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Consumer ... Interest Research Group
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MOST CREDIT LIFE INSURANCE STILL A RIP-OFF

Washington, D.C. -- This morning, the Consumer Federation of America (CFA), U.S. Public Interest Research Group (U.S. PIRG), and many grassroots consumer groups released new data revealing that most credit life insurance is still grossly overpriced. The consumer groups called on state insurance commissioners and legislators to lower the rates of this regulated product.

"In most states, credit life insurance is still a rip-off," said Stephen Brobeck, CFA Executive Director. "Most consumers should not even consider purchasing the product except from a credit union."

"Consumers should be receiving at least $.60 in benefits for each $1.00 in premiums paid, yet they actually get only $.42 on the dollar, and these benefits have been declining," said James H. Hunt, CFA Life Insurance Actuary. "As a result, consumers are overcharged more than $400 million a year for this product."

An Introduction to Credit Life Insurance

Credit life insurance pays off a loan if the borrower dies. It is sold to many consumers who take out installment loans and to a smaller, but increasing number, who acquire credit cards. Since consumers cannot effectively comparison shop for credit life insurance -- in fact, it's price is driven up by life insurers who offer financial incentives to persuade banks and auto dealers to sell the product ("reverse competition") -- the price of credit life is regulated by all states, which limit the charge on each $100 of insurance for each year.

The best indicator of the value of credit life insurance to consumers is the loss (or payout) ratio -- the proportion of premium dollars collected that are paid out in benefits. The National Association of Insurance Commissioners' model standard for credit life insurance contains a minimum 60% loss ratio. This model standard is met by nearly all those credit unions that sell credit life, but except in several states, it is rarely met by other sellers of the product.

Where Credit Life is a Rip-Off

In the nation as a whole, in 1993-95 the loss ratio was 43%. But this average masks huge differences from state to state, as the first appended table indicates.

- Only New York (77%), the District of Columbia (76%), Maine (72%), and Rhode Island (67%) had loss ratios of at least 60%.

- Louisiana (21%) had far and away the lowest loss ratio, but Mississippi (28%), New Mexico (30%), North Dakota (30%), North Carolina (32%), Nebraska (32%), Kansas (32%), Montana (33%), Kentucky (33%), Iowa (33%), Idaho (33%), South Carolina (33%), South Dakota (34%), Colorado (34%), Arkansas (34%), and Alaska (34.7%) also had loss ratios under 35%. (In 1996, Montana lowered its rates by 20 percent, so future loss ratios should be higher.)

Credit Insurance Costs Add Up

Credit life insurance is typically sold to consumers as a low-cost product (e.g., $4 a month, $8 a month). But the total payments add up. As the second table indicates, for coverage on a $10,000 loan at a 12% APR repayable over 48 months, the total charge, including finance charge, ranged from $155 in New York and Maine to $673 in Louisiana. In 13 states, this total charge exceeded $400.

Credit insurance charges are collected in one sum (single premium) by adding them to the loan. As such, they bear finance charges at whatever the loan rate is. Despite the addition of these charges to the single premium, about 40 states allow premium calculations that give no discount for paying the premium in one sum at the loan date (see note 7 to the table).

Nationwide Loss Ratios Have Declined Recently

For several years, the nationwide loss ratio increased, but recently, it has declined. In 1987, this loss ratio was 39%. Following the release of reports by CFA and NICO (now part of CFA) in 1990 and 1992, many state insurance commissioners lowered rates or persuaded their state legislatures to do so. As a result, the nationwide loss ratio rose to 45% in 1993. Unfortunately, this loss ratio fell to 43% in 1994 and then to 42% in 1995.

Several factors help account for this abrupt reversal of trend. Apparently, the industry took steps to sell less credit life insurance to high risks, thus lowering loss ratios even when regulated rates were not changed. In addition, recent increases in the amount sold has tended to depress loss ratios because, all other factors being equal, loss ratios increase with the age of the policy. Finally, few states lowered rates, as many did between 1990 and 1993. In fact, Wisconsin allowed credit insurers to charge higher rates.

CFA and U.S. PIRG Call for Improvements

CFA and U.S. PIRG call on state insurance commissioners and legislators to lower credit life insurance rates further and to enforce adequately existing regulations. In addition, the two groups urge insurance regulators to:

- eliminate the sale of excessive amounts of credit life insurance, so-called "gross debt" coverage (see note 5 on the table for explanation); and

- disapprove any requests to provide "accelerated death benefits" unless such coverage, which pays off a loan before death for someone terminally ill, is to be provided without extra charge (see note 12 to the table).

State and local groups affiliated with CFA and U.S. PIRG in more than a dozen states are launching campaigns to lower credit life insurance rates. Commenting on the participation of state PIRGs in this campaign, U.S. PIRG Consumer Program Director Ed Mierzwinski said: "State PIRGs are working for lower credit life insurance rates because these lower prices can save consumers hundreds of millions of dollars a year."

Advice to Consumers

The large majority of consumers in those states with loss ratios below 60% should not consider purchasing credit life insurance except from a credit union. In these states, the only consumers who should consider purchasing this product are the old and ill (whose risks of dying are relatively high) without other life insurance protection or adequate financial assets to pay off the loan in the event of death.

Consumers in those states with loss ratios above 60 percent and those who belong to credit unions should consider purchasing credit life insurance only if they are without other life insurance protection or adequate financial assets to pay off the loan if the borrower dies.

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CFA is a non-profit association of some 240 pro-consumer groups that was founded in 1968 to advance the consumer interest through advocacy and education. U.S. PIRG is the national lobbying office for state Public Interest Research Groups, which are non-profit, nonpartisan consumer and environmental advocacy groups.

CREDIT LIFE INSURANCE BY STATE: 1993-1995 LOSS RATIOS

	Calendar Year Loss Ratios Ratios of Claims to Single Premiums			
	1993	1994	1995	1993-1995
New York (Net Only)	72.3 %	78.6 %	82.5 %	77.3 %
District of Columbia	75.3	69.7	82.4	75.7
Maine (Net Only)	73.5	80.1	65.4	72.3
Rhode Island	88.4	76.0	49.2	66.6
New Jersey	64.5	59.1	54.6	59.3
Pennsylvania	61.9	57.6	55.8	58.3
Maryland	59.5	57.4	56.5	57.8
Vermont (Net Only)	56.5	62.6	47.3	55.2
California (Net Only)	57.2	54.7	49.8	53.7
Arizona	55.7	55.6	49.9	53.5
Florida	53.9	53.1	52.5	53.1
Virginia	52.2	50.7	50.9	51.3
Michigan	54.2	53.5	44.1	50.1
Oregon	46.0	52.9	50.2	49.7
Washington	50.4	46.0	50.0	48.8
Missouri	48.7	47.0	47.8	47.8
Massachusetts (Net Only)	50.4	47.9	41.4	46.7
Ohio	49.2	46.9	41.0	45.6
Delaware	38.4	52.5	46.4	45.5
New Hampshire	51.9	43.2	41.5	45.2
Connecticut	41.9	31.8	62.3	43.2
Wisconsin	46.0	38.2	45.5	43.0
Georgia	38.4	41.7	47.5	42.5
Minnesota (Net + 1)	41.6	41.0	43.9	42.2
Nevada	37.5	45.5	41.0	41.4
Illinois	40.8	40.3	40.9	40.7
Texas	39.5	39.8	39.2	39.5
Hawaii	39.6	37.2	38.0	38.2
Wyoming	35.7	34.4	37.4	35.8
Utah	34.4	42.1	31.7	35.7
Oklahoma	34.3	37.2	35.0	35.5
Alabama (Net + 1)	34.3	34.9	36.9	35.4
Tennessee	36.9	35.9	33.2	35.2
Indiana	35.2	35.9	34.3	35.1
West Virginia	38.5	32.0	35.2	35.0
Alaska	32.8	35.5	36.0	34.7
Arkansas	37.2	33.1	32.1	33.9
Colorado	34.6	35.3	32.1	33.9
South Dakota	36.0	30.2	35.5	33.6
South Carolina	34.1	32.1	33.9	33.3
Idaho	32.6	30.6	35.9	33.1
Iowa	32.3	32.8	34.2	33.1
Kentucky	36.2	30.7	32.6	32.7
Montana	34.8	32.1	31.0	32.5
Kansas	32.9	31.8	31.8	32.1
Nebraska	35.8	34.1	27.0	32.0
North Carolina (Net + 3)	31.5	31.3	32.9	31.9
North Dakota	35.0	30.3	27.4	30.4
New Mexico	32.3	29.8	27.3	29.7
Mississippi	28.3	27.1	28.8	28.1
Louisiana	21.9	22.2	20.1	21.3
U.S. Territories	25.5	28.0	30.5	28.2
All Jurisdictions	44.6	43.2	42.4	43.4

Source: Credit Life and Accident & Health Experience by State 1993-1995, National Association of Insurance Commissioners (NAIC), October 1996. States ranked in order of descending loss ratios for 1993-1995.

CREDIT LIFE INSURANCE BY STATE: ILLUSTRATIVE LOAN

$10,000 Loan at 12% APR Repayable in 48 Months

	(1)	(2)	(3)	(4)
	Credit Life Charges			Rate/$100 Initial Ins. per Year
	Single Premium	Finance Charge	Total Charge	
New York (Net Only)	$ 123	$ 32	$ 155	$ 0.28
Maine (Net Only)	123	32	155	0.28
Vermont (Net Only)	123	32	155	0.28
California (Net Only)	165	32	208	0.38
New Hampshire	171	46	217	0.33
Massachusetts (Net Only)	177	47	224	0.40
New Jersey	183	48	231	0.35
Minnesota (Net + 1)	184	38	222	0.40
Texas	185	49	234	0.36
Virginia	191	50	244	0.37
Wisconsin	201	53	254	0.39
Pennsylvania	202	53	255	0.39
Oregon	202	54	256	0.40
North Dakota	206	55	261	0.40
Utah	206	55	261	0.40
Hawaii	206	55	261	0.40
Rhode Island	208	55	263	0.41
District of Columbia	222	58	280	0.43
Arizona	228	60	288	0.44
Georgia	233	61	294	0.45
Alaska	238	63	301	0.46
Montana	240	63	303	0.46
Illinois	243	64	307	0.47
Iowa	243	64	307	0.47
Ohio	244	64	308	0.47
Michigan	249	65	314	0.48
North Carolina (Net + 3)	252	67	319	0.50
Colorado	254	67	321	0.49
Florida	259	69	328	0.50
Wyoming	259	69	328	0.50
Connecticut	259	69	328	0.50
Maryland	270	71	341	0.52
Idaho	281	74	355	0.54
Missouri	286	76	362	0.55
Nebraska	286	76	362	0.55
Washington	313	82	395	0.60
South Dakota	313	82	395	0.60
Kentucky	313	82	395	0.60
West Virginia	325	86	411	0.62
Delaware	340	90	423	0.65
Arkansas	340	90	423	0.65
Indiana	340	90	423	0.65
Nevada	340	90	423	0.65
Kansas	340	90	423	0.65
New Mexico	340	90	423	0.65
South Carolina	340	90	423	0.65
Tennessee	343	90	433	0.66
Oklahoma	356	94	450	0.68
Alabama (Net + 1)	374	99	473	0.80
Mississippi	422	111	533	0.80
Louisiana	533	140	673	1.00
LA, dismemberment	675	178	853	1.25

Note: Single premiums are based on credit life rates in effect in January 1997.

Notes on Consumer Credit Insurance

1. Credit life insurance pays off a loan on the death of the debtor. Credit disability insurance, not shown here but also highly profitable in most states, covers monthly payments while a debtor is sick. Rates for credit insurance do not vary by age, an important factor in judging value for individual consumers. Under Truth-in-Lending, credit insurance is voluntary, but the way it is sold often leaves consumers with the impression it is mandatory.

2. Life insurance sold with first mortgage loans is not considered consumer credit insurance; the data shown exclude it. Its sale differs in several respects from credit life insurance.

3. Premiums shown for most states are based on "*prima facie*" rates, meaning the maximum rates that may be charged in each state in the absence of claims experience justifying higher rates. Premiums shown for DC, MD, ME, PA, RI, and VT are below *prima facie* levels since enforcement of "loss ratio" standards (see 7. below) produces lower effective rates.

4. The premium for credit life insurance is almost always a one-time charge (except credit card debt) that itself becomes part of the loan. The total cost of credit life is therefore the one-time charge (single premium) plus the portion of the finance charge attributable to it.

5. CA, MA, ME, NY and VT limit credit life insured amounts to the declining scheduled principal balances of a loan -- "net debt" coverage; AL, MN, and NC allow extra margins above pure net coverage. All other states allow "gross debt" coverage, meaning that scheduled coverage each month equals the sum of the remaining monthly payments. This is analogous to a $100,000 mortgage loan with 300 monthly payments of $772 on which initial insurance of $231,500 ($772 x 300) is packaged with the loan and charged for, yet without any disclosure that insurance to pay off the loan is included in excessive amounts. In the table of charges by state, the death benefit in the first month in CT, for example, is $12,968 even though only $10,259 (loan including credit life charge) plus one month's interest of $102.59 is due at death during that month. Excess gross debt coverage reduces to zero in the last month of the loan term. For the loan illustrated, gross coverage exceeds net coverage by 17%, meaning that the premium (and finance charge on it) is 17% higher than necessary.

6. Rates per $100 (of gross coverage) per year for net (or net +) debt states in Col. (4) have been adjusted to be comparable to gross rates for other states.

7. The ratio of claims to premiums is a "loss ratio." Loss ratios (really claim ratios) are often used in other kinds of insurance to define reasonableness of premium rates. Sellers of Medicare supplements, for example, must meet federal loss ratio targets of 65% for

individually issued policies and 75% for group policies. Credit insurance is group insurance and is efficiently administered as a by-product of the loan transaction; single premiums are remitted in batch monthly. The conventional definition of a credit life insurance loss ratio is: (a) claims for the entire loan period, which can exceed ten years but is typically three years or so, divided by (b) the premium collected at the inception of the loan. From the consumer's perspective, however, the portion of finance charge attributable to the single premium should be added to (b); this would define a "consumer loss ratio, which would be more consistent with other forms of insurance where premiums are collected annually or more frequently. The effect of this adjustment can be approximated by taking 80% of any loss ratio shown.

8. The National Association of Insurance Commissioners recommends a 60% loss ratio standard. Only DC, ME, NY and RI met that standard for credit life during experience years 1993-1995; MD, NJ and PA were closer to 60% than 55%. When credit disability is included, states meeting the 60% loss ratio standard from 1993-1995 were ME, NJ, NY, PA, VT and WV.

9. When 13 states plus DC that incurred loss ratios of 50% or more for credit life and disability are removed from 1993-1995 data, the loss ratio for the remaining 38 states is just 41%. When this loss ratio is adjusted for finance charges, the consumer loss ratio in more than two-thirds of the states averages approximately 33%.

10. Premiums in Col. (1) and rates in Col. (4) are based on 1/1/97 standards. Between 1988 and 1994, 23 states reduced credit life rates. Since our last report in 1994, IL, OR, MT, SC and VA have reduced credit life rates; reductions in IL and SC were slight. For the first time in 30 years or more of observation, one state, WI, increased its rates. Because credit life coverage extends over several years, the effect of rate changes emerges slowly.

11. A significant percentage of credit life sales are to joint debtors at rates averaging perhaps 1.67 times single life rates. This multiple is reasonable in low rate states, excessive in high rate states. A recent trend is to authorize joint disability coverage.

12. Another recent credit life trend is to add "accelerated death benefit" coverage to the loan. It pays off a loan early for a terminally ill person. We understand upwards of 20 states may have approved such coverage, possibly violating laws that limit credit life coverage. We believe extra rates approved may be grossly excessive, especially if no adjustment is made to credit disability rates, whose claims would be reduced by early credit life payments.

13. A dozen states appear to allow "dismemberment" coverage to be added to loans at an extra charge. We believe the claim cost to be less than $.01/$100/year, meaning the coverage is virtually worthless. The worst offender is LA at $.25/$100/yr; since the rate

is so egregious in LA, we have shown its effect separately. AL is $.10; FL, KY, NV, and WV are $.05; IA is $.045; AZ is $.04; and, GA, MI and PA are less than $.02.

14. Maximum rates in a few states vary according to type of lender -- small loan (consumer finance) companies may have higher claim rates due to an older insured population, while auto dealer experience produces low claims for the opposite reason. In those states, we have used bank rates.

15. Creditors -- mainly auto dealers, banks and finance companies -- seek credit insurers that pay the highest commissions or other compensation, given a state's maximum rates. In the absence of state-set maximums, the nature of competition in consumer credit insurance is to increase rates to maximize commissions, a phenomenon called "reverse competition." Although credit insurance premiums are disclosed pursuant to the Truth-in-Lending Act, the nature of the coverage and the manner of its sale make it impossible for consumers to compare costs with other forms of coverage. (Further, finance charges attributable to those premiums are not separately identifiable.) This explains why all states limit rates, for better or worse.

16. Creditors may receive both commissions ("up-front" compensation) and any amounts left over at the end of an accounting period after the insurer has deducted claim payments and its negotiated expense and profit charges. Larger creditors often own the credit insurer. Total compensation to creditors varies dramatically by state, of course, and by type of creditor -- auto dealers, with the youngest age group, usually receive the largest margins. Compensation from credit life, exclusive of finance charges on premiums, averages more than 40% in the United States; the range is from 20% or less in the lowest rate states to 70% or more in LA. Note that a creditor receiving a 50% commission, for example, earns 50% of the finance charge on that premium without advancing any funds on behalf of the consumer.

17. Where regulated to the NAIC standard of returning at least 60% of premiums in claims (CFA's recommended standard is 70%, which limits commissions to about 20%) consumer credit insurance serves the public well -- it is often the only life and disability insurance many consumers have. Unfortunately, the business is poorly regulated in at least two-thirds of the states of the United States.