Credit Insurance in Wisconsin:
Regulators Fail to Protect Consumers

Consumers Overcharged by Tens of Millions of Dollars Annually

A Report to Assemblyman David Travis by
The Center for Economic Justice[1]
and Wisconsin Public Interest Research Group

May, 2001

Executive Summary

The Center for Economic Justice and Wisconsin Public Interest Research Group were asked to generally evaluate the performance of the Office of the Commissioner of Insurance (OCI) in protecting Wisconsin credit insurance consumers and to specifically evaluate the OCI's February 26, 2001 response to an inquiry from Assemblyman David Travis.

Credit insurance is insurance sold in connection with consumer loans and generally pays off the consumer loan or makes monthly payments on the consumer loan in the event the consumer dies, becomes disabled or unemployed. In the case of credit property insurance, the coverage typically provides for repair or replacement of property damaged by specific named perils. The lender is the primary beneficiary of the credit insurance because the credit insurance protects the lender's loan and provides significant commission income and additional finance charge income.

Our report shows that the OCI has failed to protect credit insurance consumers. Because the OCI has failed to enforce Wisconsin credit insurance laws and regulations, Wisconsin credit insurance consumers were overcharged by almost $150 million over the last three years and continue to be overcharged by millions of dollars per year. Table 1 shows the amount of credit insurance sold in Wisconsin by major coverage, the average payout on behalf of consumers and average commission to lenders who sell the credit insurance to consumers on behalf of the credit insurer. Table 1 not only shows that the payout on behalf of consumers has been very low, but that a higher share of the premium dollar goes to the lender as commission than goes to paying claims on behalf of consumers.

Table 2 shows the calculation of overcharges for the three-year period, 1997-99.

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[1] The Center for Economic Justice (CEJ) is a non-profit advocacy organization dedicated to representing the interests of low-income and minority consumers on insurance, credit and utility issues. CEJ has extensive experience working on credit insurance issues in many states and with the National Association of Insurance Commissioners.

Table 1
Wisconsin Credit Insurance Experience, 1995-1999

	Earned Premium ($ Millions)				
Coverage	1995	1996	1997	1998	**1999**
Life	$34.3	$33.5	$42.3	$45.1	**$46.2**
Accident & Health	$63.0	$55.4	$64.9	$69.8	**$68.7**
Unemployment	$14.5	$16.9	$17.9	$22.3	**$25.6**
Property	$3.1	$3.0	$3.2	$2.9	**$2.9**
Total	**$114.9**	**$108.9**	**$128.3**	**$140.1**	**$143.4**

	Incurred Losses To Earned Premium				
Coverage	1995	1996	1997	1998	**1999**
Life	45.5%	36.9%	39.1%	38.6%	**36.9%**
Accident & Health	45.8%	45.3%	46.6%	44.7%	**43.6%**
Unemployment	16.2%	12.5%	10.3%	8.0%	**5.7%**
Property	31.5%	36.5%	25.5%	10.8%	**2.5%**
Total	**41.6%**	**37.4%**	**38.6%**	**36.2%**	**33.9%**

	Lender Compensation to Premium				
Coverage	1995	1996	1997	1998	**1999**
Life	39.3%	42.0%	43.6%	38.5%	**41.7%**
Accident & Health	37.8%	37.4%	36.9%	35.8%	**37.3%**
Unemployment	48.8%	53.8%	57.2%	56.7%	**50.4%**
Property	35.4%	30.6%	35.4%	35.1%	**36.0%**
Total	**39.6%**	**41.2%**	**41.9%**	**40.0%**	**41.1%**

Table 2
Wisconsin Credit Insurance Overcharges, 1997-1999
($ Millions)

	Earned Premiums $ Millions	Actual Loss Ratio	Reasonable Loss Ratio	Overcharge $ Millions	Needed Rate Reduction
Life	$133.6	38.2%	50%	$31.5	-23.6%
Accident & Health	$203.5	45.0%	60%	$51.0	-25.1%
Unemployment	$65.7	7.7%	75%	$58.9	-89.7%
Property	$9.0	13.3%	75%	$7.4	-82.3%
Total	**$411.8**	**36.1%**		**$148.9**	

Further, our analysis shows that, although the OCI has identified important problems for credit insurance consumers, it has not taken any action to address these problems. A description of the problems follows.

Credit Life Rates

The OCI has interpreted the 1993 changes to Wisconsin credit insurance laws as an instruction by the legislature to depart from the 50% loss ratio standard and raise credit life rates. The OCI implemented these rate changes with a 1995 regulation that fixed expense components for 10 years and established minimum loss ratios well below 50%. The January 1, 2000 adjustment specifies a minimum loss ratio of only 39%.

The OCI has failed to comply with the most important provision of Wisconsin law – that premiums charges may not be unreasonable in relation to benefits provided and that the expense provisions included in rates must be reasonable. In establishing the expense provision in its regulation, effective January 1, 1996, the OCI adopted credit insurance industry expense proposals that were – and are – grossly excessive and unreasonable. In a recent Texas credit insurance rate hearing, the same credit industry expense proposals that were adopted by the OCI were soundly rejected by two administrative law judges and Texas Insurance Commissioner. If the OCI were to utilize *reasonable* expense provisions, a minimum loss ratio of at least 50% is indicated and credit life rate reduction of over 20% would be required.

Credit Accident and Health Rates

The OCI's credit insurance regulation specifies a method for adjusting credit disability rates every three years. However, when the OCI adjusted credit disability rates, effective January 1, 2000, the procedure was ignored. Instead of a reduction of 19.3% as specified in the regulation, the OCI arbitrarily instructed insurers to only lower rates by 15%. This technical error costs Wisconsin credit insurance consumers $3 million a year.

Very Low Loss Ratios for Some Credit Insurers

Representative Travis inquired of the OCI why some credit insurers had very low loss ratios. For example, some insurers had a loss ratio of less than 20% for credit life for the 1997-1999 period. In response to Representative Travis's inquiry about very low loss ratios for some credit insurers, the OCI responded that prima facie rates are based on industry-wide loss experience and all insurers may charge the prima facie rate – even insurers with lower-than-average loss experience. The OCI also reported that "different types of credit insurance can result in significantly different loss ratios."

Although the OCI has identified some of the reasons for some credit insurers having loss ratios far below the minimum loss ratio standard, the OCI has not taken any action to remedy the problem. In other states, regulators have addressed the shortcomings of prima facie ratemaking by establishing prima facie rates by class of business to recognize the fact that different types of lenders experience different loss ratios. In some states, regulators require all insurers to meet the target loss ratios.

The Wisconsin credit insurance statutes not only authorize the OCI to address the problems of reverse competition by establishing prima facie rates by plan and class of business, but Wisconsin Statute 424.209(2) requires the Commissioner to do so. Yet, the OCI has not carried out this legislative mandate.

Credit Unemployment and Property Rates

Although the OCI's letter to Representative Travis states that the OCI has been "proactive" in protecting credit insurance consumers, the OCI letter does not mention credit unemployment or credit property insurance. As Table 1 shows, the loss ratios for these coverages have unconscionably low in recent years. The OCI letter does not identify any action by the OCI to remedy this problem.

Single Premium Credit Insurance

In its letter to Representative Travis, OCI states that it continues to "carefully monitor . . . the sale of single premium credit life insurance in the home loan process." Yet, despite the glaring abuses of single premium credit insurance and its role in predatory lending, the OCI identifies no actions it has taken to address these problems. Rather, secondary lenders and banking regulators have turned their attention to the problems of single premium credit insurance. Although ironic that banking regulators are attempting to address problems with single premium credit insurance while the insurance regulator is monitoring the problem, the OCI's failure to address the problems with single premium credit insurance can hardly be seen as "proactive" consumer protection.

Consumer Awareness

The OCI letter to Representative Travis states, "It is important to give consumers the knowledge necessary to make informed decisions about credit insurance and how to

avoid problems." The letter also states that OCI has issued press releases on credit insurance. Yet, despite these claims, our search of the Department's web site found no consumer publications on credit insurance and only one press release on credit insurance from 1996 through the present.

Market Conduct Activities

The OCI letter to Representative Travis states, "OCI has been proactive in pursuing insurers who violate fair trade practices." The letter cites one example in which the OCI participated in a multistate examination of American Bankers. In fact, it was insurance regulators in Missouri, California and Kentucky who initiated market conduct examinations and enforcement actions against American Bankers. Further, our review of all administrative actions by the OCI from January 1996 through February 2001 revealed only one action against a credit insurer for market conduct problems – American Bankers. We found one other action of interest. In January 2000, the OCI took an action against an agent based upon "allegations of a criminal conviction substantially related to insurance marketing activities." The agent was "ordered to have his license *restricted to* credit life, accident and health until December 20, 2002."

Dramatic OCI Action Necessary to Protect Consumers

The fair regulation of credit insurance and protection of credit insurance consumers in Wisconsin requires the OCI to do the following:

1. Fix the OCI's error on credit disability rates by immediately lowering the rates to comply with the OCI's own regulation. Consumers are being overcharged by $3 million annually just due to this technical error.

2. Amend the current credit life and disability recommendation to reflect reasonable expense, profit and lender compensation provisions. A reasonable component rating analysis will produce target loss ratios of at least 50% for credit life and 60% for credit disability.

3. Address the problems with prima facie ratemaking by requiring all insurers to meet the target loss ratio or by establishing prima facie rates by type and class of business. Either of these approaches will better protect consumers from being overcharged as a consequence of reverse competition.

4. Disapprove current credit unemployment and credit property rates and require insurers to file new, lower rates. Current rates, by any stretch of the imagination, can not comply with any requirement that benefits be reasonable in relation to premium charges.

5. Address the problems of single premium credit insurance by prohibiting gross debt calculations for credit life, by prohibiting single premium coverages for terms of greater than 48 months and by introducing a single premium discount factor.

1. Credit Insurance: An Overview

Credit insurance is insurance sold in connection with consumer loans and generally pays off the consumer loan or makes monthly payments on the consumer loan in the event the consumer dies, becomes disabled or unemployed. In the case of credit property insurance, the coverage typically provides for repair or replacement of property damaged by specific named perils. The lender is the primary beneficiary of the credit insurance because the credit insurance protects the lender's loan and provides significant commission income and additional finance charge income.

1.1 Reverse Competition in Credit Insurance Markets Requires Effective Regulation to Protect Consumers

The dominant characteristic of credit insurance markets throughout the country, including Wisconsin, is *reverse competition.* The credit insurance policy is a group policy sold to a lender who then issues certificates to individual borrowers. Because the lender purchases the policy, credit insurers market the product to the lenders and not to the borrower -- the ultimate consumer who pays for the product. This market structure leads insurers to bid for the lender's business by providing higher commissions and other compensation to the lender. Greater competition for the lender's business leads to higher prices of credit insurance to the borrower. This form of competition, which results in *higher* prices to consumers, is called *reverse competition*.

A recently promulgated New York State credit insurance regulation describes this reverse competitive dynamic.

> 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.

These statements describe the most important characteristic of credit insurance markets – reverse competition.

- Credit insurance is sold to a lender who, in turn, sells the credit insurance to borrowers.
- Credit insurers rely upon lenders to present and sell credit insurance to borrowers.
- Credit insurers compete for the lenders' business by offering more compensation and commission to the lenders.
- Credit insurance is typically sold as a package of products, or coverages.
- The lender selects the package of coverages to be offered to the consumer.

In credit insurance rate hearings, the credit insurance industry has admitted that reverse competition drives up the cost of credit insurance to consumers. The following are taken from transcripts from Texas contested-case credit life and credit disability rate hearings. The witness is credit insurance industry actuary Gary Fagg.

Hearing Transcript Page 114

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.

Hearing Transcript Page 116

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.

Because of reverse competition and because of the tremendous profits available to lenders from the sale of credit insurance, there are a number of problems often found with credit insurance, including unfair and coercive sales practices and post claims underwriting. For a detailed study of problems with credit insurance, please see the 1999 study by Consumers Union and the Center for Economic Justice, *Credit Insurance: The $2 Billion a Year Ripoff*, which can be found at http://www.cej-online.org/report.pdf.

1.2 Component Rating and Reasonable Loss Ratio Standards

Credit insurers and their trade associations routinely call for component rating ratemaking instead of loss ratio ratemaking for credit insurance. With loss ratio ratemaking, the rates are determined simply by dividing claim costs by the target loss ratio. With component rating, rates are developed by determining reasonable provisions for the various rate components and then adding those components together. Component rating, as generally used by credit insurers and their trade associations, is similar to the ratemaking for most property casualty lines of insurance, such as property or automobile insurance. Credit insurers and their trade associations typically claim that component rating is the "standard" or "correct" ratemaking method and ask regulators to use this "standard" methodology.

The attempt to apply component rating to credit insurance with no reference to minimum loss ratios is misplaced for several reasons. In a normally competitive market,

one could argue that market forces reflect consumer preferences for a product and market outcomes reflect the value to consumers. Those arguments are not valid for credit insurance because of reverse competition. Further, because of the value of credit insurance to lenders and the dominant position of lenders in the credit insurance transaction, it is very reasonable to establish, as a matter of public policy, a minimum benefit for the ultimate consumer in the credit insurance transaction.

Loss ratio is the best measure of the overall value of credit insurance products to credit insurance consumers. Unlike most or all other lines of insurance, the primary beneficiary of credit insurance is not the ultimate consumer. Rather, the primary beneficiary of credit insurance is the lender. Unlike most other lines of insurance, credit insurance markets are characterized by reverse competition. In a reverse competitive market, market forces tend to drive up the cost of the product to the ultimate consumers – in contrast to normally competitive markets in which competition drives down the price to consumers.

According to credit insurers and their trade associations, any loss ratio – no matter how low – is reasonable if the rate is justified by component rating. A glaring example was provided recently. In commenting on proposed credit unemployment and credit property rates in a recent California rulemaking proceeding, American Bankers argued that the reasonable rate for two monthly outstanding balance credit unemployment products were $0.180 and $0.160, respectively. These proposed rates were developed using a component rating analysis and included estimated claim costs of $0.036 and $0.029 respectively. The loss ratios for the proposed rates are an absurdly low 20% and 18%, respectively.

If we take the component rating argument one step further, if credit insurers never paid one penny in claims on behalf of borrowers, then, according to credit insurers and their trade associations, credit insurance consumers would still be getting a good deal. Under the American Bankers proposed methodology, consumers would still be charged over $50 million in credit unemployment premiums annually in California even if expected claim costs were zero.[2]

Because of reverse competition, because the lender is the primary beneficiary and because component rating can produce absurd results, it is both reasonable and necessary to establish a minimum presumptive loss ratio for credit insurance even if a component rating analysis is used.

[2] Using a zero expected claim cost yields a proposed rate of $0.114 for both products – over a third of the current rates of $0.32 and $0.23, respectively. One-third of the 1999 California credit unemployment earned premiums of $160 million is over $50 million.

2. The Wisconsin Experience

2.1 Current Credit Insurance Rates Do Not Comply with Wisconsin Law

Wisconsin Statutes §424.209(1) provides the following rate standards:

> Notwithstanding s. 625.22 (1), the commissioner, within 30 days after the filing of any such form, may disapprove such form or rate schedule if the benefits provided are unreasonable in relation to the premiums to be charged, or if the form contains a provision which is unjust, unfair, inequitable, misleading, deceptive or encourages misrepresentation of the policy, or is contrary to chs. 600 to 646 or any rule adopted thereunder. The benefits provided by any such policy shall be presumed reasonable in relation to the premium to be charged if the ratio of losses incurred to premiums earned is, or may reasonably be expected to be, 50% for credit life insurance and 60% for credit accident and sickness insurance, or such lower loss ratios as designated by the commissioner to afford reasonable allowance for expenses for a particular plan of coverage. If the ratio of losses incurred to premiums earned is less than or can reasonably be expected to be less than the prescribed standards, the benefits provided shall be presumed unreasonable in relation to the premiums charged. Determination of the reasonable relation of benefits to premiums shall be made by the commissioner for each policy form filed for such approval.

Table 1 shows the 1995-99 Wisconsin credit insurance experience. The table shows the amount of credit insurance sold in Wisconsin by major coverage, the average payout on behalf of consumers and average commission to lenders who sell the credit insurance to consumers on behalf of the credit insurer. Table 1 not only shows that the payout on behalf of consumers has been very low, but that a higher share of the premium dollar goes to the lender as commission than goes to paying claims on behalf of consumers. Clearly, these low loss ratios are reasonable benefits in relation to premium. Further, as discussed in the sections below, the expense provisions in the credit life rates are significantly excessive and not reasonable – resulting in unreasonably high credit life rates.

Table 2 shows that Wisconsin credit insurance consumers were overcharged by almost $150 million over the last three years and continue to be overcharged by millions of dollars per year.

Table 1
Wisconsin Credit Insurance Experience, 1995-1999

	Earned Premium ($ Millions)				
Coverage	1995	1996	1997	1998	**1999**
Life	$34.3	$33.5	$42.3	$45.1	**$46.2**
Accident & Health	$63.0	$55.4	$64.9	$69.8	**$68.7**
Unemployment	$14.5	$16.9	$17.9	$22.3	**$25.6**
Property	$3.1	$3.0	$3.2	$2.9	**$2.9**
Total	**$114.9**	**$108.9**	**$128.3**	**$140.1**	**$143.4**

	Incurred Losses To Earned Premium				
Coverage	1995	1996	1997	1998	**1999**
Life	45.5%	36.9%	39.1%	38.6%	**36.9%**
Accident & Health	45.8%	45.3%	46.6%	44.7%	**43.6%**
Unemployment	16.2%	12.5%	10.3%	8.0%	**5.7%**
Property	31.5%	36.5%	25.5%	10.8%	**2.5%**
Total	**41.6%**	**37.4%**	**38.6%**	**36.2%**	**33.9%**

	Lender Compensation to Premium				
Coverage	1995	1996	1997	1998	**1999**
Life	39.3%	42.0%	43.6%	38.5%	**41.7%**
Accident & Health	37.8%	37.4%	36.9%	35.8%	**37.3%**
Unemployment	48.8%	53.8%	57.2%	56.7%	**50.4%**
Property	35.4%	30.6%	35.4%	35.1%	**36.0%**
Total	**39.6%**	**41.2%**	**41.9%**	**40.0%**	**41.1%**

Table 2
Wisconsin Credit Insurance Overcharges, 1997-1999
($ Millions)

	Earned Premiums $ Millions	Actual Loss Ratio	Reasonable Loss Ratio	Overcharge $ Millions	Needed Rate Reduction
Life	$133.6	38.2%	50%	$31.5	-23.6%
Accident & Health	$203.5	45.0%	60%	$51.0	-25.1%
Unemployment	$65.7	7.7%	75%	$58.9	-89.7%
Property	$9.0	13.3%	75%	$7.4	-82.3%
Total	**$411.8**	**36.1%**		**$148.9**	

2.2 A Reasonable Component Rating Analysis Produces A Minimum Credit Life Loss Ratio Standards of at least 50%

A glaring example of the problems with component rating for credit insurance is shown by the OCI's own credit life component rating analysis. In 1999, the most recent rate analysis by OCI, the OCI component rating analysis produced a minimum credit life loss ratio of only 39%.

When performing a component rating analysis, it is necessary to distinguish between reasonable credit compensation and actual historical credit compensation and between reasonable credit insurer expenses and actual historical credit insurer expenses. In a normally competitive market, it may be a reasonable assumption that actual historical expenses and commissions are reasonable because they resulted from a normal competitive market forces. No such assumption can be made for historical credit insurance expenses and creditor compensation. Yet, in establishing the expense provisions for credit life rates in 1995, the OCI made no mention of the impact of reverse competition in attempting to determine reasonable expense provisions.

The OCI adopted expense provisions exactly as proposed by the credit insurance industry. These expense provisions are demonstrably unreasonable.

In 1994, the credit insurance industry, through Gary Fagg, presented their case for component rating to the National Association of Insurance Commissioners.[3] The component rating formula and component values in Mr. Fagg's presentation are virtually identical to those adopted by the OCI in 1995. The order adopting the rates states, "OCI's actuary has reviewed an analysis of expense components related to credit life insurance."

[3] See "Component Rating in Credit Insurance," presented by Gary Fagg, December 1994.

In sharp contrast to the OCI's wholesale adoption of the credit industry's component rating proposals in 1995, these same expense recommendations were thoroughly rejected in a 1999 Texas credit insurance rate hearing.

The Texas rate proceeding and decision provide useful and relevant information for two important reasons. First, the Texas rate proceeding represents the most thorough hearing on credit life and health insurance rates ever held. While we disagree with some of the ultimate decisions, the hearing included:

- The provision of detailed experience and expense statistics by the Texas Department of Insurance;
- Prefiled testimony (direct, rebuttal, redirect) by five parties, including two credit insurance industry parties;
- Live testimony and cross examination of five expert witnesses before two administrative law judges over three days;
- Post hearing briefs and replies to post hearing briefs by the parties;
- A proposal for decision by the administrative law judges;
- Exceptions to the PFD and replies to exceptions by the parties;
- A hearing before the commissioner; and
- A decision by the commissioner that included over one hundred findings of fact.

Interestingly, Texas credit life claim costs are as low or lower than Wisconsin credit life claim costs. In a component rating analysis, the lower the claim costs, the lower the indicated loss ratio. Yet, despite these low claim costs, the Texas Insurance Commissioner adopted credit life expense provisions that produced credit life rates with an anticipated loss ratio of over 50%. The order is available at the following Internet address: http://www.tdi.state.tx.us/commish/co-00-0214.html.

The two most glaring errors in the OCI's adoption of the credit insurance industry's component rating analysis are the profit load and the lender commission. The OCI adopted a profit provision of +5.0% while the Texas administrative law judges and Insurance Commissioner – after detailed evidence, testimony and cross examination – adopted a credit life profit provision of –2%. The Texas Insurance Commissioner even stated that the –2% was conservative – meaning a lower profit provision was justifiable. To compensate for the conservative profit provision, the Texas Insurance Commissioner included a factor in credit life rates that lowers the rates as the term of coverage decreases – a factor that is equivalent to lowering the profit provision to about –5%. A negative profit provision means that the credit insurer earns so much investment income from premium and loss reserves that the credit insurer can pay out over a dollar in claims and expenses and still make a reasonable profit. Attachment 1 to our report shows the development of a reasonable profit provision for credit insurance and Sheet 1 show that credit insurers have earned investment income of over 17% of the premium dollar.

The other major error in the OCI's component rating analysis is an excessive commission for lenders. In 1995, the OCI adopted a fixed commission amount of 11.6 cents in the rate. This amount represented lender commissions of 35% of the rate in effect at the time. In Texas, the commissioner's order included the following findings of fact:

43. For credit life insurance, it would be unreasonable to set rates using actual commissions (35% of the current 36-cent rate) because of reverse competition.
44. A reasonable commission component for credit life insurance is 25%.

The OCI not only used an excessive commission amount in the expense provisions, but fixed that amount in cents instead of making the commission a percentage of the premium dollar. Thus, when claim costs decline, commission becomes a bigger percentage of the rate. This is exactly what happened with the January 1, 2000 OCI rate adjustment.

2.3 1999 Credit Accident and Sickness Prima Facie Rate Adjustment was Erroneous

The OCI has failed to enforce its own regulation regarding credit accident and sickness prima facie rate adjustments with a cost to Wisconsin credit insurance consumers of $3 million per year.

Wisconsin Administrative Code §3.25 (13) provides a specific procedure for the triennial adjustment of credit accident and sickness prima facie rates.

5. The credit accident and sickness insurance adjustment factor is determined using the same procedure specified in subd. 4., except that:

a. Data for the specifically described categories of credit accident and sickness insurance are summed separately for prima facie earned premium and for incurred claims;

b. A composite credit accident and sickness insurance basic loss ratio is computed as the average of the basic loss ratio for each category of coverage weighted by the corresponding proportionate amount of prima facie earned premium for that category of coverage; and

c. If the quotient of the credit accident and sickness loss ratio at prima facie rates divided by the composite credit accident and sickness basic loss ratio is greater than .95 and less than 1.05, the credit accident and sickness adjustment factor shall be 1.00.

7. For credit accident and sickness coverage, the new prima facie premium rate per $100 initial coverage for each category of coverage and for each duration

equals the then currently effective prima facie premium rate per $100 for the same category of coverage and duration multiplied by the credit accident and sickness insurance adjustment factor, rounded to the nearest cent.

An October 14, 1999 memo from Dave Heineck describes the development of the January 1, 2000 credit accident and sickness prima facie rates. The composite basic loss ratio, per 5.b., was .5946. The experience period prima facie loss ratio was .4801. The ratio of the experience loss ratio to the basic loss ratio was .8074. Applying a factor of .8074 would reduce rates by 19.3%

Because this ratio is outside of the range of .95 to 1.05, the credit accident and sickness disability rates must be adjusted per section 7. However, the adjustment factors were deemed by Mr. Heineck to produce "anomalies." The procedure to adjust rates per section 7 was then ignored. Instead, Mr. Heineck reports that a uniform factor or .85 (a 15% reduction) was employed.

The rationale for the use of the .85 was completely arbitrary and violated WAC 3.25. Mr. Heineck justified the .85 factor by calculating the ratio of the historical loss ratio *adjusted for the .85 factor* to the basic loss ratio. This calculation produced a ratio of .95. He then invented a new test for rates completely outside the regulation. He deemed the .85 factor reasonable because, if the experience period rates had been 15% lower, then the adjustment factor would have been .95 and in the "no change" range. In effect, Mr. Heineck unilaterally lowered the required loss ratio by 5% and instead of an average rate reduction of 19.3%, as required by the regulation, the January 1, 2000 credit accident and sickness rate adjustment was only a 15% reduction.

The arbitrary nature of Mr. Heineck's new test is easy to demonstrate. As the table below shows, any adjustment factor from .77 (23% reduction) to .85 (15% reduction) would have satisfied Mr. Heineck's new test. Instead of a reduction of 15%, Mr. Heineck could have picked a reduction of 23% and the resulting calculations would have produced a ratio in the "no change" range. It is interesting to note that Mr. Heineck *selected* the adjustment factor most favorable to credit insurers and lenders and most harmful to consumers.

If the OCI wanted to employ a uniform adjustment factor, then that factor should have been .807 and not .85. Based upon an estimated $70 million of annual credit disability premium in 1999, the OCI's failure to correctly implement its own regulation has resulted in overcharges of $3 million annually to credit accident and sickness consumers.

WAC 3.25 Credit A&S Prima Facie Adjustment

1	Credit Accident and Sickness Composite Basic Loss Ratio	0.5946
2	Experience Loss Ratio at Prima Facie Rates	0.4801
3	Prima Facie Rate Adjustment Factor (2 / 1)	0.8074

Mr. Heineck's Analysis

1	***Reduce Historical Premium by 15%***	0.85
2	Calculate Hypothetical Experience Loss Ratio	0.5648
3	Calculate Hypothetical Adjustment Factor	0.9499
4	Round Adjustment Factor	0.95
5	If historical rates had been 15% lower, Within "no change" range	

Alternative Heineck Analysis

1	***Reduce Historical Premium by 23%***	0.77
2	Calculate Hypothetical Experience Loss Ratio	0.6235
3	Calculate Hypothetical Adjustment Factor	1.0486
4	Round Adjustment Factor	1.05
5	If historical rates had been 23% lower, Within "no change" range	

2.4 Prima Facie Ratemaking Does Not Adequately Address the Problems of Reverse Competition

Wisconsin credit insurance regulations provide prima facie rates for credit life and credit disability insurance. Any credit insurer can use the prima facie rates and those rates are presumed reasonable for that insurer. However, the prima facie rates are based upon industry average experience. Insurers with worse than average loss experience can apply for higher rates through a deviation process. But, insurers with lower than average loss experience are able to charge the prima facie rate. And because of reverse competition, these credit insurers will not lower rates to reflect the better-than-average loss experience, but will charge the prima facie rate and pay more commission to the lender.

The problems with prima facie ratemaking – effectively one rate for credit life and one set of rates for credit disability – is shown in Tables 3, 4 and 5. Table 3 shows the 1997-1999 experience by major coverage. The table shows that single premium coverages have lower loss ratios than MOB coverages and indicate that MOB coverages should not be established on the basis of actuarial equivalency with single premium coverages but should be established on MOB experience. Table 3 also shows that the loss ratio for 7-day retro single premium credit disability is lower than the loss ratios for other single premium credit disability coverages. The loss ratio for 7-day retro coverage should be higher because of greater expected claim costs. We recommend that 7-day retro coverages be eliminated because they provide no greater consumer benefit than 14-day coverages, but cost more.

Table 3
1997-99 Experience by Coverage and Plan of Business

Coverage	Earned Premium	Actual Loss Ratio	Prima Facie Loss Ratio
Life MOB	$25.3	65.2%	63.0%
Life SP	$108.3	31.9%	31.3%
Disability			
SP 14R	$153.1	45.1%	46.3%
SP 14NR	$3.7	48.8%	56.7%
SP 30R	$1.2	59.0%	59.8%
SP 30NR	$0.6	83.2%	95.1%
SP Other	$0.7	80.5%	86.4%
SP Total	$159.5	45.5%	47.0%
MOB	$44.0	42.9%	50.8%

Tables 4 and 5 show the 1995-1999 experience for the top writers of Wisconsin credit life and credit disability, respectively. The loss ratios vary among the top writers from 10% to 95% for credit and 14% to 56% for credit disability over the three-year period. Clearly, the loss experience of different insurers varies because the experience varies by class of business. The loss experience for credit insurance sold by auto dealers is significantly lower than the loss experience of other classes of business. In Wisconsin, JMIC Life's book of business is exclusively auto dealers and its three-year credit life and credit disability loss ratios were only 11.7% and 14.7%, respectively.

Table 4
Top Writers of Credit Life Insurance in Wisconsin, 1997-1999

Company	Group	Earned Premium *($Millions)*	Loss Ratio
American General Assur Co	American General	$26.9	35.4%
Union Fidelity Life IC	GE Global	$21.5	35.1%
Union Security Life IC	Fortis	$11.3	56.2%
CUNA Mutual Ins Society	CUNA Mutual	$9.7	53.1%
North Central Life IC	American Gen	$7.7	30.2%
Pekin Life IC	Pekin Ins	$6.1	24.3%
Western Diversified Life IC	Protective Life Ins	$5.8	35.1%
JMIC Life IC	JM Family Ent	$5.7	23.4%
Associates Financial Life IC	Associates First Cap	$5.2	49.5%
Resource Life IC		$4.0	17.4%
Universal Underwriters Life IC	Zurich Ins	$4.0	20.9%
American Bankers Life Of Fl	Fortis	$3.9	59.4%
Central States H & L Of Omaha	Central States	$3.2	55.8%
Madison Natl Life IC Inc	Geneve Hol Inc	$2.7	31.6%
North American IC	Amerco Corp	$2.4	28.8%
Family Icrp	Assoc First Capital	$1.5	39.6%
American Natl IC	American Natl Fncl	$1.3	26.6%
Balboa Life IC	Countrywide Credit	$1.2	43.0%
Household Life IC	Household Finance	$1.0	50.4%
Allstate Life IC	Allstate Ins	$0.9	67.5%
Centurion Life IC	Centurion Ins	$0.9	47.9%
Life Investors IC Of Amer	Aegon Usa Inc	$0.9	17.8%
JC Penney Life IC	JC Penney Co	$0.7	25.6%

Table 5
Top Writers of Credit Disability Insurance in Wisconsin, 1997-1999

Company	Group	Earned Premium *($Millions)*	Loss Ratio
American General Assur Co	American General	$30.6	52.8%
Union Fidelity Life IC	GE Global	$28.1	39.6%
CUNA Mutual Ins Society	CUNA Mutual	$27.5	58.0%
Union Security Life IC	Fortis	$12.6	45.6%
Pekin Life IC	Pekin Ins	$10.8	46.6%
Western Diversified Life IC	Protective Life Ins	$10.0	41.3%
JMIC Life IC	JM Family Ent	$9.3	30.3%
North Central Life IC	American Gen	$9.0	44.3%
Resource Life IC		$7.8	37.1%
Madison Natl Life IC Inc	Geneve Hol Inc	$6.2	54.6%
American Bankers IC of FL	Fortis	$6.1	29.5%
Universal Underwriters Life IC	Zurich Ins	$5.7	33.8%
North American IC	Amerco Corp	$5.2	38.9%
Central States Ind of Omaha	Berkshire Hathaway	$4.5	46.8%
Family Ins Corp	Associates First Cap	$3.8	41.6%
American Natl IC	American Natl Fncl	$3.0	49.6%
Associates Financial Life IC	Associates First Cap	$3.0	42.1%
American Bankers Life Of Fl	Fortis	$2.2	33.5%
Life Investors IC Of Amer	Aegon USA Inc	$1.4	29.7%
Allstate Life IC	Allstate	$1.2	60.9%
American Health & Life IC	Citigroup	$1.0	53.2%
Minnesota Life IC	Minnesota Mut	$1.0	49.5%
Central States H & L Co Of Omaha	Berkshire Hathaway	$1.0	45.0%
Centurion Life IC	Centurion Ins	$0.9	44.5%
Merit Life IC*	American General	$0.8	70.6%
United Life IC	United Fire & Cas	$0.7	43.3%
State Farm Mutual Auto IC	State Farm	$0.7	65.0%
Balboa Life IC	Countrywide Credit	$0.6	48.1%
Allstate IC	Allstate	$0.5	60.0%
Guarantee Trust Life IC	Guarantee Trust	$0.5	45.9%

In response to Representative Travis's inquiry about very low loss ratios for some credit insurers, the OCI responded that prima facie rates are based on industry-wide loss experience and all insurers may charge the prima facie rate – even insurers with lower-than-average loss experience. The OCI also reported that "different types of credit insurance can result in significantly different loss ratios." Although the OCI has identified some of the reasons for some credit insurers having loss ratios far below the minimum loss ratio standard, the OCI has not taken any action to remedy the problem.

In addition to lowering prima facie rates, other action is needed to address the problems of reverse competition. One approach is to create rates by class of business. Under this approach, separate prima facie rates are established for auto dealers, other dealers, banks, finance companies, credit unions and all other. Several states use class of business rating, including California.

A different and superior approach is to require individual insurers to meet the target loss ratio. Under this approach, an insurer whose historical loss ratio is more than five percentage points below the loss ratio standard must file new rates that are expected to achieve the loss ratio standard. This is the parallel to credit insurers seeking higher rates when their historical loss ratio is more than five percentage points above the loss ratio standard. This approach is the most consistent with the Wisconsin credit insurance statute.

The Wisconsin credit insurance statutes not only authorize the OCI to address the problems of reverse competition by establishing prima facie rates by plan and class of business, the statutes ***require the Commissioner to do so.*** Wisconsin Statute 424.209(2) states:

> The commissioner of insurance from time to time shall raise or lower the acceptable premium charges permitted for such insurance for **any particular creditor, class of creditor or class of transaction** whenever the commissioner determines that the actual loss experience for that particular creditor, class of creditor or class of transactions produces a ratio of losses to premiums which differs substantially, based on credible data for a relevant period of time, from the loss ratio standards established by sub. (1). [emphasis added]

Despite claims of "proactively" protecting credit insurance consumers, the OCI is clearly not doing all it can to protect consumers from reverse competition.

2.5 Credit Unemployment and Credit Property Rates are Significantly Excessive

Clearly, current rates for credit unemployment and credit property insurance are excessive. As Table 1, above, shows, the industry loss ratios are far too low for rates to be considered anything but grossly excessive. Tables 6 and 7 show premiums and loss ratios by company for the two coverages. For credit unemployment and credit property, insurers file the rates with OCI. As can be seen from the low loss ratios for every company, the OCI should be disapprove each and every current credit unemployment and credit property rate filing and cause the insurers to file new, lower rates.

Several states have been successful in getting credit insurers to file lower credit unemployment and credit property rates simply by notifying the insurers that the rates are excessive and new filings are indicated. For example, the Iowa insurance commissioner recently notified insurers of excessive credit unemployment and credit property rates. In response, Allstate Insurance Company reduced unemployment rates from $0.35, $0.33, and $0.25 per month to $0.02, $0.02, and $0.01 per month and property rates from $0.15 to $0.01 per month.[4] For another example, in response to a letter from the Texas Department of Insurance, American Bankers reduced its single premium unemployment rate from $4.00 to $2.45 while more than doubling the benefits.[5] The Virginia Bureau of Insurance has had similar success.[6]

[4] Contact Ramona Lee at the Iowa Department of Insurance, (515) 281-4095.
[5] Contact Phil Presley at the Texas Department of Insurance, (512) 475-3017.
[6] Contact Mary Bannister at the Virginia Bureau of Insurance,(804) 371-9826.

Table 6
Top Writers of Credit Unemployment Insurance in Wisconsin, 1997-1999

Company	Group	Earned Premium *($Millions)*	Loss Ratio
American Security IC	Fortis	$17.5	2.8%
American Bankers IC of FL	Fortis	$15.9	8.4%
Central States Ind of Omaha	Berkshire Hathaway	$12.9	8.1%
Standard Guaranty IC	Fortis	$7.4	15.8%
Allstate IC	Allstate	$3.2	3.2%
Balboa IC	Countrywide Credit	$2.6	13.4%
JC Penney Cas IC	JC Penney	$2.0	7.5%
American General Ind Co	American General	$1.1	10.2%
Centurion Cas Co	Centurion	$0.7	5.9%
Yosemite IC	American General	$0.6	13.5%
Triton IC	Citigroup	$0.4	24.1%
Wesco IC	Household	$0.4	17.2%
Associates IC	Associates First Cap	$0.2	1.1%

Table 7
Top Writers of Credit Personal Property Insurance in Wisconsin, 1997-1999

Company	Group	Earned Premium *($Millions)*	Loss Ratio
American Bankers IC of FL	Fortis	$4.0	18.8%
Triton IC	Citigroup	$1.7	5.2%
Allstate IC	Allstate	$1.2	2.0%
American Security IC	Fortis	$0.9	19.1%
Wesco IC	Household	$0.5	10.1%
Ace American IC	Ace Limited	$0.3	4.4%
Voyager P & C IC	Fortis	$0.2	24.8%
Balboa IC	Countrywide Credit	$0.1	35.0%

2.6 The Problems with Single Premium Credit Insurance

Most credit insurance, as measured by premium volume, is sold as a single premium product. Single premium gross reducing term credit life and credit accident and health insurance premiums are calculated on the basis of the total (gross) indebtedness – the total of principal and interest payments. On longer-term loans, including car loans and home equity loans, the credit insurance premiums are substantial and are typically financed. It is no coincidence that Service Life sells single premium credit life insurance in conjunction with auto loans and has the lowest loss ratio of any credit life insurer in New Mexico.

The role of single premium credit insurance in **predatory lending** has been highlighted by recent events. In recent months, both Freddie Mac and Fannie Mae have announced new guidelines to prevent predatory lending. The refusal to purchase or securitize loans with single premium *credit life insurance* was the first item on both organizations' lists.

Franklin D. Raines, Chairman and Chief Executive Officer of Fannie Mae stated, "We have an obligation to define the loans we will not buy, and practices we will not support – practices that can have the effect of encouraging predatory lending. . . . But in light of recent indisputable evidence that some predators are taking unfair advantage of consumers and stripping them of wealth and equity, we feel an obligation to clearly state our expectations and standards . . . .Prepaid Single Premium Credit Life Insurance Policies -- Fannie Mae will not purchase or securitize any mortgage for which a prepaid single-premium credit life insurance policy was sold to the borrower in connection with the origination of the mortgage loan, regardless of whether the premium is financed in the mortgage amount or paid from the borrower's funds."

Why is single premium gross indebtedness reducing term credit life insurance so harmful to consumers? Gross indebtedness refers to the sum of all principal and unearned interest payments. With a gross indebtedness premium calculation, the credit life insurance premium is based not on the amount borrowed, but on the amount borrowed plus all the interest payments over the term of the loan. In the typical gross indebtedness credit insurance premium calculation, the insurance premium is typically financed and the premium is then based on the total of loan principal, loan interest, credit insurance premium, and credit insurance premium loan interest. To illustrate, consider an auto loan of $20,000 for 72 months at 12% interest with credit life and credit disability insurance in Wisconsin.

As can be seen from the auto loan example, the lender's use of the single premium credit insurance causes the consumer to purchase an amount of insurance 46% greater than the amount necessary to pay off the loan.

Example: Auto Loan, $20,000 for 60 months at 12%		
Single Premium Credit Life – Joint Life, Disability		
1 Loan Principal	$20,000.00	
2 Credit Insurance Premium	$1,855.17	
Life		***$904.25***
Disability		***$950.92***
3 Amount Financed	$21,855.17	
4 Finance Charges:	$7,314.20	
a. On Principal	$6,693.34	
b. On Credit Insurance	$620.86	
5 Gross Indebtedness (3 + 4)	$29,169.37	
Ratio of 5 to 1	146%	
Monthly Payment Before CI	$444.89	
Monthly Payment After CI	$486.16	

The harm to consumers increases dramatically as the term of the loan and the interest rate on the loan increase. The table below shows the calculations for single interest credit insurance sold with a 10-year home equity loan with a principal amount (before credit life insurance) of $40,000 and a sub-prime interest rate of 17%.

In this home equity loan example, the single premium credit life insurance premium is $6,938.73 – an amount added to the principal that must be repaid. The credit life insurance not only adds almost $7,000 in amount financed, but also adds over $7,500 in additional finance charges. The consumer is paying for over $97,000 of coverage – even though she has borrowed $40,000. As is evident from this example, predatory lenders use single premium credit life insurance to massively increase the amounts borrowed by consumers and, because the lenders take a security interest in the real estate securing the loan, lead consumers put their homes at risk.

Example: Home Equity, $40,000 for 120 months at 17%		
Single Premium Credit Life – Joint Life		
1 Loan Principal	$40,000.00	
2 Credit Insurance Premium	$5,940.34	
Life		***$5,940.34***
Disability		***$0.00***
3 Amount Financed	$45,940.34	
4 Finance Charges:	$49,871.54	
a. On Principal	$43,422.87	
b. On Credit Insurance	$6,448.67	
5 Gross Indebtedness (3 + 4)	$95,811.88	
Ratio of 5 to 1	240%	
Monthly Payment Before CI	$695.19	
Monthly Payment After CI	$798.43	
Sum of MOB Payments		$2,918.07
NPV of MOB 5% Discount		$2,431.78

To further illustrate the inappropriateness of single premium gross indebtedness credit life insurance, we can calculate the cost of credit life insurance paid monthly over the ten-year term of the loan coverage and based only on the outstanding principal balance. If, instead, the consumer had paid monthly credit insurance premiums based on the *net indebtedness*, the total premium would have been only *$2,200 spread out in monthly payments over the ten years of the loan*. In this example, the gross indebtedness calculation causes the consumer to pay over 50% more premium – plus thousands of dollar more in additional finance charges – than under the net indebtedness calculation. With the single premium product, the consumer pays an inflated amount up front and must finance the insurance. With net indebtedness, the premium calculation is based only on remaining principal. The consumer does not pay a premium based on unearned interest payments as in the gross indebtedness calculation.

In addition to the extra premium from the single premium coverage, the credit insurer and lenders get all the money up front, thereby earning significant investment returns that the consumer could have been earning had he or she been paying the premiums over the term of the loan. Thus, the difference in premiums understates the cost to consumers of gross indebtedness coverages compared to net indebtedness coverages.

Example: Home Equity, $40,000 for 120 months at 17% Single Premium Credit Life – Joint Life, Disability		
1 Loan Principal	$40,000.00	
2 Credit Insurance Premium	$11,174.41	
Life		***$6,617.13***
Disability		***$4,557.28***
3 Amount Financed	$51,174.41	
4 Finance Charges:	$55,553.50	
a. On Principal	$43,422.87	
b. On Credit Insurance	$12,130.62	
5 Gross Indebtedness (3 + 4)	$106,727.91	
Ratio of 5 to 1	267%	
Monthly Payment Before CI	$695.19	
Monthly Payment After CI	$889.40	

Lenders choose gross indebtedness credit insurance coverages and that choice provides substantial benefits to lenders – not to consumers. Recall that it is the lender who chooses the credit insurance products that will be offered to the consumer. The consumer is offered only to take it or leave it. The credit insurer gets the entire premium up front and the producer gets the entire commission up front. By getting the entire premium up front, the credit insurer gains significant investment income that the consumer would have gained under a monthly outstanding balance coverage. The credit insurer further benefits because the credit insurance premium is based upon an amount *50% greater* than the original loan amount. The lender benefits because the amount lent is increased by the total of insurance premium and interest on that premium.

2.7 Stopping the Abuses of Single Premium Credit Insurance

Several actions can be taken to stop the abuses of single premium credit insurance.

First, gross indebtedness premium calculation for credit life should be prohibited. Gross indebtedness calculations cause the consumer to pay credit insurance for more coverage than necessary to protect the lender's interest. Gross indebtedness calculations make the consumer pay not only to protect the lender's principal, but also the lender's unearned finance charges. The NAIC credit insurance model provides only for net indebtedness premium calculations for credit life insurance.

The NAIC model defines "Net Debt" as the amount necessary to liquidate the remaining debt in a single lump sum payment, excluding all unearned interest and other unearned finance charges. Under the "Amount of Insurance" Section 4, the NAIC model provides, "The amount of credit life insurance shall at no time exceed the greater of the actual net debt or the scheduled net debt. If the coverage is written on the actual net debt, then the amount payable at the time of loss may not be less than the actual net debt less any payments more than two (2) months overdue.

Second, prohibit single premium coverages for loans greater than, say, 48 months. Even with a net indebtedness basis, financed single premium coverages for longer-term loans are inappropriate for, and harmful to, consumers. A requirement for monthly outstanding balance insurance on longer-term loans is not unreasonable. Citibank, in an effort to gain approval of its merger with the Associates, a sub-prime lender, offered to make monthly payment credit insurance available to all credit insurance consumers. The Commissioner currently has statutory authority to implement such a prohibition because 62.B.07 requires the Commissioner to disapprove products that are unfair and unjust.

Third, introduce a single premium discount factor. Any single premium credit insurance rate should be adjusted downward for an interest and mortality discount. The interest discount is appropriate because the credit insurer is able to earn significant investment income on the single premium paid up front in comparison to the monthly outstanding balance approach. The consumer should not be harmed by losing the investment income on the amount of credit insurance premium because the lender chose a single premium product instead of a monthly outstanding balance product. The Commissioner currently has authority to require a single premium discount factor because 62B.07 requires the Commissioner to disapprove rates that are excessive.

A mortality discount is also appropriate because the full single premium is earned by the credit insurer if the borrower dies. Thus, if a borrower dies two months into a 60-month loan, the credit insurer earns the entire 60-month premium. In comparison, a consumer who dies two month into a loan based upon monthly outstanding balance premiums will pay only two months of credit insurance premiums.

The discount factor used for interest and mortality discount can also be used to reduce rates as loan term increases. Because some of the costs of issuing a credit insurance policy are fixed, lower rates per year with longer term coverages is necessary and reasonable.

The following formula is used to develop the interest/mortality/term discount factor for single premium credit life rates. This factor is applied to the single premium credit life rates:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.045)n}{24}}$$

where n equal the coverage term in months.

The following formula is used to develop the interest/term discount factor for single premium credit disability rates. The factor is applied to single premium credit disability rates:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.0563)n}{24}}$$

2.8 Consumer Education and Market Conduct

The OCI letter to Representative Travis states, "It is important to give consumers the knowledge necessary to make informed decisions about credit insurance and how to avoid problems." The letter also states that OCI has issued press releases on credit insurance. Yet, despite these claims, our search of the Department's web site found no consumer publications on credit insurance and only one press release on credit insurance from 1996 through the present.

The OCI letter to Representative Travis states, "OCI has been proactive in pursuing insurers who violate fair trade practices." The letter cites one example in which the OCI participated in a multistate examination of American Bankers. In fact, it was insurance regulators in Missouri, California and Kentucky who initiated market conduct examinations and enforcement actions against American Bankers. Further, our review of all administrative actions by the OCI from January 1996 through February 2001 revealed only one action against a credit insurer for market conduct problems – American Bankers. We found one other action of interest. In January 2000, the OCI took an action against an agent based upon "allegations of a criminal conviction substantially related to insurance marketing activities." The agent was "ordered to have his license *restricted to* credit life, accident and health until December 20, 2002."

Other states have been far more active in identifying and stopping credit insurance abuses. The CEJ / CU report cites several examples by the California and Texas insurance departments.