**Supplemental Comments of the Center for Economic Justice**

**To the Unclaimed Benefits Model Drafting Working Group of the**

**NAIC Life Insurance (A) Committee**

**January 18, 2016**

The Center for Economic Justice (CEJ) writes to comment on credit life insurance issues raised during the January 15, 2016 teleconference of the working group. As a matter of background, Birny Birnbaum has worked on credit insurance issues since 1991 and has authored two national reports and numerous state reports on credit insurance experience and practices. He has been accepted as an expert in administrative and judicial proceedings on credit insurance rates and practices.

These comments are organized as questions raised during the January 15, 2016 call, followed by CEJ's answers to the questions.

1. **Can the amount of credit life coverage exceed the remaining principal amount (payoff amount) of the loan?**

**Yes.** There are two payment methods for credit life insurance – monthly payment and financed single premium. Generally, with monthly payment, the coverage amount is the remaining principal balance, although there are exceptions in which the coverage amount will exceed the remaining principal of payoff amount. However, with financed single premium (SP) credit life, ***the coverage amount will always exceed the payoff amount.***

The majority of financed SP credit life is written on a gross coverage basis. This means that the coverage amount is based on the amount of gross debt, which is the total amount borrowed plus the total interest payments expected for the term of coverage. Stated differently, with gross debt financed SP credit life, the amount of coverage equals the amount borrowed before credit insurance), interest on the amount borrowed, the amount of the credit insurance premium and the interest on the financed credit insurance premium. If other products are also financed in the transaction – if credit disability insurance, credit involuntary unemployment insurance, credit personal property insurance and/or GAP insurance or GAP waiver – the credit life coverage amount will increase by the amount of the premium and expected interest for these products.

To illustrate, I've calculated the credit life coverage amount for a $20,000 seven-year term auto loan with an interest rate of 12% using Tennessee rates filed by Plateau Insurance in 2015. The table below shows that the credit life insurance coverage for this $20,000 loan is $31,838, which is $11,838 more than needed to pay off the loan at the beginning of the loan. If credit disability coverage is added, the credit life coverage amount increases to $35,324 – now $15,324 greater than the $20,000 needed to pay off of the loan at the beginning of the loan.

**Financed Single Premium Credit Life Coverage Example**

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| Credit Life Rate | $0.66 per $100 of gross debt / year |
| Credit Disability Rate | $6.20 per $100 of gross debt / 84 month term |

| | Credit Life Only | Credit Life & Disability |
|---|---|---|
| Total Amount Financed / Credit Life Coverage | $31,838 | $35,324 |
| Credit Life Premium | $1,471 | $1,632 |
| Credit Disability Premium | | $2,190 |

The difference between the amount of coverage and payoff amount on the loan increases with longer loan terms and higher interest rates. Up until the early 2000's, large amounts of financed SP credit insurance was sold in connection with real-estate loans. Because of the length of the loans (up to 30 years) and term of credit insurance coverage (typically 10 years) and high interest rates targeted at vulnerable consumers, the U.S. Departments of Treasury and Housing and Urban Development concluded that financed SP credit insurance sold in connection with real-estate secured loans was an abusive, predatory lending practice. Eventually, Fannie Mae and Freddie Mac stopped buying or guaranteeing mortgages that included SP credit insurance and federal agencies promulgated rules declaring that, unlike credit insurance sold with other types of loans, the premium for financed SP credit insurance sold in connection with a real estate loan was a finance charge and had to be included in the APR calculation.

2. **Do lenders have an economic incentive to pursue every credit life claim?**

**No.** The original argument put forth by the credit life industry and lenders in support of the exemption was that lenders have an economic incentive to pursue every claim because the lenders avoid collection costs from family of the deceased insured and obtain payment in full for the loan of the deceased debtor.

As we pointed out in earlier comments, this story is missing some key parts. Many lenders who sell credit insurance have established captive reinsurance arrangements to share in the risk and profit of the credit insurance transactions. In particular, auto dealers utilize captive reinsurance in connection with financed SP credit insurance. Our earlier comments documented the existence of hundreds of such captive reinsurance arrangements.

With such an arrangement, if the remaining coverage on the credit life policy was, using our example above, $35,324 and the loan payoff was $20,000, then $20,000 would go the lender and the $15,324 should go to the beneficiary. However, if the lender has a captive reinsurance arrangement, there is an economic incentive to not identify the death claim because the lender realizes a greater overall return if the claim is not paid -- $35,324 retained instead of $20,000 received as the death benefit.[1]. The lender may then sell the non-performing loan to a debt collector for some additional revenue. If the non-lender beneficiary of the credit life insurance is not aware of the existence of the credit insurance, she or he may pay the debt collector.

***It is important to state that CEJ has no evidence that lenders do not diligently seek to identify credit life beneficiaries. Nor do we have any evidence that they do.*** Proponents of the credit life exemption have also not provided any evidence to support their theory. They ask for an exemption based solely on what they present as a logical argument of economic self-interest of lenders. CEJ has pointed out that the industry argument is faulty and that economic self-interest would lead some lenders to not identify and pay credit life death benefits. Given the actual economic self-interest to not identify and pay claims and given the absence of any evidence that application of the unclaimed benefits model would not identify unclaimed benefits for credit life (as has occurred for other types of life insurance and annuities), there is no basis to exempt credit life from the unclaimed benefits model.

**3. If lenders did have an economic incentive to purse every credit life claim, would that mean every death benefit would be paid?**

**No.** The purpose of the unclaimed benefits model is not to be punitive to life insurers, but to require the life insurers to take additional actions to identify beneficiaries who were not aware they were a beneficiary of a life insurance policy or annuity contract. It may be possible that each and every time a borrower with a credit life policy stops making payments on the loan, the lender and credit life insurer determine if the borrower/insured has died and starts a claim. But it is also possible – in fact, likely – that lenders and credit life insurers do not pursue each and every instance of delinquent payments for evidence of a credit life beneficiary.

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[1] The actual amounts would be somewhat different because of the administrative costs of the captive reinsurance agreement.

4. **Do bank "call" reports eliminate the possibility that a credit life insurance claim will not be paid?**

**No.** On the call, Mr. Lemon asserted that a bank must regularly file reports with its regulators about non-performing loans. Mr. Lemon concluded that a lender's failure to report a credit life claim would be a fraudulent act which no lender would risk. Given the recent history of lenders making millions of fraudulent mortgages, the basis for Mr. Lemon's assertion is unclear. Putting that issue aside, the majority of financed SP is sold in connection with auto loans sold through auto dealers and other indirect lenders – not banks. Finally, even if we assume best intentions, such good intentions do not equate to perfect outcomes. Lenders who operate in good faith may still not identify beneficiaries through the historically normal process.

5. **Do the regulatory settlements to date provide evidence that credit life insurance identify and pay all death benefits?**

**No.** None of the insurers who have been audited and/or party to a regulatory settlement sells credit life insurance. Consequently, the audits and settlements to date could not have any findings related to credit life. The industry argument is analogous to concluding that there are no unclaimed benefit issues with annuities because the life insurer audited only sold life insurance so the audit had no findings on annuities.

6. **Does the "successful business model" of credit life insurers preclude the possibility that death benefits will not be paid?**

**No.** CEJ has always maintained that credit insurance can be a valuable product for some consumers if sold and priced fairly. During the call, CCIA representatives referred several times to their industry's "successful business model." While it is unclear what is meant by that phrase or why it is relevant to the working group's discussion, we will point out that some forms of credit insurance have been termed abusive and predatory by financial regulators and that financial advisers ranging from Suzie Orman to Jane Bryant Quinn to Dave Ramsey, as well as many consumer organizations, strongly counsel consumers not to buy credit insurance.

7. **Does the adoption of the NCOIL model provide any evidence that application of the unclaimed benefits model to credit life insurers would not identify beneficiaries owed insurance benefits?**

**No**. The credit industry representatives are correct that the states adopting unclaimed benefits laws to date which exempt credit life have made a policy decision to do so. That, however, is not evidence that application of the unclaimed benefits model requirements to credit insurers would or would not result in identification of a significant number of beneficiaries who would otherwise have not received their benefits.

8. **Have the proponents of the exemption provided any evidence that lenders pursue all claims and/or that application of the unclaimed benefit model to credit life insurers would not identify any beneficiaries.**

**No**. The credit industry representatives complained during the call that they were being asked to prove a negative. On the other hand, they are asking regulators and consumers to accept that application of the unclaimed benefits model would not yield identification of additional beneficiaries – without any evidence to support their position. Given the lack of empirical evidence, what should the basis for a decision by the working group be? The credit insurance industry offered a logical argument – economic self-interest by lenders – in the absence of evidence, but CEJ has demonstrated that the industry's logical argument is flawed and lenders do have economic self-interest to fail to identify all death claims. If the basis for the working group's decision in the absence of empirical evidence is logical argument, then the working group must conclude that no credit life exemption is warranted.

***An alternative approach would be to generate empirical evidence by performing unclaimed benefits audits on a couple of credit life insurers, at least one of whom specialize in financed SP credit insurance. If the results of such audits, performed as rigorously as those done on other life insurers to date, are that few or no unclaimed beneficiaries are identified, CEJ will withdraw our objection to the credit life exemption.***