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April 30, 2002

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

By Electronic Mail

Re: New Information Regarding NCOIL Resolution on Credit Property Model

Dear Commissioners Parsons and Kreidler:

I have additional information for the working group to consider during the May 1, 2002 conference call. I received yesterday afternoon a letter from Louisiana State Representative Shirley Bowler. Representative Bowler was the Chair of the NCOIL Property Casualty Committee in 2001 and the driving force behind the credit property resolution. Representative Bowler's letter responds to comments in our March 17, 2002 letter to NCOIL President Larkin. I was unable to scan her letter, but I have typed the full text of her letter in Attachment 1 to this letter.

Representative Bowler's letter includes, "Instead of creating some arbitrary government control, a better alternative is to let the free market system prevail. Let competition keep prices down." She adds, "You are correct that Louisiana law sets maximum rates for credit insurance premiums; however, insurers are free to deviate down from those rates to compete for business."

With all respect to Representative Bowler, she does not appear to understand the reverse competition dynamic of credit insurance markets. Competition in credit insurance markets drive prices up – not down. Attachment 2 documents the dynamics of reverse competition – the preamble to the New York State regulation and the admissions of credit industry witness Gary Fagg in Texas credit insurance rate hearings.

It would be wrong for the NAIC to remove the minimum loss ratio standard in the credit property model in response to an NCOIL resolution based upon a profound misunderstanding of credit insurance markets. We urge the working group to adopt CEJ's recommended drafting notes.

Thank you for your consideration.

Sincerely,

Birny Birnbaum

Attachment 1: Letter from Representative Bowler

April 16, 2002

Re: Credit property insurance

Dear Mr. Birnbaum:

Your letter of March 17, 2002, to Senator William Larkin, president of NCOIL, implies that by taking a stand contrary to your position on Credit Property Insurance issues, I demonstrate disregard for my constituents who may be consumers of credit insurance.

Quite the opposite is true. I recognize that there are costs associated with delivering all products to market, including insurance products. For some products, including credit insurance, distribution costs make up a large percentage of the product's cost. Without meeting these costs, there can be no product at all. Without the product, some consumers would be left with devastating losses and no recourse.

Instead of creating some arbitrary government control, a better alternative is to let the free market system prevail. Let competition keep prices down. It's an economic theory that has worked for centuries.

While revisiting issues at NCOIL is an activity we do routinely through sunset reviews, I am confident that any reconsideration of the credit property resolution would reach a conclusion consistent with our current stand.

Best regards,

Shirley D. Bowler
State Representative

P.S. You are correct that Louisiana law sets maximum rates for credit insurance premiums; however, insurers are free to deviate down from those rates to compete for business.

cc: Sen. William Larkin

Attachment 2: Reverse Competition

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.

In past Texas credit life and credit accident and health insurance rate hearings, the credit insurance industry has admitted that reverse competition drives up the cost of credit insurance to consumers. The industry witness is Gary Fagg.

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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.

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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.