

Credit Insurance In New Mexico: The \$25 Million A Year Rip-Off

Ineffective Regulation Fails to Protect Consumers

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New Mexico credit insurance consumers are being overcharged by tens of millions of dollar a year. Over the period 1997-1999, New Mexico credit insurance consumers paid *twice as much* for credit insurance as they should have. One of the worst problems with credit insurance is the financed single premium product used by predatory lenders to strip consumers of their home equity.

The Center for Economic Justice recommends that the Department of Insurance take the following actions to reduce excessive credit insurance rates in New Mexico:

- Lower credit life and disability prima facie rates to levels that will produce an expected loss ratio of 55%, as required by New Mexico law;
- Introduce class rating for credit life and disability and/or require individual insurers to meet the loss ratio standard to counter the harmful impact of reverse competition;
- Disapprove current credit unemployment and credit personal property rates and require insurers selling these coverages to file significantly lower rates;
- Address the problems with single premium credit insurance by prohibiting gross indebtedness premium calculations for credit life, prohibiting single premium coverages for coverages greater than 48 months and introducing a single premium discount factor; and
- Fix other problems with the New Mexico credit insurance regulation.

The Center for Economic Justice (CEJ) is a non-profit advocacy organization dedicated to representing the interests of low-income and minority consumers on insurance, credit and utility issues. We have extensive experience working on credit insurance issues in many states and at the National Association of Insurance Commissioners. New Mexico ACORN is an organization of over 2000 low and moderate income families that fights for living wage jobs, affordable housing, neighborhood improvements and against predatory lending.

Recent New Mexico Credit Insurance Experience

Table 1 shows earned premiums and loss ratios for credit life, credit disability, credit unemployment and credit property insurance in New Mexico for the years 1995 through 1999. In each of the five years, the loss ratios for credit life and credit disability have been far below even the modest 55% minimum loss ratio required by 13 NMAC 18.2.17.2. The credit life loss ratios have been in the range of 25% to 31% while the payouts on behalf of consumers for credit disability dropped to less than 34 cents on the dollar in 1999. The credit unemployment loss ratios over the past several years have been unconscionably low, dropping to less than 7% in 1999. Clearly, the low credit unemployment and credit property loss ratios cannot comply with any requirement that benefits be reasonable in relation to premium.

Table 1
New Mexico Credit Insurance Experience, 1995-1999

<u>Coverage</u>	<i>Earned Premium (\$ Millions)</i>				
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Life	\$19.1	\$18.9	\$20.2	\$21.0	\$20.6
Disability	\$15.4	\$15.4	\$14.1	\$16.7	\$15.6
Unemployment	\$5.8	\$6.7	\$7.1	\$9.4	\$9.5
Property	\$8.1	\$4.8	\$6.4	\$6.6	\$7.4
Total	\$48.5	\$45.8	\$47.7	\$53.6	\$53.2

<u>Coverage</u>	<i>Incurred Losses To Earned Premium</i>				
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Life	27.3%	29.5%	30.3%	25.6%	31.3%
Disability	44.3%	42.4%	44.5%	37.2%	33.4%
Unemployment	17.2%	8.8%	10.7%	9.0%	6.9%
Property	41.0%	38.8%	34.4%	27.7%	27.9%
Total	33.8%	31.8%	32.2%	26.5%	27.1%

<u>Coverage</u>	<i>Lender Compensation to Earned Premium</i>				
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Life	36.6%	34.2%	35.1%	34.5%	28.3%
Disability	32.5%	29.2%	32.0%	28.7%	29.0%
Unemployment	44.2%	47.6%	47.1%	43.3%	40.7%
Property	40.9%	29.7%	34.6%	27.0%	36.0%
Total	36.9%	34.0%	35.9%	33.3%	31.2%

Current New Mexico Credit Insurance Rates Do Not Comply with New Mexico Law

13 NMAC Sections 18.2.17.2.1 and 18.2.17.2.2 specify a minimum loss ratio for credit life and credit disability insurance, respectively, of 55%. Yet, the 1997-1999 average loss ratio for these two coverages was 29.0% and 38.2%, respectively.

The failure to enforce your regulation has resulted in massive overcharges to New Mexico credit insurance consumers. For the period 1997-1999, consumers were overcharged \$29.1 million for credit life and \$14.2 million for credit accident and health, based upon the required 55% loss ratios, respectively. Using a reasonable 75% target loss ratio for credit unemployment and credit property, the overcharge for these coverages was \$35.3 million.

Table 2
New Mexico Credit Insurance Overcharges, 1997-1999
 (\$ Millions)

<u>Coverage</u>	<u>Earned Premium</u>	<u>Loss Ratio</u>	<u>Overcharge</u>	<u>Necessary Rate Reduction</u>
Life	\$61.7	29.0%	\$29.1	-47.2%
Disability	\$46.4	38.2%	\$14.2	-30.6%
Unemployment	\$26.0	8.7%	\$23.0	-88.4%
Property	\$20.5	29.8%	\$12.3	-60.2%
Total	\$154.5		\$78.6	

New Mexico credit insurance consumers are overcharged more than \$25 million a year and paid more than twice as much as they should have if rates had been set at levels producing reasonable loss ratios. As the chart indicates, based upon anything close to a reasonable target loss ratio, significant rate reductions are required.

Reverse Competition in Credit Insurance Markets

The dominant characteristic of credit insurance markets throughout the country, including New Mexico, is *reverse competition*. The credit insurance policy is a group policy sold to a lender who then issues certificates to individual borrowers. Because the lender purchases the policy, credit insurers market the product to the lenders and not to the borrower -- the ultimate consumer who pays for the product. This market structure leads insurers to bid for the lender's business by providing higher commissions and other compensation to the lender. Greater competition for the lender's business leads to higher prices of credit insurance to the borrower. This form of competition, which results in *higher prices to consumers*, is called *reverse competition*.

A recently promulgated New York State credit insurance regulation describes this reverse competitive dynamic.

NY State Insurance Department Regulation 27A (11NYCCR 185)

185.0(b) 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.

(c) 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, fees, 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.

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 credit insurance rate hearings, the credit insurance industry has admitted that reverse competition drives up the cost of credit insurance to consumers. The following are taken from transcripts from Texas contested-case credit life and credit disability rate hearings. The witness is credit insurance industry actuary Gary Fagg.

Hearing Transcript Page 114

Fagg: . . . But given a comparable set of claim costs, higher rates provide more income that will be shared by either the insurer or the creditor, and in the traditional credit insurance marketplace that would be shared primarily with the creditor.

Q: So I take it, the answer to my question then is yes, that creditors benefit by higher commissions from higher rates.

Fagg: Well, your question said they would. I would say they could.

Q: Generally they do, though, don't they?

Fagg: Generally they do, yes.

Hearing Transcript Page 116

Q: You say, "As expected, virtually all of the credit life insurance was written at the prima facie rate." Why is it expected that everyone will charge the maximum rate for credit insurance?

Fagg: Creditors press credit insurance companies to provide the maximum compensation. If we charge a rate that is less than the prima facie rate and pay less commission, the creditor is going to come to us and say, why can't you pay more compensation? The state has set a rate. The state in its regulation says that rate is fair and reasonable. Why can't I charge that rate? Everybody else in the state can charge it. It's deemed fair and reasonable. And that's what happens with rate regulation.

Hearing Transcript Page 119

Q: Okay. Turning now to what you alluded to a minute ago, and that was the 60 to 120 month data. The data that we have for 60 to 120 month, at that time the rate was unregulated. Right?

Fagg: Yes.

Q: Okay. And you claim that the average rate in the unregulated market was 53 cents?

Fagg: Yes.

Q: Now, if there were – during that same period based on the data that we've talked about, an insurer could have made adequate profits had they reduced their commission based on a 40 cent rate.

Fagg: Yes.

Q: Okay. So if there were true competition in the market, an insurer could have undercut the 53 cent rate and could have been charging 40 cents.

Fagg: They could have been charging it. They probably wouldn't have written any business.

Q: And why is that?

Fagg: Because the pressure is to pay the maximum that's payable within the rate.

Q: Do you think any consumers would have been interested in paying a 40 cent rate rather than a 53 cent rate?

Fagg: Yes.

Hearing Transcript Pages 205-6

Q: Let me read the first paragraph of Commandment No. 5 and tell me if I read this correctly: "Do not covet your neighbor's business. Actually it's not too bad to covet business, but just because your neighbor pays a 50 percent commission does not mean you can pay 51 percent. The way the marketplace is going, we'll be paying 100 percent commissions by the year 2,000." Did I read that correctly?

Fagg: Yes.

Q: So if I understand this, the way credit insurers compete for business is by offering a higher commission. Right?

Fagg: That's one way of doing it.

Q: Another way would be to offer a lower rate to the producers. Right?

Fagg: They could chose to do that.

Q: They wouldn't get very far, though, would they?

Fagg: No.

Q: And you don't recommend it in the Ten Commandments of Credit Insurance, do you?

Fagg: No.

Q: And that's because if they did try to sell at a lower price, they're not going to get any business, are they?

Fagg: Substantially no business.

Because of reverse competition and because of the phenomenal profits available to lenders from the sale of credit insurance, there are a number of problems often found with credit insurance, including unfair and coercive sales practices and post claims underwriting. For a detailed study of problems with credit insurance, please see the 1999 study by Consumers Union and the Center for Economic Justice, *Credit Insurance: The \$2 Billion a Year Ripoff*, which can be found at <http://www.cej-online.org/report.pdf>.

Introduce Class Rating / Require Individual Insurers to Meet Loss Ratio Standards

New Mexico credit insurance regulations provide prima facie rates for credit life and credit disability insurance. Any credit insurer can use the prima facie rates and those rates are presumed reasonable for that insurer. However, the prima facie rates are based upon industry average experience. Insurers with worse than average loss experience can apply for higher rates through a deviation process. But, insurers with lower than average loss experience are able to charge the prima facie rate. And because of reverse competition, these credit insurers will not lower rates to reflect the better-than-average loss experience, but will charge the prima facie rate and pay more commission to the lender.

Table 3 shows the 1995-1999 experience for the top writers of New Mexico credit life insurance. Not one of the top writers met the modest 55% target loss ratio over the five-year period. And the top writer – Service Life and Casualty Insurance Company – showed a loss ratio of only 11.1%. Service Life, whose customers are exclusively auto dealers and/or the reinsurers owned by auto dealers, experienced very low losses, but continued to charge prima facie rate

In addition to lowering prima facie rates, other action is needed to address the problems of reverse competition. One approach is to create rates by class of business. Under this approach, separate prima facie rates are established for auto dealers, other dealers, banks, finance companies, credit unions and all other. Several states use class of business rating, including California. The New Mexico regulation creates classes of business, but fails to establish rates by class of business.

Another approach is to require individual insurers to meet the target loss ratio. Under this approach, an insurer whose historical loss ratio is more than five percentage points below the loss ratio standard must file new rates that are expected to achieve the loss ratio standard. This is the parallel to credit insurers seeking higher rates when their historical loss ratio is more than five percentage points above the loss ratio standard.

Disapprove Current Credit Unemployment and Credit Property Rates

Clearly, current rates for credit unemployment and credit property are excessive and must be disapproved. Several states have been successful in getting credit insurers to file lower credit unemployment and credit property rates simply by notifying the insurers that the rates are excessive and new filings are indicated. For example, the Iowa insurance commissioner recently notified insurers of excessive credit unemployment and credit property rates. In response, Allstate Insurance Company reduced unemployment rates from \$0.35, \$0.33, and \$0.25 per month to \$0.02, \$0.02, and \$0.01 per month and property rates from \$0.15 to \$0.01 per month.¹ For another example, in response to a letter from the Texas Department of Insurance, American Bankers reduced its single premium unemployment rate from \$4.00 to \$2.45 while more than doubling the benefits.² The Virginia Bureau of Insurance has had similar success.³

When reviewing new credit unemployment rate filings, it is vital that expected losses be based upon current unemployment rates and not an average of historical unemployment rates. The best predictor of near-term future unemployment rates is the current unemployment rate. It should be obvious the January 2001 unemployment rate is a better predictor of the 2001 unemployment rate than the much higher 1992 unemployment experience.

Problems with Single Premium Credit Insurance

Most credit insurance, as measured by premium volume, is sold as a single premium product. Single premium gross reducing term credit life and credit accident and health 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. It is no coincidence that Service Life sells single premium credit life insurance in conjunction with auto loans and has the lowest loss ratio of any credit life insurer in New Mexico.

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.

Franklin D. Raines, Chairman and Chief Executive Officer of Fannie Mae stated, "We have an obligation to define the loans we will not buy, and practices we will not support – practices that can have the effect of encouraging predatory lending. . . . But in light of recent indisputable evidence that some predators are taking unfair advantage of

¹ Contact Ramona Lee at the Iowa Department of Insurance, (515) 281-4095.

² Contact Phil Presley at the Texas Department of Insurance, (512) 475-3017.

³ Contact Mary Bannister at the Virginia Bureau of Insurance, (804) 371-9826.

consumers and stripping them of wealth and equity, we feel an obligation to clearly state our expectations and standardsPrepaid Single Premium Credit Life Insurance Policies -- Fannie Mae will not purchase or securitize any mortgage for which a prepaid single-premium credit life insurance policy was sold to the borrower in connection with the origination of the mortgage loan, regardless of whether the premium is financed in the mortgage amount or paid from the borrower’s funds.”

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 10% interest with credit life and credit disability insurance in New Mexico.⁴

1	Loan Principal	\$15,000.00
2	<u>Credit Insurance Premium</u>	<u>\$1,287.33</u>
3	Amount Financed	\$16,267.33
4	Finance Charges:	
	a. On Principal	\$4,122.34
	b. On Credit Insurance	\$353.79
5	Gross Indebtedness (sum of lines 1 to 4)	\$20,763.46

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 25% 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%.

⁴ The New Mexico credit life and credit disability rates are \$2.60 and \$3.60, respectively, per \$100 of initial indebtedness. The premium can be calculated by multiply \$6.20 times \$20,763 divided by \$100. The actual calculation is complicated because the amount of gross indebtedness is function of credit insurance premiums which is, in turn, a function of the gross indebtedness.

1	Loan Principal	\$40,000.00
2	<u>Credit Life Insurance Premium</u>	<u>\$4,865.67</u>
3	Amount Financed	\$44,865.67
4	Finance Charges:	
	a. On Principal	\$43,422.87
	b. On Credit Insurance	\$5,282.04
5	Gross Indebtedness (sum of lines 1 to 4)	\$93,570.58

In this home equity loan example, the single premium credit life insurance premium is \$4,865.67 – an amount added to the principal that must be repaid. The credit life insurance not only adds almost \$5,000 in amount financed, but also adds over \$5,000 in additional finance charges. The consumer is paying for over \$93,000 of coverage – even though she has borrowed \$40,000. 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.

To further illustrate the inappropriateness of single premium gross indebtedness credit life insurance, we can calculate the cost of credit life insurance paid monthly over the ten-year term of the loan coverage and based only on the outstanding principal balance. If, instead, the consumer had paid monthly credit insurance premiums based on the *net indebtedness*, the total premium would have been only \$2,574.73 *spread out in monthly payments over the ten years of the loan*. In this example, the gross indebtedness calculation causes the consumer to pay almost 100% more premium – plus another \$5,282 in additional finance charges – than under the net indebtedness calculation. With the single premium product, the consumer pays an inflated amount up front and must finance the insurance. With net indebtedness, the premium calculation is based only on remaining principal. The consumer does not pay a premium based on unearned interest payments as in the gross indebtedness calculation.

In addition to the extra premium from the single premium coverage, the credit insurer and lenders get all the money up front, thereby earning significant investment returns that the consumer could have been earning had he or she been paying the premiums over the term of the loan. Thus, the difference in premiums understates the cost to consumers of gross indebtedness coverages compared to net indebtedness coverages.

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.

Stopping the Abuses of Single Premium Credit Insurance

Several actions can be taken to stop the abuses of single premium credit insurance.

First, gross indebtedness premium calculation for credit life should be prohibited. Gross indebtedness calculations cause the consumer to pay credit insurance for more coverage than necessary to protect the lender's interest. Gross indebtedness calculations make the consumer pay not only to protect the lender's principal, but also the lender's unearned finance charges. The NAIC credit insurance model provides only for net indebtedness premium calculations for credit life insurance.

Second, prohibit single premium coverages for loans greater than, say, 48 months. Even with a net indebtedness basis, financed single premium coverages for longer-term loans are inappropriate for, and harmful to, consumers. A requirement for monthly outstanding balance insurance on longer-term loans is not unreasonable. Citibank, in an effort to gain approval of its merger with the Associates, a sub-prime lender, offered to make monthly payment credit insurance available to all credit insurance consumers.

Third, introduce a single premium discount factor. Any single premium credit insurance rate should be adjusted downward for an interest and mortality discount. The interest discount is appropriate because the credit insurer is able to earn significant investment income on the single premium paid up front in comparison to the monthly outstanding balance approach. The consumer should not be harmed by losing the investment income on the amount of credit insurance premium because the lender chose a single premium product instead of a monthly outstanding balance product.

A mortality discount is also appropriate because the full single premium is earned by the credit insurer if the borrower dies. Thus, if a borrower dies two months into a 60-month loan, the credit insurer earns the entire 60-month premium. In comparison, a consumer who dies two month into a loan based upon monthly outstanding balance premiums will pay only two months of credit insurance premiums.

The discount factor used for interest and mortality discount can also be used to reduce rates as loan term increases. Because some of the costs of issuing a credit insurance policy are fixed, lower rates per year with longer term coverages is necessary and reasonable.

The following formula is used to develop the interest/mortality/term discount factor for single premium credit life rates. This factor is applied to the single premium credit life rates:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.045)n}{24}}$$

where n equal the coverage term in months.

The following formula is used to develop the interest/term discount factor for single premium credit disability rates. The factor is applied to single premium credit disability rates:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.0563)n}{24}}$$

Other Problems with 13 NMAC 18.2

In addition to other problems cited above, there are two other major problems with 13 NMAC. The deviation procedure – sections 18.2.29 through 18.2.33 – and the prima facie rate adjustment procedure –sections 18.2.44 and 18.2.45 – are seriously flawed.

Deviation Procedures – Complement of Credibility

The deviation procedures are flawed for two reasons. The complement of credibility should be the historical industry loss ratio at prima facie rates instead of the target loss ratio and because the deviation formulas create excessive rates.

The calculation of case rates relies upon a credibility-adjusted loss ratio. In developing the credibility-adjusted loss ratio, insurers are directed to use the expected or target as the complement of credibility. This procedure is inappropriate because it guarantees that low-credibility, low-loss ratio experience groups will never achieve the target loss ratio. This occurs because the credibility adjusted loss ratio used in the deviation calculation is inflated by the use of the presumptive loss ratio as the complement of credibility.

We recommend that the appropriate industry loss ratio at prima facie rates be used as the complement of credibility. This approach matches a loss ratio from related and credible experience with the low-credibility business being rated. If the case experience is not credible, the first option for the complement of credibility should be the prima facie loss ratio for entire relevant class of business for the plan of coverage being rated. If this

experience is still not fully credible, then the next option should be the prima facie loss ratio for the entire class of business across all life or all disability plans of business for class and type of business. If this experience is still not fully credible, then the next option should be the prima facie loss ratio for all life or all disability, as appropriate.

Deviation Procedures – Case Rating Formula

The formulas for calculating deviated rates are skewed against consumers. For downward deviations, the formulas provide a reduction in rates that match the difference in actual claim costs from expected claim costs in the prima facie rate. Thus, no matter how low the claim costs go, the non-claim costs remain constant. As shown below, if claim costs were drop to zero, the deviation formula would still produce a credit life single premium rate of \$0.23 per \$100 per year.

The downward deviation formula is unjustified because some of the non-claim costs are fixed expenses and some are variable expenses. To the extent some of the expenses are variable, fewer cents are needed with lower rates. The downward deviation formula stands in stark contrast to the upward deviation formulas which provide for increased non-claim amounts as the claim costs rise.

Table 4 shows the loss ratios resulting from the deviation procedures in 13 NMAC sections 18.2.29 through 18.2.33. The downward deviation formula is the same for both life and disability so the resulting loss ratios are the same. The upward deviation formulas for life and disability differ – life uses a factor of 1.1 while disability uses a factor 1.2. The fact that the upward deviation formulas use a factor higher than 1 means that the dollar amount of the non-claim portion of the rate increases with the upward deviation. The Factor 1 Deviated Loss Ratio column shows that the deviated loss ratios would be higher if the same procedures were used for upward deviations as for downward deviations. The last two columns show how the amount of non-claim cost dollars increases with upward deviations. The effect is particularly pronounced for the disability deviation because of the 1.2 factor.

Table 4
Effect of Deviation Procedures

Credibility Adjusted Loss Ratio	Deviated Life Loss Ratio	Deviated Disability Loss Ratio	Factor 1 Deviated Loss Ratio	Life Non-Claim Component	Disability Non-Claim Component
0%	0.0%	0.0%		\$0.234	\$1.346
5%	10.0%	10.0%		\$0.234	\$1.346
10%	18.2%	18.2%		\$0.234	\$1.346
15%	25.0%	25.0%		\$0.234	\$1.346
20%	30.8%	30.8%		\$0.234	\$1.346
25%	35.7%	35.7%		\$0.234	\$1.346
35%	43.8%	43.8%		\$0.234	\$1.346
40%	47.1%	47.1%		\$0.234	\$1.346
45%	50.0%	50.0%		\$0.234	\$1.346
50%	52.6%	52.6%		\$0.234	\$1.346
55%				\$0.234	\$1.346
60%	56.9%	56.6%	57.1%	\$0.237	\$1.375
65%	58.6%	58.0%	59.1%	\$0.239	\$1.405
70%	60.1%	59.3%	60.9%	\$0.242	\$1.435
75%	61.5%	60.5%	62.5%	\$0.244	\$1.465
80%	62.7%	61.5%	64.0%	\$0.247	\$1.495
85%	63.9%	62.5%	65.4%	\$0.250	\$1.525
90%	65.0%	63.4%	66.7%	\$0.252	\$1.555

To demonstrate the problems with the deviation methodology, let us take the example of Service Life. Let us suppose that Service Life wanted to file for a downward deviation – even though we know that because of reverse competition the company never would do such a thing. If the Service Life experience was 100% credible, the company’s 11.1% loss ratio would produce a single premium credit life deviated rate of \$0.29, which would be expected to produce an actual loss ratio of only about 20%. If the Service Life experience was 50% credible, then the deviation formula would produce a single premium deviated rate of \$0.41, which would be expected to produce an actual loss ratio of about 14%. The Service Life example vividly illustrates the need to require individual credit insurers to meet the target loss ratio standard.

Flawed Prima Facie Rate Adjustment Procedures

13 NMAC 18.2.44 and 18.2.45 provide for automatic reductions in prima facie rates if the actual loss ratio at prima facie rates is significantly below the target loss ratio. This procedure is flawed because the procedure only causes the rates to achieve 90% of

the target loss ratio, thereby effectively turning the 55% target loss ratio into only a 49.5% target loss ratio. The 55% target loss ratio is already too low – the NAIC model specifies a 60% minimum loss ratio. There is no rationale to further reduce the target by 10%.

The prima facie rate adjustment procedures are further flawed because the procedures will take over ten years to achieve the reduced target loss ratio for credit life. As Table 5 shows, because the credit life loss ratios are so low, it will take six adjustments to achieve a loss ratio greater than the modified target loss ratio of 49.5%. Clearly, prima facie rates must be adjusted more quickly and more substantially to fulfill the statutory requirement that benefits be reasonable in relation to premiums. If the regulation declares a 55% loss ratio as the minimum level of benefits to premiums, but it takes 14 years from the adoption of the regulation to achieve that loss ratio, then the regulation is not fulfilling the statutory requirements.

The life table is based upon the single premium rate of \$0.52 per \$100 and the 1997-1999 actual loss ratio of 29.0%. The disability table is based upon the 36-month, 14-day retro single premium rate of \$2.99 and the 1997-1999 actual loss ratio of 38.2%.

Table 5
Prima Facie Adjustment Procedure

<i>Life</i>		
<u>Year</u>	<u>New Rate</u>	<u>Resulting Loss Ratio</u>
2002	0.47	32.1%
2004	0.42	35.9%
2006	0.38	39.7%
2008	0.34	44.4%
2010	0.31	48.6%
2012	0.28	53.9%

<i>Disability</i>		
<u>Year</u>	<u>New Rate</u>	<u>Resulting Loss Ratio</u>
2002	2.69	42.5%
2004	2.42	47.2%
2006	2.18	52.4%

These prima facie adjustment procedures need to be replaced with a requirement that all insurers annually submit rate filings with rates designed to meet the target loss ratios.

Table 3
Top Writers of Credit Life Insurance in New Mexico, 1995-1999

<u>Insurance Company</u>	<u>Insurance Group</u>	<i>\$ Millions</i>				
		<u>Earned Premium</u>	<u>Incurred Losses</u>	<u>Lender Compens.</u>	<u>Loss Ratio</u>	<u>Compens. Ratio</u>
Service Life & Cas Ins Co	Service Life Grp	\$9.3	\$1.0	\$3.5	11.1%	37.3%
Union Security Life Ins Co	Fortis Grp	\$8.2	\$2.4	\$4.2	29.8%	50.8%
American Bankers Life Asr Co Of Fl	Fortis Grp	\$7.8	\$3.0	\$2.8	38.7%	35.6%
Associates Financial Life Ins Co	Assoc First Capital Grp	\$6.5	\$1.7	\$0.0	25.3%	0.0%
American General Assur Co	American Gen Grp	\$5.5	\$1.3	\$2.9	24.3%	53.4%
Cuna Mut Ins Society	Cuna Mut Grp	\$5.3	\$2.4	\$1.1	45.1%	20.3%
Central States H & L Co Of Omaha	Central States Grp	\$4.5	\$2.1	\$2.0	45.9%	45.6%
American Heritage Life Ins Co	Allstate Ins Grp	\$4.0	\$1.3	\$2.2	33.0%	55.2%
Federal Home Life Ins Co	Ge Global Grp	\$3.8	\$1.7	\$1.0	44.1%	27.4%
Centurion Life Ins Co	Centurion Ins Grp	\$3.4	\$0.9	\$0.0	27.0%	0.0%
North Central Life Ins Co	American Gen Grp	\$3.4	\$0.5	\$2.2	15.8%	63.6%
Union Fidelity Life Ins Co	Ge Global Grp	\$3.2	\$0.5	\$1.0	14.1%	31.3%
Universal Underwriters Life Ins Co	Zurich Ins Grp	\$2.6	\$0.6	\$1.4	23.9%	54.9%
Central Natl Life Ins Co Omaha	Presidential Life Grp	\$2.6	\$0.8	\$0.0	28.9%	0.0%
United Mercantile Life Ins Co	Surety American	\$2.5	\$0.7	\$1.1	27.1%	42.5%
American Natl Ins Co	American Natl Fncl Grp	\$2.5	\$0.9	\$1.3	37.2%	52.0%
American Health & Life Ins Co	Citigroup	\$2.5	\$0.6	\$0.1	22.9%	5.9%
Allstate Life Ins Co	Allstate Ins Grp	\$1.7	\$0.9	\$0.0	53.3%	1.9%
Prudential Ins Co Of Amer	Prudential Of Amer	\$1.5	\$0.7	\$0.5	44.9%	31.2%
Voyager Life Ins Co	Fortis Grp	\$1.1	\$0.3	\$0.5	30.3%	40.6%
Old United Life Ins Co	Van Ent Grp	\$1.1	\$0.1	\$0.4	13.4%	35.0%
Landcar Life Ins Co	Landcar Ins Grp	\$1.1	\$0.2	\$0.5	16.3%	45.4%
Balboa Life Ins Co	Countrywide Credit Grp	\$1.0	\$0.2	\$0.4	16.4%	37.9%
Industry Total		\$99.7	\$28.7	\$33.6	28.8%	33.7%