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February 22, 2002

The Honorable Craig Eiland
Texas State Representative
Chair, NCOIL Executive and Property Casualty Insurance Committees

By Electronic Mail and Fax

Re: NCOIL Resolution Regarding NAIC Credit Personal Property Model Act

Dear Representative Eiland:

The Center for Economic Justice writes to ask NCOIL to reconsider its recent resolution regarding the NAIC Credit Personal Property Model Act. In the November 16, 2001 resolution, NCOIL urges the NAIC to remove the provision in the model act that establishes a minimum loss ratio as part of the standard for establishing that credit property insurance benefits are reasonable in relation to premiums paid. This provision in the model act is an essential protection for consumers of credit insurance.

The NAIC model was the result of over a year's work and numerous meetings of regulators and interested parties. The model had broad support among insurance regulators – it was adopted unanimously by the NAIC membership. The credit insurance industry had many opportunities to present their case for straight component rating and the issue was discussed extensively on many occasions. The industry simply could not convince the state insurance commissioners that straight component rating was appropriate. In contrast, many consumer and fair housing groups supported the model, including AARP, Consumer Federation of America, the Coalition for Responsible Lending, National Fair Housing Alliance, US Public Interest Research Group, the National Consumer Law Center and others.

While the model does not contain all of the provisions we believe are reasonable to protect consumers of credit property insurance, the model reflects a reasonable compromise on a variety of issues. For example, we asked for far stronger consumer disclosures and a prohibition against "phantom coverage" – a situation where a consumer could be charged for coverage but for which no coverage actually exists. On that issue, insurers argued that it would be too expensive and cumbersome for the lender or insurer to track covered items on credit card purchases. The compromise was, in part, to permit the continued use of outstanding balance as the basis for premium calculation, but to require two other items – a minimum loss ratio standard and separate rate analysis by type of lender. The combination of a minimum loss ratio standard and evaluation of experience by different types of lenders will serve to reduce the impact of phantom coverage.

One of the most important provisions of the model is found in the *Section 7: Reasonableness of Benefits in Relation to Premium Charge*. The section provides for a component rating approach to ratemaking coupled with a minimum loss ratio. The minimum loss ratio standard is vital for consumer protection because it sets out a concrete standard of benefits in relation to premium. The industry proposal for component rating alone was rejected by the working group, Market Conduct Committee, Executive Committee and full NAIC membership because, we believe, credit insurers can manipulate a component rating approach to produce absurdly low loss ratios. For example, we provided an example of an insurer using a component rating methodology to justify a loss ratio of less than 20%.

A minimum loss ratio standard must be coupled with component rating to ensure reasonable benefits in relation to premium. The reasonableness of a component rating methodology is predicated on the availability of data on <u>reasonable</u> expense information. Because of reverse competition in credit insurance markets, as described in Section 3 of the model, there is no basis to conclude that actual expenses of insurers, including commissions to lenders, are <u>reasonable</u> expenses. It is the reverse-competitive market structure of credit insurance markets that makes the minimum loss ratio standard an essential consumer protection.

The 60% minimum loss ratio standard is reasonable and not arbitrary. The NAIC has used the 60% loss ratio standard for other credit insurance products. A reasonable component rating analysis <u>produces</u> a loss ratio higher than 60%. We provided extensive documentation and analysis of credit property insurance rates that demonstrated that loss ratios even higher than 60% would provide insurers with reasonable profit and lenders with reasonable commissions.

Credit property insurers can easily meet the 60% loss ratio standard simply by ensuring that the credit property coverage provides substantial benefits. Increasing the scope of coverage leads to increased expected loss ratios under a component rating analysis. We have already seen the movement, in a number of states, from credit property coverage with major exclusions to an all perils credit property coverage that provides greater benefits to consumers.

We respectfully urge NCOIL to reconsider the credit property resolution. I will be at the Spring 2002 NCOIL meeting in Charleston and am happy to answer any questions that you and the other members of NCOIL may have on this issue. Thank you for your consideration.

Sincerely,

Birny Birnbaum
Executive Director