Comments of the Center for Economic Justice to the

NAIC Unclaimed Life Insurance Benefits Model Working Group

November 4, 2015

CEJ writes in support of deleting the exclusion for credit life insurance from the unclaimed life insurance model.

The credit insurance industry, through the ACLI and CCIA, argue that imposing the requirements of the unclaimed life insurance benefits model act on credit life insurers is unnecessary because lenders are the insureds of master credit life insurance policies. Consequently, because these lenders have a financial interest in receiving payment from credit life insurance coverage, they will take action to ensure claims are paid when insured borrowers die.

In fact, in many – likely most – credit life insurance circumstances, lenders have a financial interest in credit insurance beyond the repayment of loan principal because of financed single premium credit insurance – which creates coverage amounts greater than the remaining principal of the loan – and captive reinsurance agreements – which provide profits to affiliates of lenders that increase with lower claim payments.

Credit life insurance protects the lender's loan by providing a payment to the lender – the remaining principal amount of the loan – from the credit insurer if the borrower dies. Not content to have borrowers pay for the credit insurance coverage that protects the lender and relieves the lender of collection costs from family members of the deceased, lenders typically have a greater financial interest in the sale of credit life insurance. One type of financial interest is commission from the credit insurance.

Other types of lender compensation are of particular relevance to the working group's deliberations. These other types of lender compensation from the sale of credit life insurance create incentives for the lender to <u>not</u> pursue death claims. These two forms of compensation are the sale of financed single premium credit life insurance and the use of captive reinsurance arrangements by which the lender receives compensation based on claims paid (or unpaid).

Financed single premium (SP) credit insurance is a form of credit insurance in which the entire premium for a multi-year credit life insurance policy is charged to the consumer as a single premium at the loan origination and then financed as part of the consumer's loan. With financed SP, the amount of coverage sold is greater –sometimes far greater – than the original principal balance of the consumer loan because the amount of credit insurance coverage, if done on a gross basis, is the sum of the original loan balance, the projected interest on the original loan balance, the insurance premium and the projected interest on the insurance premium. Since the amount of coverage exceeds the lender's interest in the loan, the borrower is also an insured and her beneficiary should receive the difference between the amount of coverage remaining and loan principal balance paid to the lender.

The chart below illustrates the coverage amount and credit insurance premium for an auto loan of $15,000 for 60 months at 10% interest taken from CEJ's 1999 national report on credit insurance. The rates used are those in effect in Kentucky at the time for credit life and credit disability of $3.00 ($0.60 per year) and $5.68, respectively, per $100 of initial indebtedness. The premium can be calculated by multiply $8.68 times $21,501 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.

With this example, if the borrower died the day the loan was originated, the credit insurer would pay $16,866.34 to the lender and $4,635.25 to the borrower's beneficiary. If the lender had a captive reinsurance arrangement, then failing to pay the claim would effectively increase the lender compensation by $4,635.25.

1		Loan Principal	$15,000.00
2		Credit Insurance Premium	$1,866.34
3		Amount Financed	$16,866.34
4		Finance Charges	
	A	On Principal	$4,122.34
	B	On Credit Insurance	$512.91
5		Gross Indebtedness / Amount of Coverage	$21,501.59

The second piece of the lender compensation structure related to the working group's deliberation is the use of captive reinsurance by lenders to seek additional compensation from the sale of the credit life insurance. With the captive reinsurance arrangements, the credit insurer is effectively an administrator of the credit life insurance and it cedes the credit life insurance premium to lender's affiliated reinsurance company. The lender's compensation from the credit insurance is inversely proportional to the claims (loss) ratio of the credit insurance.

Under these common credit life structures – financed single premium credit insurance sold by a lender with a captive reinsurance arrangement – the lender has a financial interest in the credit life insurer not paying claims upon the insured's death. If the claim is paid, the lender is paid the remaining principal amount of the loan and the insured's beneficiaries are paid the remaining difference between the coverage amount (which is greater than the remaining principal because of financed SP credit life =) and the remaining principal paid to the lender. If the claim is not paid, then the lender, through the captive reinsurance arrangement, receives the total amount of coverage as profit from the captive reinsurance arrangement.

In summary, the ACLI and CCIA assertion that lenders have an incentive to always seek death benefits from credit insurance policies is incorrect regarding financed single premium credit life insurance sold in connection with a captive reinsurance arrangement. This type of credit life sale has been and continues to be common.

The industry argument for exempting credit life insurance from the Unclaimed Life Insurance Benefits model is not based on any empirical evidence that credit life insurers always pay credit life death benefits whenever an insured borrower dies. Instead, the industry argues that such payments should occur because of the lender's financial interest. CEJ has shown, above, that in many – or most – instances of credit life insurance death benefits, the lender has a financial interest in not seeking the death benefit.

Given the economic incentives in many circumstances for the credit life insurer to not pay the death benefit and the absence of empirical evidence that credit life insurers' compliance with the proposed model would not yield significantly more benefit payments to borrower's beneficiaries, we urge the working group to exclude any exemption for credit life insurance.

In the alternative, any exemption from credit life insurance should be limited to those types of credit life insurance for which the lender does not have a financial interest in not seeking a death benefit for itself and the borrower. Such an exemption might be phrased:

> *Credit life insurance sold on a net coverage, monthly outstanding balance premium payment basis with no lender-affiliated captive reinsurance.*

Thank you for your consideration.