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April 29, 2002

Commissioner David Parsons
Commissioner Mike Kreidler
Co-Chairs, NAIC Credit Insurance Working Group

By Electronic Mail

Re: NAIC Response to NCOIL Resolution on Credit Personal Property Model

Dear Commissioners Parsons and Kreidler:

CEJ offers the following comments on the NCOIL resolution. Attached please find our letters of February 22, 2002 and March 17, 2002 to NCOIL objecting to their resolution about the NAIC Credit Personal Property Model Act. As the second letter points out, the discussion at NCOIL was not clear about what NCOIL's objection actually was. In any event, there appear to be two issues – the use of a minimum loss ratio standard and the inclusion of such a standard in a model law.

As we argued during the development of the model (as discussed ion our February 22, 2002 letter to NCOIL), a minimum loss ratio standard *coupled with component rating* is reasonable, necessary and actuarial best practice for credit insurance *because of the problem of reverse competition in credit insurance*. Component rating is predicated on the ability to identify reasonable component costs. But in a reverse competitive market, there is no basis to believe that actual expenses incurred are reasonable expenses. We provided numerous examples to the working group during the development of the model to demonstrate the cost-inflating dynamic to consumers of reverse competition and the problems with straight component rating. We observed another such example just last week when the CCIA presented recommendations to the Texas Insurance Commissioner for revisions to the credit life and credit disability prima facie rates. Based upon a component rating analysis (which relied upon actual expenses and lender compensation for the component values), CCIA recommended 43% and 48% increases, respectively, for credit life and credit disability. Their component rating analysis produced "reasonable" rates with expected loss ratios of 25% and 30%, respectively. For the credit insurance industry, a component rating analysis can simply not produce a loss ratio too low to satisfy the standard of reasonable benefits to premium.

Matt Merlino's drafting note fails to preserve the critical consumer protection in the model – a minimum loss ratio coupled with component rating. Further, the proposed language renders the 60% figure meaningless by coupling any *other* loss ratio as acceptable. The addition of "other" amounts to the same result as the CCIA proposal.

The CCIA's comments are simply not credible. CCIA argues for straight component rating, calling it "actuarial best practice," but never mentions the contradiction in their support for

the component rating language in the NAIC credit life model that puts a *cap* on the loss ratio. Apparently, a *cap* on the loss ratio is good actuarial practice for the CCIA.

The fact is that CCIA advocates aggressively for component rating is those states where such an approach leads to higher rates but never advocates for component rating in states where the approach would lower rates. CCIA argues that loss ratio standards should not be in a statue, but have they complained about the *rates* in the Louisiana, Mississippi or other states' statutes? Apparently, the fact that the states with the highest rates are also the ones that place the rates in statute lessens the CCIA's concern over empowering the Commissioner with authority over rates.

As noted in our March 17, 2002 letter, we strongly object to NCOIL's resolution and to the NAIC gutting the credit property model in response. And while we are skeptical about the arguments put forth by NCOIL, we offer the following suggestions to address the arguments/concerns.

1. At the end of Section 1, add the following drafting note: *A state may wish to authorize the Commissioner to adopt the consumer protections in this model as a regulation. If so, this model can generally be adopted as a regulation with minor editorial changes.*

This drafting note addresses the concern about certain standards set out in statute versus regulation.

2. After Section 7B, add the following drafting note: *A state may wish to utilize a minimum loss ratio standard other than 60%. However, it is the belief of the NAIC that a minimum loss ratio standard must be coupled with a component rating approach to ensure consumer protection in the reverse competitive credit property insurance market. It is also the belief of the NAIC that the 60% standard is reasonable and easily defensible.*

   This drafting note addresses the concern that some states (or commissioners) may want to establish loss ratio standards other than 60%. However, the drafting note reinforces the need for some minimum loss ratio standard.

   The reasonableness of the 60% standard is evidenced by the two most recent credit personal property filings to the Texas Department of Insurance. The filings, by First Colonial Insurance Company of the Allstate Group, included one MOB product and one SP product. The rates are expected to produce loss ratios of 65% or more for each product.

Finally, it is important to recall that SP credit property is typically sold with high-interest consumer loans and, with necessary rate protection for consumers, can be a tool of predatory lenders. The minimum loss ratio standard – and 60% – provide critical consumer protections from unscrupulous lenders.

Thank you for your consideration.

Sincerely,

Birny Birnbaum