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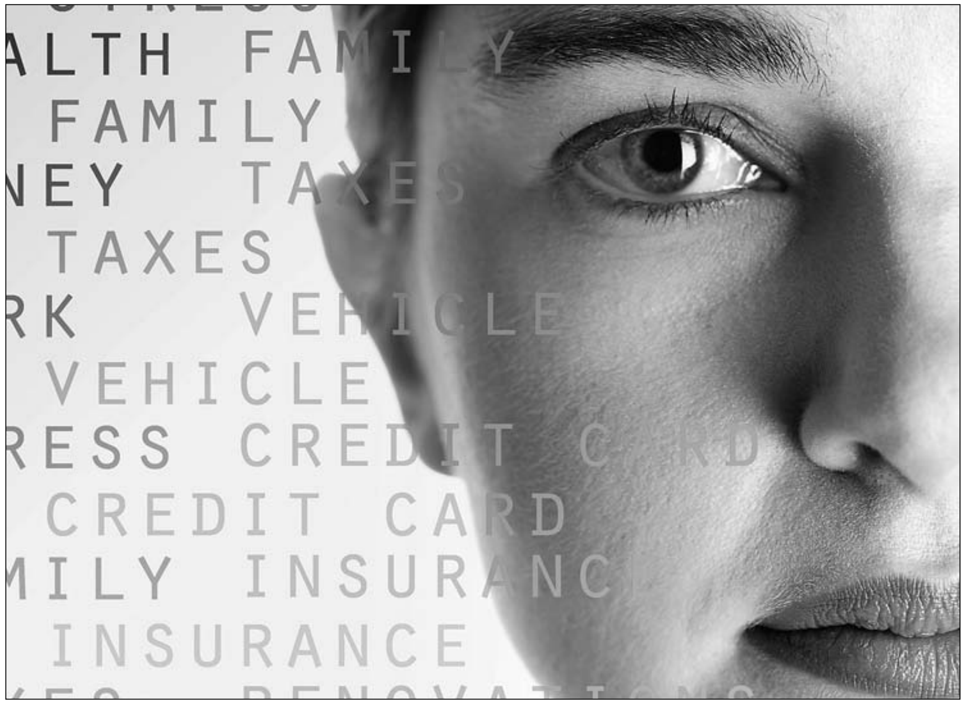
What's New in Credit Insurance?

by Chris Hause



The Emergence of Debt Protection

Of course, the biggest news of all in the credit insurance business is the continued emergence of debt cancellation and suspension ("debt protection") business as a competing product.

For those of you who aren't entirely "in the know," debt protection was legitimized by the Gramm-Leach-Bliley Act (GLBA) as a permitted activity for national banks. By adding an addendum to their loan agreement, a bank may agree to cancel or defer all or a part of the debt upon occurrence of certain events. Due to parity laws and actions by their respective regulatory bodies, most state chartered banks and credit unions may also offer this benefit without involvement of an insurer.

The primary source of debt protection remains in the credit card business. This is true with retail cards as well as bank cards. The benefits start with the "traditional" credit insurance coverages of life, disability and unemployment. However, today the typical credit card debt protection program will have limited monthly benefits for marriage, divorce, national disaster, call to active military service, nursing home and hospital confinement.

The regulation of debt protection contains a great deal in the way of disclosure to the consumer, but very little in limiting the types of benefits offered, and the fees charged for these benefits.

Many of the credit card issuers retain 100 percent of the risk contained in their debt protection programs. However, as other types of loans become covered, such as installment, home equity and mortgage, banks will be increasingly looking to contractual liability policies to "reinsure" or share the risk.

Probably the biggest impediment to the unrestrained growth of non-insurance debt protection is the requirement that the lender offer a "bona fide monthly alternative" to single premium debt protection. This requirement took many lenders by surprise. Many lenders providing smaller and shorter-term loans can simply not provide coverage due to the economics of very small loans. Additionally, the majority of bank loan origination and administration software was not ready for monthly credit insurance premiums.

Home Ownership and Equity Protection Act

This requirement was a reaction by the regulators to the other major movement affecting credit insurance production. This movement started primarily on a local and state level and goes by the name of "predatory lending." This rather dramatic moniker has come to mean the underhanded practice of loading up a sub-prime loan with nonrefundable fees and eroding the equity in a real estate secured loan. This movement became nationalized with the Home Ownership and Equity Protection Act (HOEPA), which shed national attention on the issue. HOEPA increased regulation and cast a negative shadow on any loan secured by real estate where the up-front financed fees and charges exceeded a certain level. This included financed (single premium) credit life and disability insurance in spite of the termination value of the coverage.

Those lenders that continued to provide credit insurance coverage on real estate secured loans did so primarily on a monthly premium basis, either with a level payment or one based on the outstanding balance. But more often, these loans now are going entirely uncovered. Part of the problem here is the same issue that is stalling efforts to write debt protection on installment loans: quoting and administration of the monthly premium insurance. However, with real estate secured loans, the economics are more justifiable than in the small loan market.

Between GLBA and HOEPA, these two events caused an overall decrease in the credit life and disability written premium of some 30-40 percent industry wide.

The good news is that for now, written premium levels seem to have stabilized, albeit at a much lower level. It was reported recently that the credit life face amount issued actually went up in 2004.

Statutory Reserving Standards

On the valuation side, there have been two major events in the setting of reserves for credit life and disability insurance.

Credit Life Mortality Basis

On the life side, the NAIC has adopted, and some states have followed suit with, a model regulation dealing with credit life insurance. This was the culmination of many meetings and negotiations between various regulatory actuaries and industry representatives.

The model prescribes the use of the 2001 CSO Male Composite Ultimate Table, with dynamic valuation interest rates and the Commissioner's Reserve Valuation method. As demonstrated in the report by the SOA's Credit Insurance Experience Committee, the 2001 CSO table sets liabilities at a significantly lower level than the prevailing standards of 1958 and 1980 CET tables.

Credit Disability – Morbidity-Based Reserves Take Hold

For credit disability, after an extensive study of credit disability claim cost experience, the industry had proposed use of the 1985 CIDA Table as a morbidity basis for single premium credit disability insurance. This is the first table specifically recommended for credit disability. The standard that is now a part of the Model A&H Valuation Regulation contains a 12 percent margin over the base table, and uses the 14-day table for all waiting periods 14 days and longer. The interest rate to be used is the dynamic "whole life" rate.

A follow-up study to the 1997 disability study was recently completed by the Credit Insurance Experience Committee. The report is now available on the SOA Web site. The study shows trends in the business since the earlier study and confirms the conservatism in using the 1985 CIDA Table, as modified, for valuation of single premium credit disability.

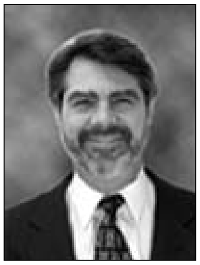
The model allows for a revaluation of in-force reserves, since this is the first table of its kind, but some states may not allow a revalution.

It has been estimated that, on an industry-wide basis, adoption of the new basis will allow a release of redundant reserves equal to approximately 25 percent of current reserves. The model allows for a revaluation of in-force reserves, since this is the first table of its kind, but some states may not allow a revaluation.

While there are still some issues to be settled, the disability standard has been adopted in several states. This (because of the "state of filing" language in the actuarial opinion) makes the calculation of single premium reserves on the morbidity basis a necessity for most writers, even though actual reserves held may be based on the unearned premiums.

The Horizon

Credit insurance continues to be an evolving coverage in many ways. The future may produce an entirely different benefit package and delivery system from the current environment, but I feel sure that loan protection will continue to be an important product for providers and consumers alike. ●



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