

The Center For Economic Justice

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May 8, 2000

David Parsons
Commissioner
Alabama Department of Insurance
201 Monroe Street, Suite 1700
P.O. Box 30351
Montgomery, AL 36130-3351

By Fax (334) 241-4192

Re: Credit Property Insurance Working Group

Dear Commissioner Parsons:

The Center for Economic Justice (CEJ) offers the following initial comments for your consideration regarding the development of a credit property insurance model law and regulation. CEJ has extensive experience in credit insurance matters generally and in credit property insurance, specifically. The March 1999 report by CEJ and Consumers Union provided a detailed analysis and discussion of credit property insurance, including a review of credit property insurance regulation in ten states. The report is available on our Web site at <http://www.cej-online.org/credit.htm>.

Problems with Credit Property Insurance

Credit property insurance regulation suffers from the same problems as other credit insurance coverages, including excessive rates and unfair and coercive sales practices. There are additional problems with credit property insurance, due to the fact that the coverage is related to “property” and that there is little regulation of the product:

- *Phantom coverage* refers to premium calculations based on amounts in excess to the amount of coverage provided. One example occurs with credit card credit property insurance because the premium calculation is based on the monthly outstanding balance. However, the outstanding balance typically includes any number of items that are not covered property under the credit property insurance coverage, such as meals, finance charges, and services. Consumers pay for *phantom* coverage – they pay the premium but get no coverage in return.
- *Loan packing* refers to the practice of lenders of adding to, or “packing,” the amount financed by a consumer through the sale of expensive, unnecessary and often unwanted products, such as credit insurance. Lenders have great incentive to pack credit insurance because of the large commissions and lack of adequate regulation.

Adding credit insurance allows insurers to increase the amount financed, in some cases allowing them to surpass statutory thresholds that allow the lender to take a security interest in the home. Lenders' use of *single premium gross indebtedness products* is often a part of predatory lending practices.

- *Overvalued Collateral* occurs when lenders overvalue the property used as collateral or take an interest in collateral solely to sell credit property insurance on the property. The collateral may be worth very little relative to the loan amount, but the lender may sell credit property based on overvalued collateral, or an amount higher than the loan amount.
- *Lack of Consumer Protections* results from the fact that, in many states, *credit property insurance is simply not regulated*.

We suggest the following items for inclusion in a model law and/or regulation.

1. Adequate And Clear Definitions Of Coverages Subject To Credit Property Insurance Regulation.
2. Provide Effective Consumer Disclosure, Not a Shield for Unfair Practices. Most consumer disclosures are worse than inadequate. Effective consumer disclosures must include monthly statements to the consumer, printed on the credit card or other billing notice, regarding the voluntary nature of the coverage, the cost of the coverage and the average expected loss ratio for the coverage.
3. Prohibit Gross Indebtedness Premium Calculations. Consumers should not be required, at the lender's choice, of paying credit insurance premium for coverage beyond that necessary to protect the lender's interest.
4. Prohibit the Sale of Duplicative Insurance. Consumers should not only be informed that coverage is not needed if they carry other insurance, but creditors should not be permitted to sell duplicative insurance if the consumer already has the relevant coverage.
5. Limit Credit Property Sales to Purchases Over A Minimum Amount. Prohibiting the sale of sale of credit insurance on loans for purchases under a minimum amount, such as \$1,000, will discourage insurance packing and eliminate unnecessary sales of credit insurance for very small loan amounts.

6. Limit Premium Calculation to Durable Personal Property. Phantom coverage must be eliminated by requiring that credit insurance premium calculations be based only on the cost of items actually covered by the insurance. One approach is to define durable personal property and require that premium calculations be based only on purchases of durable personal property.
7. Limit Premium Calculations to the Lesser of Purchase Price or Loan Principal Amount. Premium calculations should be based on the lesser of the purchase price or the original debt amount, which is the remaining principal at the time of policy issuance. This will help ensure that the basis for premium calculations is related to the coverage provided and protect consumers from overcharges and phantom coverages.
8. Prohibit Post-Claims Underwriting. Credit insurers should be prohibited from denying coverage after a reasonable period of time in which they can verify representations made by the consumer. Post-claims underwriting should be declared an unfair trade practice.
9. Establish Minimum Loss Ratios and Enforce The Standards. Although higher standards are reasonable, the rock-bottom minimum loss ratios of 60% for credit life and disability and 75% for credit unemployment and credit property insurance should be enforced. Further, credit insurers who substantially fail to meet these standard should be required to rebate excessive premiums to consumers.
10. Enact Additional Prohibitions and Stronger Penalties Against Credit Insurers for Unfair and Coercive Sales Practices. For example, credit insurers should be prohibited from selling credit insurance until *after* the underlying loan has been made.
11. Provide Consumer Choice. Credit insurers and lenders should be required to offer consumers a choice of purchasing individual coverages instead of only a complete package of coverages.

We look forward to assisting you and the members of the working group by providing a consumer perspective and our technical expertise. Thank you for your consideration.

Sincerely,

Birny Birnbaum