @ $0.75 /$100/yr**		
1 Loan Principal	$40,000.00	
2 Credit Insurance Premium	$7,416.84	
Life		***$7,416.84***
3 Amount Financed	$47,416.84	
4 Finance Charges:	$51,474.39	
a. On Principal	$43,422.87	
b. On Credit Insurance	$8,051.51	
5 Gross Indebtedness (3 + 4)	$98,891.23	
Ratio of 5 to 1	247%	
Monthly Payment Before CI	$695.19	
Monthly Payment After CI	$824.09	
Sum of MOB Payments		$3,524.89

These examples demonstrate that the suitability regulation must apply to single premium credit insurance.

Response to Industry Comments

The comments of Assurant and CCIA to my December 2, 2000 letter are either factually incorrect or silly.

Assurant writes that because credit insurance is uniquely suited for the purposes for which it is designed, it is therefore suitable for all consumers. All life and annuity products that have led to suitability concerns are uniquely suited for the purposes for which they were designed. That fact does not make them suitable for all consumers and, in fact, products that are not suitable for consumers are too often sold to those consumers.

CCIA invents the notion that the suitability regulation “seems to put forth the proposition that there is an ideal state of ‘insuredness’ in which an individual has the optimum amount of life insurance.” CCIA then claims that, if this premise is true, then credit insurance must always be suitable because every time a consumer takes out a loan, he or she needs more insurance. Putting aside the fact that the suitability regulation does not even remotely suggest an ideal state of 'insuredness' and that the entire argument is therefore specious, the single premium examples above show that credit insurance coverage is not related to the amount consumers need to pay off loans.

CCIA writes that the lender is the entity that determines how much insurance the borrower needs and that the lender may ask for more security. While this is true for some loans in which a lender requires property insurance to protect the collateral supporting the loan, lenders do not require credit life or credit disability insurance. It is, in theory, a voluntary purchase. But CCIA argues that a lender has a different perspective from the borrower and it would be "paradoxical" for the lender to perform a suitability analysis for credit insurance for the borrower. But the lender is selling the insurance! And the lender has already pre-selected one type of coverage for all borrowers and thereby mis-performed any reasonable suitability analysis. Although likely not intended, CCIA's description of the lending process perfectly demonstrates why single premium credit insurance must be covered by the suitability regulation.

CCIA's final argument is that credit insurance is a legal product and therefore should be exempt from suitability requirements. Needless to say, the fact that a product is legal does not make suitable. The vanishing premium products were legal.

The American Bankers Association Insurance Association and Association of Banks in Insurance argues that because a lender is unable to offer any alternatives to borrowers, the lender should not be required to evaluate the suitability of the credit insurance. Stated differently, since they only sell credit insurance, it must be suitable. Clearly, this logic is misplaced and does not protect consumers.

ABAIA and ABI also argue that credit insurance should be exempt from the suitability regulation because it is a legal product and approved by insurance departments. As stated above, the fact that a product is legal does not make it suitable for all consumers.

Finally, ABAIA and ABI argue it is beyond the scope of the loan officer's duties to develop information for a suitability analysis. But the lender is selling insurance! The lender is selling a product that can cost consumers thousands of dollars. It is really too much to ask that the lender have some idea whether other types of life insurance – or any additional life insurance at all – is more suitable for the borrower?

Thank you for your consideration of my comments. Again, I apologize for not being at the meeting.

Sincerely,

Birny Birnbaum
Executive Director