CCIA
Consumer Credit Industry Association

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January 22, 2019

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429.
Submitted via email: Comments@fdic.gov

Re: FDIC Small-Dollar Lending RFI
RIN 3064-ZA04

Dear Mr. Feldman,

These comments are submitted on behalf of the Consumer Credit Industry Association ("CCIA") in response to the Federal Deposit Insurance Corporation FDIC ("FDIC") request for information ("RFI") regarding small-dollar lending.

CCIA is a national trade association comprised of manufacturers, administrators and distributors of consumer asset and credit protection products such as credit insurance, debt protection, guaranteed asset protection and service contracts. Made available to U.S. households through lenders and automobile dealers as part of the extension of a loan, these products help U.S. borrowing households withstand financial shocks by helping households cover payment obligations when something unforeseen occurs. For over 60 years, CCIA has worked to foster the financial security of American households by assuring a healthy market for these consumer financial protection products.

The FDIC issued this RFI to seek public input on steps the FDIC could take to encourage FDIC-supervised institutions to offer economically viable small-dollar credit products that address the credit needs of bank customers. CCIA shares in the FDIC's recognition of the importance that small-dollar lending plays "…as part of the spectrum of credit and savings products offered by banks, in helping consumers meet the need for credit for purposes such as addressing cash-flow imbalances, unexpected expenses, or income volatility."[1]

[1] FDIC Small-Dollar Lending RFI, 2018

Of the products noted above, optional credit insurance is generally the sole offering in the small-loan market. CCIA observes that credit insurance helps consumers in one of the key areas cited by the FDIC for this RFI: cash-flow imbalances. When households incur debt, they are increasing their personal financial risk. That risk may be exacerbated if an unforeseen event inhibits their cash-flows. This can be especially challenging for households of modest means. Fortunately, credit insurance is an affordable solution that pays off the loan balance if one or more borrower(s) dies or, in the case of disability, involuntary job loss, or other unforeseen covered events, it covers loan payments during a critical period for the borrower(s) and their families.

The FDIC offered 21 suggested questions for public comment in this RFI. Given that credit insurance focuses on mitigating financial risk caused by incurred debt, CCIA accordingly focuses its comments on the following two questions:

> 7. What are the key ways that banks offering small-dollar loan products should manage or mitigate risks for banks and risks for consumers?
>
> 19. What other products and services that supplement or complement small-dollar credit offerings should banks consider? Are there other ways that banks can help consumers address cash-flow imbalances, unexpected expenses, or income volatility besides small-dollar credit products?

The short answer to both questions is this: the **FDIC should support the use of credit insurance in small-dollar lending since credit insurance helps consumers address their cash-flow imbalances when unforeseen events occur, thereby helping banks and consumers manage and mitigate risk**.

The long answer is found in the following material, demonstrating:

- Credit insurance addresses consumer needs and helps their credit rating
- Consumers have a very favorable view of credit insurance
- The operating model coupled with robust regulation inure to the benefit of consumers
- Retaining the APR defined by Congress assures consumers have the freedom of choice to mitigate financial risk.

Credit insurance addresses consumer needs

The consumer need for credit insurance is clear. While the U.S. continues to recover from the Great Recession, U.S. household finances are in strikingly poor shape:

- 40% of American households said an unforeseen $400 expense would be challenging to pay off in the same month.[2]
- 63% of Americans say they're unable to handle a $500 car repair or a $1,000 emergency room bill.[3]
- 55% of American households are savings-limited, meaning they can replace less than one month of their income through liquid savings.[4]
- 70% of Americans would experience financial difficulty if their paycheck was delayed for one week.[5]
- 37% of adult Americans have no savings earmarked for emergencies.[6]

At the same time, life events can imperil individuals and their families. A period of disability is more common than most people think. More than 1 in 4 of today's 20-year-olds will become disabled before they retire.[7] Many Americans unexpectedly lose their jobs due to periodic budget tightening or due to more cataclysmic events like the Great Recession.

The significant cash flow exposure is exacerbated by the fact that many Americans lack protection from adverse life events:

- 46% of U.S. adults have no life insurance.[8]
- More than 50% of consumers say they would have immediate or near immediate trouble paying living expenses if their primary wage earner died.[9]
- 68% of Americans working in the private sector have no long-term disability insurance.[10]
- More than 95% of disabling accidents and illnesses are not work-related, and thus are not covered by workers' compensation.[11]

Finances for many U.S. households are fragile and highly exposed. Millions are struggling financially where even a mere $400 expense can imbalance their finances. It is fair to say that Americans are underinsured or uninsured for the financial risks in their lives. Fortunately, credit insurance protects household cash-flow imbalances against such perils as death, disability, unemployment and family leave. For consumers of small-dollar loans that may struggle managing cash flows, have little to no emergency savings and are challenged to secure credit – the very consumers of loans in the scope of the RFI – credit insurance is an essential financial safety net.

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[2] Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2017, May 2017
[3] CBS News Moneywatch, "Most Americans Can't Handle a $500 Surprise Bill (article on Bankrate.com consumer survey, December 2015)
[4] The Pew Charitable Trusts, "The Precarious State of Family Balance Sheets," January 2015
[5] American Payroll Association, "Getting Paid in America" Survey, September 2018
[6] Consumer Federation of America, "America Saves Week" survey, February 2016
[7] Council Disability Awareness, "Chances of Disability – Me Disabled?" 2016
[8] LIMRA, Facts About Life 2017
[9] Ibid
[10] Social Security Basic Facts, April 2014
[11] Council for Disability Awareness, "The 2014 Council for Disability Awareness Long-Term Disability Claims Review," 2014

Credit insurance helps consumers maintain their credit standing

Consider the quantitative implications of these consumer needs and how credit insurance provides real value to consumers with respect to the cost of credit. For instance, credit scores are important to U.S. households in the areas of:

- **Cash flows:** the cost of credit, or the amount of interest in the loan, is a key factor in the total loan payment which impacts the household's cash outflows
- **Financial resiliency:** the amount of the loan payment(s) relative to household emergency funds / liquid assets impacts the household's ability to withstand financial shocks
- **Financial mobility:** the size of the loan payment (as influenced by the interest rate) impacts the household's ability to save for future needs and/or build net worth.

Credit scores are a quantitative proxy for borrower risk level: higher risk borrowers – those with lower credit scores – are typically charged higher interest rates. An estimated 75% of Americans have a credit score below 700[12] while almost 30% have a credit score below 580.[13] According to the long-standing credit education and counseling non-profit credit.org, the latter segment equates to "poor credit" and much of the "sub-prime" segment (sub-prime is 550-620).[14]

The National Foundation for Credit Counseling states that approximately 35% of a consumer credit score is based on payment history: *late payments*, judgements, bankruptcy and tax liens can lower your [credit] score.[15] (emphasis added). Indeed, Freddie Mac suggests (with their own emphasis added) that "*The most important component of your credit report is whether you make your payments on time.* Any time that your credit report shows a late payment—30 days, 60 days, or 90 days—a "red flag" is raised and you may be denied credit or pay more to get it."[16] Keeping current on payments clearly helps maintain and possibly improve consumer credit scores.

It is estimated by FICO that if a consumer's credit score is 680 (i.e., at the lower bound of "good credit" per credit.org[17]) and a consumer becomes 90-days delinquent, then the consumer's credit

[12] Motley Fool, "The Average American Has This Credit Score. How Do You compare?" Todd Campbell, January 11, 2015
[13] Ibid., data quoted from Credit Karma
[14] "What Credit Scores Are Good Credit Scores?" credit.org, November 6, 2014
[15] National Foundation for Credit Counseling, Better Fortunes: Control Your Money. Control Your Life, 2006
[16] Freddie Mac, "CreditSmart® - A Guide to Better Credit, Money Management, and Responsible Homeownership," Publication Number 169
[17] Ibid., credit.org

score will drop 60 to 80 points to 600-620 on average and as low as 530.[18] The following data[19] illustrates the financial implications for a 12-month, $2,000 personal loan:

Credit Score		APR	Interest	Cost over Excellent	Cost over Good
Excellent	720 - 850	13.9%	$148		
Good	690 -719	18.0%	$196	32%	
Average	630 - 689	21.8%	$244	65%	24%
Poor	350 - 629	27.2%	$304	105%	25%

For consumers on the lower end of Good credit, dropping to Average or Poor increases their borrowing costs by 24% and 25%, respectively, over their previous Good credit rating (and of course even more — more than 100% — over Excellent).

When something unforeseen arises, such as the death, disability and/or job loss of the borrower(s), credit insurance helps households weather these perils by making loan payments, thereby helping consumers stay current on their loans. With an average disability claim duration of 8 to 9 months and an involuntary unemployment claim duration of 6 to 7 months,[20] credit insurance covers loan payments that easily span the critical 90-day late payment criteria that can identify a loan as delinquent to the lender. When consumers stay current on their loans, the risk of their credit score dropping decreases. Thus, *credit insurance helps protect consumers against an increase in their cost of credit, especially for those aspiring to achieve or return to a Good or Excellent credit standing.*

Thankfully, credit insurance is highly accessible to consumers. There is little to no individual underwriting at point-of-sale, thereby enabling consumers to conveniently opt for a financial safety net when they need it most. Accessibility and convenience are meaningful to consumers. Consider consumer consumption of individual life insurance as an example. Credit insurance helps address eight of the top ten reasons why people do not buy life insurance[21]:

1. *It costs too much* – Per the information stated later in this comment letter, credit insurance is highly affordable and price-efficient.
2. *I don't need it because I have plenty of assets to leave my loved ones* – Cited above, many U.S. households are struggling financially, with very few assets; credit insurance protects consumers of all financial means, especially struggling households that cannot afford to miss loan payments.

[18] Sam Dogen, Financial Samurai, "Will A Late Credit Card Payment Hurt My Credit Score?", Updated for 2016 and Beyond
[19] Nerdwallet, Nerdwallet Personal Loan Calculator, March 2018
[20] The Society of Actuaries Credit Insurance Experience Committee, "A Credit Disability Insurance and Credit Involuntary Unemployment Insurance Claim Termination Study," December 2012
[21] Bryan Ochalla, "Top 10 Reasons People Don't Buy Life Insurance," October, 2016, https://quotewizard.com/lifeinsurance/why-people-dont-buy-life-insurance; the remaining two reasons include "I'm healthy" and "It makes me think about death."

3. *I've got too many other things to worry about right now* – Since credit insurance is offered at point-of-loan, consumers are focused on the purchase, the loan and the exposure. Thus, credit insurance fits well into the consumer purchase process.
4. *I don't understand it well enough to buy it* – Credit insurance has simple, short-form contracts with fewer exclusions, stipulations and features than individual insurance products.
5. *I find the process intimidating* – Credit insurance does not require invasive testing nor represent large purchases; rather, a few health questions are asked (if any) and the amount of coverage is scaled to the loan amount or plan selected.
6. *I have other financial obligations that are more important than life insurance* – For a nominal cost, credit insurance in fact helps protect the family's other financial obligations by providing a safety net.
7. *I don't trust insurance companies or agents* – Since credit insurance is offered through lenders -- often times by lenders with whom the consumer already has an established relationship -- the process engenders higher trust.
8. *I'll get to it eventually* – Credit insurance is conveniently offered at point-of-loan in a process where the consumer is highly engaged, thereby reducing consumer procrastination over purchasing insurance.

Consumers value credit insurance

Academic research over four decades demonstrates that consumers value credit insurance. The highly respected Survey Research Center of the University of Michigan ("SRC") conducted a total of 1,200 nationally-representative interviews about consumers' experiences with credit insurance (and its consumer-equivalent product, debt protection). Thomas A. Durkin (retired) and Gregory Elliehausen, Senior Economists with the Federal Reserve Board's Division of Research and Statistics, published a report (enclosed)[22] in December 2017 after analyzing the SRC's data set. The results of their analysis show that:

- 84.4% of installment loan borrowers that purchased credit insurance rated the products as "Good" (a consistent rating over four decades)
- Even installment loan consumers that did <u>not</u> purchase credit insurance rated the products as "Good" *over half the time* (53.6%)
- 70.2% installment loan consumers that purchased the product would purchase it again

An important consideration in any consumer financial product is assuring that sellers disclose key terms and consumers are not forced into offers they cannot afford. Of the consumers offered credit insurance, Durkin and Elliehausen note:

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[22] Durkin, Thomas A., and Gregory Elliehausen (2017). \New Evidence on an Old Unanswered Question: Why Some Borrowers Purchase Credit Insurance and Other Debt Protection and Some Do Not," Finance and Economics Discussion Series 2017-122. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2017.122.

> *Significantly, not one respondent in either the purchasers or non-purchasers groupings reported belief the purchase decision was not voluntary. Among purchasers who indicated recollection of the circumstance (96 percent), almost all (again 96 percent) reported the lender had explained the terms. The proportion was almost as high among non-purchasers (89 percent), even if a lot of explanation to them would seem unimportant as soon as they indicated they were not purchasing.*

The academic research demonstrates a favorable consumer view of credit insurance.

Credit insurance operating model supports consumer protections

The research results make sense in the small-loan market because lenders offer credit insurance directly to the consumer during the loan origination process, thereby setting consumer expectations about the product. The voluntary nature of the products is explained, mandated disclosures are given, eligibility questions (if any) are asked, and benefits and exclusions are explained. If the consumer chooses to purchase credit insurance, the consumer signs the product application and the cost is figured into the amount that the consumer can afford to repay. If the consumer later changes his or her mind, a full refund is offered if canceled within the first 30 days of protection (30 days is the norm). Thereafter, the product(s) may be canceled, and any unearned premium is refunded without affecting the underlying loan.

Frequency of loans and loan turnover are also important considerations in the small-loan market. When a borrower decides to purchase credit insurance again (e.g., with a refinanced loan), the prior protection is canceled, and the fees are refunded. The new premiums are added to the new loan. Thus, multiple premiums are not additive – they are not layered on top of each other – one is canceled and a new one goes into effect. Consumers are protected up-front from "buyer's remorse" via the aforementioned 30-day trial period, and they are protected beyond that timeframe through the refund process as dictated by state departments of insurance.

Generally, credit insurance is a contract between the insured consumer, lender and insurer. The lender has an insurable interest as a beneficiary of the insurance. The lender, typically the group policyholder, has a contractual obligation with the insurer and the insured to file a claim when the insured borrower dies, becomes disabled or experiences another life event identified in the credit insurance contract.

To that end, the lender works with the borrower(s) (or in the case of death, the individual(s) responsible for settling the estate or handling the deceased individual's personal affairs). A lender failing to file or cooperate in the filing of a claim violates state insurance laws and regulations regarding claim payments and subjects the lender to possible regulatory or private actions in addition to criminal fraud actions.

The lender as a beneficiary of a credit insurance policy also has an insurable and vested interest in obtaining any policy benefits on behalf of their customer(s). The lender mitigates credit risk by immediately eliminating or reducing the outstanding debt for a customer household. The lender also enhances its relationship with the borrower's household by sharing the good news that the debt will be extinguished or reduced.

As one barometer of consumer outcomes, consumer complaints regarding credit insurance are extremely low. Consumer complaints on insurance can span multiple topics, such as marketing, billing, cancellations, refunds, general servicing (e.g., name/address change) and claims. According to the National Association of Insurance Commissioners, across the 50 states and consistently for the past five years, consumers have filed one complaint for each 41,814 credit insurance certificates issued (a percentage of 0.00239%).[23] This extremely favorable outcome is consistent with the research findings and reflective of how today's credit insurance business model inures to the benefit of consumers.

Credit insurance is affordable and incorporated into lending methodology

In the small-loan market, almost all loans are closed-end, typically made to consumers who are more credit-challenged, and the vast majority of credit insurance sold to consumers are single-pay products financed over the term of each loan. The cost of credit insurance is thus included in the Amount Financed. Consistent with the Truth-In-Lending Act ("TILA") and its implementing Regulation Z,[24] credit insurance costs are not included as a cost of credit when properly disclosed. The credit insurance cost is considered when determining whether the loan will meet debt-to-income ratios when evaluating loan affordability for the consumer. In most cases, since the credit insurance cost is so small, loan affordability issues do not arise. However, if the product causes any affordability thresholds to be exceeded, the products are not sold to that customer.

Credit insurance is highly affordable and adds a miniscule amount to the loan. Consider an example of a $2,000 loan payable over 12 months at a 36% interest rate. The borrower elects optional credit disability to cover loan payments should they become disabled. The monthly cost for the coverage is only $2.20. If the borrower opted only for credit life to pay off the balance should they die during the loan, the monthly cost is only $0.68. If the borrower opted for disability and life on the same loan, the monthly cost would be only $2.88. The estimated total cost of credit disability and credit life insurance over the term of the loan would be merely $34.60, equating to only 1.41% of the total loan payments[25] (see Figure 1).

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[23] NAIC Closed Complaint Summary Index Reports (2005-2009)
[24] See 12 CFR Part 226
[25] Credit life rates per the state of Ohio, effective 1/1/17 per Ohio Department of Insurance Memorandum of 8/22/16

Scenarios (each with $2000 principal loan for 12 months)	36% Interest Rate	36% Interest Rate + Credit Disability	36% Interest Rate + Credit Disability + Credit Life
Monthly Payment	$200.92	$203.95	$204.40
Interest Charges	$411.09	$416.52	$418.20
Credit Insurance Premium		$26.40	$34.60
Total Payments	$2,411.09	$2,442.92	$2,452.80

Figure 1: Small-Loan Illustration with Credit Insurance

Furthermore, research shows the products are cost-efficient for consumers. A Fellow of the Society of Actuaries, Chris Hause conducted a study and published a paper (enclosed) to address the assertion by some that term life insurance is a better deal than credit life insurance. After comparing rates for credit life insurance with term life insurance from fifteen large insurers, Hause found that the average credit life rate is 14% lower than the average for term life for $10,000 of coverage (the lowest amount of term life available for analysis). He concluded:

> *…if term insurance providers made level term insurance policies available at the same low face amounts at which credit insurance is purchased, their premium cost for level term life would actually be higher than credit life policies sold today…While the numerical relationships vary by age and gender, all comparisons suggest that credit insurance is an efficient vehicle for providing small amounts of life insurance.*[26]

Said another way, a typical credit life insurance policy simply costs less than an ordinary term life insurance policy for the same amount. Thus, credit insurance is price-efficient for many American consumers.

Credit insurance is not only price-efficient, it affords consumer value. Some suggest the loss ratio – the ratio of incurred claims to earned premium – is the proper measure of consumer value, then assert that credit life insurance provides "low consumer value" because the loss ratio is lower than that for other products, such as term life insurance. In the same paper, Hause finds that for $50,000 of coverage (a minimum amount of individual life insurance recommended by many), the term life loss ratio is an astounding 58% lower than that for credit life insurance. He observes:

> *Since the alternative being advocated is a level term life policy, one would assume these advocates believe that the level term policy provides a better consumer value, in terms of loss ratio, than a credit life policy…the conclusion is that, relative to individually underwritten term life insurance, credit life is a reasonably priced product and – if loss ratio is in fact a valid measure of consumer value*[27] *– credit life actually provides a better value to policyholders than level term insurance.*

[26] Christopher H. Hause, FSA, "Term Insurance Versus Credit Life", March 2016

[27] CCIA does not concede this assertion

Credit insurance is highly regulated

The underpinnings of today's robust state regulation described below stem from decades of regulatory and industry experience and the National Association of Insurance Commissioners ("NAIC") Consumer Credit Insurance Model Act and Model Regulation. The Model Act defines the products and the Model Regulation addresses policy forms, premium rates, benefits, eligibility and disclosures for both closed-end and open-end credit transactions. All states have adopted some form of the Model Act and the Model Regulation, creating a strong credit insurance regulatory framework to protect consumers and assure a healthy market.

Product Pricing. Premium rates for credit insurance are strictly regulated by the states. Every year, each state insurance department requires credit insurers to file an experience report of consumer credit insurance written during the calendar year. State insurance departments regularly review the losses paid by insurance companies and the premium rates or prices currently approved in that state. The department sets pricing using industry experience as compared to the mandated target loss ratio for the state.

Product Structure. States define permissible product features including coverage terms, maximum limits, eligibility requirements, premium calculation and refunding methods. Insurance companies must file consumer forms and have any variations in product features approved prior to use with consumers.

State insurance laws allow consumers to cancel their credit insurance at any time and provide the formula to calculate any refund due. Additionally, state laws provide each consumer with a "free look period" (or "free trial period") which typically is 30 days – meaning that any consumer can cancel coverage within 30 days and receive a full refund of any premiums charged. Refunding methods set by the state and actuarially justified for an insurance exposure that decreases with the term of the installment loan.

Consumer Disclosures. State laws and regulations provide for very specific protections for credit insurance consumers. Consumers electing credit insurance must receive evidence of coverage. This requires the delivery of a policy or certificate and proscribes the details that such forms must contain, including: a full description of the coverage; any limits, exceptions and exclusions; the term of the insurance; the premium charged; who receives the benefits and how benefits are obtained.

Credit insurance must also adhere to the federal TILA, as implemented by Regulation Z. It requires disclosures to the consumer during the loan transaction, including provisions regulating the purchase of credit insurance. The following disclosures are required before the consumer can purchase optional credit insurance:

- That the purchase of credit insurance is voluntary and not required to obtain credit;
- That there is an additional, separate charge for the coverage and that charge is disclosed; and
- Additional details about the product terms and costs, depending on the specific terms and conditions of coverage.

To obtain coverage, the consumer must acknowledge understanding and agreement with these disclosures by signing or initialing the document.

Market Conduct. State statutes or regulations provide for the licensing of producers of credit insurance and that an insurer is responsible for conducting periodic reviews of their producers to ensure compliance with the insurance laws and regulations of the state. State insurance departments conduct rigorous market conduct and financial examinations of credit insurance underwriters to assure underwriters and their producers comply with the required state laws and regulations.

FDIC should retain the APR as prescribed in Regulation Z

The FDIC may receive comments to this RFI that suggest a new view of the Annual Percentage Rate ("APR") with a supposed goal to protect consumers. The FDIC should not entertain any proposals that deviate from the APR as prescribed by Congress in TILA and its implementing Regulation Z. Doing so fails the test of a "finance charge," contravenes federal law and most important, exposes U.S. households by limiting access to credit and the safety net afforded by credit insurance.

Created in 1968 by Congress in TILA, the APR is a required disclosure of the cost of consumer credit, intended to promote the informed use of consumer credit through clear and unequivocal disclosures relating to the terms and costs of loans.

APR is a defined and well-understood term under TILA that has been the standard measure for comparing like credit products for decades. The key is that it is useful for comparing like credit transactions by setting a single standard to determine the cost of credit in each proposed transaction. It was not intended to be (and is useless as) a tool to measure unlike credit transactions.

Because the APR is valid only for comparing comparable credit transactions and relates only to the cost of the credit, APR has never been associated with the cost of goods, services, or insurance. This is why, in TILA, the cost of credit insurance is expressly excluded from the finance charge if the creditor provides the consumer with previously described written disclosures, the cost is disclosed, and the borrower makes an affirmative election – hence, credit insurance is excluded from the APR.

Despite this proven and clear approach to the APR calculation, there have been proposals to create a separate APR calculation that includes all fees – including credit insurance premiums -- in the APR. Frequently, this so-named "All-in APR" is coupled with a maximum rate cap, such as 36%. The rationale offered for this method is to ensure consumers understand what they are financing.

Proponents may cite the Military Lending Act ("MLA") as an anchor point, where an all-in APR was codified by Congress in 2015, including a 36% rate cap. However, Congress enacted the MAPR and only Congress can redefine the APR — no agency has statutory authority to redefine the APR inconsistent with TILA without an act of Congress.

From a practical perspective, the MLA approach applies only to a very narrow segment of consumers -- service men and women – that comprise less than 1% of the U.S. adult population. It would be highly imprudent to apply a narrow model to the broader 99% of the population.

Further, unlike TILA's APR, the MLA's MAPR is not a disclosure. In fact, creditors are unlikely to disclose the MAPR to military personnel and their dependents for concern over confusing them with two rates, i.e., the APR and the MAPR. Rather, the MAPR is a substantive limitation on the amount of charges military personnel and their dependents may be contractually obligated to pay in a financing transaction.

Credit Insurance Is Not a Finance Charge. From a practical perspective, the consumer chooses to purchase credit insurance separate from the loan and that purchase is usually financed. The **consumer gains value from this separate purchase**, not an increase in the cost of financing for the full credit insurance premium as All-in APR proponents suggest.

From a technical perspective, the consumer's decision to purchase credit insurance has no bearing on the lender's decision to offer credit to the prospective borrower; that is, the lender's credit decision is not predicated on the purchase of credit insurance. Thomas Durkin, Senior Economist with the Board of Governors of the Federal Reserve (retired), observed in his letter[28] to the Consumer Financial Protection Bureau:

> *…it is not the voluntary nature of the debt protection [including credit insurance] that determines the designation [of a finance charge]. Rather, it is whether or not the lender is willing to agree to the credit without the debt protection. If the lender is willing to agree, then adding debt protection does not change the nature of the underlying credit agreement and the charge for the protection is not a finance charge.*

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[28] Durkin, Thomas A., Comment letter to Director Richard Cordray of the Consumer Financial Protection Bureau, Docket No. CFPB-2012-0028, RIN 3170-AA19, November 2012. Mr. Durkin has written extensively on the topic of consumer lending, including co-authoring with Gregory Elliehausen the following books: Truth in Lending: Theory, History and a Way Forward (published in 2011) and Consumer Credit and the American Economy (published in 2014).

<u>*All-In APR Restricts Access to Credit*</u>. Furthermore, the All-in APRs with rate caps *artificially reduce* the APR that creditors may charge to cover their expenses and risk premium. As a result, an all-in APR cap would restrict access to consumer credit since fewer creditors could cover these costs for higher-risk loans.

At the same time, the All-in APR *artificially inflates* the APR by including credit insurance in the calculation. This artificially inflated APR will vary by lender and credit insurance options chosen, but its net effect will be to require a cost of credit calculation that includes items that are unrelated to the cost of credit. This contradicts and distorts the purpose behind TILA and Regulation Z to enable consumers to comparison shop for credit.

Increased complexity and attendant regulatory compliance requirements can inhibit lenders from offering credit altogether. The 2015 amendment to the Military Lending Act ("MLA") regulations expanded the All-in APR to a wide variety of credit products, unfortunately resulting in a marked decrease in consumer credit extended to servicemembers.[29]

<u>*All-In APR Exposes Household Finances to Increased Financial Risk*</u>. Consumers may also be exposed to increased financial risk. In the case of the *artificially reduced* APR, the lender may choose to limit available credit insurance options to assure sufficient rate is available to cover the lender's requisite expenses and risk charges. On the other hand, in the case of an *artificially inflated* APR, consumers may choose not to protect themselves by declining credit insurance to reduce a perceived artificially high APR for a loan. And, for consumers at the margin, this *artificial inflation* of the APR can cause the APR cap to be exceeded, thereby limiting consumer access to a protected loan.

In the event of an unforeseen event such as death, disability or job loss, consumers would be left financially exposed through either limited or no access to credit insurance from lenders, or their own uneasy decision to forgo credit insurance to avoid a higher perceived APR.

<u>*All-In APR Violates Federal Law by Regulating Insurance*</u>. The **McCarran Ferguson Act**, *15 U.S.C. §§ 1011 et seq*. ("MFA"), exempts the "business of insurance" from federal antitrust and other regulation, providing:

> *(a) State regulation*
> *The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.*
>
> *(b) Federal regulation*

[29] In a letter to the U.S. Department of Defense, CUNA & Affiliates and the Defense Credit Union Council observed a 150-basis point decrease in the expected ratio of the number of personal unsecured loans to members (consumers) at credit unions with military fields of membership (expected = 15.2%; actual = 13.7%); May 11, 2017

> *No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. . ."*[30]

Congress enacted the MFA to allow the states to regulate the business of insurance "free from inadvertent preemption by federal statues of general applicability."[31] The MFA reverses the usual rules for preemption, creating a "clear-statement rule . . . that state laws enacted 'for the purpose of regulating the business of insurance' do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise."[32]

The MFA does not define the term "business of insurance," but case law supports the contention that the term includes more than simply underwriting risk. For example, the 9th Circuit has declared,

> *"The phrase 'business of insurance' refers to 'the relationship between the insurance company and the policyholder" and includes "the fixing of rates [,] ... [t]he selling and advertising of policies, and the licensing of companies and their agents."*[33]

The Supreme Court has characterized statutes aimed, directly or indirectly, at protecting or regulating the relationship between insurer and insured, are laws regulating "the business of insurance" within the meaning of 15 U.S.C. §1012(b). *See,* Fabe at 501 (quoting *SEC v. Nat'l Secs., Inc.,* 393 U.S. 453, 460, 89 S.Ct. 564, 568, 21 L.Ed.2d 668 (1969). *Fabe* further states that:

> *"The broad category of laws enacted 'for the purpose of regulating the business of insurance' consists of laws that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance."*[34]

To determine whether the MFA pre-empts a proposed All-In and thus limit consumers' ability to finance or purchase credit insurance, it is necessary to consider:

1. Whether the proposal "specifically relates to the business of insurance";
2. Whether state laws regulating the offering of credit insurance were enacted "for the purpose of regulating the business of insurance";

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[30] 15 U.S.C. § 1012
[31] *Merchant's Home Delivery Serv., Inc. v. Frank B. Hall & Co*., 50 F.3d 1486, 1488-89 (9th Cir. 1995)
[32] *United States Dept. of the Treasury v. Fabe*, 508 U.S. 491, 507 (1993)
[33] *Gerling Global Reinsurance Corp. of America v. Low,* 240 F.3d 739, 744 (Ninth Circuit, 2001), citing, *SEC v. National Sec., Inc.,* 393 U.S. 453, 460, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969)
[34] *Id.* at 505 (quoting Black's Law Dict. 1236, 1286 (6th ed.1990))

3. If the proposal does not specifically relate to the business of insurance, whether it invalidates, impairs or supersedes state laws regulating the offering of credit insurance.

Such a proposal – All-in APR – is likely not intended to specifically relate to the business of insurance. However, All-In APR would directly impinge on the ability of licensed insurance agents to sell and finance credit insurance.

The U. S. Supreme Court has considered when a federal law invalidates, impairs or supersedes a state insurance law for purposes of the MFA, indicating that the term "invalidate" ordinarily means" to render ineffective, generally without providing a replacement rule or law."[35] The Court concluded that federal law impairs state insurance law when it directly conflicts with state regulation, and when application of the federal law frustrates any declared state policy or interferes with a State's administrative regime.[36] The Court further stated that the term "supersede" ordinarily means "to displace (and thus render ineffective) while providing a substitute rule."[37]

Including the cost of credit insurance an All-In APR as the "total cost of credit" inhibits the ability of state-licensed insurance agents to sell or finance the cost of state-approved and regulated credit insurance -- this, the MFA does not permit absent explicit authorization by Congress.

Pursuant to the MFA, credit insurance sales are regulated by State law, and any federal effort to impose limitations on when and how a credit or other insurance product may be sold impair a state-licensed insurance agent's ability to engage in the business of insurance on terms authorized under State law. Not only will this limitation block consumers with the greatest need for these products from obtaining them, it will have a negative economic impact on: (1) lenders who seek to offer it as an option for consumers to enhance consumers' ability to repay a loan after a covered occurrence, (2) credit insurance providers and agents in every State by limiting their ability to generate revenue from the business of insurance and (3) the States and municipalities by decreasing their revenue collected from premium taxes.

In addition, the **Dodd Frank Act** ("DFA") specifically recognizes the limitations imposed by the MFA by providing, *"[t]he term "financial product or service" does not include (i) the business of insurance . . .*"[38] It defines the "business of insurance" as:

> *"[T]he writing of insurance or the reinsuring of risks by an insurer***, including all acts necessary to such writing or reinsuring and the activities relating to the writing of***

[35] *Humana Inc. v. Forsyth*, 5252 U.S. 299 (1999)
[36] Id. at 307
[37] Id.
[38] 12 U.S.C. §5481(15)(C)

> ***insurance or the reinsuring of risks*** *conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons."*[39] (emphasis added)

One can reasonably conclude that in legislating this rather broad definition, Congress accepted the jurisprudence of States defining the "business of insurance" at the time the DFA was enacted, e.g., Gerling and Fabe, *supra*.

All-In APR Is a Constructive Ban on Credit Insurance, in Violation of the DFA and MFA. By including credit insurance premiums in the APR, such a proposal will effectively ban the sale of such products. This constructive ban violates both the DFA and MFA in that it is an attempt by a federal agency to regulate the business of insurance by impeding a licensed insurance agent's ability to sell a state-approved and regulated insurance product.

The MFA leaves the regulation of insurance to the States, absent an act of Congress to the contrary. By exempting the "business of insurance" from CFPB jurisdiction in the DFA, Congress reinforced the primacy of MFA in leaving the regulation of insurance to the States.

FDIC should not entertain any proposals to deviate from the APR as prescribed by Congress in TILA and its implementing Regulation Z since it fails the test of a "finance charge" and contravenes federal law. Most important, such proposals expose U.S. households by limiting access to credit and the safety net afforded by credit insurance.

Conclusion

Credit insurance offers a means for lenders and their borrowing customers to each mitigate the risk that arises from the very extension of credit itself, including the small-dollar lending market. Credit insurance helps reduce debt when the borrower(s) incurs an unforeseen event, such as loss of life, disability and/or unemployment. A host of studies and statistics illustrate consumers' need to protect their finances -- consumers need financial safety nets – especially those of modest means. Fortunately, academic research over four decades demonstrates that consumers value optional credit insurance and a significant majority would purchase it again to protect their finances. The FDIC should therefore support and promote the availability of credit insurance for the small-dollar lending market, including retaining the APR calculation as prescribed in TILA and Regulation Z.

Thank you for the opportunity to comment. Our team stands ready to assist with any questions you may have.

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[39] 12 U.S.C. §5481(3)

Sincerely,

[redacted]

Tom Keepers
Executive Director & EVP
Consumer Credit Industry Association

Enclosures:

- Durkin, Thomas A., and Gregory Elliehausen (2017). "New Evidence on an Old Unanswered Question: Why Some Borrowers Purchase Credit Insurance and Other Debt Protection and Some Do Not," Finance and Economics Discussion Series 2017-122. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2017.122
- Hause, Christopher H., "Term Life Versus Credit Life Insurance," March 2016

New Evidence on an Old Unanswered Question: Why Some Borrowers Purchase Credit Insurance and Other Debt Protection and Some Do Not

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October 20, 2017

Abstract

Credit related insurance and other debt protection are products sold in conjunction with credit that extinguish a consumer's debt or suspends its periodic payments if events like death, disability, or involuntary unemployment occur. High penetration rates observed in the 1950s and 1960s raised concerns about coercion in the sale of credit insurance. This study presents evidence on credit insurance purchase and debt protection decisions from a new survey. The findings provide little evidence of widespread or systematic coercion in purchases. Instead, findings suggest that risk aversion and health or financial concerns motivate consumers to purchase credit insurance and debt protection, just as these concerns also motivate purchases of other types of insurance.

JEL Codes: D14, D18, G22
Keywords: Personal Finance, Insurance, Consumer Protection, Credit Insurance

New Evidence on an Old Unanswered Question: Why Some Borrowers Purchase Credit Insurance and Other Debt Protection and Some Do Not

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In an environment where unfortunate consequences are possible but timing is unpredictable, both consumers facing risks and entrepreneurs looking for productive opportunities have searched for and engineered ways of spreading and mitigating those risks. Life insurance is well known for mitigating financial risks to a family concerned about the unpredictable timing of death of a breadwinner and is often available through employers as an employee benefit. Likewise, casualty insurance like fire insurance and automobile/truck operating coverages are also well known and even mandatory in many circumstances and jurisdictions. Many states require automobile casualty insurance with auto and truck registrations, for instance. But these are not the only areas where insurance and other risk-spreading techniques have arisen for individuals; consumer borrowing and lending is another. On consumer loans, taking on a stream of monthly installment payments can be risky for individuals, even though overall expected performance of an insurance policy portfolio usually is predictable for insurers. This property makes consumer borrowing another candidate for insurance products.

For almost a century, many installment lenders have made available to their borrowers insurance and insurance-like products that extinguish a consumer’s debt or suspend periodic payments on it if unfortunate events like death or temporary disability occur. In effect, these products spread the financial risks of unfortunate occurrences like death, disability, involuntary employment loss, and loss to security property across all purchasers using actuarial principles and methodologies. While these products have never been of interest to all borrowers, evidence of demand for them among borrowers concerned about these financial risks has long been available. Such events could easily lead to considerable unpleasantness for families of deceased debtors or to the debtors themselves unable to work and make their periodic payments on schedule. Beyond just an impact on credit scores of consumers facing these events, in some cases they could lead to negative estates for heirs and even to repossession of critical assets like the family car for debtors or their families at the worst possible moment. Such situations can be unpleasant for creditors as well as for borrowers.

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Over the years, several academic studies have investigated debt protection long known as “credit insurance” but also including “debt cancellation or suspension products” that are not legally insurance products at the consumer level. The number of such analyses has been small, however, at least in comparison to studies of other kinds of insurance. Most studies have focused on the public policy question whether debtors have been “coerced” to purchase credit insurance by self-interested lenders. These studies began after some observers contended in the 1950s and 1960s that monopoly position of lenders enabled them to take advantage of borrowers by coercing them to take and pay for unneeded life and casualty insurance to cover the debts.[2] Consumer surveys began with the “Ohio University Study” in 1973 (referred to below), and have continued with a list of further studies on the same general topic in the decades since. They include four Federal Reserve System reports 1977-2012. Despite such periodic attention to policy aspects of debt protection products, previous studies have not conducted an extended multivariate analysis of factors influencing consumers’ decision to purchase these insurance and insurance-like products.

The purpose of this study is twofold: 1) to update the periodic Federal Reserve studies of these products focusing on these long-standing policy issues and 2) to use new consumer survey data to look at aspects of demand for these products among current users.[3] Data are from a new nationally representative survey of consumers undertaken during March and April 2017 by the Survey Research Center of the University of Michigan (SRC). SRC is the same survey organization that provided the data examined previously in the four Federal Reserve analyses. To ensure continuity and comparability, the new study used the same questions and methodology as previously, with some new questions this time concerning product demand elements and a new simple question that helps address the coercion supposition noted earlier. The first part of this report provides updated discussion and tables based upon those in the 2012 and earlier Federal Reserve efforts, and the second part employs univariate and multivariate statistical evidence to look at aspects of demand for credit insurance and related products.

New Survey

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[2] For example, see Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 83rd Congress, 2nd Session, *Report on the Tie-In Sale of Credit Insurance in Connection with Small Loans and Other Transactions (Committee Print* 1955).

[3] Despite past studies that have developed relevant research evidence, these products have remained controversial among some observers, See, for example, Carolyn Carter, et al., “Installment Loans: Will States Protect Borrowers from a New Wave of Predatory Lending?” (Boston: National Consumer Law Center, July 2015).

The authors have extensively described credit insurance and other debt protection products before, including product features, costs, and controversies, and it seems redundant to do so at any length again.[4] Basically, credit insurance products consist foremost of credit life insurance that repays the debt in the event of the debtor's death, and credit casualty insurance which continues the payments in the event of the debtor's incapacity due to covered conditions (typically, accidents and health-related incapacities, involuntary loss of employment, or loss to property securing a loan). These products have been around for almost a century (since 1919), and millions of borrowers have purchased them over the decades.

Related products called "debt cancellation contracts" and "debt suspension agreements," both developed decades ago, do the same things from the consumer's viewpoint. They are two-party loan agreements between the borrower and the lender for the lender to cancel the debt, in a lump sum or through a series of loan payments (debt cancellation agreements), or suspend loan payments for covered events (debt suspension agreements). As two-party loan agreements these products are not insurance products and are regulated under federal and state banking laws. Since they are similar looking to insurance from the debtor's standpoint, they are considered here together with traditional credit insurance.

In March and April 2017, the SRC conducted a total of 1200 nationally-representative interviews about consumers' experiences with credit insurance and other debt protection products.[5] The first part of the survey was based explicitly upon the 2012 survey project in order to provide evidence of similarities and trends. Indeed, some of the questions were unchanged from the 1977 Federal Reserve survey and used unchanged in 2017 for the fifth time overall. The SRC's research approach produced a nationwide probability sample of respondents that is representative of the contiguous 48 states within statistical confidence limits. The SRC coded the interview results and provided a machine-readable data set in SAS format. The authors wrote the SAS computer program to produce the tables reported here.

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[4] See Thomas A. Durkin and Gregory Elliehausen, "Consumers and Debt Protection Products: Results of a New Survey of Borrowers," *Federal Reserve Bulletin*, December 2012. For extended discussion of features, costs, and controversies associated with credit insurance and other debt protections, see Thomas A. Durkin, Gregory Elliehausen, Michael E. Staten, and Todd J. Zywicki, *Consumer Credit and the American Economy*, (New York: Oxford University Press, 2014, Chapter 12).

[5] The interviews actually were representative of the contiguous 48 states and did not include Alaska and Hawaii. The authors thank SRC and the Consumer Credit Industries Association (CCIA) for making the data available. The analysis and views expressed here are those of the authors and not those of either of these organizations.

Survey Findings

One goal of the survey was to observe again the long-term trends in the purchase of these insurance and insurance-like products. A population survey design over time is the only way to determine such trends. Examining evidence from insurance companies would not be revelatory because it would contain information only on those who purchase the products from them and not on those who purchase from others or do not purchase. Likewise, insurance companies would not have information about debt cancellation agreements and debt suspension agreements because these are issued by the potentially thousands of lenders and creditors that might provide such products in the marketplace.

Survey evidence from SRC on prevalence of debt protection has previously been available for 1977, 1985, 2001, 2012, and now also for 2017.[6] The results show that frequency of purchase of debt protection products on consumer installment credit was much higher in 1977 and 1985 than in later years. In the earlier years when the "coercion" issue became a public-policy concern in some quarters, purchase prevalence on consumer installment credit (frequently called the "penetration rate") exceeded 60 percent (Table 1). The penetration rate has dropped by almost two thirds since then, to measurements in the 22 to 26 percent range. The decline in the penetration rate after 1985 seems to have brought it well under the early range that triggered concerns of systematic purchase "coercion" in earlier times.[7]

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[6] The earlier survey results are in Thomas A. Durkin and Gregory E. Elliehausen, *The 1977 Consumer Credit Survey* (Washington: Board of Governors of the Federal Reserve System, 1978); Anthony W. Cyrnak and Glenn B. Canner, "Consumer Experiences with Credit Insurance: Some New Evidence," Federal Reserve Bank of San Francisco *Economic Review*, Summer 1986; Thomas A. Durkin, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance," *Federal Reserve Bulletin*, April, 2002; and Durkin and Elliehausen, "Consumers and Debt Protection Products: Results of a New Survey of Borrowers" (2012) referenced in footnote 2. Also discussing these survey results are Robert A. Eisenbeis and Paul R. Schweitzer, *Tie Ins Between the Granting of Credit and Sales of Insurance By Bank Holding Companies and Other Lenders* (Washington: Board of Governors of the Federal Reserve System, Staff Study 101, 1979) and Durkin, Elliehausen, Staten, and Zywicki, *Consumer Credit and the American Economy* (2014), referenced in footnote 2, Chapter 12.

Other survey findings and discussion of credit insurance are in Charles L. Hubbard, ed., *Consumer Credit Life and Disability Insurance* (Athens, Ohio: College of Business Administration, Ohio University, 1973); Joel Huber, *Consumer Perceptions of Credit Insurance on Retail Purchases* (West Lafayette, Indiana: Purdue University Credit Research Center, 1976); and John M. Barron and Michael E. Staten, *Consumer Attitudes toward Credit Insurance* (Norwell, Massachusetts: Kluwer Academic Publishers, 1996).

[7] The three latter measurements for the penetration rate reported here are within normal statistical sampling range for being three measurements from the sampling frame. So, statistically, they may be considered close to identical and no strong conclusions should be drawn from the small differences among the three more recent surveys.

To examine the coercion issue more fully, all of the SRC surveys have included specific questions about this concern. As in earlier years of this series of survey projects, the first approach was to question respondents directly about their experiences at the point of sale.[8] Consumers with common closed-end consumer installment credit outstanding were asked whether or not they had purchased any debt protection products and about the debt protection offering experience at the point of sale. It appears that experience has changed sharply over the decades since 1977.

In 1977, the majority (72 percent) of closed-end consumer installment credit users who had purchased debt protection reported that the lender had either recommended the purchase of the protection or recommended it strongly (Table 2). This proportion fell to under 20 percent in 2017.

That the penetration rate was also much lower in the more recent years is worth noting again. This decrease in the penetration rate means that among closed-end installment credit users, the proportion who both purchased and who noted receiving a recommendation to that effect fell sharply after 1977 due to both lower penetration rates and fewer experiences of a recommendation. Specifically, in 1977 about 46 percent of closed-end installment credit users reported that they purchased and received a purchase recommendation from the creditor of varying intensity (that is, the 72.4 percent who said that debt protection was “recommended” or strongly “recommended/required” (Table 2) of the 63.9 percent who purchased (Table 1)). These percentages compare to only about 5 percent in 2017 (19.7 percent of the purchasers who said that debt protection was “recommended” or “strongly recommended/required” (table 2) of the 26 percent who purchased (Table 1)). This decline is substantial and suggests that even if widespread aggressive sales are being attempted by some providers, they are not very successful.[9]

Table 1 also reports penetration rates for debt protection products for consumers with credit card accounts. As discussed more fully in 2012, these rates measure proportion of respondents having any card account with debt protection. Since consumers may individually have many credit cards, penetration rates for any one kind of account or brand would be lower (see Durkin and Elliehausen, “Consumers and Debt Protection Products: Results of a New Survey of Borrowers” (2012), referenced in footnote 2, p. 6.

[8] The next few paragraphs draw upon the outline of similar discussion in Durkin and Elliehausen “Consumers and Debt Protection Products: Results of a New Survey of Borrowers” (2012), referenced in footnote 2.

[9] In each survey year, some purchasers indicated the lender did not mention the product at point of sale, which must mean either they purchased it after some kind of follow up after the fact by telephone or mail, or they brought it up themselves at the point of sale before mention by the lender. If somehow it were to indicate that the lender just placed it in the contract, then it seems there would also be evidence that

To look at experience at the point of sale more directly, respondents who either did or did not purchase debt protection but indicated that protection was offered or recommended to them were then asked directly about their understanding of whether the offered or recommended product was voluntary. Significantly, not one respondent in either the purchasers or non-purchasers groupings reported belief the purchase decision was not voluntary. Among purchasers who indicated recollection of the circumstance (96 percent), almost all (again 96 percent) reported the lender had explained the terms. The proportion was almost as high among non-purchasers (89 percent), even if a lot of explanation to them would seem unimportant as soon as they indicated they were not purchasing.

It is worth repeating that many respondents were not even offered these products. In each of the survey years except 1985, more than half of those who did not purchase a protection product on closed-end consumer credit reported that protection products were not even mentioned by the lender. Even in the exception year 1985, the proportion not hearing any mention was about 45 percent. It is difficult for people to be pushed into buying an add-on or ancillary product to a credit transaction if it is not even mentioned to them at the point of sale. The proportion of non-purchasers who said the products were not mentioned reached two thirds (67 percent) in 2017.

Along with the hypothesis that if coercion is widespread evidence of it should show up in direct questioning, a second hypothesis is that consumers who felt pressured to buy an add-on or ancillary product they did not want would probably not be very favorably inclined toward the add-on or ancillary product. To examine this possibility, consumers over the years with and without debt protection were asked about their feelings toward buying the protection, specifically whether such purchase is “a good idea or a bad idea.”

Experience in 2017 confirms prior findings that the overwhelming majority of purchasers of debt protection on closed-end consumer credit consider its purchase to be a good idea. The proportion answering good or good with some degree of qualification exceeded 85 percent in each of the interview years (Table 3). In contrast, the proportion responding “bad” was less than 10 percent in all but the 2012 survey, in which it reached 11 percent. Although the proportion in 2012 is not statistically significantly different from 2017, the slightly higher incidence of this response in 2012 may be an artifact of the lengthy prior recession that had recently ended. It seems possible in any year, but maybe more so in worse economic times, that

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the attitude of these buyers toward the product would not be very good. In fact, a look at attitudes of the individuals in this relatively small group whether the insurance/protection product is good or bad, discussed next in more detail for the larger sample size of respondents as a whole, does not suggest this possibility.

if consumers find themselves in a situation where they realize after the fact that an expenditure on insurance or an insurance-like substitute did not result in a payoff, they may to some degree regret the expenditure at a time when budgets are tight. Of course, they did not suffer the loss they insured against either, and the peace of mind entailed with the protection purchase may still resonate with many of them.

Table 3 also demonstrates that attitudes are much different between purchasers and non-purchasers of the protection products. For the non-purchasers, attitudes toward the protection products are decidedly less favorable than among purchasers, but a majority of non-purchasers still expressed a favorable view anyway in every survey year except 2001. Nonetheless, a somewhat higher portion of non-purchasers with unfavorable attitude toward the protection products is consistent with their choices not to purchase.

Attitudes were also measured in a related but somewhat different manner. Specifically, purchasers of debt protection were asked directly about their satisfaction with the protection product purchased. Obviously, this view could not be asked of non-purchasers. Again, using this measurement, purchasers of debt protection expressed favorable views. Approximately four fifths of purchasers suggested satisfaction in each of the years when measurements were undertaken (2001, 2012, and 2017, Table 4). Although in each survey year that included this question some respondents appeared indifferent, relatively few expressed dissatisfaction. For this reason, it appears important to remember the views of users as well as non-users in any discussion of regulatory changes affecting availability of debt protection products.

Purchasers also expressed a high degree of willingness to purchase debt protection on future credit use. More than 70 percent of purchasers indicated willingness to purchase again on installment credit in each survey year (Table 5). While a favorable attitude now does not necessarily translate directly into a purchase later, it is also possible that actual purchases later could be higher than the attitude expressed now. When entering into the next credit contract, financial anxieties may surface again and purchasing debt protection may again produce the peace of mind that it apparently did in many cases in the past. In any case, the favorable proportion on this measurement appears to have settled in the 70 percent to three quarters range, down a bit from the extremely high measurement in 2001. (The measured difference between 2012 and 2017 is not statistically significantly different.) Thus, neither direct nor indirect findings about possible coercion in purchase of debt protection suggest the kind of unhappiness with a product that might arise if purchasers felt that they were being pushed into the purchase or that the product itself was not very useful.

Evidence on Potential Factors Associated with Willingness to Purchase Debt Protection

If coercion is not the explanation for the decision to purchase debt protection by users of installment credit who purchase, then what other factors are possibly explanatory? Based on previous studies of demand for life insurance, it is easy enough to hypothesize quite a few and ask survey questions about them.[10] The 2017 survey did this and they are summarized in Table 6. The table contains five groupings of possible underlying reasons that might be associated with purchase of debt protection:

1) Current perceptions of “underinsurance” in other areas by some purchasers who, therefore, might believe that debt protection is a means of managing this concern in at least one area of their lives.

2) Current health issues that might make some individuals more concerned over their financial future than other individuals.

3) Other financial concerns that might make scheduled repayments potentially more problematic for some individuals than for others. These concerns could include desire to build or protect a credit reputation as evidenced in a credit score.

4) Differences in basic risk aversion among segments of the population. Some individuals may simply be more risk averse than others, apart from specific health or financial concerns. The survey also examined this possibility.

5) Difference in demographic/economic status including income, assets, age, life cycle stage, and others that indicate differences in underlying current situation.

Univariate display of relevant variables in Table 6 looks at each of these areas individually before passing to multivariate review. The table consists of five columns for each of 22 separate measurements plus some sub measurements listed in column 1. Multivariate review involves looking at the same variables but accounting for (holding constant) the simultaneous effects of the others in a statistical equation.

[10] For a summary of the literature on demand for life or credit life insurance, see L. Lee Colquitt, Stephen G. Fier, Robert E. Hoyt, and Andre P. Liebenberg, “Adverse Selection in the Credit Life Insurance Market,” *Journal of Insurance Regulation*, Winter 2012. Colquitt, et al. is the only other study of components of demand for debt protection. It necessarily had to rely upon state-wide averages for most of its demand-related variables because of unavailability of micro data.

The table is read as follows: The first column notes, possible characteristics of surveyed individuals with installment credit outstanding that might be related to demand for debt protection. The second column is the percent of surveyed debtors *who did not purchase debt protection* who had this characteristic. The third is the percent of debtors who *did purchase* protection who had this characteristic.

For instance, looking at the first row, other life insurance, the second column shows that 76.8 percent of surveyed individuals with installment credit and who *had not* purchased debt protection had other life insurance. Still looking at this row, the third column shows that 78 percent of those with installment credit and *had* purchased debt protection had other life insurance.

The other rows of the table work the same way. For example, the second row shows that among borrowers with installment credit and other life insurance, 65 percent of non-purchasers of debt protection had other life insurance of $50,000 or more while only 59 percent of debt protection purchasers had this much other life insurance.

The fourth column of the table then indicates the prior hypothesis whether the row criterion is more likely for non-purchasers of debt protection. “Yes” indicates the hypothesis that likelihood is greater for non-purchasers of protection than for purchasers. For instance, the first row indicates the expectation that non-purchasers of protection would be *more likely* to have other life insurance than purchasers (“Yes” hypothesis). (As it turns out, column 5 shows that the evidence does not support this first hypothesis, although the univariate evidence is consistent with most of the other hypotheses.)

Column 5 then shows, row by row, the relationship of actual survey results to the relevant expectations. The findings are presented with the positive or negative sign of the actual relationship of column 1 (non-purchasers of protection) to column 2 (purchasers) for each characteristic.

As indicated, survey results are consistent with expectations of differences in hypothesized demand-related criteria in almost every case where there is an expectation. The first grouping of variables involves evidence of other insurance holdings. The general contention here is that if some debtors have less other insurance, they may feel underinsured when taking on more installment debt, and so they purchase debt protection as at least a partial remedy for this concern. Life, health, and disability insurance can provide benefits similar in some ways to common forms of debt protection. Thus, not having these types of insurance likely stimulates demand for debt protection.

In general, Table 6 shows consistency with the hypothesized relations, although holdings of other insurance seem less important as a univariate explanation of debt protection demand than other classes of borrower criteria. For example, life insurance holding is quite widespread among both non-purchasers and purchasers of debt protection but actually slightly more common among debt protection buyers (line 1 of the table). And so, life insurance demand already seems strong in the experience of debt protection users.

Debt protection purchasers are more likely to have smaller *amounts* of life insurance (line 2), however, and those with small amounts of life may feel underinsured. Survey results summarized in column 5 show that those with small amounts of life insurance are more likely to purchase debt protection than consumers with life insurance of $50,000 or more. Holding of health insurance and disability insurance also have the expected relationships between non-purchasers and purchasers of debt protection, although the differences are not large.

The most sizable difference in the insurance area concerns the question about holding of long-term care insurance. Long-term care insurance covers a distant large expense, whereas credit insurance involves a relatively small amount limited to the amount of debt over a relatively short period of time. As such, these products would not seem to be substitutes, but the difference between purchasers and non-purchasers of debt protection is fairly large, with purchaser of debt protection more likely also to have long-term care coverage. (Frequency of this sort of insurance actually is lower both with purchasers and non-purchasers of debt protection compared to other kinds of insurance.) There may be an explanation, however. One possibility is that in purchasing long-term care insurance installment credit users, who are mostly young or middle aged, exhibit foresight for future large risks. In this case, the purchase of long-term care insurance seems more a reflection of these consumers’ risk aversion than concern that one is underinsured for an immediate shorter term risk.

A different explanation involves non-financial considerations. In discussion with the authors, one knowledgeable insurance specialist suggested that purchase of long-term care insurance for many purchasers does not solely involve financial concerns like other insurance. In his words, long-term is also “dignity insurance” and so involves elements of a bit different nature. In this view, it potentially saves dignity of elderly individuals and so it may be relatively more important to those with fewer other resources, possibly including debt protection purchasers, for protecting dignity in old age. Whatever the specifics of this relationship that ultimately might involve psychological elements as well as financial, more extensive buying of long-term care coverage by purchasers of debt protection does not seem like this purchase solely involves a financial decision. Both of these two potential explanations seem plausible and are not mutually exclusive.

In the second grouping in the table, health concerns, survey measurements of a group of possible health concerns among non-purchasers and purchasers of debt protection are consistent with hypotheses (lines 6 through 11 in the table). In general, the finding is that those with health concerns are more likely to purchase debt protection, consistent with reasonable expectations in this area. In particular, the survey provides evidence of adverse selection arising because of only limited underwriting allowable for debt protection but where there is asymmetric information (i.e. consumers have better private information on their health than the insurers). This makes debt protection more attractive to higher-risk consumers. The idea is that consumers having bad health will disproportionately choose debt protection. This, of course, results in a worsening of the risk pool. The worsening of the risk pool can then lead to higher prices, causing lower-risk consumers to leave the market and produce an upward spiral of risk and price.

The findings in the health area provide evidence supporting the adverse selection hypothesis, and the differences are mostly larger than for the mainstream insurance-holding measures. The exception is whether the respondent is a smoker, but this difference disappears when whether spouse or partner (or either individual in the relationship) is a smoker is also taken into account. Immediate health issues over the near term seem to be relevant to the decision to purchase debt protection for installment credit.

The third grouping of factors that might be relevant is financial concerns. Again, the survey measures in Table 6 are consistent with hypotheses, and the differences are mostly large (lines 12 through 15). Especially large is the difference in whether the respondent rates credit history for self (and spouse, if any) as “very good,” with debt protection users considerably less likely to indicate “very good” credit history (line 12). This suggests a strong possibility that protecting credit history is associated with purchasing debt protection. Since a very good credit history can lower the cost of credit arrangements by considerably more than the cost of debt protection lowers it, this is not especially surprising.[11]

Other measured relevant financial concerns include two measures of ability to meet financial emergencies, with limitations on financial reserves directly associated with likelihood of purchasing debt protection (lines 13-14). Finally in this litany of financial matters, worry over current job security also apparently enters into

[11] For further discussion of this point, see Durkin, Elliehausen, Staten, and Zywicki, *Consumer Credit and the American Economy*, referenced in footnote 2, Chapter 12.

the demand for debt protection. Those somewhat worried or very worried over job security are more likely to be purchasers of debt protection than non-purchasers (line 15).

All of these factors taken one at a time on a univariate basis may well come together in a question on overall risk aversion (line 16). In this case, those who do not have debt protection are considerably more likely to express they are willing to take financial risks than those who have debt protection. A lot of the background for this willingness to take financial risks may well rise from their greater financial ability to take on such risks. Those with a bit less insurance, but sometimes with greater health or financial concerns may well be looking for ways to reduce risks rather than take on more.

Finally, a series of demographic variables also collected with the rest of the survey information offers some more description of debtors who purchase debt protection relative to those who do not. For instance, purchasers of debt protection are a bit younger but less likely to be married (lines 17-18). This suggests they are more likely to be facing risks alone, probably with lower family income. This income description is borne out with direct family income measurement where installment debtors with debt protection are considerably less likely in the highest income quintile (line 21). They also are less likely to be home owners (a measure of asset holding, line 22), and holders of credit cards (not in table).

A multivariate logistic regression analysis of the debt protection choice supports the findings suggested by the univariate analysis. The dependent variable is whether or not the consumer purchased debt protection for an installment loan. Explanatory variables include the sets of variables reflecting other insurance coverage, health concerns, financial concerns, basic risk aversion, and demographic characteristics discussed in Table 6. Some categories have been combined in slightly different ways (Table 7). Explanatory variables also include a price, the state prima facie rate for credit life insurance, stated as dollars per $100 per year.[12] Credit insurers generally charge this rate in each state.[13]

The first column of Table 7 lists the statistically important variables using the same variable definitions as Table 6. The estimated regression is statistically significant at the one-percent level. Many of the variables identified as statistically related to

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[12] Source: *Fact Book of Credit-Related Insurance* (Atlanta: Consumer Credit Industry Association 2016). The *Fact Book* also reports state prima facie rates for credit disability insurance, but the reference version of this product is not offered in several states. For the states that offer the reference version, prima facie rates for credit disability and credit life are strongly positively correlated.

[13] See Gary Fagg, *Credit-Related Insurance* (Hurst, Texas: CreditRe, 2004).

the purchase of debt protection when examined individually remain important when multiple variables are taken into account simultaneously. Having other life insurance of $50,000 or more is negatively related and health or disability insurance is positively related to using debt protection, but neither estimated coefficient is statistically significant. Having long-term care insurance is statistically significant and positive. The odds ratio, which measures the size of an explanatory variable’s effect on the dependent variable, indicates that the odds of purchasing debt protection for consumers having debt protection are 2.256 times that for consumers not having long-term care insurance.[14]

Having bad health is statistically significant and positively related to purchasing debt protection. Consumers who have bad health are about twice as likely as healthy consumers to purchase debt protection. This finding suggests the possibility of adverse selection in debt protection markets. That is, an unfavorable risk pool leads to high prices, which causes healthy consumers to avoid debt protection products.

Among financial concerns, consumers having good credit, a reserve fund of $400 or more, and the ability to cover 90 days of expenses are less likely than other consumers to choose debt protection. Consumers who are worried about job losses are more likely than other consumers to choose debt protection. These findings are each believable, although the estimated coefficients are not statistically significant.

Consumers who are risk averse are significantly more likely than consumers who are not risk averse to choose debt protection. The odds ratio estimate indicates that risk averse consumers are 1.72 times more likely to purchase debt protection than consumers who are willing to take financial risks.

The price of debt protection has a negative sign, indicating the expected result that that the likelihood if purchasing debt protection decreases as price increases, as expected for the demand for any product. However, the estimate is not statistically significant either, showing that the effect is not very strong.

Of the demographic characteristics, consumers with a college degree and married consumers were less likely than consumers in lower

[14] Odds are the ratio of the probability of x (purchasing debt protection, for example) to the probability of not x (i.e. not purchasing debt protection). The odds ratio for an indicator variable (having long-term care insurance) is the probability of purchasing debt protection for consumers who have long-term care insurance divided by the probability of purchasing debt protection for consumers not having long-term care insurance. The odds ratio can be calculated by exponentiating the coefficient for having long-term care insurance from the logistic regression. That is, exp(0.842)=2.321.

education categories or unmarried consumers to purchase debt protection. Consumers in the third income quartile were significantly more likely than consumers in other income groupings to purchase debt protection.

Thus, the multivariate examination also finds a profile for debt protection purchasers of individuals with health concerns, who are more likely to register credit concerns, who are not in the highest income or education groupings, who have life insurance but not a great deal of it, and often without large financial reserves. A general measure also often finds them individually risk averse. Ultimately, this describes a likely prospect to purchase insurance for perceived risks. That they sometimes do so when entering into consumer credit arrangements is not surprising.

Conclusion

And so, survey research suggests other reasons for purchasing debt protection than the old argument that purchase reflects lack of understanding or even widespread coercion at the point of sale. Direct questioning again shows a long-term decline in purchase penetration rate and in the frequency and strength of offers to the point where only about 5 percent of installment credit users reported both that the creditor had recommended the product and they had bought it. Furthermore, not one respondent reported feeling that debt protection was other than a voluntary option. In contrast, a substantial majority of purchasers believed that purchase was voluntary and that they would do it again.

Rather, survey evidence shows that debt protection amounts to an add-on in credit arrangements preferred by some but not by others. Over the longer term its prevalence as part of installment credit arrangements has declined, probably reflecting long-term growth in employment, income, and assets that have permitted more consumers to self-insure themselves in the marketplace. Evidence suggests it is useful to many consumers, however, and is much more than a niche product. Installment debtors who purchase debt protection are somewhat otherwise less insured than product purchasers and more frequently have either health, financial, or possibly both kinds of concerns. They generally are not among the financially elite, and they tend to be quite risk averse. Their wealthier brethren who are similarly risk averse may often be candidates for purchase of other specialized insurance products like trip-cancellation insurance. Why would anyone except the omniscient argue that such preferences are unreasonable?

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Table 1. Debt Protection Penetration Rates
1977-2017
(Percentage Distributions Within Groups of Credit Users)

	1977 Install Credit	1985 Install Credit	2001 Install Credit	2012 Install Credit	2017 Install Credit	2001 Credit Card	2012 Credit Card	2017 Credit Card
Have	63.9	64.7	22.7	22.0	26.0	20.1	14.0	19.2
Do not have	30.1	33.1	74.4	75.6	70.6	73.9	82.0	75.4
Do not know/ Refuse	6.0	2.2	2.9	2.4	3.4	6.0	4.0	5.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note:

Columns may not sum to totals because of rounding.

Table 2. Recommendations Concerning Debt Protection Purchase at Point of Sale on Installment Credit, 1977-2017

(Percentage Distributions Within Groups of Users and non Users of Installment Credit, With and Without Debt Protection)

	1977		1985		2001		2012		2017	
	Protection		Protection		Protection		Protection		Protection	
	Have	Not Have	Have	Not Have	Have	Not Have	Have	Not Have	Have	Not Have
Recommendation:										
Never mentioned	10.6	52.2	14.8	45.2	15.4	53.3	18.7	62.7	30.0	67.4
Offered	15.0	22.6	44.7	35.5	53.2	33.9	43.5	29.5	42.9	21.3
Recommended	33.1	17.0	16.4	12.9	12.2	4.1	17.6	0.5	9.6	1.6
Strongly recommended/ required	39.3	2.3	20.1	2.6	16.6	3.4	20.1	0.9	10.1	0.3
Do not know/Refuse	2.1	5.9	3.9	3.9	2.6	5.3	*	6.5	7.4	9.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

* Less than one half of one percent.

Columns may not sum to totals because of rounding.

Table 3. Attitudes Toward Debt Protection Among Users of Installment Credit, 1977-2017

(Percentage Distributions Within Groups of Users and non Users of Installment Credit, With and Without Debt Protection)

	1977		1985		2001		2012		2017	
	Protection		Protection		Protection		Protection		Protection	
	Have	Not Have	Have	Not Have	Have	Not Have	Have	Not Have	Have	Not Have
Attitude:										
Good	86.7	59.8	89.9	56.4	88.5	32.3	85.5	53.8	84.4	53.6
Good with qualifications	8.6	18.9	2.9	8.3	3.8	6.1	*	3.2	2.6	*
Neither good nor bad	2.1	9.1	1.9	6.4	3.2	13.9	3.1	1.8	4.1	5.8
Bad with qualifications	*	2.7	*	2.6	*	1.6	*	6.5	*	*
Bad	2.2	9.5	5.2	26.3	4.5	46.0	11.4	40.5	8.8	40.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

* Less than one half of one percent.

Columns may not sum to totals because of rounding.

Table 4. Satisfaction With Purchase of Debt Protection on Installment Credit 2001-2017

(Percentage Distributions Within Groups of Installment Credit Users)

Satisfied with Purchase?	2001 Installment Credit	2012 Installment Credit	2017 Installment Credit
Very	27.8	38.2	29.6
Somewhat	65.6	40.9	43.3
Subtotal: Satisfied	93.4	79.1	72.9
Neither satisfied nor not	3.9	20.9	17.5
Somewhat dissatisfied	2.7	*	4.7
Very dissatisfied	*	*	5.0
Total	100.0	100.0	100.0

Notes:

* Less than one half of one percent.

Columns may not sum exactly to totals because of rounding.

Table 5. Willingness to Purchase Debt Protection Again
Among Users of Installment Credit
2001-2017
(Percentage Distributions Within Groups of Credit Users)

Purchase again?	2001 Installment Credit	2012 Installment Credit	2017 Installment Credit
Yes	94.2	74.6	70.2
No	5.8	24.4	29.7
Total	100.0	100.0	100.0

Notes:

* Less than one half of one percent.

Columns may not sum exactly to totals because of rounding.

Table 6. Factors that May Associate with Instalment Credit Users' Willingness to Purchase Debt Protection

Installment credit users *who have*:	Proportion among *non*-purchasers of debt protection (Percent)	Proportion among purchasers of debt protection (Percent)	Hypothesized to be greater for non-purchasers?	Actual percent points by which non-purchasers exceed purchasers*
1. Other life insurance	76.8	78.0	yes	- 1.2
2. Other life insurance of $50,000 or more	65.3	59.5	yes	5.8
3. Health insurance	95.0	94.5	yes	.5
4. Disability insurance from employer	49.7	47.8	yes	1.9
5. Long-term care insurance	20.5	38.2	uncertain	- 17.7
Health concerns				
6. Respondent has bad health	13.2	22.7	no	- 9.5
7. Spouse has bad health	10.4	16.9	no	- 6.5
8. Respondent or spouse has bad health	15.4	29.4	no	- 14.0
9. Respondent smokes	15.2	13.9	no	1.3
10. Spouse smokes	11.5	20.7	no	- 9.2
11. Respondent or spouse smokes	18.0	22.4	no	- 4.4
Financial concerns				
12. Respondent or spouse has very good credit	61.4	42.5	yes	21.9
13. Has reserve funds of $400 or more	83.7	76.4	yes	7.3
14. Could cover living expenses for 90 days	81.3	62.9	yes	18.4
15. Respondent or spouse worried about job security	15.9	19.1	no	- 3.2
Basic risk aversion				
16. Unwilling take above average risks	67.6	88.2	no	- 20.6
Demographic characteristics				
17. Age				
Less than 35	22.0	27.2		- 5.2
34-44	19.0	18.5		.5
45-54	18.9	19.1		- .2
55 and older	40.0	35.2		4.8
18. Married	73.9	63.8		10.1
19. Children	33.6	34.1		- .5

20. Education:			
High school diploma or less	15.2	18.5	- 3.3
Some college	17.1	25.9	- 8.8
College degree	67.7	55.6	12.1
21. Income quintile			
Lowest	16.4	25.3	- 8.9
Second	25.0	26.9	- 1.9
Third	20.9	25.3	- 4.4
Highest	37.8	22.6	15.2
22. Home owner	73.1	65.0	8.1

Note:

* Actual percentage point difference measured by the survey by which frequency of purchase of debt protection (Column 2) exceeds non purchase (Column 1) for those meeting the line criterion.

Table 7. Logistic Regression of Factors Associated with Instalment Credit Users' Willingness to Purchase Debt Protection

Variable	Coefficient estimate		Standard error	Odds ratio
Price				
crliferate	- .178		1.230	.837
Other insurance				
haslife50+	- .363		.405	0.695
hashealth	.429		.738	1.536
haslongterm	.814	***	.295	2.256
Health concerns				
healthbad	.650	**	.348	1.916
smokes	.211		.340	1.235
Financial concerns				
creditvgood	- .429	†	.334	.651
reserve400+	- .054		.420	.947
exp90day	- .175		.421	.840
jobloss	.112		.374	1.118
Basic risk aversion				
riskaverse	.543	†	.379	1.720
Demographic characteristics				
age<35	.230		.374	1.259
age55+	- .450		.338	.638
married	- .409		.351	.664
haschild	.007		.319	0.993
incquart1	.078		.521	1.081
incquart2	.024		.408	1.025
incquart3	.638	*	.354	1.893
somecollege	- .038		.420	.963
collegedeg	- .416		.373	.660
homeowner	.312		.340	1.366
Intercept	-1.249		1.152	
Likelihood ratio	42.420	***		
McFadden's R-squared	14.3			
Number of observations	336			

Note:

Significance levels: *** 1 percent, ** 5 percent, * 10 percent, † 20 percent

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TERM LIFE VERSUS CREDIT LIFE INSURANCE

Within the discussion of the role of credit life insurance in providing loan protection, industry critics often argue that credit life premium rates are "too high" and consumers would be better served by purchasing a level term life insurance policy to cover their loan protection needs.

These same critics also argue that credit life insurance provides "low consumer value" because the historical loss ratio is lower than some other types of insurance. Since the alternative being advocated is a level term life policy, one would assume these advocates believe that the level term policy provides a better consumer value, in terms of loss ratio, than a credit life policy.

However, the facts do not support either of the above positions. While the demonstration below is not an exhaustive study nor does it purport to recommend a course of action for any given borrower, the conclusion is that, relative to individually underwritten term life insurance, credit life is a reasonably priced product and – if loss ratio is in fact a valid measure of consumer value – credit life actually provides a better value to policyholders than level term insurance.

Premium Cost Comparison

Credit life insurance critics frequently support the price argument by making a comparison between a credit life policy and a level term policy issued to a healthy, non-smoking, 25 year old, female who can often purchase much more coverage than actually needed to protect a new consumer loan for the same premium cost.

The primary fallacy in the argument is that the scenario is based upon the best possible risk classification on one side compared to a contract that spans many traditional risk classes on the other side. While level term life insurance premiums vary by age, gender, smoking and health status, credit life is rated the same across a much broader range of health and age groups. With the credit life insurance, the premium rate is the same for all applicants regardless of age, gender, or health conditions and the amount of coverage is designed to meet the incremental protection needs of a new loan. So while level term insurance cost per thousand dollars of coverage may be lower for young healthy females, level term insurance generally costs more for older and less healthy males.

The other fallacy in the argument is that Credit life insurance is sold in amounts restricted by regulation to only cover the exposure created by the consumer loan for which the coverage is sold. Conversely, level term insurance is purchased at larger face amounts where the cost per thousand dollars of coverage can be lower. But the concept of increased pricing efficiency with increased volume is not unique to term insurance. My analysis suggests that if term insurance providers made level term insurance policies available at the same low face amounts at which credit insurance is purchased, their premium cost for level term life would actually be higher than credit life policies sold today.

While the numerical relationships vary by age and gender, all comparisons suggest that credit insurance is an efficient vehicle for providing small amounts of life insurance.

The Procedure

To perform the comparison, I compiled the ten year level term rates of fifteen large writers of term insurance and took an average of them by age and underwriting class. Ten year level term was chosen because it is the shortest term for which rates are available from a large number of companies. The premium rates were obtained from a commercial website maintained for the purpose of comparing term insurance quotes.

Since none of the term insurers offer individual level term in an amount as small as the average credit life policy issued in 2013 of $5,600[1], I extrapolated the rates for a $50,000 policy down to what the cost would be for a $10,000[2] ten year level term life policy. I accomplished this extrapolation by separating the premium into the average policy fee and the rate per $1,000 of coverage. Taking an average across ages and underwriting classes, I then calculated a credit equivalent cost per $100 per year, which is the basis for credit life rates and allows direct comparisons of rates for the two products.

The Graphical Results

The results are illustrated on the graphs in the attached Comparison Exhibits. Exhibit I illustrates the credit life equivalent rates for the 15 providers of level term insurance. The credit life equivalent cost per $100 for term policies would vary from a low of about $.51 to a high of about $.64 with an average of $.57. Based on this average, the overall cost of the term plan would be about $.08 higher than the nationwide average for credit life insurance of $.49 per $100[3]. This first graph illustrates that credit life is actually more efficient than other term life insurance products at providing coverage for small face consumer loans.

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[1] Source is the American Council of Life Insurers (ACLI) 2014 Life Insurer Fact Book with data derived from the Association of Insurance Commissioners (NAIC) data.

[2] I chose the $10,000 face amount since it still exceeds the average credit life policy issued today while representing a reasonable target coverage amount for consumers requiring a basic life insurance policy. Comparisons using the actual average policy size of $5,600 would be even more favorable.

[3] National average credit life rate as documented in "The Fact Book of Credit-Related Insurance" for 2014 as published by the Consumer Credit Industry Association.

Exhibit II illustrates the comparisons between the average credit life rate and the average credit life equivalent term insurance rates from the same fifteen companies at various issue ages. The results are as expected; the non-age rated credit life rates are higher than the term rates at the younger ages and lower at the higher ages. With aging demographics, credit life will continue to compare favorably against term life for providing coverage at a reasonable cost.

Policyholder Return Comparison

Critics of insurance in general – and credit life insurance in particular – often maintain that the value of an insurance policy to the consumer can be measured solely in terms of the aggregate amount of premium returned to policyholders in the form of claims, i.e., the loss ratio. The minimum acceptable value for such loss ratio (the benchmark loss ratio) is oftentimes chosen without consideration for specific product characteristics, reasonable margins for the distribution and administration of the insurance product, or other consumer decision making criteria.

Industry critics have stated that the loss ratios reported for credit life are simply too low based upon their chosen benchmark loss ratio. We show in Exhibit III that when the credit life insurance value is measured against term life insurance using the loss ratio approach, credit life insurance actually provides a much better return to policyholders. So, if these critics are correct and loss ratio is the measure of consumer value, then credit life insurance actually provides a better consumer value than level term life insurance.

The Procedure

I used the same premium data for the ten year level term rates of fifteen large writers of term insurance and selected the average rates by gender and age using three underwriting classes (preferred nonsmoker, standard nonsmoker and standard smoker). I then developed reasonable mortality assumptions for each class and age using the 2008 Valuation Basic Table, which is a recent table of insured life mortality published by the Society of Actuaries.

I then calculated a loss ratio over a typical credit insurance term of five years, ignoring policy lapses and without discounting for interest. This is the measure of loss ratio which is most comparable to the methodology used to calculate credit life loss ratios.

I calculated the term insurance loss ratios using ten year level term rates for a face amount of $50,000. This is obviously higher than the $5,600[4] average size for credit life or the

[4] Source is the American Council of Life Insurers (ACLI) 2014 Life Insurer Fact Book with data derived from the Association of Insurance Commissioners (NAIC) data.

$10,000 policy used in the rate comparisons but more consistent with the recommended approach promoted by those who might recommend buying a larger term life insurance policy to address the consumer's insurance needs.

The Graphical Results

The graphical results are illustrated in Exhibit III. The average term loss ratio for a $50,000 face amount is 19.8%, versus 47.5% for credit life for calendar years 2013-2014. The loss ratio for credit life is significantly higher than the loss ratio for level term insurance across all ages, genders, and underwriting classes confirming that credit life insurance would be considered a better consumer value.

The question as to whether level term insurance is a better buy than credit life insurance relative to rates and loss ratio is certainly one worth debating; however, the supposed superiority of term life in providing value to the policyholder based upon loss ratio is not consistent with the facts.

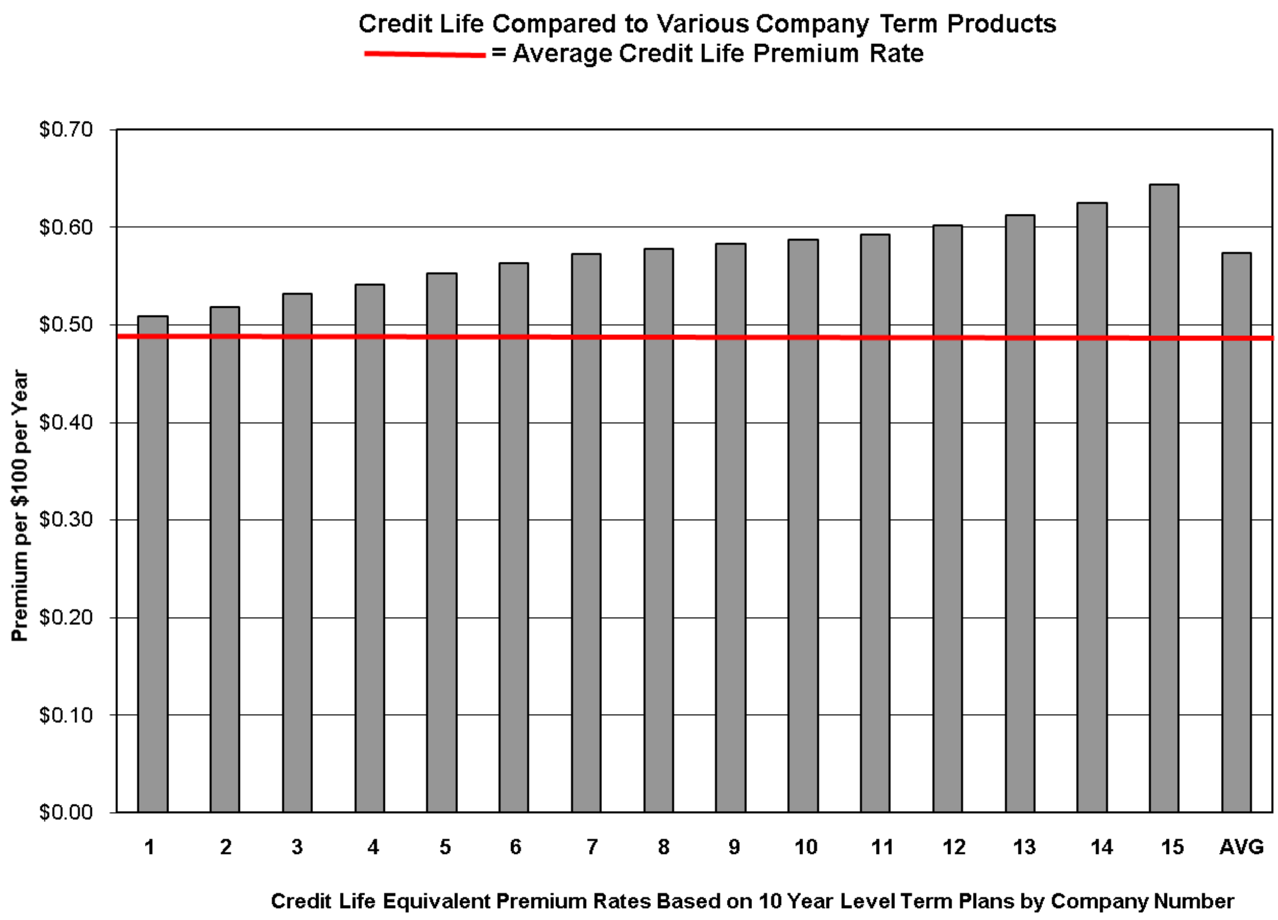
[redacted]

Christopher H. Hause, FSA, MAAA March, 2016

About the Author

Christopher Hause is the President of Hause Actuarial Solutions, Inc. in Overland Park, Kansas. Hause Actuarial is an actuarial consulting firm providing a wide range of consulting services to the insurance industry including product design/pricing, policy and claim reserves, financial statement opinions, regulatory advocacy, and actuarial software programs that assist insurance actuaries in evaluating, pricing and modeling life, health and annuity products.

Exhibit I



Credit Life Compared to Various Company Term Products
= Average Credit Life Premium Rate
$0.70
$0.60
$0.50
$0.40
$0.30
$0.20
$0.10
$0.00
Premium per $100 per Year
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
AVG
Credit Life Equivalent Premium Rates Based on 10 Year Level Term Plans by Company Number

Exhibit II

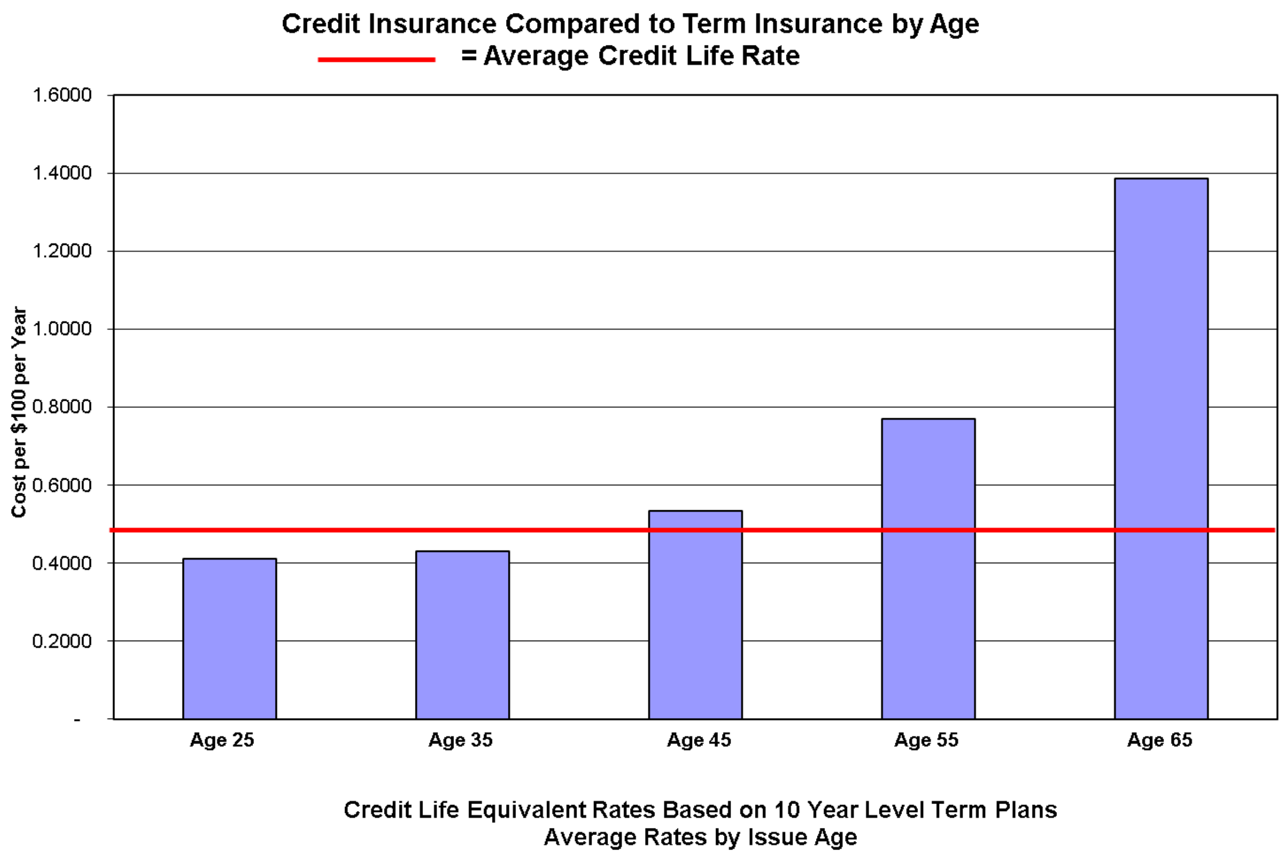
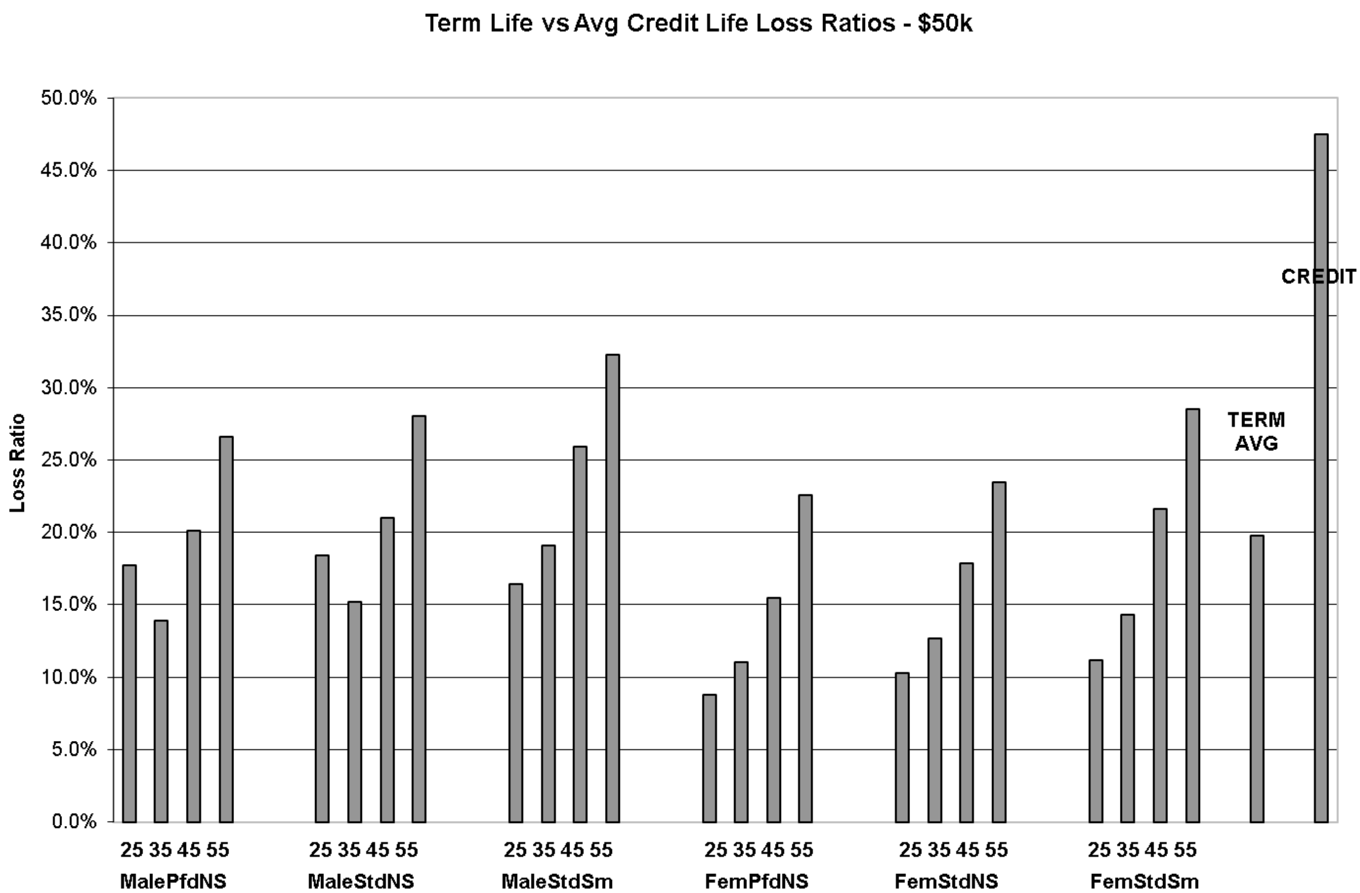

Credit Insurance Compared to Term Insurance by Age
= Average Credit Life Rate
Cost per $100 per Year
1.6000
1.4000
1.2000
1.0000
0.8000
0.6000
0.4000
0.2000
-
Age 25
Age 35
Age 45
Age 55
Age 65
Credit Life Equivalent Rates Based on 10 Year Level Term Plans
Average Rates by Issue Age

Exhibit III



Term Life vs Avg Credit Life Loss Ratios - $50k
50.0%
45.0%
40.0%
35.0%
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
Loss Ratio
CREDIT
TERM AVG
25 35 45 55
MalePfdNS
25 35 45 55
MaleStdNS
25 35 45 55
MaleStdSm
25 35 45 55
FemPfdNS
25 35 45 55
FemStdNS
25 35 45 55
FemStdSm