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April 23, 2001

Roseanne Mead
Chair, NAIC Suitability Working Group

By Electronic Mail

Re: Life Insurance and Annuities Model Regulation

Dear Ms. Mead:

The Center for Economic Justice continues to object to a blanket exemption for credit life insurance in the Life Insurance and Annuities Suitability Model Regulation. Given <u>any</u> reasonable purpose for a suitability regulation, **single premium credit insurance** should clearly be subject to, and not exempt, from a suitability regulation.

Our comments are organized as follows. First, we describe briefly the single premium credit life insurance product that is often sold unsuitably to consumers. Second, we respond to the various arguments offered as justification for a credit life insurance exemption. Finally, we provide a few general comments on the current draft.

Our comments can be summarized as follows. Single premium credit life insurance is one of the best examples of a product for which consumers need the protection of a suitability requirement. The product can cost thousands of dollars, provide far more coverage than necessary to pay off a loan at the beginning of the loan, provide insufficient coverage to pay off the same loan later in the term of coverage and place the consumer in financial jeopardy. For many, if not the majority of consumers, far more suitable and inexpensive alternatives to single premium credit insurance exist.

The arguments offered in support of an exemption for single premium credit life insurance are either factually incorrect or illogical. For example, the current draft provides an exemption for credit insurance when, among other things, only one product is offered. If a product is unsuitable for a large number of consumers, it is illogical to exempt that product because the seller is only offering that product. The fact that a lender only offers one credit life coverage does not make that one product suitable.

For another example, the presence of disclosures is not a basis for exemption of credit insurance from suitability requirements. Even one of the studies cited by Mr. Burfeind demonstrates that disclosures have failed to inform and protect consumers of credit insurance. Other evidence, including a study by two federal agencies, shows that, despite disclosure requirements, consumers are sold single premium credit life insurance even though such a purchase is clearly unsuitable and harmful to the consumer.

The Product

There are a number of different credit life insurance products within the broader category of credit life insurance. Credit life can be sold on a monthly outstanding balance (MOB) basis or single premium (SP) basis. For MOB products, the consumer makes a monthly premium payment based upon either the average amount owed during the month or the amount owed at the end of the month on the loan or revolving debt. Amount owed means generally the amount necessary to pay off the loan – the remaining principal. For SP products, the consumer pays for the entire multi-year coverage at the beginning of the loan. The SP premium is typically financed and, in most states, the premium and coverage amounts are based upon gross indebtedness – which means the sum of principal and all scheduled interest payments.

It is the lender who decides what type of credit life insurance product will be offered to the borrower. As Mr. Burfeind points out in his letter of April 10, 2001, the lender will select one – and only one – product to offer to the consumer. And as Mr. Burfeind also points out in his February 23, 2001 letter, the lender may decide to offer truncated coverage – coverage for a term less than the term of the loan. For credit life sold in connection with home equity loans, lenders also often limit the maximum amount of coverage, so that in some situations the credit insurance provides far more coverage than necessary to pay off the loan at the beginning of the loan, but provides insufficient coverage to pay off the loan later in the term of coverage.

Despite Mr. Burfeind's claims to the contrary, the example I cited in an earlier letter was representative of a major sub-prime lender's practices. I know this because I have reviewed all the loans sold with credit life insurance for this lender over a five-year period in a particular state. In that state, the average term of credit life coverage was just under 15 years.

The example I provided earlier <u>understated</u> the cost to the consumer because the lender charges points on the amount borrowed as a finance charge in addition to interest. The points – typically around 8% of the amount borrowed – are fully earned. Thus, even if a consumer pays off the loan a day after taking out the loan, the points on the credit insurance stay with the lender. The table below updates the example, using a <u>lower</u> interest rate than the previous example, again using Iowa credit life rates.

As mentioned in our earlier letter, the cost of the single premium credit life insurance increases dramatically with term of coverage, term of loan and interest rate. The premium for truncated coverages is still thousands of dollars.

Example: Home Equity, $30,000 for 120 months at 15%		
Single Premium Credit Life – Single Life		
1 Loan Principal	$30,000.00	
2 Points on Loan Principal	$2,400.00	
3 Credit Insurance Premium + Pts	$3,365.16	
Life Premium		***$3,115.89***
Disability Premium		***$0.00***
Points on Credit Insurance		***$249.27***
4 Amount Financed	$35,765.16	
5 Finance Charges:	$33,476.89	
a. On Principal+Pts		$30,327.03
b. On Credit Insurance + Pts		$3,149.86
6 Gross Indebtedness (4 + 5)	$69,242.05	
Ratio of 6 to 1	231%	
Monthly Payment Before CI	$522.73	
Monthly Payment After CI	$577.02	
Sum of Credit Insurance Premium, Points And Finance Charges		$6,515.02
Sum of MOB Payments		$1,746.84
Financed Credit Insurance Premium + Points		$3,365.16
NPV of MOB Payments @ 5% Discount		$1,458.72

We now ask, what is the premise behind a suitability requirement? The working group to date has indicated its belief that the purpose is to stop the sale to consumers of life insurance and annuity products that are unsuitable or inappropriate for that consumer. We believe that this concern must be extended to recommendations, too. However, even if limited to sales, it should be clear that consumers who are sold single premium credit life insurance – or to whom the purchase of single premium credit life insurance is recommended – require the consumer safeguards of a suitability requirement.

Despite Mr. Burfeind's claims to the contrary, the abuses associated with single premium credit life insurance are well documented. In our earlier letter, we cited a study by the United States Departments of Housing and Urban Development and Treasury describing the these abuses. We also cited the comments and policies of Fannie Mae.

We offer further documentation of the problems with single premium credit life insurance. The following statements were made by Mike Medland, Associate General Counsel of CUNA Mutual Group at the September 6, 2000 hearing regarding proposed changes in the California credit life and disability regulation (pages 17-19 of transcript).

> We [CUNA Mutual Insurance Society] write our coverages exclusively in the credit union market. Credit unions are also not-for-profit cooperative financial institutions owned by their members, democratically run by an elected board of directors, noncompensated board of directors; and they run exclusively for the benefit of their members.
>
> Our historic loss ratios in California and elsewhere are consistently among the most favorable in the industry. For the three years, 1997 through 1999, for example, our credit disability incurred loss ratio in California was 73%, and the average premium rate on credit disability insurance were [sic] approximately 20 percent below the prima facie rate . . ..
>
> More than 99 percent of our business is written using the monthly outstanding balance premium basis. Only one percent – less than one percent is on a single premium basis. And in comparison, financing at single premium in monthly outstanding is generally more cost favorable to consumers, but it is considerably more expensive for creditors to administer.
>
> In addition, approximately two-thirds of our credit disability insurance business is written on a 30-day nonretroactive benefit plan, which is the least costly plan to consumers, and only about two percent is written on the 14 retro plan, which is the most costly to consumers.
>
> These facts amply demonstrate, I believe, that the CUNA Mutual and California's credit unions are dedicated to providing credit union members with consistently high-value products at the lowest possible cost consistent with sound business practices.

It is clear that credit unions – lenders who arguably have the greatest concern about the welfare of their borrowers – have decided that single premium credit life insurance is not a suitable product.

Finally, Mr. Burfeind cites a number of studies purporting to prove the absence of unfair and coercive sales practices for credit insurance. Even if we put aside the other evidence we have presented, at least one of Mr. Burfeind's cited studies buttresses our case. The study was done by the Credit Research Center and published in March 1994. The study and the CRC generally are supported by banks and insurance companies, who sit on the CRC Governing Board, 1999-2000. The study was based upon a 1993 survey of consumers of 3600 consumers who had the "opportunity to purchase credit life insurance in conjunction with all types of consumer loans, except first mortgages and credit cards." The study's results included:

- Of those who actually purchased credit life insurance, 19.3 percent said it was not explained to them that the insurance was optional. Relative to whites, African American borrowers were less likely to remember hearing that the purchase of credit insurance was not required.

- Of those who actually purchased credit life insurance, 15.1 percent said that they felt buying credit insurance improved their chances of obtaining the loan; 7.3 percent thought the purchase of credit insurance improved their credit terms.

- Of those who actually purchased credit life insurance, 12 percent said they felt pressured to purchase it.

The results of this industry-sponsored study, along with the other ample evidence of consumer abuses associated with single premium credit life insurance, demonstrate that disclosures alone have failed to protect consumers.

Responses to Arguments

The credit insurance industry has offered to several reasons why it believes credit life insurance should be exempt from the suitability recommendations. We explained why some of those arguments were incorrect in our February 13, 20001 and our comments today focus on arguments made after that date.

1. *Credit insurance is always a suitable product for loan repayment. (CCIA, 2/23/01; CCIA 4/10/01)*

This argument confuses suitability for a particular task with suitability for a particular consumer. The fact that a product designed for a specific purpose is suitable for that purpose does not mean that the product is suitable for all consumers. An annuity is always suitable for providing an income stream in the future, but that does not mean that an annuity is suitable for all consumers.

2. *Credit insurance is a group product and the creditor is required to offer the product to all eligible debtors. (CUNA Mutual, 3/20/01, CCIA 4/10/01)*

Key characteristics of credit insurance are that the lender selects the one product to be offered to the consumer and the lender has a major financial interest in the sale of the product. It is unreasonable to conclude that because the lender has selected a group product that this product is suitable for all consumers who obtain loans from that lender.

3. *The duty of the loan officer selling credit life insurance is to make disclosures required by law and regulation and it is too much to ask the loan officer to make suitability*

> *recommendations. (CCIA, 2/23/01, CCIA 4/10/01) Credit insurance is offered by individuals who are not licensed insurance agents or who hold limited credit insurance licenses. (CUNA Mutual, 3/20/01)*

CCIA argues that because lenders typically hold limited licenses as producers or "group enrollers," they are not qualified to assess consumer insurance needs.

We respectfully submit that the CCIA – and the current draft exemption for credit insurance – create a sort of Catch-22 for credit insurance. The industry argument is that because the lender only offers one product and because the person selling that product is not qualified to assess the consumer's needs, suitability is neither required nor feasible.

By this logic, any insurer could avoid suitability by limiting the number of products it offers to one. If the only product that a life insurance agent had to offer was a variable annuity, would that make the variable annuity *per se* suitable? Of course not –but that is exactly the argument offered by CCIA. Now suppose that the sales person offering the variable annuity only had knowledge of the annuity and no other products – would that take that sales person off the hook for any suitability requirement? Again, of course not and, again, that is exactly the argument offered by the CCIA.

If a lender is offering a single life insurance product that costs thousands of dollars, that provides far more coverage than necessary to serve the purpose of the product (i.e., to pay off the loan), that may not provide coverage necessary to pay off the loan at some point during the term of coverage, and that has been identified as a product associated with known consumer abuses, we submit that such a product is **the** example of the need for suitability requirements.

Finally, Mr. Burfeind admits that lenders do ask questions of the borrowers for purposes of underwriting. The question arises, why do the lenders have the ability to underwrite the consumers loan and the ability to underwrite the credit insurance product, but then become mindless dummies when it comes to the ability to evaluate the suitability of the product for the consumer? In fact, the lender has made a number of suitability decisions. For example, Mr. Burfeind claims that industry practice is to truncate coverage to five years because "most home equity loans are repaid or refinanced in five years." By making decision to truncate the term of coverage or the amount of coverage or the type of coverage, the lender is routinely making suitability decisions that may be appropriate for some consumers, but are clearly not appropriate for all consumers.

5. *Credit insurance is highly regulated, including disclosures. (CUNA Mutual, 3/20/01 and others)*

The fact that insurance products are regulated – including disclosures – does not mean that the products are – *by definition!* – suitable for all consumers. We hope this is obvious. However, the credit insurance industry cites a number of federal disclosure requirements presumably to argue that single premium credit insurance consumers do not need the protection of a suitability requirement. As mentioned above, even with disclosures, an industry study identified a large percentage of consumers for whom disclosures did not work. And despite the presence of disclosures, the US Departments of Housing and Urban Development and Treasury have cited abuses with single premium credit insurance.

The fact is that disclosures have not been effective in protecting credit insurance consumers and the presence of disclosure requirements **cannot** be a reasonable justification for exempting single premium credit life insurance from suitability requirements.

6. *The home equity examples are not representative of industry practice. (CCIA 2/23/01)*

First, the example is representative are absolute representative of significant industry practice, as described above.

Second, given Mr. Burfeind's examples, we have a product sold that will not pay off the loan if the consumer does not repay or refinance in five years or less. Thus, the product is no longer universally suitable for repayment of the loan.

Finally, we want to cite a section from a letter from CitiFinancial to federal regulators regarding the sale of credit insurance. We cite the letter for two reasons. First, the letter indicates the need for suitability based on the CitiFinancial description of the product.

Second, the letter demonstrates that CitiFinancial wants to offer a choice – MOB or SP coverages. Although such a choice is clearly a benefit to consumers, under the current draft suitability proposal, CitiFinancial would not be exempt from suitability, while a lender who only offered the SP product would be. This is clearly wrong.

The citations are from a November 7, 2000 letter from CitiFinancial to the New York State Banking Department, the Comptroller of the Currency and the Federal Deposit Insurance Corporation regarding real-estate secured consumer financial lending initiatives in connection with Citigroup's acquisition of Associates First Associates.

Much criticism has been leveled at various products, or product features, in the consumer finance industry. Public examples of misconduct, which involve individual consequences to which no reasonable person could fail to be sympathetic, ***involve bad sales practices and product design features which sometimes enable bad sales practices to occur. Therefore, it is critical to look at both sales practices and product design to ensure the appropriate conduct of business.*** The following discussion of specific product issues must be read in light of CitiFinancial's strong history and culture of compliance and the sales practices initiatives outlined above. [emphasis added]

Single Premium Credit Insurance

Perhaps no other insurance product today involves so many criticisms as does single premium credit insurance. Critics complain that the product is unnecessary, adds to the amount financed and puts the borrower in jeopardy of losing equity in the borrower's home. In addition, the term of the loan can exceed the term of the insurance. On the other hand, this product is approved by the insurance departments in nearly all states, is sanctioned by state credit laws and has long been offered by the consumer finance industry as well as banks, credit unions, thrifts, and retailers.

Like many other companies in this industry, CitiFinancial has long offered single premium credit insurance. Single premium credit insurance can be a valuable product when sold to customers with the right needs, using clear and conspicuous disclosures and obtaining informed consent. Prepaid single premium credit insurance for persons who may not be able in a particular month to continue coverage under a monthly premium plan can ensure that person wold not lose his or her home in the event of the death, disability, or unemployment of the insured or his or her spouse. At the same time, insurance policies can be misunderstood and sold inappropriately. CitiFinancial will continue to ensure that borrowers understand the choices they have the benefits and costs of various options. In addition, we believe that the level of discussion has evolved to the point that it is proper for CitiFinancial to <u>change</u> its current credit insurance product features.

<u>Full Choice</u>

When originating a real estate-secured loan, CitiFinancial branch offices historically have offered customers the choice of the loan without credit insurance or taking it with insurance paid in a single premium at the time of closing. Going forward, whenever CitiFinancial branch offices offer single premium credit insurance, customer who choice credit insurance will be offered the additional choice of monthly premium credit insurance. Thus, customers will be able to choose no insurance, monthly premium insurance or single premium insurance.

Other Comments

Suitability requirements should be not be limited to sales, but also to recommendations. We believe the arguments offered against the inclusion of recommendations were contradictory. At the Spring Meeting, several committee members argued against inclusion of recommendations by claiming that abuses in recommendations could be identified by reviewing complaints and addressed through existing regulatory tools. Of course, if this were the case, there would be no need for a suitability regulation because the same regulatory tools that could be used to address unsuitable recommendations could be used for unsuitable sales. Further, the evidence is that these existing tools are not sufficient to address suitability requirements – as a number of recent class actions regarding inappropriate sales of life insurance products to consumers illustrate.

Suitability requirements should apply to produces and insurance companies. We endorse the comments of the National Association of Insurance and Financial Advisors on this issue and recommend that the suitability model cannot achieve its desired results unless insurance companies share responsibilities for suitable recommendations with producers of the companies' insurance products.

Thank you for your consideration.

Sincerely,

Birny Birnbaum

Birny Birnbaum
Executive Director