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Credit Insurance In Connection With Real Estate Loans

by Bill Burfeind

The Consumer Credit Insurance Association (CCIA) is a national trade association of insurance companies engaged in the business of insuring consumer credit transactions. Our members account for more than 80% of the national premium volume written for these lines of insurance. Since its incorporation in 1951 as an Illinois corporation, CCIA has been dedicated to preserving and enhancing the availability, utility, and integrity of insurance and insurance-related products delivered through financial institutions or in connection with financial transactions.

CCIA shares the concern over marketplace practices that have brought about an unprecedented level of home mortgage foreclosures. Collectively, the practices are referred to as predatory and are said to include financed single premium credit insurance. But keeping the whole picture in perspective, the heart of the matter is how loans are

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Chairperson's Corner

Negative Discoveries

by James B. Smith, Jr.

Have you ever encountered a negative discovery? In the 1700s people thought that a great continent existed between Antarctica and Southeast Asia, making the Indian Ocean a lake. The legendary continent was thought to be a promising empire with natural wealth of incalculable size. When Captain James Cook proved that Great South Land did not exist, he experienced one of the greatest negative discoveries of all times.

A negative discovery is much less welcomed than an affirmative discovery. It is far easier to enjoy an affirmative discovery than to prove that some long-admired fixture of the imagination does not exist. Moreover, we are inclined to forget or underestimate the difficulty of a negative discovery.

Isn't this also true in the world of business? Negative discoveries in the insurance industry waste time when poorly designed products or ill-conceived distribution decisions are pursued. Popular opinions and good intentions may ultimately lead to a negative discovery.

What are some examples of negative discoveries in a nontraditional distribution insurance channel such as bancassurance?

- Negative Discovery #1: Due to financial modernization legislation, banks will acquire insurance companies. Banks certainly have the financial resources to purchase insurance companies, but they may not have the financial incentives. The chairman of a mega-bank has said that the returns from insurance companies do not

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presented to consumers by a relatively small number of lenders in the subprime market. Credit insurance properly presented neither causes nor contributes to the incidence of foreclosure. Indeed, it advances the public interest objective of preserving home equity. Credit insurance is an important and valuable option for consumers when they seek to protect their ability to repay loans, including loans in which borrowers offer their homes as security.

Credit Insurance—A Valuable Consumer Option

Home ownership represents the largest investment most consumers will ever make. Credit insurance is an option available to consumers to preserve this most important asset for themselves and their families. The consumer's ability to make timely mortgage loan payments is most threatened by death, disability, or unemployment. Often a death is preceded by a period of disability and unemployment. In fact, HUD estimates disability causes 46% of conventional mortgage foreclosures. In the absence of savings or other insurance, it is credit insurance benefits that maintain a timely repayment schedule and pay off the balance in the event of death.

Credit insurance consumers generally have low to moderate incomes and, accordingly, higher levels of financial insecurity than do those with substantial incomes or wealth. Absent abundant savings, the purchase of insurance is a cost-effective way to address financial insecurity. Even so, too many consumers have little or no insurance.

A recent life insurance industry study concluded that 25% of US households have **NO** life insurance. [*Americans' Financial Insecurity*, Prepared for The Life and Health Insurance Foundation for Education (LIFE) by Roper Starch, October 1998.] Additionally, 75% agree they need more life insurance and 96% agree that providing for dependents is the most important reason. But, the study notes, "life insurance isn't on the top of people's list of financial concerns…. The most important is paying current bills." Meeting the monthly mortgage payment is listed as the first critical day-to-day challenge.

> *"Credit insurance is not a lending provision; it is valuable insurance for home borrowers. Credit insurance can assure repayment of a home loan in the event of death, disability, or unemployment."*

Making that monthly mortgage payment is crucial to providing for dependents. Both lender and borrower are counting on a stream of income to make this payment. The biggest risk of interruption to income is unemployment, disability, or death. For those consumers who have no insurance, or wish to supplement existing insurance, credit insurance is affordable, available, and convenient. Credit insurance is not a lending provision; it is valuable insurance for home borrowers. Credit insurance can assure repayment of a home loan in the event of death, disability, or unemployment. Indeed, in the real estate secured market segment—more than 60% of the credit life and credit disability premium dollars paid by consumers are returned to consumers as life and disability insurance benefits.

The Purchase of Credit Insurance Is Voluntary

It's important to differentiate good insurance products from bad lending practices. Selling insurance products, or any other goods or services for that matter, without consumer informed consent, is a bad lending practice. Informed consent is the key to a prudent decision. Both Federal and State law and regulation provide for informed consent.

The Federal Truth-In-Lending Act, implemented by the Federal Reserve Board Regulation Z, promotes the informed use of credit by requiring disclosures about the credit transaction terms and costs. As required by Regulation Z, loan documents prominently disclose that credit insurance is not required to obtain credit, and will not be provided unless the consumer signs for it. It's clear that the purchase of insurance is optional; that there is an additional charge for the coverage; and, the borrower has indicated election of the coverage in writing.

The Federal Reserve Board has twice examined allegations of coercion or tie-in sales. The 1977 survey concluded:

> "The relatively low proportion of loan customers, especially those of retailers and commercial banks, who perceive pressures, either explicitly or implicitly, to make the joint purchase (of the loan and the credit insurance) is not consistent with the hypothesis that

involuntary tying is widespread. This conclusion is given further support by the very high rate of approval of the service and by the high proportion of customers who do not regard the service as expensive. Rather, the high frequency of purchase of credit insurance together with the consumer attitudes are more consistent with the hypothesis that the joint purchases are voluntary." [Eisenbeis, Robert A., and Paul R. Scheitzer. *Tie-ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies and Other Lenders*. Staff Study 101. Board of Governors of the Federal Reserve System. 1979.]

A 1985 survey reached a similar conclusion:

"These findings are consistent with the view that creditors in general do not subject borrowers to undue pressure to purchase a product (credit insurance) that they do not want. Overall ... the results suggest that the widespread abuses alleged by industry critics are not perceived by most borrowers as important concerns." [Cyrnak, Anthony W., and Glenn B. Canner. *Consumer Experiences with Credit Insurance: Some New Evidence*. Federal Reserve Board. 1987.]

The most recent comprehensive study of credit insurance consumer attitudes was conducted by the Credit Research Center in 1993. [Barron, John M., Ph.d.,and Michael E. Staten, PH.D., *Monograph 30 Credit Insurance Rhetoric and Reality*. Krannert Graduate School of Management: Purdue University. 1994. ***Note:*** The Credit Research Center has relocated to Georgetown University.] A copy of the study has been provided the Federal Reserve Board for independent review, but a couple of relevant findings are as follows:

"Purchase patterns for credit insurance are readily explainable without reliance on seller coercion as a factor."

"We estimate that marketing/coercion alone accounts for a maximum of 3.4% of credit life insurance sales."

"Borrower awareness of the insurance purchase appears to rise with the size of the loan to be insured (and corresponding rise in the premium). Thus, borrowers erred more frequently in their recall of the insurance purchase on consumer loans, relative to auto and *home equity* loans."

In addition to the loan document disclosures, the credit insurance purchaser receives evidence of coverage in the form of a policy or certificate explaining the terms and conditions. Also, credit insurers routinely provide a "free look" for up to 30 days whether or not required by state law. This means that the credit insurance purchaser can cancel and get a full refund of the premium.

Given the consumer protections already in place it's doubtful that credit insurance "packing" is a pervasive practice. Nevertheless, to ameliorate remaining concerns, credit insurers would be amenable to a requirement for a post-closing notice in connection with real estate secured loans. The notice could be mailed immediately after closing; recite pertinent cost and coverage information; and, provide cancellation instruction. Being received and reviewed in the privacy of the home after the loan process has concluded, such a procedure would validate the voluntary purchase and eliminate concerns about coercion or abusive sale practices.

Consumers Need The Financed Single Premium Purchase Option

Credit insurance in conjunction with home equity loans is typically a financed single premium product. Since most home equity loans are repaid or refinanced within five years—a survey of leading lenders in one state found 90% of such loans repaid or refinanced within 48 months—credit insurance on home loans is usually offered for a truncated period. This means the initial term of insurance is for a shorter period than the full term of the loan, which keeps the insurance cost affordable. When a consumer repays the loan before the end of the period of insurance, the unearned premium is refunded in accordance with state insurance laws.

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There is consumer value in a financed single premium. While other premium payment modes might be available, financing the insurance premium over the full term of the loan makes the coverage affordable to many consumers. For example, a $50,000 / 25 year loan at 12% will have a monthly payment of $526.61 without credit insurance. With financed single premium credit life insurance for five years the monthly loan payment becomes $549.98 (National average prima facie rates used). For the additional $23.37 a month, the home equity is secured against the untimely death of the borrower. In contrast, if that credit insurance premium were to be collected on a level monthly outstanding balance (MOB) basis, the loan payment becomes $566.01, an additional $16.03. The ability to finance the single premium helps keep the coverage more affordable to many budget conscious credit insurance consumers.

Another consumer value of financed single premium is continuity of coverage (persistency in insurance speak). Having pre-paid the single premium for the full term of coverage, the coverage remains in force even if the loan payments become erratic or delinquent. With MOB the borrower is essentially purchasing 30 days of coverage at a time. Since premiums are collected with each loan payment and continuation of coverage depends on premium payments being made in a timely manner, MOB coverage will often lapse when or soon after loan payments become delinquent. Given that death and disability are often preceded or accompanied by budget-busting medical bills, this is an important consideration for credit insurance consumers and public policy decision makers.

Also, it is important to note that unlike rates for products like ordinary term life insurance, single premium credit insurance rates will not rise as an individual ages. Generally, there is one rate for everyone, regardless of age or medical condition. Indeed, while credit life insurance may be subject to some evidence of individual insurability, it is offered without the more extensive underwriting criteria typical of term or other forms of life insurance.

These factors make credit insurance especially attractive to middle aged and older consumers/borrowers, who constitute the majority of equity home mortgage borrowers. Typically, the majority of such borrowers are above the age of 45—an age when uniform rates with little or no underwriting requirements are a clear benefit to those seeking life or disability insurance.

That's important when people take a loan using their homes as collateral, because our homes are usually the largest investments and the largest assets we have. Credit life, disability, or unemployment insurance on a home loan assures that if the insured borrower dies, becomes disabled, or loses a job, his or her family is able to maintain ownership of the home, keep a roof over their heads, and continue building equity wealth.

Any examination of financed single premium credit insurance should recognize the following advantages credit insurance offers consumers:

- Credit insurance is not a loan requirement. It is a valuable, optional, affordable choice for consumers seeking to protect themselves when they borrow.
- Federal and state laws require that consumers be told credit insurance is a choice that is not required to obtain a loan.
- Credit life, disability or unemployment insurance on a home loan assures that a loan will be repaid in the event a borrower dies, becomes disabled, or loses a job.
- Consumers get a "free look" at credit insurance—they can cancel the insurance within a set period, usually ranging from 10 days to as many as 30 days, and get a full refund.
- After the free look period consumers can still cancel at any time and receive a proportionate refund of the credit insurance premium.
- States strictly regulate credit insurance rates, which are periodically adjusted to pass on to consumers the savings of good group claim experience.

Single premium credit insurance is an affordable, fair consumer option to protect home loans. In no way is it a questionable lending practice indicating a loan was made under abusive circumstances. It is a means to protect home equity through insurance protection against the predators of time and nature like accidents, ill health, or death.

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