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Give Me Some Credit! The 50-Year History of Credit Regulation

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Summary: A lot has changed over the last 50 years with respect to credit insurance. The presenters review some of the highlights of this history, including:

- *How credit insurance regulation has developed over the years since the first of such regulations was passed in 1949*
- *How consumers' attitudes toward credit insurance have changed since the first survey of such attitudes was conducted by the state of Colorado in 1951*
- *How the products and marketplace have changed and grown over the years*
- *How the Consumer Credit Insurance Association has evolved since its founding in 1951*

The panelists then look into the future to discuss where the credit insurance industry is heading in such areas as the development of new products, consumer attitudes, further changes in regulation, and new methods of marketing the products.

Mr. Robert J. Butler: We are going to talk about where credit insurance is today, how we got there, and where we think we are going in the future. We are going to cover more than credit regulation. We will cover all aspects of credit insurance: the product, the market, and the consumer attitude.

Since I have a captive audience, I want to digress for a second. I am going to discuss briefly the credit valuation standards. Right now there is no model credit valuation standard. It is state regulated. In my opinion, the current valuation laws are onerous. The common requirement for credit life is a mortality reserve based

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on 130% of the 1958 CSO. For credit disability we must hold the gross unearned premium reserve. I am a member of the Consumer Credit Insurance Association (CCIA) Actuarial Committee, and we are promoting the use of the 1980 CSO for credit life. I personally would like to see us change the NAIC's model valuation law for individual life to include provision for credit life and allow us to use the table for extended term insurance.

I am on a working group of the CCIA consisting of Steve Ostlund, Chris Hause, and Craig Squire. We have been working on building a credit morbidity table that can be used for valuing credit disability policy reserves. The table also can be used for valuing pending claim reserves. We are seeking the endorsement of the SOA. They have named Gary Fagg to head up a working group to give it a peer review. We have created a binder with other memorabilia dealing with credit insurance. I'll let Gary talk about the memorabilia that have been put on display.

Let me introduce our three speakers. First will be Gary Fagg, president of CreditRe Corporation. His company provides consulting service to the NAIC, the board of directors of the CCIA, numerous credit life insurance companies, and various state insurance departments such as those of Ohio, Pennsylvania, and Rhode Island. Gary has written a number of books. He wrote the first book on credit insurance titled *Credit, Life, and Disability Insurance*. He also co-authored a book with Joe Fairchild titled *Credit-Related Property and Casualty Insurance*, and he recently authored *Money on the Table*. Gary has also provided expert testimony at regulatory hearings and at the NAIC on credit insurance products. He is a graduate of the University of North Carolina.

The next speaker will be Bill Burfeind. He is the CEO of the CCIA. He has held that position since 1978. Prior to that he was pursuing a successful career in government affairs for the American Insurance Association (AIA). He is the key spokesperson for the CCIA. He promotes public policy goals before national forums, including the NAIC. Bill has a B.S. in business administration from Valparaiso University and a J.D. from John Marshall Law School.

The third speaker is Bruce Camacho. Bruce currently is the group executive vice-president and chief marketing officer of the Assurant Group. The Assurant Group is a two-month-old company that is the merger of American Bankers Insurance Company and American Security Group. The group is a wholly owned subsidiary of Fortis. Prior to the merger Bruce had many executive positions at American Bankers. His prior positions were the executive in charge of government affairs, head of international development, head of our information services department, and head of investor relations. I hold him chiefly responsible for the $55-per-share price that we got for American Bankers Insurance Group, which I appreciate very much. Prior to joining American Bankers he worked at Price Waterhouse. He is a graduate of Pryor Park College in Bath, England. He has his B.S. from Florida State University. He is a member of the AICPA and a member of the Florida Society for CPAs.

Mr. Gary T. Fagg: We are going to take a brief tour of the 70-year history of the credit insurance industry, its growth, and how the industry evolved. We are a producer-controlled industry, much more than any other segment of the insurance industry. We are dominated by our producers. It has been an interesting evolution of how the insurers basically gave control from the insurance company to all the producers.

For those of you who have not spent a lot of time on credit insurance, we are talking about some very simple concepts and products. We have 50 million policies in force. If you ask anybody who has policies in force what this product is all about, you will get a simple answer: When I die, I get the loan paid off. If I become disabled, I get my monthly loan payment made for me. If I get involuntarily unemployed, I get my monthly loan payment made for me. If I buy something or put something up as collateral, the credit property insurance product will repair or replace it if it gets destroyed or damaged.

We are talking about consumer credit. We are not talking about first mortgages. Credit insurance generally covers all loans except first mortgages. Everywhere you have the opportunity to buy consumer goods and to finance the purchase of those consumer goods, you are going to have the opportunity to buy credit insurance. People have taken the opportunity for many years to sell credit insurance where they sell consumers the goods or where consumers are doing their financing. The credit insurance producers are not like the rest of the insurance world, where you have a professional who is trained to sell insurance. The credit insurance is being presented by the people who are generally there to do something else, such as sell goods and make loans.

The question is, How did we get to where we are today? I'll give you the bad news first. We were invented by a lawyer. He was a pretty good lawyer, a pretty interesting guy, and a pretty interesting lawyer. His name is Arthur Morris. Morris had a legal practice in Norfolk, Virginia, around the turn of the century. At that time the only way you could get credit from a bank was to prove to it that you didn't need it. You could not borrow money from a bank unless you had unimpeachable collateral, so people were coming to Morris and saying, "Help me get a bank loan." As a result, Morris sent people throughout the country and discovered that working people had no ready access to credit.

He then formed a bank in Norfolk, Virginia, on the idea that every working person who could show good character and the ability to repay the loan should have the opportunity to borrow money. His bank did not take deposits. Instead, he went to investors to put the money in the bank that he could then lend out. Morris had some friends in Atlanta. He went down, and together they formed a bank in Atlanta about the time the Atlanta papers had a big exposé on loan sharks.

The papers portrayed Morris's bank as a viable alternative to loan sharks. He then got the idea of franchising. We are talking 1915, and this guy wants to franchise. Morris went to New York and met with the major financiers of the country. At that time you could literally get them all in a room. Morris told them his ideas, and they said, "Let's do it. We will support your doing it." They agreed to form a New York bank, and Morris would travel the country. He would meet with local businesspeople and get them to put up 75% of the ownership to form a local Morris Plan bank.

To hear Morris tell the story in his writings, the local businesspeople asked, "What are we going to call this?" And one of the people said, "Of course, we'll call this the." Morris said, "No, I am far too modest to accept that." Well, I talked with several people who knew Arthur Morris, and they said, "Believe me, he is the most egotistical person you could expect to meet. He would have nothing to do with it unless it was named a Morris Plan bank."

Morris started traveling the country. He started in the Mid-Atlantic states, went across the Midwest, and then dropped down through the center of the country. At the peak there were about 200 Morris Plan banks. Morris was very successful and had a very good experience. But eventually he realized that when you have consumer lending, you basically have an unsecured loan, and the collateral of a consumer loan is the earning power of the insured. Like any good banker, which is what he had become, he asked, "What can impeach my collateral?" He realized that death, disability, and unemployment were the things that could hurt the collateral of the consumer loan, so he decided he needed to insure these debts. Morris came into New York again and this time met with the actuaries and the other people at Metropolitan. He explained about the group of borrowers he wanted to insure. The actuaries said, "No, that sounds a little squirrelly to us." And so he went across the river and saw the people at Prudential. They also said, "No, I don't think we want to do that." He then went back to his financiers and said he wanted to form an insurance company, and he did.

The only mistake he made was forming a New York insurance company. He formed the Morris Plan Insurance Society as a New York company in 1917, and the first group credit policyholder, of course, was good old A.J. himself. Morris began to market his credit life product. He had a disability product also, but it was really a totally and permanent disability product. What Morris developed was not like any of the credit life insurance you have seen today. It was basically one-year term insurance with age-banded rates, and it had weekly premiums. It was not the credit insurance we know, but ultimately Morris was very successful. The company still exists as Banker Security Life Insurance Company in Washington, D.C.

One of the stops of Arthur Morris as he began his travels in 1917 was the industrial town of Springfield, Ohio. Back then it was actually one of the biggest cities in Ohio. The local businesspeople formed a Morris Plan bank, but they didn't really like Morris. Morris was very aggressive and very brusque, and these were good old midwestern folks. They chose not to participate in the Morris Plan Insurance Society. I know the chairman of the board who was there for 55 years. He swears this is true: they literally had a cigar box, and every time they made a loan they took a dollar and put it in the cigar box. Every time someone died they took the money out of the cigar box and paid off the loan. That was basically debt cancellation insurance.

In 1926, a bank examiner came in and said their practice was really insurance, and they could not do that without an insurance company. The local bankers went over to Columbus and said they wanted to form an insurance company. They explained the concepts of borrowers and insurance to them. The insurance department said, "No, that sounds a little screwy to us," so the bankers met with one of the prominent lawyers there in town. The lawyer said, "This sounds like group insurance." Group insurance had only been around for about 15 years at this time, and he said, "Let's go back." They went back and approached the insurance department again with the idea of a group insurance policy. They formed in 1926 the Credit Life Insurance Company, and they wrote a group insurance policy. That policy was the first group credit policy, and it is basically the credit insurance that you see today. Basically, the way they designed and operated credit insurance at Credit Life Insurance Company of Springfield is basically the way you are still doing a lot of credit insurance today.

They weren't quite as imaginative in coming up with their motto. It read, "Insurance on the life of the creditor in favor of the creditor." Credit Life Insurance Company took the red out of credit and the if out of life and put the aid in paid. I know the chairman of the board. I can see him writing this today. The company continued, and that's where I grew up and worked for many years. It is now Union Fidelity Life Insurance Company, which just exited the credit insurance business.

The next year, 1927, Prudential developed an arrangement with National City Bank, which is now Citigroup. It wrote what is called a *noncontributory policy,* where the bank paid the premium on behalf of all of the borrowers. The cost of the product, of course, was absorbed as a part of the cost of running the operation. In 1927 Prudential entered the credit insurance business, and for many years it was a major player in the industry.

In 1948 it entered into the GMAC group policy, where it insured the borrowers of General Motor Acceptance Corporation's loans. For 30 or 40 years this was the largest group policy in the world. The last of the original credit companies was CUNA Mutual. The credit union movement was starting to gather steam by the late 1920s. In 1935 the credit unions came together and formed CUNA, the Credit Union National Association. Once the association was formed, it formed CUNA Mutual Insurance Societies. Within two or three years it was the largest provider of credit insurance in the country and still has a very dominant role in the credit union marketplace. Today it has about a 70–80% market share of the credit union market. The earliest policy that it could find dates back to 1935. The imprint of what it calls "the little man" was the motto of CUNA Mutual for many years, representing the lending and the insuring of the lives of just working-class people.

I have been fortunate over the years to collect a lot of the history of this industry. I now own the earliest known credit insurance policy. I have an Arthur Morris policy from 1919. I have one of the articles from a 1953 issue of *Better Homes and Gardens* extolling the virtue of credit insurance and of worry-proofing your debt. There were four, five, or six companies in the credit insurance industry by 1940. We went into World War II and, of course, consumer borrowing just went kaput. Credit insurance almost died. Coming out of World War II there was an explosion of consumer products, and we had institutions willing to lend that money. Finally, we had other insurers that wanted to become credit insurers. Banks for the first time stepped into consumer lending. Also, the credit insurance industry grew so that by 1955 there were hundreds of companies in the credit insurance business.

But at that time the insurance company was truly an insurance company. It issued the policy, and it owned the financial risk that was being insured. It had a good time. It had a gross margin, including expenses of about 20% of premium. The chairman of the board of Credit Life of Springfield lived until he was 85. He didn't have a lot of wear and tear. It was a very profitable place. He was a very successful gentleman. He paid the producer a front commission only. All of a sudden the producers had many people knocking on their doors for their credit insurance business. That started a rumble in the industry that has continued unabated through today.

The producer started saying to the credit insurance industry, "More money. Give me more money. I have to have more money." Basically what happened with all these people coming into the industry was a situation where the producer was talking to the credit insurance salesperson, and the salesperson was saying, "We want to be your credit insurance company. We have just gotten in the industry. We are here to serve. We are going to give great service." The producer said, "We have a credit insurance company, and it is doing well." Finally, that salesperson, as all good salespeople, would say, "What does it take to get your business?" The producer said, "More money. Give me more money." And so gradually the levels of front compensation just kept going up and up. Finally, after ten years of that competition, we reached the point where the front commissions were no longer acceptable.

In time we had a lot of the producers beginning their own insurance companies, particularly in the consumer finance market. The small finances companies were beginning to form their national, and later their international, operations. They were selling a lot of credit insurance, and they realized how profitable our business was.

Finally, the producer said to the insurance industry, "You have to share the underwriting profits with me"—the underwriting profits being the premiums, less the claims, less the compensation, less something for the direct-writing insurance company. We developed underwriting profits. Eventually the salesperson said, "I am authorized to share those profits with you." And the producer said, "This is great, this is good, you have the right idea, but share." The salesperson thought, "Wait a minute, how are we going to share it?" Maybe the insurer/salesperson said, "We'll split it 50/50." And the producer said, "Absolutely not. I want 100% of the profits." And the salesperson said, "OK, no problem."

The salesperson probably reported to the home office, "This is great. We have a new account. It's going to be the biggest thing. It's going to put us on the map, but I had to be willing to share the profits." And the executive team said, "OK, but how are you going to share it?" The salesperson replied, "I told them we'd give them 100% of the profits. Well, we have to get in the market. We have to have market share."

The executive team went on, "OK, you can do it. But what if there are losses?" The salesperson said he hadn't thought about that, and he went running back to talk to the producer. "You are going to get 100% of the underwriting profit, but what if there are losses?" The producer said, "You are the insurance company. That's your problem. You have all the losses." What did the salesperson say? "OK, no problem, we'll do it."

That is basically what retroactive compensation was all about, and that calmed things down for a long time. But then the rumble began again. The finance companies began to grow to where they were producing dramatic amounts of credit insurance. They began to say that the insurance companies were making so much money. Years ago I remember hearing a Louisiana automobile dealer who was making a 65% commission tell me that insurance companies make so much money. I was on a conference call about five months ago with insurance people in Australia, and I was saying the producers down there just don't understand the economics. They said, "Yeah, mate, but you have to understand we insurance companies are making so much money."

It's a universal thing that everybody thinks the insurance companies are making so much money. The finance companies believed the insurance companies were still getting 15% of premium plus the investment income, and they wanted more. "You are making too much money. What are you going to do?" The credit insurers said, "There's nothing left but for you to be the insurance company." The finance companies said, "Fine, we will do that. Show us how."

The credit insurers started showing them how. They said you have to form a company in one state, you have to get it licensed in all the states where you want to do business, and you have to file a policy and get that policy approved everywhere you want to do business. "Whoa!" said the producer. "What are you talking about? That's work. We don't want to work. We just want all the money. Surely you can come up with something better than that."

And what did we come up with? We came up with the idea of producer-owned reinsurance companies. Starting in the 1950s we went to Arizona and began to form reinsurance companies. I think the first finance company probably formed a reinsurance company around 1953. Valley National Bank was really the first bank holding company that formed a reinsurance company, around 1956. The credit insurer now issued and administered the policy, but now transferred all of the financial risk to the producer-owned reinsurance company.

What has evolved in the last 40 years is that virtually every major bank holding company has its own Arizona reinsurance company. Every major automobile dealer in this country has its own reinsurance company in either Arizona or offshore in the Caribbean. Or it is in a multiclass or exotic reinsurance company, where you have an insurance company generally formed by the direct writer, and each producer of credit insurance gets a share of stock. There are a good 2,000 automobile dealers that own a share of multiclass stock, and there are probably another 2,000 that have their own stand-alone reinsurance company.

The finance companies are in a similar situation, but now most of the finance companies, particularly the larger ones, have evolved to where they have become the direct writers. The credit insurers today have become very concentrated. The top 15 groups now write 83% of the credit insurance market, and Bob and Bruce's company, the Assurant Group, has a 33% market share. CUNA Mutual is nominally owned by its producer. It's owned by the credit unions. Associates is owned by a finance company. Allstate was formed by a retail producer for its own business. American General is owned by a finance company. Citigroup is owned by a bank holding company, and Household and Beneficial groups are owned by a finance company.

Throughout the top 15, about half of the companies are direct-writing insurance companies owned by the producers. They exist solely to provide the credit insurance for those producers. Most of the other credit insurers are totally out of the risk-taking business. The risk in one form or another is passed to the producer through either retroactive compensation or through reinsurance. I estimate that 75% of the total financial risk of the credit insurance industry is passed along to the producers in one form or another.

Mr. William F. Burfeind: Gary described the product as simple, and certainly what you saw was pretty simple. We have often thought that the product is a very simple product, yet the regulation that has grown up around this product is not so simple. The product represents less than 1% of all the insurance premiums written. I am sure that those of you who are from state insurance departments or have worked with the credit insurance product over the years realize that a lot more than 1% of the industry time is devoted to the regulation of the credit insurance business.

My task is to try to take 50 years of continuously mutating credit insurance regulation and somehow boil it down to something that is comprehensive and meaningful. In almost every 1 of those 50 years there was some influence affecting the business. If I were to trace all those influences and all those outcomes, we would get totally lost. I'm going to go back and hit what I think are some of the higher points in terms of influences and outcomes.

I have looked at that 50-year period and decided it breaks down into about six periods. I have labeled the first period the "awakening," which ran from about 1944 to 1954. This was a time when the need for credit insurance regulation was recognized and some initial steps were taken to get some regulation in place. The next period I call the period of "diplomacy," which ran from about 1954 to 1969. In one way or another most of the discussion during that period had to do with how the credit insurance rates were going to be regulated. The competing forces and interest in the debate and the diplomacy were really between insurers with different points of view and between insurers and regulators that did have a common interest in getting a regulatory scheme in place that sustained the business and protected the consumer.

The third period I call "consumerism," and that is roughly the decade of 1970–80. Consumerism does continue on well past that decade. We are still in a time of consumerism in many respects, but that was the period of time in which consumer influence began to emerge not just in our business but in other businesses as well. In the early to mid 1970s I was with the AIA lobbying the legislature in the state of Illinois on behalf of big property and casualty companies. There were a few self-proclaimed consumer advocates active in Springfield working the legislature. For the most part, they did not get much respect from the legislators. They had no clout and were often ridiculed and dismissed almost out of hand. They began to get clout when they cultivated the consumer reporters within the various media. Once what they were saying was broadcast in their home district on television or in newspapers, the legislators began to take notice. Suddenly what the consumer advocates had to say had a lot more merit. They became a new player and another party to negotiate with.

The fourth period, from about 1981 to 1989, I will call the period of "survival." You might recall that this was a period shortly after Ronald Reagan was elected. We had the recession. The financial services went through a period of inflation. There were very few loans being written at that time. You can't have high interest rates and make loans; therefore, you cannot sell the credit insurance. A lot of companies were looking for a way to survive. That was also the period in time in which a number of mergers and acquisitions took place. Some companies exited from our business at that time. That activity hasn't abated. The industry has continued to consolidate.

The fifth period I call "revelation." The period of revelation ran from 1990 to 1995. I think the most significant event that caused me to name the period "revelation" was in the regulatory environment. Finally people realized that a loss-ratio standard is not always attainable. You begin to recognize that you cannot just apply a loss-ratio standard to claim cost and generate an adequate rate. People began to look at some alternative ways to regulate the credit insurance business.

Last, from about 1996 on, is the period that I simply call "new directions." We are seeing some new products emerging and, perhaps, some new direction in regulation. I want to touch on some of the new directions. I'm not going to say much on new products, because the next speaker will cover this.

Let me go back through these periods and just hit on some of the things that I think in retrospect were significant influences with significant outcomes. The first probably does not need a lot of explanation. It has to do with the Supreme Court case *U.S. v Southeastern Underwriters* in 1944. The case essentially declared that insurance was interstate commerce and subject to federal regulation. State regulators didn't like it. The insurance industry didn't like it. The reaction was the quick enactment of the McCarran-Ferguson Act by Congress, which said that to the extent that the insurance business is regulated by the states, the federal regulation is preempted. Our business at that point wasn't regulated very much. There was a common interest between the insurance industry and state regulators to put in place regulation and keep the federal government out.

Another influence at that time was the National Association of Small Loan Supervisors. It was inviting the states to legislate that loan companies could sell insurance. Those of us involved in marketing credit insurance through small loan companies certainly had an interest in seeing that small loan companies could continue to sell insurance. We needed to get involved in the activity as well. In 1951 the CCIA was formed to aid and abet the credit insurance business in any and all proper means.

In 1952 there also was the first, to my knowledge, consumer survey taken on credit insurance. It was a simple survey conducted in the state of Colorado, with three or four simple questions on a postcard. The essential conclusion was that this was a product that people liked, thought was a good idea, and would buy again. Those same types of results were repeated through subsequent studies as well through the years.

From 1951 to 1954, the NAIC held a series of hearings. Let me interject here that when I talk about the regulatory activity, I'm referring to what the NAIC did. Clearly, individual states were doing things. Clearly, individual states didn't always adopt exactly what the NAIC proposed, but the NAIC was a forum in which all the parties were debating the big questions. The state implementation of NAIC model acts was always subject to the local political compromises to get laws enacted. The NAIC held a series of hearings identifying what were perceived to be the abuses in the business at that time. These were the sale of excess coverage and failure to cancel insurance when a loan is refinanced so you ended up with layers of insurance or pyramiding of the product.

Some questions were emerging about whether consumers knew they were buying the coverage. The coercion and the tie-in sales arguments were already surfacing. There were some questions about claim payments. Were the claims being paid? In 1954 the NAIC adopted its first set of rules and regulations on this. It was not a model act yet, just rules and regulations. It was more like guidelines that it was advocating at this point. The guidelines stated that insurance should be limited to the amount and the term of the loan and that the lender should give evidence of coverage. The debtor should have the right to furnish an existing policy if indeed insurance was going to be required on the loan and the insurance company was responsible for the claim payments.

Then we get into the diplomacy period, which started in 1954 with what we refer to as the Langer hearings. Senator William Langer was the chairman of the Antitrust and Monopoly Subcommittee of the Judiciary Committee. He held hearings on tie-in sales with small loans. His report was critical of state regulation of the credit insurance business, and he was threatening federal regulation.

The NAIC began to hold a series of hearings on these points, ultimately leading to a model bill. On the industry side the debate was with respect to pricing: Are we going to limit compensation, or are we going to go with a loss-ratio approach? There were strong feelings on both sides of the issue. There were some on the industry side that simply wanted to limit compensation; everything else will take care of itself. Others said, "No, we do not want to limit our compensation. Let us just go with the loss-ratio approach." There also was debate on what the loss ratio ought to be.

In the end the NAIC adopted a model bill that included the earlier points and the consumer protections that we just talked about. It also included the requirement for the filing of forms. It gave the insurance commissioners the right to disapprove forms if the benefits were not reasonable in relation to the premium charged. The CCIA, along with many in the industry, began to promote the adoption of the model act to fend off federal regulation. In 1959 the NAIC settled on, and adopted by resolution, a loss-ratio benchmark for the first time. A rate producing a loss ratio of less than 50% should be considered to be excessive. Gary had some interesting discussion between creditors and insurers about who gets the money. When the 50% loss ratio was first adopted, as some of the older people in the business told me, many of the creditors believed that the loss ratio simply meant 50% to the creditor and 50% to the insurer. That is what they thought a 50% loss ratio meant. It took them a few more years to understand that we needed more than the 50% for pure claims.

Another significant development at the time was that New York adopted prima facie rates, and the Old Republic Insurance Company challenged them. The model bill didn't give regulatory authority over rates. The statute in New York didn't give regulators the authority to set rates. The New York court and the New York appellate court ultimately upheld the right of the state insurance department to establish prima facie rates, provided there was a provision that allowed companies the right to get a rate deviation. The company must show cause and justify why it should be permitted to write at a rate higher than the state's prima facie rates. It must show that the deviated rate was a reasonable rate. That established the right of the state insurance departments to set prima facie rates.

I would also note that during this period of time, 1963, the Office of the Comptroller of the Currency (OCC) first authorized the use of debt cancellation contracts (DCCs) by national banks, which the NAIC immediately characterized as insurance. For the next 20 years or so no activity really took place with regard to DCCs. At that time New Jersey and Arizona developed some mortality and morbidity statistics relative to the credit insurance business. For the first time we were able to begin to look at some experience data, apply a 50% loss ratio, and see if the resulting margins were sufficient to run the business. The claim costs at that time were high enough that most of the industry concluded that yes, we could live with a simple 50% loss-ratio standard.

Critical to the regulation of this business was the adoption in 1966 of the Richmond resolution. It took a lot of effort to get everybody on board—both the state regulators and the insurance industry. The industry was divided over what the appropriate loss-ratio standard ought to be. Some were insistent that 40% be the highest loss-ratio standard. Some were at 50%. There were a couple of companies that were at 60%. CUNA was writing noncontributory credit life business, and the Prudential Insurance Company had a lot of credit union business on its books. It saw a 60% loss-ratio standard as giving it a competitive advantage. As long as it could lump all of its business together to satisfy the 60% loss-ratio standard, there would be enough higher loss-ratio business from credit unions to offset the lower loss ratios from the other markets.

Ultimately, all the active trade associations (at the time there were four of them), the industry, and the regulators came to grips with the issue. They adopted the Richmond resolution that said a number of things. It said all the states ought to be enacting the model bill to protect the consumer. There ought to be a 50% minimum loss-ratio standard. States ought to set reasonable prima facie rates. There ought to be a deviation procedure, and you shouldn't cap compensation. The model bill was what the industry and the regulators sought to implement. By about 1968 or so, the model bill with these provisions either in the bill or in accompanying regulations was indeed in place in most states.

The threat of federal regulation still wasn't over at this point. Senator William Proxmire in 1967 was holding truth-in-lending hearings, and ultimately the Truth in Lending Act was adopted in 1968. Concurrently, Senator Hart was holding hearings on the credit insurance industry. Those hearings not only generated some consumer studies to offset some of the allegations that were being made but also added more impetus to the industry and the regulators to get adequate consumer protection regulations adopted in the states. The federal government still wasn't done.

Senator Proxmire in 1969 held more hearings using his position as chairman of the Subcommittee on Financial Institutions within the Committee on Banking and Currency. Senate Bill 1754 was introduced to regulate the credit insurance business at the federal level. It provided rate regulation standards that would be enforced by the Federal Reserve Board and provided three criteria to be used in deciding what an appropriate rate ought to be. The Federal Reserve Board was instructed to consider an 80% loss ratio that other group insurance business seemed to produce. It was also instructed to look at the noncontributory business and instructed to consider what the rate would be if you simply added to the claims cost the insurer's expenses and the incremental expenses of creditors for administration of this business.

From these three tests the appropriate rate would be determined. Because of the state regulatory activity on credit insurance, this federal bill ended up getting a lot of publicity, but the bill itself didn't go anywhere. Also, in 1969, Regulation Z and the Truth in Lending Act were adopted. This was the beginning of the consumerism period.

In the interests of time, let's go to the middle of the consumerism period. Around 1975 was the first time that an organization called the National Insurance Consumers Organization put in an appearance, to my recollection. The consumer advocates had discussions with the NAIC and had discussions with the various states. We saw a number of issues arising, such as gross versus net life coverage and enforcement of the loss-ratio standard. We encountered for the first time the concept of discounting for interest and mortality the single premium. The reverse competition issue began to get a lot more play. Compensation limits again presented themselves as an issue to be dealt with, as well as proper disclosure.

This was a period of time when loan terms increased and the NAIC adopted a long-term model act. The long-term model act took into account loans in excess of five years. It provided that life coverage be limited to net loan balance plus 5% for delinquency. It also introduced the concept of discounting the single premium for interest and mortality. It considered for the first time the concept of a surrender charge for credit insurance. This was not adopted, but it was talked about. The NAIC long-term model was never enacted in any state. It was only introduced, to the best of my knowledge, in one place, where we shot it down immediately in committee. Subsequently the NAIC went back and simply extended the term of loans covered by the short-term Credit Model Act. This was also the period of time when credit property first became a regulatory issue. The NAIC established a working group to look at it. The National Consumer Law Center then produced a report on it. We, the CCIA, produced a report on credit property insurance in rebuttal to all the contentions in the NAIC 1979 white paper. We countered the finding that credit property loss ratios were too low. While disturbingly low to some, they are nevertheless understandable in the context of the business.

At this time we also had the Federal Trade Commission (FTC) looking at credit insurance practices. The FTC noted that penetration rates were about 75% on small loan transactions. I believe that 1979 was probably the peak year in terms of credit insurance penetration rates. My calculations indicate that 75% of all outstanding consumer indebtedness was covered by insurance. Outstanding consumer debt did not include mortgage loans.

The election of Ronald Reagan in 1980 was significant for two things. One was that with the help of Congress, the government told the FTC that insurance was outside of its jurisdiction. All the problems that our companies and the lenders were having at the FTC vanished overnight. The other was that Congress cut some of the funding for the Legal Assistance Foundation. Many of the Legal Aid Societies in the various states were getting politically active, which was outside of their charters. Their funding was cut, and many of them vanished. The National Consumer Loss Center, being the biggest and the best organized, had to redeploy its assets to activities that were authorized within its charter.

For the period of survival, I have just a couple of quick notes. In 1985, the credit insurance experience exhibit supplement was adopted. Now the NAIC was able to keep better and more exact statistical data on the credit insurance business. This was also the time when regulators began to take a personal interest in just what this loss-ratio regulation of our business meant.

The Illinois insurance commissioner was faced with an action filed by a consumer group asking the court to compel the insurance commissioner to enforce the 50% loss-ratio standard. The Illinois loss-ratio standard was an ultimate loss ratio over 50%. We intervened in that action to defend the insurance commissioner. He had his own defense, but we weren't sure he was going to defend it the way we wanted it defended, so we intervened. We made the argument that as long as the regulation states an ultimate loss ratio, you won't know what the ultimate loss ratio is until all the business on a policy form runs off. As long as you have business on a policy form, you'll not know what the ultimate loss ratio is.

In any event, the defense tied up the regulation and the court action long enough that the insurance commissioner and his staff decided they did not need a loss-ratio standard. They rewrote the regulation to get rid of the loss-ratio standard and put in the first form of what became known as component rating. It said that in establishing the rate, you look at all the elements that go into making up a rate. It also said the prima facie rate was subject to automatic periodic adjustment. Every three years experience would be looked at, and to the extent that the claim component changed, the prima facie rate could be changed.

The only thing looked at was the claim cost. If the claim cost went down two cents, you could reduce the rate two cents. The margin for the insurer was held constant. This was significant for the industry and the regulators outside the state of Illinois.

Let me just hit one key point on the revelation period and why I called it revelation. In 1996 the NAIC amended the model act to recognize two alternatives for rate regulation, one alternative being a 60% loss-ratio standard. The second alternative was a 60% loss-ratio standard or such lower loss ratio as may be required in order to provide an adequate margin. It listed all the components needed to preserve the margin. Yes, the prima facie rate might need to be less than a 60% loss ratio for this business to have an adequate rate.

Mr. Bruce Camacho: This is a marketing person supposedly talking about trends in regulation, which is funny enough. However, I'm a bean counter who has now taken over the marketing of insurance. I have spent a lot of time, especially in my last year, with the regulatory process. I'm going to spend a little bit of time on where I think it is right now and where it's headed in the future. I think the industry certainly needs to know a little bit about some of the challenges that are in the industry right now and a little bit about where we are going. I will also talk about where I think the products need to go from a marketing perspective.

Anyone who has basically been around the industry—and I've been in it since about 1976—wonders what the end is for credit insurance. I recall Mark Twain's comment that the report of his death was an exaggeration. I think that certainly is true about the credit insurance industry. Everyone thinks the end is up. I personally don't think so. I think there is a huge amount of opportunity left for the industry. I'll talk a little bit about that now.

Consumer debt has been tracked from the end of World War II, and it has never gone up for more than two consecutive quarters. I'll spend a little bit of time talking about what I mean by consumer debt, how the credit insurance industry has changed tremendously over the last 30 years, and how it will change again over the next 30 years.

The product has value. You can go arguing back and forth on how you determine value, whether you are looking at value as a consumer group would or looking at it strictly on its cost. Consider the many studies, the last one being the 1994 Purdue University study that showed 65% of the people who have credit insurance don't have any other insurance, and 85% of the people who have credit insurance know they have it and would buy it again. People like buying it. A lot of it has to do with convenience.

Insurance needs to be sold. It is rarely sought by people. Often no one else is trying to sell them insurance. We offer credit insurance in a very convenient package. For our credit card business it is a bundled product. It has the life, disability, and unemployment insurance components and sometimes property insurance. Now we are offering leave of absence, marital breakdown, and other types of insurance. It is a convenient package. The way it is billed is also another convenience. Most of the time people buy insurance for a 6-month or a 12-month period. With credit insurance they can pay for it through their credit cards. These conveniences are never talked about at all.

Price points are a very, very important aspect as well. The state regulatory bodies basically set most price points. They are studying prima facie rates and maybe their rate components. There is a price threshold where people will elect not to buy. We are always working with our banks, consumer finance companies, and retailers. These producers just can't gouge, as some people may think. The sale is voluntary to the public. Consumers are concerned about their total monthly payment. If it is too high they will drop the insurance. We are not only kept in check by the regulators, but we are also kept in check by market forces. The normal capitalist market pressures keep the rate at a very competitive level. You are seeing this even with the debt –cancellation–type programs that are being introduced.

The area of consumer debt and commercial lending is growing. I'll talk to you specifically about where it is growing and where credit insurance doesn't even play a role today. If I have any influence, we will have a role in it tomorrow. We are seeing a lot of pressure from the states. There is huge pressure on the state insurance departments now from federal regulators. I'm not sure where all this activity is going to fall out.

What I do know is that there are basically three issues that need to be addressed. One is licensing, the second one is pricing, and the third one is consumer privacy. I'll talk specifically about each of these. The industry has grown up and the regulatory body around it has grown up in such a fragmented manner that it hasn't really been a productive approach. We need to have things done on a more global basis.

Globalization is affecting every organization. It has happened to the banking regulators, and it is going to happen to the insurance regulators unless we take a very proactive approach. The NAIC is certainly trying. I know it is very difficult when you are dealing across 50 states and 50 regulatory bodies in those states and the appointed commissioners and elected commissioners and different states. I have worked in all the different facets of it. I do know that if you get to the right people in the legislative levels in the states, a lot of things can be accomplished. The problems are more apparent now because of the whole debt deferment/debt cancellation thing that is being driven by the OCC, not by the insurance departments. I'll show you some of the accomplishments that have been realized.

And it is even more up-front to us right now because of the whole debt deferment/debt cancellation thing that has been driven by the OCC, not by the insurance departments at all.

There is the licensing issue. There are so many different licensing laws in the different states that it is mind-boggling. There are group exemptions, limited licenses, and enrollment exemptions. Some states have all three, and some of the insurance departments don't even know they have all three types in their state. It is even more impossible when you are dealing with massive globalization of the banking institutions, the consumer finance institutions, and the retailers. They have to survive, and they are crossing new boundaries. You have the Internet, you have e-commerce emerging, and you have direct response from telemarketing. It is extremely difficult to do proper licensing.

The licensing laws have not kept pace. It started in Texas, and it is now in Florida. And it is going to be in Kentucky and in California. It is the awareness of the insurance departments of why are we trying to have employees of large employers licensed to sell a very unsophisticated product. We are not trying to sell and solicit complicated uninsured motorist coverage to a person at point –of sale. I'm not trying to explain to them why they need uninsured motorist coverage. Credit insurance is very simple, as we heard. You are saying to the borrower that if you die, we pay off the loan. If you become disabled or unemployed, we continue to make the payments for you. It is not rocket science.

Why are we having to license employees who have large turnover, such as in retail departments? They may have 60% turnover, and they each need a limited license. By the time they file the application form, they are on to another job. You have this continuous process of trying to have thousands and thousands of application forms going into the state.

Texas did recognize the problem. The insurance companies and the retailers use a script to sell through the employee. The script is easily available to the regulator. It is simply read by the employee. They are not trying to add advice. They are basically offering a product that is voluntary. It is very specific. Texas is not going to require individuals to have licenses anymore. Now Texas has a specialty license that is an entity license. With one license you can sell any bank, any consumer finance company, and any retailer. Any telemarketer can now sell credit life, credit property, and casualty insurance right across the board with one site license. It was also because the Texas insurance commissioner started looking at his own licensing rules and found that he had 64 different licenses in the state of Texas to sell insurance. He said, "This is ridiculous," and he is trying to get it down to seven.

Credit insurance now falls under a specialty license. It is the same as a rental car license. Florida has adopted it. That state has a little bit of a variation that we have no problems with. It is by location instead of by corporate entity. For instance, you are a Circuit City, and you have 100 locations in the state of Florida. You have to have 100 licenses, 1 posted in each Circuit City store. Any employee of Circuit City can now sell, procure, and negotiate credit insurance. This is going to happen in Kentucky and California.

The agency associations support it because we are not trying to take away their business. This is not business that agents write. We now have the agents backing us, and we certainly have the regulators backing us. I'd like to see more of this type of cooperation on other credit insurance issues. I think it is going to happen a lot, especially when we start getting into e-commerce. How are they going to control the massive telemarketing?

Second, there are issues on pricing. We have heard a lot about it. I am not going to spend a lot of time on the loss-ratio versus the component-rating approach. I personally think that the insurance industry has to make money. That is why it is called a for-profit industry and not a not-for-profit industry. I'm sure that our producers want to make money. We heard that the insurance industry does not make the biggest share. I can certainly vouch for that. We make very slim margins in this business.

If you start using just loss ratio and not really looking at the components set by the actuaries, you can very easily go through the margins and lose money, especially with the current marketing cost. Most of this business is done through a direct-mail telemarketing solicitation where you are getting a 1% penetration. Some consumer advocates will say that if you only get 1% positive response, this is a bad product and you shouldn't be selling it.

Well, they don't recognize that if you are selling automobile insurance or any type of insurance through the mail or through the phone, you are going to be lucky to get a 1% response rate. It has nothing to do with the product. It is the fact that people just don't like buying insurance. It has to be sold, because people just don't go out and buy it. None of us wakes up in the morning and says, "I think I need a little bit more insurance." It is not something that we like to do.

I think the whole component-rating approach is something that we would like to see. Why aren't other insurance lines attacked? You will never hear about title insurance, which is the largest rip-off in the world. I wonder why not. There must be a lot of insurance companies that have attorneys on both sides of the fence. Somehow it is never brought up.

The surety business is another type. I have been involved in many, many surety businesses and have looked at their loss ratios, which are sometimes zero. They might even be negative. I think the whole issue of recognizing what this industry is all about and the component-rating structure is something that needs to get a lot more play.

The third issue is consumer privacy. This is something that we are involved in. I don't believe it is a major issue for our industry now. We are on top of it because of what will happen in the future. We want to sell new insurance programs that add value to the consumer. Credit insurance is a necessary part of a banking transaction or a consumer financial transaction. Even with HR-10 and SB-900, consumer privacy legislation won't affect our business because we are considered a financial institution. We are an integral part of another financial institution's transaction. The sending of data back and forth between two financial institutions that are associated on a financial transaction is OK. It will not affect credit insurance because it is so tied into the giving of credit. But with anything outside the lending, such as selling term insurance, you step outside of the extension of credit.

Then you have to be concerned with consumer privacy. We obviously want to make sure that the regulators don't put telephone numbers, addresses, and names that are public domain information into the consumer privacy bill.

Debt cancellation is here, and it is a challenge. Am I concerned about it? Not really. Why not? I think because it is going to face exactly the same battles that we just heard today over the last 60 years. There is no way that debt cancellation is going to survive in its current form with the OCC saying no rate and no form regulation. It is impossible.

Consumer groups are circling on this issue right now, and they will start spreading their attack in newspapers and directly attacking the producers, who do not have the protection from the 100 years of jurisprudence. They cannot say they have a filed and approved rate. I am just using the filed rate. I am just using the filed form. As soon as you lack that defense, watch out for plaintiff attorneys and consumer groups.

I am not concerned about it, because it is coming. We are being very proactive with our clients. We are trying to inform them of what we think is going to happen if we don't have at least proactive regulation. It will be reactive regulation. We have seen it. We have been through it. We lived through it today, so I am not too concerned. We always have downward pressure on rates. Then there is negative publicity from the irresponsible consumer advocates. I keep on talking about the fact that they keep on harping on one issue, that being loss ratio. They never look at the exact facts. Every single time you do a consumer survey, which they can run themselves, it shows the public wants to buy the credit insurance programs.

Here are some of the new things happening. Most of the credit insurance today is on small short-term loans. What is happening now is they are making home-equity loans. They are making second mortgages. It is all big items. All the banks are writing the big items. They are into the mortgage business. All the big manufactured housing dealers are now into prefabricated housing, and it is all big loans. A typical credit life insurance rating scheme just does not work in these types of loans. It prices you right out of the market. You will sell it. You have to change a product. We are changing a lot of our product mixes right now. We call our new product "equity guard." The retailers seem to be always going out of business. You don't know which retailer is going to survive.

Here are some of what I think are the opportunities for growth. First of all, any insurance company that has a credit insurance focus only is history. It is not going to survive. It is gone. Even the companies like the Associates do more than just credit insurance. Credit insurance is just another part of their insurance portfolio, because they recognize that they cannot survive just selling credit insurance. We are certainly not going to be only a credit insurance company if I have anything to do with it come ten years from now. We probably will still be writing about $4 billion in credit insurance, but we will probably be writing $10 billion in other business. It will be done through a lot of our membership offerings.

What we are seeing is a lot of what we call lifestyle marketing. It is being sold too much to more upscale borrowers. This ties back to the privacy issue. The need to get data and information is critical to any business today. We have to watch very carefully what is going on in HR-10 and SB-900. The rationale behind almost every bank merger, almost every consumer finance merger, every retail merger, and any kind of merger in the financial institution business involves sharing of data. We are seeing our clients doing much more of what we call lifestyle marketing. We are bundling products.

I will just give you an example on what we call a woman's sense. Women make most of the credit card purchases. If you look at any credit card base, it is 40% women, and 90% of the use is by women. Men primarily use their cards when they are out buying a gift for someone or using it for a hotel, restaurant, or airfare. Most of the other purchasing is made by women. Also, what we found out is many of the women are single moms. About 40% of our portfolios are single parents, and they are concerned about their kids, their kids' education, their kids' security, and their kids' day care.

A lot of the programs that we are building on now are taking the basic card insurance program but extending benefits to fill these needs. We are getting back into the group business again. We are taking the credit business and asking, How can we give consumers an added benefit? When they lose their jobs today they are getting the credit card paid through disability or unemployment benefits, but they have to keep their kids in day care, and it is costing them $100 a week. They have to keep their kids in day care to look for a job.

We are coming up with what we call additional benefits, which have to be filed as a group program. We call it cash benefits. We are giving another $400 benefit a month to them for a period of six months so that they can continue to put their kids in day care. It is sold as a day-care endorsement. The women want memberships wrapped around helping them with the automobile. Every time they go to an automobile dealer or a repair person, such as a plumber, they get ripped off. We are wrapping around a lot of our credit-related programs with membership offerings that bolster the whole marketing effort.

Where else is debt growing? Debt is growing in margin accounts and 401(k)s. Consumer debt is exploding in this country. I don't see my credit card receivables growing at all. It is because it is in margin accounts and in 401(k) plans, and there is no insurance on this at all. There is a need for it.

Why is there a need for it? Most blue-collar workers who are our customers have started with their 401(k)s, and it is actually the only retirement plan they have.

They are relying on this for their pension, and guess what is happening to them now? They are now aging baby boomers. Their kids now are college age. or the kids want to go to college. They are encouraging their kids to go to college. They can't really get financial aid, but they can borrow against their 401(k) plans.

Almost 40% of the 401(k) plans we have looked at have loans against them. When people die, what happens? Their entire savings are wiped out. Their entire nest egg for their spouse and their kids is gone. There are going to be product offerings on the 401(k) plan. Is it credit? Yes, it is credit, because it's a loan. Is it going to be the same traditional credit life? Absolutely not. It is probably going to be more like a term insurance program, but it is going to be sold based on the same needs analysis for which we sell credit.

And the same thing is happening on the margin accounts. Most margin accounts were on upscale individuals ten years ago. We tried to sell credit insurance on margin accounts but failed, because they were all well-off people who did not want credit life. Now the typical working-class person has a margin account. Everyone now wants to get into this market. These are unprotected loans. Home-equity loans are growing, and these are also unprotected.

There is a lot of activity on the Internet. I spend most of my time now on the Internet trying to get information right at the fingertips of the loan officers at a bank so they can rate the insurance, issue the certificate, and negotiate and procure insurance right on the desktop. That brings in a whole bunch of regulatory issues, such as point size of the printed material. Is it really six, seven, or eight? You can enlarge it on the screen. What do you do? How do you print it? There are a lot of issues here.

We are also including a lot of appliance protection programs when we are selling the mortgage life insurance. We are also in the utility market selling the same life, disability, and unemployment programs. It is group insurance and not credit insurance, but this is just a cosmetic difference. We pay the utility bill for a period of time if you are disabled or unemployed. There are a lot of new things going on that are changing what we say is the old traditional credit insurance business. I personally think the old credit insurance business, the Morris Plan, really paralleled the old debit of business—the monthly premium that was sold door to door. All that happened is that the credit card business started being collected on a monthly basis, but it is credit insurance. It is almost like a burial policy.

Tomorrow the competition is not DCCs or any one of those items I mentioned before, and it is certainly not going to be another insurer. I personally think it's e-commerce. I have my own technicians inside the company who are going to be attacking my own businesses from inside. We have a whole group of technical people, and we are going to start attacking our markets.

We will attack the same way that the CEO of Bank One, who set up wingspan.com, attacked Bank One. We are going to start attacking our own businesses from inside to prepare for the future. We will learn where our vulnerability is. I think tomorrow's competition is going to be someone who can actually put an infrastructure in place to have everything done electronically and cut the insurance company totally out of the picture, especially if DCCs survive. This is still the key. One thing that I think regulators and insurance people have to recognize is that it is still sales. People do not just buy insurance. It has to be sold, and sold hard.

We are repositioning and repackaging a lot of our programs. There is still the same needs analysis. We cannot plan for the future by the past.