Consumer Federation of America

CENTER FOR ECONOMIC JUSTICE

July 29, 2009

The Honorable Christopher Dodd
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member
Senate Committee on Banking,
Housing and Urban Affairs
Washington, DC 20510

The Honorable Barney Frank
Chairman
House Committee on Financial Services
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
House Committee on Financial Services
Washington, DC 20515

Dear Chairman Dodd, Chairman Frank, Ranking Member Shelby and Ranking Member Bachus:

On July 15, 2009, thirteen insurance industry trade organizations[1] sent you a letter asking that no insurance products or practices be included in the proposal to create a Consumer Financial Protection Agency (CFPA). The arguments made in opposition to including insurance in CFPA are self-serving, misleading and inaccurate and should be rejected by Congress.

Indeed, the current Treasury Department proposal for creation of CFPA does not go far enough to protect insurance consumers in America.

The CFPA legislation proposed by the Administration and introduced by Chairman Frank would only give the new agency jurisdiction over three credit-related insurance products: credit insurance, title insurance and mortgage insurance. (See Appendix 1 for a description of the various types of credit insurance.) All of these products are sold in connection with a credit transaction and are intertwined with loans. For this reason, we believe the CFPA should have the same authority over these products that it has over other credit-related financial products.

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[1] Association of Advanced Life Underwriting, American Council of Life Insurers, Agents for Change, American Insurance Association, American Land Title Association, Consumer Credit Industry Association, The Council of Insurance Agents and Brokers, National Association of Insurance and Financial Advisors, National Association of Mutual Insurance Companies, National Association of Independent Life Brokerage Agencies, NAVA – The Association of Insured Retirement Solutions, Professional Insurance Agents and Property Casualty Insurers Association of America.

Under the legislation, the agency would not have jurisdiction over either investment-type products, such as annuities, or other personal insurance products, such as personal auto, residential property, and other consumer property and casualty insurance products. In general, CFA believes this is the appropriate division of responsibility, with three exceptions:

- The CFPA should have the same authority for forced place insurance, also known as creditor-placed insurance and another type of credit-related insurance, as proposed for credit insurance, title insurance and mortgage insurance.

- The authorization for the CFPA should be clear that all forms of payment protection products authorized by federal regulators – including debt cancellation contracts and debt suspension agreements – are considered activities associated with the extension of credit to prevent regulatory arbitrage. From a consumer's perspective, credit insurance and payment protection products are equivalent products; there should not be gaps in consumer protection because of differences in terminology. (For additional information on payment protection products, see Appendix 2.)

- The CFPA should have the authority to advocate for and represent consumers of personal insurance products (such as auto or homeowners and other property insurance) before the state insurance regulators. Some have said that this consumer advocacy authority might rest with the proposed new Insurance Office within the Department of Treasury, but CFA believes consumer advocacy is better placed in CFPA, an agency whose mission is to protect consumers.

Problems for Consumers Buying Insurance Products Related to Lending Transactions: Why Credit Related Product Consumers Need CFPA Coverage

Reverse Competition Hurts Consumers: The dominant characteristic of insurance markets related to credit transactions throughout the country is *reverse competition.* The consumer who pays for the product does not select the insurer; rather, the parties receiving compensation for the insurance select the insurer. For example, an insurer might sell a credit insurance group policy to a lender. The lender then sells the credit insurance to the borrower on behalf of the credit insurer and issues a certificate of insurance under the group policy to the borrower. This market structure leads insurers to bid for the lender's business by providing higher commissions and other compensation to the lender. As a result, greater competition for the lender's business leads to higher, often unfair prices of credit insurance to the borrower. In fact, CFA's Director of Insurance, J. Robert Hunter, was once at a credit insurance hearing in Virginia at which Prudential was asked why they wrote so little credit insurance in the state. The Prudential witness said they were non-competitive because their rates were "too low." The same sort of system holds in title insurance and mortgage guarantee insurance, which are covered under the President's plan, and forced-place insurance, which is not.

In addition to raising prices, reverse competition also harms consumers by limiting consumer choice, often to products that offer little real value to consumers. This results from the fact that, in a reverse-competitive market, the consumer is unable to effectively exert normal competitive pressure on the original seller of the product. In credit insurance, mortgage guarantee insurance, title and forced place insurance (but not mortgage insurance), the lender is almost always involved in the selection of the insurer, while the ultimate consumer – the borrower – is effectively limited to accepting or rejecting the package offered. If a consumer purchases a product and finances the purchase at one store or auto dealer, he or she cannot decide to go elsewhere to purchase the credit-related insurance for that loan. There is no marketplace for the insurance separate from the lender financing the purchase. As a result, lenders are able to dictate the terms of the credit insurance sale, determining what coverages will be offered, for example. Because the credit-related insurance transaction is typically a minor aspect (to the borrower) of a larger transaction – the loan to purchase a car, jewelry or furniture – consumers are willing to go along, particularly if they believe they must purchase the credit-related insurance to get the financing to buy the product they want.

As a result of this market dynamic, lenders rather than borrowers are the primary beneficiaries of credit-related insurance sales. First, the lender's loan is protected against events that impair the borrower's ability to repay. With credit-related insurance in place, the lender need not incur any costs to force payment from the surviving spouse or relative of a deceased borrower or from a borrower who has become disabled or unemployed. Second, the lender often gets substantial commission and other revenue from the insurance premium. Commissions and other compensation are typically 40 percent or more of the premium. Third, for financed single premium products, the lender gets additional interest income from financing the insurance premium.

Consumers, on the other hand, often obtain little if any benefit. The best measure of overall value of credit insurance to consumers is the loss ratio – the ratio of benefits paid on behalf of the consumer to the premiums paid by consumers. Consumer groups have advocated regulation to ensure that consumers receive a loss ratio of at least 60 percent, meaning that, on average, at least 60 percent of the premiums paid by borrowers should be ultimately paid out in claim benefits on behalf of borrowers.

While the vast majority of states regulate credit insurance rates, most have done a poor job. The table below shows countrywide loss ratios over the past ten years for the three major credit insurance coverages – credit life, credit disability and credit unemployment. Credit life loss ratios have been in low 40s, dropping into the mid 30s for credit disability and ranging from only 6% to 14% for credit unemployment. Using the modest 60% loss ratio standard, credit insurance consumers have been overcharged by billions of dollars.[2]

[2] The credit-related insurance loss ratios were compiled from Credit Insurance Experience Exhibit data submitted by credit insurers annually to state insurance regulators and published by the National Association of Insurance Commissioners (NAIC). The NAIC is not responsible for the calculations.

For many years, mortgage guaranty products had a very low loss ratio, less than 25 percent, until the ratio rose to 135 percent in 2007 in the midst of the current mortgage crisis. Similarly, title insurance loss ratios have been under 10 percent for many years. One study found, for example, that between 1995 and 2004, title insurance loss ratios averaged 4.6 percent and the loss ratio was below five percent eight out of ten years.[3] In 2008, the loss ratio "jumped" to 11.7 percent.[4]

In short, all of these products represent remarkably poor value for consumers. State regulators have, with a handful of exceptions,[5] utterly failed to rein in reverse competition and end the wholesale consumer abuse the practice represents. The special interest determination to hold off reform at any cost has proven highly effective. For these reasons, we believe America's consumers need CPFA to cover credit-related insurance products.

	Credit Life Premium ($Millions)	Loss Ratio	Credit Disability Premium ($ Millions)	Loss Ratio	Credit Unemploy-ment Premium ($ Millions)	Loss Ratio
1999	2,255	41.5%	2,457	44.2%	1,143	7.6%
2000	2,206	40.8%	2,374	46.4%	1,108	6.0%
2001	2,243	40.9%	2,382	50.0%	1,077	8.8%
2002	2,110	41.4%	2,199	49.3%	911	13.7%
2003	1,857	42.9%	1,933	47.2%	727	13.5%
2004	1,624	43.1%	1,797	46.9%	551	9.6%
2005	1,559	41.3%	1,679	40.4%	477	10.4%
2006	1,442	43.1%	1,570	39.4%	431	8.1%
2007	1,348	42.8%	1,514	36.8%	395	14.2%
2008	1,257	44.0%	1,410	38.3%	383	13.1%

[3] "Title Insurance Cost and Competition," Testimony of J. Robert Hunter, Director of Insurance, Before House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, April 26, 2006.

[4] Missouri Department of Insurance, Financial Institutions and Professional Regulation, at http://www.insurance.mo.gov/reports/lossratio

[5] Examples include Iowa, which has successfully reformed title insurance, and New York and Maine, which have gotten considerable control of credit insurance costs through effective and reasonable maximum loss ratio regulation.

Some states do much better than the average, but most states do a poor job of protecting credit insurance consumers. In 2008, the best and worst states for these coverages were:

2008		Credit Life Loss Ratio		Credit Disability Loss Ratio		Credit Unemployment Loss Ratio
Worst	NV	24.6%	SD	20.7%	AR	0.0%
2nd Worst	LA	27.4%	NV	22.8%	MI	0.0%
2nd Best	RI	67.3%	VT	66.0%	PA	33.2%
Best	ME	69.8%	ME	72.8%	VA	39.7%

One of the worst examples of the failure of state regulators to protect credit insurance consumers is with a coverage called credit family leave, which is supposed to make monthly payments on the consumer's loan in the event the consumer goes on an approved family leave. In the five years since data has been collected for this product, the loss ratio has been almost zero: about 2 (two) dollars in benefits paid for every $1,000 dollars of premium collected. Consumer groups have alerted insurance regulators to these egregious results since 2005, yet regulators continue to allow insurers to sell a worthless product, a product which insurers told regulators would pay out at least 50 cents on the dollar in benefits.

Credit Family Leave

	Premium	Claims Paid	Family Credit Leave Loss Ratio
2004	$50,396,018	$82,163	0.2%
2005	$39,851,001	$93,388	0.2%
2006	$29,179,076	$63,975	0.2%
2007	$25,486,677	$55,849	0.2%
2008	$22,508,468	$52,978	0.2%
2004-08	$144,912,772	$295,375	0.2%

State regulators have also done a poor job with creditor-placed insurance, which lenders purchase, force place on charge to the borrower in the event the borrower does not maintain the required auto or property insurance for the vehicle or property loan. This type of insurance is big business: over $600 million in creditor-placed auto and almost $2 billion in creditor-placed property insurance. The loss ratios in 2007 and 2008 have been dismal, in the low 20s.

	Creditor Placed Auto		Creditor Place Home		Credit Personal Property	
	Premium ($Millions)	Loss Ratio	Premium ($Millions)	Loss Ratio	Premium ($Millions)	Loss Ratio
2007	500	24.3%	1,402	20.5%	183	14.2%
2008	628	21.2%	1,991	23.2%	328	7.8%

These creditor-placed premiums are inflated by commissions paid to lenders and by other unreasonable expenses, which state regulators have endorsed instead of limiting. Lenders get a commission or other forms of compensation that create a significant profit center from virtually every force-placed policy, despite the fact that the policy is being placed to protect the lender. Moreover, the premium often includes expenses for tracking consumer loans to ensure insurance is in place, including for the borrowers that are not forced-placed and would never be, because their insurance is paid out of escrow. Thus, two to three percent of the borrowers who are forced-placed pay for the escrow tracking for 100 percent of the lender's portfolio. In a market in which consumers do not choose to purchase the product, state regulators' failure to protect these consumers is powerful evidence of the need for some insurance responsibility residing with the CFPA

The chart above also shows the results for credit personal property insurance – a coverage sold in connection with loans for consumer goods which pays to repair or replace the property serving as collateral for the loan if that property is damaged or lost. The table shows extremely low loss ratios for 2007 and 2008 for this coverage, which is typically sold in connection with high-cost loans targeted at low-income consumers.

Title insurance loss ratios are truly dismal. Over the 20 years prior to 2007, title insurance paid out benefits averaging 6.1 percent of premium. Over the decade prior to 2007, the number dropped to 4.9 percent.[6] In 2008, the loss ratio "jumped" to 11.7 percent.[7]

In summary, state regulation of credit-related insurance products has, for most consumers, failed to protect them from unreasonable prices and practices. There is great variation among the states, with some states doing a good job on some products, but most states doing a poor job on most products.

The main reason that states have done, on average, such a poor job protecting credit insurance consumers is the powerful lobbying of the business interests who benefit from the sale of these products – lenders, auto dealers and credit insurers. Now, these special interests are determined to hold off reform at the federal level by defeating the CFPA. We urge Congress to stand up for consumers who don't have the resources to lobby for favorable treatment and create a strong consumer advocate on selected insurance issues within the CFPA to begin to balance the influence of insurers and dealers in both the

6 Source: "U.S. Title – 2007 Market Review, A. M. Best Special Report, October 13, 2008, Page 4.
7 Missouri Department of Insurance, Financial Institutions and Professional Regulation, at http://www.insurance.mo.gov/reports/lossratio

marketplace and the regulatory arena. For these reasons, we believe America's consumers need CPFA to cover credit-related insurance products.

The agency should study credit-related insurance products to determine exactly what actions are needed to protect consumers from the ravages of reverse competition. The agency should, for example, establish minimum benefits and rate standards to ensure consumer protection in these reverse-competitive- markets. If a state fails to achieve these minimum standards then the agency would have the authority to bring a legal action to seek to accomplish the needed relief. The agency should be able to prohibit the use of products that are inherently unfair, abusive or deceptive to consumers. The agency should also be advocating for the states to develop real (as opposed to reverse) competition in these lines of insurance and should develop ideas for accomplishing this. Possible approaches might include: educating consumers about their rights to shop for alternative sources of coverage; breaking up the cartel-like control over information about who needs such insurance so that other providers of coverage could contact consumers in time to compete for the sale; and abolishing the kickback arrangements that leave low-priced competitors unable to sell their products.

Why the Proposal from the Insurance Trade Organizations to Exclude all Insurance Products from CFPA should be Ignored

The distinction raised by trades between credit-related insurance products and credit products is irrelevant for purposes of consumer protection. Credit-related insurance products are tied to specific credit transactions and related to the sale of loans. The fact that debt cancellation (a banking product) and credit insurance (an insurance product) are functionally identical means that failure to include credit insurance while including debt cancellation will create the same type of regulatory arbitrage that prompted banks to move from credit insurance to debt cancellation.

The industry is simply wrong when it claims that the CFPA is simply overlaid on top of the state regulatory system and would result in a duplicative regulatory regime with insurers, producers and consumers caught in the middle, causing different and inconsistently-applied consumer protection standards for all insurers and producers. There will be no duplication of regulation -- the CFPA will ensure minimum standards in the same way that HIPAA has worked with state-based regulation. There is no duplication of regulation, but the creation of a consumer voice that, in the majority of states, simply does not exist for these insurance products.

State-based regulation is already inconsistent with regards to credit-related insurance products. If anything, the actions of the CFPA will provide greater uniformity by developing meaningful consumer protection floors that will move a number of states to uniformity with one another -- in the same manner as NARAB or HIPAA. The insurers, who have long called for greater uniformity in insurance regulation, demonstrate that they only seek uniformity that lowers consumer protection as they oppose uniformity that might actually help consumers.

State-based regulation of credit-related insurance products has been poor; consider the extremely low loss ratio statistics cited earlier. Despite each state having laws that require the commissioner to disapprove credit insurance products that do not provide reasonable benefits in relation to premiums or which have misleading or unfair provisions, state insurance regulators have in almost every state approved products that in 2000, the Departments of Housing and Urban Development (HUD) and Treasury described as abusive and unfair to consumers. To this day, the problems with financed single premium credit insurance have not been addressed in any manner by state insurance regulators. Despite presenting evidence to insurance regulators in 2005 that credit family leave was a bogus product -- virtually no claims paid, a 0% loss ratio -- states have done nothing to rectify that. From 2004 through 2008, the benefits paid for this product were essentially zero. Other examples can be supplied: California legislation in 1999 required minimum loss ratios and regulation of credit unemployment and personal property. To this day, the California Department of Insurance has failed to implement that statute and loss ratios for these coverages have continued to languish at remarkably inefficient levels that abuse consumers.

The credit-related insurance markets are all characterized by reverse competition. For some products, states regulate ineffectively, with credit insurance is an example. In other products, states by and large do not regulate at all, with title insurance is an example.

Insurers have been accused of redlining and unfair discrimination for decades; HUD first cited insurers for redlining in the mid-1970s. Yet state insurance regulators have rarely required insurers to report data allowing the regulators, let alone the public, to monitor the market performance of insurers. Insurers routinely go to court to prevent public release of data even though the data sought may be far more aggregated than Home Mortgage Disclosure Act (HMDA) data. A recent example is insurance credit scoring -- all objective data point to insurance credit scoring discriminating on the basis of race and penalizing consumers who are victims of predatory lending, the financial crisis and terrible economic conditions. Yet, not one state has collected data to even examine these issues. Instead, state regulators ask insurers if their practices are harming low income or minority consumers. Imagine if the banking regulators had to rely on banks to report their market performance on an ad hoc basis instead of banking regulators and the public relying on HMDA data.

The insurer argument that, because they do not collect information on race or ethnicity, their underwriting and rating cannot discriminate on these bases is simply absurd. For years, insurers argued that their use of age and value of the home was objective -- older and lower-valued homes were charged more for insurance. In fact, communities with older homes and lower-valued homes were systematically redlined -- predominantly minority communities. Insurers have historically used proxies for race and income and insurance scoring is the latest tactic, along with education, occupation, prior liability limits and other factors tied to socio-economic status. While there may be a legitimate debate over the reasonableness of some of these practices, there can be no serious objection to the collection of data to evaluate the availability and affordability of insurance.

The trades argue that a good regulatory system should foster conditions that encourage investment, competition and innovation, and not perpetuate duplication, inconsistency, and waste. First, not all competition is beneficial to consumers. The credit-related insurance products are characterized by reverse competition that harms consumers. The creation of a federal consumer protection agency does not duplicate existing regulation since most states have no consumer insurance advocacy. Competition and regulation are not only compatible; the recent financial market problems have shown that meaningful competition *requires* a strong regulatory framework that empowers consumers. CFA's comprehensive study of auto insurance regulation found that well-conceived regulation and enhanced competition serves consumers best. California's comprehensive auto insurance regulation, adopted by the people of California in 1988 under Proposition 103, produced the lowest price increases since then, as well as reasonable insurer profits. California also has the fourth most competitive market in the nation, as measured by the HHI.[8]

We urge Congress to include insurance in CFPA, expanding the scope of the current Administration's approach to include forced-placed insurance, and to give consumers an advocate before every state in personal lines (auto and home) insurance.

Sincerely,

J. Robert Hunter
Director of Insurance
Consumer Federation of America

Birny Birnbaum
Executive Director
Center for Economic Justice

8 www.consumerfed.org/pdfs/state_auto_insurance_report.pdf

Appendix 1: Description of Consumer Credit Insurance Coverages

Credit insurance refers to a group of insurance products sold in conjunction with a loan or credit agreement. Credit insurance makes payments for the consumer to the lender for a specific loan or credit agreement in particular circumstances. The common types of credit insurance sold include:

- *Credit Life* pays off the consumer's remaining debt on a specific loan or credit card account if the borrower dies during the term of the coverage.

- *Credit Accident and Health,* also known as *Credit Disability,* pays a limited number of monthly payments on a specific loan or credit card account if the borrower becomes disabled during the term of coverage.

- *Credit Involuntary Unemployment* pays a limited number of monthly payments on a specific loan or credit card account if the borrower becomes involuntarily unemployed during the term of coverage.

- *Credit Personal Property* typically pays to repair or replace property that is serving as collateral for a loan.

- *Creditor-Placed Insurance* is auto or property insurance placed by a lender if the consumer fails to maintain the insurance required by the terms of the auto or home loan.

- *Credit Family Leave* makes monthly payments if the borrower goes on an approved family leave.

- *Credit GAP* pays the difference – or gap – between the amount owed on the auto loan and the amount paid by the insurance company on the auto insurance policy in the event there is an accident resulting in a total loss to the vehicle and the amount of insurance payoff is less than the amount owed on the loan. GAP is sometimes used as acronym for Guaranteed Auto Protection.

- *Non-Filing* pays the lender in the event loan documents have not been correctly filed.

- *Mortgage Guaranty* pays the lender in the event the borrower defaults on the mortgage loan.

Appendix 2: Properly Regulating Insurance "Look Alike" Products

Many insurance products are perfect or near-perfect substitutes for financial products; it is logical for the CFPA to represent consumers on all substantively similar products.

Consumer credit insurance products are – from the consumer's perspective – equivalent to debt cancellation contracts and debt suspension agreements – products which federal banking regulators have declared to be banking products.

Debt Cancellation Contracts (DCCs) and related products like Debt Suspension Agreements (DSAs) are products sold in connection with a consumer loan and which promise to provide some debt relief to the consumer if certain events occur. The events triggering the benefit under the DCCs/DSAs are typically events that impair the borrower's income or place a financial burden on the borrower. DCCs/DSAs are part of the group of payment protection products that include credit insurance and which promise, among other things, to preserve the borrower's credit rating in adverse circumstances.

Since 2000, lenders have shifted their payment protection product offerings from credit insurance to DCCs/DSAs, initially in connection with credit cards and more recently in connection with closed-end loans. One of the earliest forms of DCC sold in connection with a closed-end loan was GAP Waiver sold in connection with auto loans.

To a consumer, DCCs and credit insurance are very similar – or even identical – products. For a one-time or monthly fee, DCC will cancel the debt or make monthly payments if certain events occur – just as credit insurance performs. For example, a credit card credit insurance program containing credit life, credit disability and credit involuntary unemployment coverages provides the identical benefits for a consumer as a DCC program for death, disability and involuntary unemployment.

The major difference between credit insurance and DCC is in regulatory oversight. Federal banking regulators have declared DCC to be a banking product and, consequently, not subject to state insurance regulation if sold by banks or credit unions with federal charters. Although state insurance regulators challenged these decisions, claiming that DCC was an insurance product, banks who sought the federal oversight of DCC and the federal agencies have prevailed in legal challenges. State regulation of DCCs offered by state-chartered financial institutions has generally followed the federal rules.

The rationale for not regulating DCC as an insurance product is that, unlike credit insurance, where a borrower, a lender and an insurance company are involved, there are only two parties involved with DCC – the borrower and the lender. The DCC is an addendum to the loan contract that states that, under certain circumstances, the lender will cancel the debt or the monthly payment. So, in theory, no insurance company need be involved.

In practice, DCC programs are administered in almost the same manner as credit insurance programs. Credit insurance companies provide the same administrative and sales services as with credit insurance. The lender purchases a contractual liability policy from the credit insurance company, and this policy pays any claims made under the DCC program offered by the lender. Credit insurance companies, including CUNA Mutual, now sell and administer DCC programs as well as credit insurance programs.

The difference in regulatory oversight of DCC versus credit insurance is dramatic. With credit insurance, the products (policy forms) must be approved by state insurance regulators prior to use and the rates subject to prima facie maximum rate regulation. A credit insurer wishing to offer a national program must obtain approvals in all states and comply with different rates in all states as well as variations in product requirements among the states. Under rules promulgated by the Office of the Comptroller of the Currency (OCC) and other federal financial regulators, lenders can offer a single DCC product nationally. Lenders have moved from credit insurance to DCC for several reasons:

- No oversight or limitations on fees charged
- Few limitations on product design and benefit provisions – no restrictions on bundling, flexibility in product design
- Ability to use one product nationally
- No agent licensing requirements
- No form or rate filing requirements
- No premium taxes

DCCs and DSAs generally provide much worse value to consumers than credit insurance – higher prices, fewer benefits and fewer consumer protections. In prior reports and testimony, CFA has estimated the loss ratio for DCCs and DSAs to be less than 5%. In addition to lower benefit payouts, the administrative costs for DCCs are lower than for credit insurance because of the ability to utilize a single program across the states, the absence of product filings and approvals, and the absence of a premium tax.

Failure to allow the CFPA to represent insurance consumers will lead to regulatory arbitrage – the shifting of banking products to insurance products.

When the federal banking regulators declared debt cancellation contracts to be banking products – and not subject to state insurance regulation – lenders started changing their products from credit insurance to debt cancellation or debt suspension to take advantage of the more favorable (to lenders) regulatory structure for the debt cancellation and debt suspension products. This is one example of regulatory arbitrage – regulated entities playing off competing regulators for the most advantageous – to the regulated entities – regulatory regime. Failure to include credit-related insurance products under the jurisdiction of the CFPA would reverse that trend, encouraging financial institutions to shift from use of regulated bank products to less regulated insurance products. Consumers would be the losers.