An Introduction to

CREDIT-RELATED INSURANCE

by

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CREDITRE
Hurst, Texas
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Chapter One

Overview

Important Definitions

Consumer credit is a financial transaction in which a borrower receives cash, or purchases a consumer product, by agreeing to repay the amount advanced by the creditor. It does not include credit secured by a first mortgage on real estate. The term borrower is used to describe the consumer who utilizes consumer credit.

Credit-related insurance is insurance sold in conjunction with consumer credit, where the policy terms and benefits are related to the specific consumer credit obligation.

Producers of credit-related insurance are the corporate entities making the presentation to the borrowers. They include automobile dealerships, banks, credit unions, finance companies, and retailers. Credit-related insurance is usually presented to the borrower at the time and location where the consumer credit is arranged.

Consumer Credit

In the first half of this century, the concept of extending credit solely on an individual’s future earning power was introduced and accepted. Installment credit repaid in monthly installments became the standard. After World War II, the demand for consumer products increased explosively. Consumers began to borrow money routinely to purchase automobiles, modern appliances, and other consumer products. In the 1960s, open-end credit became significant with the introduction of credit cards, which allowed the cardholder to borrow for any purpose up to a pre-approved limit. Home equity credit grew in importance in consumer credit after the 1986 Tax Act. For today’s consumer, borrowing is easy and convenient.

The growth of financial institutions willing to extend credit to consumers has both satisfied and fueled the demand for consumer credit. Credit unions, Morris Plan banks, finance compa-
nies, and automobile manufacturers’ acceptance corporations were the first to meet the demand. In the 1950s, commercial banks expanded into consumer credit and became a major force. Other credit organizations were formed to satisfy specialized needs, such as Farm Credit Banks, which provide credit to farmers.

Consumer credit hinges on the premise that the borrower can meet the credit obligation from future wages. Earning power serves as the collateral for the credit. When this idea was first introduced, creditors knew that the death, disability, or unemployment of the borrower could place the “collateral” of the credit in jeopardy. Insurance on the borrower’s life and ability to work was introduced to protect the creditor and cushion the borrower’s loss.

Insurance for Installment Credit

Two specialty insurance products, credit life insurance and credit disability insurance, emerged to meet the specific needs associated with consumer credit. In general, credit life insurance pays off the credit if the insured borrower or co-borrower dies. Credit disability insurance provides a monthly benefit equal to the monthly payment obligation if the primary borrower is disabled. Regulation of these products now requires that the insurance can only be sold in conjunction with a specific credit obligation. Because of this stipulation, the credit terms and conditions define the basic nature of coverage provided by a particular credit-related insurance policy.

Credit-related insurance products are a specialized subset of traditional life and disability coverages. They share many of the characteristics of their traditional insurance counterparts.

Credit life insurance is simply term life insurance. Premiums are paid for life insurance protection for a specified term with specified amounts of insurance in force during the term of coverage. Most policy provisions are similar to their traditional insurance counterparts.

Credit disability insurance provides the same type of benefits as traditional disability income policies. It is often called credit accident and health insurance in published literature and industry usage. This disability income protection is one type of accident and health insurance, but the term disability insurance is more precise and more readily understood. A monthly benefit is paid if the insured becomes disabled, once an initial period of disability is satisfied. Policy provisions and benefits are similar to those found in traditional products.
Still, some characteristics clearly set these products apart. Since the insurance product was tied to a specific credit obligation, credit-related insurance pioneers developed a unique product and marketing structure while meeting the usual requirements for insurance products.

Consumer credit balances were relatively small, so the amount of credit-related insurance sold was less than the average size of most other insurance policies. To meet the needs of the installment borrower, the insurance had to be presented at the time the credit was extended.

These factors led to a marketing approach where the insurance products were offered to the borrower by the producer, rather than by a fully trained insurance agent. Policy forms, premium structures, and underwriting conditions had to be simple. Several characteristics emerged to meet these conditions, and they still apply to most credit-related insurance written today.

The result is a product that can be easily explained and presented to the borrower, who needs only to decide whether to accept or reject the insurance. If the insurance is accepted, the coverage takes effect immediately, along with the credit obligation.

### Characteristics of Credit-Related Insurance Sold in Conjunction with Installment Credit

1. At the inception of the installment credit, the producer offers the borrower the opportunity to buy insurance. To be eligible, the borrower must be less than a maximum age, generally 65, and not be aware of a serious health condition.

2. Credit life and disability insurance is offered independently as a voluntary option on the part of the borrower.

3. Coverage matches the credit. Life insurance in force during the term of insurance equals the sum of the remaining payments due on the credit (gross coverage). The monthly disability benefit is equal to the required monthly payment.

4. The first beneficiary of the policy proceeds is the creditor, who uses the proceeds to extinguish the credit. Any additional proceeds are paid to the second beneficiary or the insured’s estate.

5. The premium charged is a single premium paid at the inception of the insurance. The premium is included in the amount advanced and is financed along with the principal of the credit.

6. For life insurance, the same premium rate is charged to every borrower of a producer in a state. There is one rate for all ages and both sexes. Disability insurance rates also vary by term of insurance.

7. The initial policy size is generally under $20,000, and the term of insurance is short, generally 60 months or less.

8. Policy forms contain few exclusions.

9. Insurance terminates when the credit ceases. If the credit is repaid prior to the scheduled maturity date, a refund of the unearned single premium is paid to the borrower.
Insurance for Open-End Credit

Retailers have offered revolving charge accounts for many years, but open-end credit did not take off until the widespread introduction of bank credit cards in the 1960s. Insurers began to offer credit life and disability insurance with monthly premiums based on the outstanding card balance each month. Credit life insurance paid the outstanding balance on the date of death. If the insured became disabled, credit disability insurance paid the minimum monthly payment during the period of disablement.

Since card balances were generally under $3,000, these two insurance products did not generate sufficient premium dollars to support the fixed expenses of processing the insurance products. Credit insurers chose to add a new product, involuntary unemployment insurance (IUI). If the insured became involuntarily unemployed, IUI paid the minimum monthly payment during the period of unemployment. The insured events included layoff, firing, lockout, and strike. In most other policy provisions, IUI was similar to credit disability insurance. This product was one of the few opportunities for individuals to insure against the contingency of involuntary unemployment. The coverage has proven to be an attractive addition in our uncertain employment environment.

Since 1985, these programs have been a common option for open-end credit cardholders. Insurers offer the three insurance products as a package. An offer is made when the card is issued. Additional solicitations are made periodically with billing inserts, with messages on billing materials, and by telemarketing.

Credit-related insurance provides advantages to both the borrower and the producer. The borrower has the security of knowing that a credit obligation will not be an added burden to the family in the event of death, disability, or involuntary unemployment. Medical bills or a reduction of income associated with a death, disability, or job loss often creates additional financial strains on family resources.

Many borrowers are underinsured. They are aware of their insurance need but choose to avoid discussion of the matter. The ease with which credit-related insurance can be purchased, without significant inquiry into the details of the borrower’s personal life or medical condition, is a definite plus in the minds of borrowers. Given the opportunity to meet a portion of their insurance needs quickly and easily, a high percentage of borrowers elect to purchase credit-related insurance.

The producer benefits by having added security concerning the borrower’s ability to repay the credit. The prospect of collecting the unpaid credit balance or of repossessing a consumer product from a widow or widower is not pleasant. Collecting from a disabled or unemployed borrower is just as taxing. Credit-related insurance provides a valuable social service, easing the burden on both the borrower and the producer.

Producers receive compensation from insurers for presenting the product to borrowers and assisting in the product administration. This income can be a significant source of revenue. Some producers even participate in the underwriting risk by forming affiliated insurance or reinsurance companies.
Benefits to borrowers and producers, as well as simplified product structure and marketing methods, account for the widespread availability of credit-related insurance. Since 1917, more than a billion borrowers have chosen to purchase credit-related insurance.

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<tr>
<td>2. The consumer is offered a package program containing life insurance, disability insurance, and involuntary unemployment insurance.</td>
</tr>
<tr>
<td>3. Life insurance pays the outstanding balance on the date of death. Disability and involuntary unemployment insurance pay a level monthly benefit while a claim is in progress. The benefit equals the minimum monthly payment on the date of disability or involuntary unemployment.</td>
</tr>
<tr>
<td>4. The first beneficiary of the policy proceeds is the creditor. Benefits reduce the outstanding balance on the card.</td>
</tr>
<tr>
<td>5. Insurance is provided on a month-to-month basis. Premiums are paid monthly based on the card’s outstanding balance on the billing date.</td>
</tr>
<tr>
<td>6. The same premium rate is charged to every borrower of a producer in a state for the package of products. There is just one rate for all ages and both sexes.</td>
</tr>
<tr>
<td>7. The average insured balance is about $3,000.</td>
</tr>
<tr>
<td>8. Policy forms contain few exclusions.</td>
</tr>
<tr>
<td>9. Insurance terminates at age 65 (higher in some states) or when the card is terminated.</td>
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The Morris Plan Insurance Society

The idea of credit-related insurance was conceived and implemented by one person, Arthur J. Morris. An individual of many accomplishments, he was instrumental in the development of bank consumer credit. Some of his contemporaries acknowledged him as the founder of consumer credit. He laid the foundation for the consumer credit practices that revolutionized consumer product consumption in this century.

Even today, many borrowers feel that banks extend credit only to those who can prove that they do not need it. At the turn of the century, this was literally true. Banks would not extend credit unless the borrower had deposits at the bank or could provide unimpeachable collateral.

Morris practiced law in Norfolk, Virginia, but he had many contacts in the banking industry. He was often approached by individuals asking for his assistance in securing credit. With the growing number of requests, Morris realized that a significant number of credit-worthy people could obtain credit only from small loan operations and loan sharks.

In 1906, he dispatched a group of people to travel around the country to study the credit environment. From the survey, he concluded that 80% of working people and small business owners had no ready access to credit. Banks would not extend credit simply on the earning power of the borrower.

Morris developed an idea for the democratization of credit. He believed a bank should be willing to extend credit if the borrower could show good character and the earning power to repay the credit obligation. The concept was not unique. Mutual banks already existed in Europe, organized like today’s credit unions and mutual savings banks. In 1910, Morris organized a privately-owned bank in Norfolk on these principles.

Although his intentions were honorable, his banking plan was designed to legally circumvent credit regulations. A primary reason credit was not available to working people was usury.
laws that limited interest rates to 6%. Creditors could not extend credit for small amounts and make a profit. Morris made one-year loans but charged the interest in advance and charged a processing fee. In addition, he required the borrower to establish a savings account and to make specified weekly deposits to the account. At the end of the year, the savings account reached the level to repay the credit. The effective rate of interest was about 18%.

Arthur Morris had a dream far bigger than owning a bank in Norfolk—he was one of the first individuals to consider the concept of franchising. Along with local individuals, he formed a bank in Atlanta. The Georgia newspapers soon began an exposé on loan sharks, and the Atlanta bank was prominently portrayed as a viable alternative for working people.

As publicity about the Atlanta bank spread, a number of inquiries about Morris’s banking plan arrived. He formed the Fidelity Corporation of America, the first bank holding company, to aid in establishing other local banks. The holding company owned about 25% of each local bank. After 14 banks were formed, Morris wanted to take the program nationwide. He traveled to New York and met with prominent financiers who agreed to provide financial backing. The strategy called for Morris to travel throughout the country meeting with leading local business people to gain support for a local bank. Banks were formed with about 75% local ownership, with the holding company owning the remainder. Standardized procedures, forms, and advertising were provided to the local operation.

At the initial New York meeting, one of the financiers suggested the name Morris Plan Banks. Those who knew Morris doubted if it took much effort to persuade him to accept the honor. At the peak, 170 Morris Plan Banks were operating. Over the years, these banks evolved into state or national banks or became finance companies; the Morris Plan concept was somewhere between the two. A few Morris Plan Banks still exist today.

Morris soon realized that the death or disability of the borrower cut off the earning power that was the basis of the credit. The Morris Plan concept required a co-maker on the credit. Collecting from a borrower’s co-maker was fairly successful in those days, but the task was unpleasant. Morris decided that insurance was needed to complete the concept.
He visited several of the major insurers of the day. With little data on which to base rates, the insurers were unwilling to venture into this new field. Undaunted, Morris formed his own insurance company in 1917—The Morris Plan Insurance Society, with the motto, “No man’s debt should live after him.”

The original policy was a level term individual life policy sold with weekly premiums based on the age of the insured. Weekly premiums soon gave way to monthly premiums, with an option to pay annually in advance. In those days the term of both the credit and the insurance was 12 months. The first decreasing term policy was introduced in 1922. Although the company is no longer active in the credit-related insurance industry, it is still in business today as Bankers Security Life Insurance Society.

Other Early Credit Insurers

One stop on Morris’s itinerary was the industrial town of Springfield, Ohio, where a local Morris Plan Bank was formed in 1917. The relationship between the New York holding company and the local bank was never particularly good. The local management chose not to enter the insurance program of The Morris Plan Insurance Society. Instead, a portion of each credit obligation was set aside, with the stipulation that the obligation was paid in full in the event of the primary borrower’s death. On a routine bank examination in 1925, the bank examiner declared that this stipulation was insurance and ruled it illegal, saying only life insurance companies could provide life insurance protection.

The ruling caused consternation at the Springfield bank. Officers knew the practice was popular with its borrowers. They submitted a proposal to the Ohio Insurance Department to form an insurance company for the purpose of providing this insurance. The proposal initially met with skepticism. Then the idea was presented as a form of group insurance, and the bankers were successful in obtaining the approval of the Department. The Credit Life Insurance Company was formed in 1925.

In early 1926, the company issued the first group credit policy in the United States to the Springfield Morris Plan Company. The policy provided life insurance for the amount of the credit, as well as total and permanent disability coverage. Both coverages paid the remaining unpaid weekly payments owed by the borrower. All borrowers up to age 60 were accepted for amounts up to $1,000 at a premium rate equal to 1% of the gross note. This rate evolved into the common single premium credit life insurance standard of $1.00 per $100 per year. The group insurance concept its founders developed is the basis of most credit-related insurance written today. Their motto was “Insurance on the Debtor in favor of the Creditor.”

The Springfield Morris Plan Company eventually converted to a national bank and is still in business today as a locally owned bank. The insurance company grew steadily through the years. The Credit Life Insurance Company rose to number one in new business issued in 1979. After a difficult decade in the 1980s, it was purchased and merged into another insurance company. The name has been retired.

Both The Credit Life Insurance Company and The Morris Plan Insurance Society charged borrowers for the insurance. Two other credit insurers entered the field shortly afterward with a different concept. In 1928, The Prudential Insurance Company of America wrote a group policy
for National City Bank of New York. Under this policy, the bank, not the borrower, paid a monthly premium per $1,000 of all outstanding credit. The bank absorbed the cost of the insurance, and all borrowers were insured. This is known as non-contributory coverage. In 1941, Prudential began writing the credit-related insurance for General Motors Acceptance Corporation, which financed automobile credit for General Motors. For many years, this was the largest group policy in the world. Prudential exited the credit-related insurance industry in 1996.

Credit unions, which began in the United States in 1909, also recognized the need for credit-related insurance protection. When the Credit Union National Association (CUNA) held its first national board meeting in January 1935, the first order of business was to address the insurance needs of the credit union movement. The Board voted to establish the CUNA Mutual Insurance Society, which was incorporated in May 1935 as a Wisconsin life insurance company.

With a $25,000 loan from Edward A. Filene of Boston, a staff of two people opened the doors of the company for business in August 1935 in an old rented mansion in Madison, Wisconsin. The first claim, in the amount of $40, was paid in October when a Milwaukee railroad switching operator died.

CUNA Mutual first offered life insurance on a voluntary (contributory) basis. However, the directors felt that the credit union ideals of cooperation and risk-sharing dictated group insurance that should be provided to all borrowers and paid for by the credit union. In 1936, “loan protection insurance” was introduced to promote this non-contributory group life coverage. One early motto was, “The debt shall die with debtor.” The little man with the umbrella was also a symbol of the company for many years.

In 1938, CUNA Mutual began to expand beyond credit-related insurance by offering group insurance on credit union member savings up to $1,000, “life savings insurance.” Since then, CUNA Mutual Insurance Society has become the CUNA Mutual Insurance Group, which encompasses nine companies offering a full line of life, health, accident, and casualty insurance protection to credit union members throughout the world.

By 1946, fifty-one companies were writing credit-related insurance, but by 1955 the number of insurers had mushroomed to 237. The phenomenal growth was a response to the growth in consumer credit and continuing demand for the coverage. Now, about 300 insurers in the U.S. and Canada issue credit-related insurance.

**Growth of Credit Life Insurance**

Growth of credit life insurance was steady from 1917 until 1941. In 1941, World War II necessitated Regulation W, which sharply curtailed purchases of consumer products, and credit life insurance in force declined. A spectacular period of growth occurred in the decade following
the war. Consumer spending grew, but the percentage of insured credit obligations grew even faster. Insured credit obligations increased from 9% of all credit in 1946 to 47% by 1956. The growth of insurance was spurred by the product’s acceptance by creditors and the broadening of state laws to clearly permit the products. Figure 2.1 illustrates the growth of credit life insurance in force.

Figure 2.1 - Growth of Credit Life Insurance in the United States (1920-2001)

The growth also resulted from increases in both the number of consumer purchases and the cost of consumer products. Postwar economic expansion and availability of installment credit made a vast array of consumer products available to many Americans. Automobiles became a necessity, along with televisions and other modern appliances. Inflation created a steady increase in the cost of most consumer products. As a result, the average amount in force per policy has risen sharply over the years.

The size of new credit has paralleled the rising cost of consumer products. Automobile credit typically exceeds $10,000. In several market segments, there is a demand for credit-related insurance in amounts similar to ordinary insurance. Second mortgage credit, home equity credit, and lines of credit can go up to $250,000; manufactured housing and recreational vehicle credit offers exceed $100,000.
As the cost of consumer products has risen, creditors have extended the term of credit. In 1955, 65% of all consumer credit was for one year or less. Gradually, 24-month and then 36-month terms became standard. New automobile credit moved to 48-month terms in the late 1970s then continued to 60 months (or more) by the late 1980s. This trend has greatly lengthened the average term of credit life insurance policies over the years.

### Growth of Credit Disability Insurance

Several early credit insurers provided a total and permanent disability benefit. This lump sum benefit paid off the credit obligation if the insured met rather strict conditions for being totally and permanently disabled. Around 1935, the modern version was introduced with monthly benefits.

Growth was slow. Disability policies were written on an individual policy form because of restrictive group statutes. The mutual companies offered only total and permanent disability coverage. By 1956, the total credit disability premiums were just $32 million. Over time, the group statutes were liberalized, and the producers and borrowers began to recognize the value of the coverage.

Rapid growth has occurred in the last 30 years. All producers of credit-related insurance have contributed to the growth. The product is now offered in almost every situation that credit life insurance is sold.

### Growth of Credit Involuntary Unemployment Insurance

The contingency of unemployment has always been considered a difficult risk to underwrite. Few insurance products have ever been sold to insure against this contingency. Insurance regulations have also presented a hurdle. The average credit card balance is under $4,000 and the
average retailer revolving charge balance is under $1,000. On a $2,000 balance, the monthly cost of credit life and disability insurance is under $6.00. To generate more premium income to cover the fixed processing costs, credit insurers began to consider the last contingency that could impair the “collateral” of consumer credit. Since voluntary acts are generally not insurable, the product that was introduced only protected against the contingency of involuntary unemployment.

Every U.S. insurance company must choose between being a life insurance company or a property and casualty (P&C) insurance company. Only a life insurance company can underwrite credit life insurance; either form of insurer can underwrite credit disability insurance. For this reason, most credit insurers were formed as life insurance companies. Until recently, only a P&C insurer could underwrite the contingency of unemployment.

Growth was slow until the mid-1980s. Since then, a package of life, disability, and IUI has been a staple auxiliary product offered to cardholders. Over $900 million of IUI premium was written in 2002. Only 10% of this premium volume was single premium IUI written in conjunction with installment credit.

**Consumer Credit Insurance Association**

Insurance companies have formed several trade associations to promote the industry and to assist in development of laws and regulations. The primary trade association for credit insurers is the Consumer Credit Insurance Association (CCIA). Founded in 1951, CCIA now has more than 180 member companies, including all of the major credit insurers.

The Association has four purposes stated in its Articles of Incorporation:

1. To act as a trade association of insurance companies engaged in the business of underwriting creditor’s life insurance and allied lines of insurance;
2. To promote high ethical standards for the consumer credit insurance business and related lines of insurance;
3. To disseminate information and provide for the exchange of ideas among and between its members; and
4. To aid and advance the business of its members by any and all proper means.

CCIA holds an annual membership meeting in the spring of each year. Speakers lead discussions on technical aspects of the product and provide updates on legislative and other matters of topical interest. Seminars are sponsored on topics requiring special attention, along with general education seminars.

Direct inquiries concerning credit-related insurance to the CCIA staff at:

Consumer Credit Insurance Association
542 South Dearborn Street, Suite 400
Chicago, Illinois 60605
Phone: 312-939-2242
Fax: 312-939-8287
Important Definitions

**Installment credit** is consumer credit where the borrower agrees to repay the credit in substantially equal monthly payments. Typical transactions are:

- *Cash credit.* The borrower receives cash for the purchase of consumer products or for other expenditures.
- *Installment sale contract.* The purchaser receives a consumer product in exchange for entering into a consumer credit obligation requiring periodic payments.

*Credit life insurance on installment credit* is single premium term life insurance, purchased in conjunction with installment credit, that provides a benefit in the event of an insured’s death during the term of the coverage. The benefit is equal to the scheduled indebtedness of the credit.

There are exceptions to the general definition that are still considered credit life insurance. The payments under automobile lease contracts may be insured. Some commercial credit is also insured with credit life insurance. A few coverages do not insure the full amount of the credit, while others do not provide coverage for the full term of the credit. These exceptions represent a small percentage of the total market and are discussed in Chapter Eight.

**Installment Credit**

Since credit life insurance is tied to a specific credit obligation, it is necessary to understand the basic structure of the installment credit that defines the insurance protection. The primary structure is **installment** or **closed-end credit**.
Installment credit is called closed-end credit because the amount and term of the credit are fixed at the inception of the credit, and the credit is repayable in equal monthly payments. The principal of the credit is the cash advanced, or the portion of the purchase price of the product that is financed. A single premium is charged for the insurance. The total amount advanced includes the principal plus the insurance premium. Another term for the total amount advanced is the initial net indebtedness. At the credit’s inception, the initial gross indebtedness is also calculated. The interest charges over the scheduled term of the credit are determined. The initial gross indebtedness is the initial net indebtedness plus the scheduled interest charges.

If the credit is repayable in equal monthly installments, the monthly payment is equal to the initial gross indebtedness divided by the term of the credit. Each monthly payment provides for the payment of the approximate interest charges for the current month based on the remaining net indebtedness at the beginning of the month. The remainder of the monthly payment is applied to reduce the net indebtedness. The outstanding balance of the credit at any time is the remaining net indebtedness. The following illustrates a simple installment credit obligation.

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<td><strong>Finance Charges</strong></td>
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<tr>
<td><strong>Total of Payments</strong></td>
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</table>

Monthly Payment equals $600.00/12 or $50.00
The calculations for the first monthly payment are:

Monthly interest rate

\[
\text{(Annual rate) / (Number of months per year)} = \frac{18\%}{12} = 1.5\%
\]

Portion of first payment for interest

\[
\text{(Beginning net indebtedness) x (Monthly interest rate)} = 545.38 \times 1.5\% = 8.18
\]

Portion applied to net indebtedness

\[
\text{(Monthly payment) - (Part of 1st payment for interest)} = 50.00 - 8.18 = 41.82
\]

Outstanding net indebtedness at the beginning of the second month

\[
\text{(Beginning net indebtedness) - (Portion applied to net indebtedness)} = 545.38 - 41.82 = 503.56
\]

The gross indebtedness declines in equal amounts on a monthly basis. The amount of monthly decrease is equal to the required monthly payment. The net indebtedness declines each month also, but the pattern of the decrease is not uniform, since interest charges consume more of the early payments.

Insurance Coverage on Installment Credit

Most credit-related insurance is tailored to provide coverage exactly matching the particular installment credit. **Term of coverage** is defined by the term of the credit, normally expressed in months. The **effective date** and the **termination date** of the insurance are set by the corresponding dates of the credit. Voluntary termination of the credit by early repayment terminates the insurance in most states. On early termination, a **premium refund**, approximating the cost of insurance for the remaining term and benefits, is paid to the borrower.
The most common form of credit life insurance is **gross coverage**, which means that the amount of insurance equals the scheduled gross indebtedness of the credit. **Uniform decreasing term life insurance** is the resulting plan of insurance for installment credit. The amount of insurance in force begins at the initial gross indebtedness. Each month, the amount of insurance in force decreases by the amount of one monthly payment. In other words, the amount of insurance in force is the sum of the remaining monthly payments.

The death benefit is the outstanding gross indebtedness. If there are no delinquent payments, this amount exceeds the amount necessary to pay off the credit—the net indebtedness. Any excess over the net indebtedness is paid to the borrower’s estate. Even where delinquencies have occurred, the gross indebtedness is usually sufficient to pay off the entire credit balance.

In addition to providing for delinquencies, gross coverage has the advantage of simplicity. The uniform decreasing coverage is easy to understand. Premium calculations can be verified and refunds can be calculated by hand if necessary.

**Group or Individual Policies**

Credit life insurance is available through group or individual insurance policies. Under a **group policy**, the contractual relationship is between the insurance company and the producer. The producer is issued a group policy, where the group is defined as the consumers obtaining credit from the producer. When insurance is elected, the borrower is enrolled in the group and receives a **certificate of insurance** as evidence of insurance. For example, if the producer is a bank, the bank is the group policyholder. Borrowers obtaining consumer credit at the bank and buying credit life insurance are certificate holders.

Under an **individual policy**, the contractual relationship is directly between the insurance company and the borrower. In this case, the borrower receives an individual policy as evidence of insurance.

Most credit-related insurance is sold under group policies. All states permit the borrowers from a particular producer to be considered an eligible group. An individual policy is generally used in states with low group life insurance maximum limits. From the borrower’s standpoint, there is little difference between the two types of policies. From the insurer’s standpoint, there are differences in the contractual relationship and a few administrative procedures. There is little, if any, difference in the actual coverage provided or the premium rates charged.

**Single and Joint Coverage**

If there is only one borrower, single life coverage is offered. When there is a co-borrower, the borrowers can elect single life coverage on the primary borrower. Another option, joint life coverage, is permitted in all states. A joint policy provides a benefit on the death of either insured. If both die simultaneously, the death benefit is only the stated amount of insurance on the primary borrower, since the insurance proceeds can never exceed the indebtedness of the credit. The cost of joint life insurance is less than single life coverage on each of the two lives.
Conditions of Eligibility

Age of the borrower is the primary consideration affecting eligibility to purchase most credit life insurance policies. Credit life insurance is generally available to all borrowers under age 65, but a few states require a higher maximum age.

The original concept was that a consumer qualifying for credit qualified for the purchase of credit-related insurance. Now, a potential insured must meet certain underwriting standards to be eligible to purchase insurance. For credit under $5,000, a common requirement is that the potential insured(s) sign a statement to the effect, “I am in good health to the best of my knowledge and belief.” This is traditionally called a good health statement.

Alternatively, the insured(s) may be required to sign a more detailed good health statement called an underwriting statement. It lists specific conditions, such as, “I am in good health to the best of my knowledge and belief, and I have not received care or treatment during the last 12 months for cancer, AIDS or AIDS-related complex, or diseases of the heart, lungs or liver.”

Most policies for more than $5,000 require the insured(s) to answer specific underwriting questions. In general, there are only two or three questions addressing serious health conditions or recent medical treatment. Typical underwriting questions are:

- During the past twelve (12) months, have you consulted a physician, been diagnosed as having, or been treated by medication or otherwise, for any of the following: cancer, stroke, heart disease or any other conditions relating to the heart, or disease of the lungs, kidneys, liver, or respiratory system?
- During the past twelve (12) months, have you been diagnosed as having, or been treated by medication or otherwise for Acquired Immune Deficiency Syndrome (AIDS), AIDS-related complex (ARC), or AIDS-related conditions?

If a borrower states that he or she meets the eligibility requirements, the coverage is issued. If a claim is later presented to the insurer, the insurer conducts an investigation to verify that the answers given were accurate. If the insured made a material misstatement in answering the eligibility statement, the insurance is rescinded. No death benefit is paid, since valid insurance was never in force, but the full original gross premium is refunded. In most states, the rescission must take place during the contestable period, commonly within two years after the effective date of the coverage.

Exclusions

Most credit life insurance is sold without any exclusions except for suicide. If suicide is the cause of death and occurs within a specified time after issue (from six months to two years, depending on the state where the policy is issued), the death benefit is limited to a return of the gross premium paid.
Contributory and Non-Contributory Premiums

Contributory premiums are charged when the borrower has the option to purchase the protection and pays an identifiable charge. If a producer provides the insurance without an identifiable charge to the borrower, the premium is called non-contributory. Protection is provided to all borrowers, and the producer absorbs the cost. Except in the credit union market, almost all credit-related insurance is contributory. Since this is the common case, the reference to the contributory aspect is often omitted from the description.

Premium Calculations

Since the credit life policy provides a relatively small amount of insurance for a short term period, the single premium payment mode has been traditional. A premium is calculated to pay for the full coverage provided and is charged to the insured in one sum at the inception of the credit. The premium is added to the amount borrowed and is financed along with the principal of the credit.

Single premium rates are expressed in terms of the initial gross indebtedness, but the calculation reflects the actual decreasing coverage provided. Rates are expressed per $100 of initial gross indebtedness for each year of coverage (¢/$100/year). For example, $0.50/$100/year means the premium rate is $0.50 for each $100 of initial gross indebtedness, times the number of years of coverage. The gross premium for the example on Page 14 is calculated below.

\[
\text{Gross Single Premium} = \frac{\text{(Premium Rate)}}{100} \times \frac{\text{(Number of $100s of Gross Indebtedness)}}{100} \times \frac{\text{(Number of Years of Coverage)}}{12}
\]

\[
= \frac{0.50}{100} \times \frac{600}{100} \times \frac{12}{12} = 3.00
\]

This mode is important in maintaining administrative simplicity. Since the credit life insurance gross premium is typically less than $250, periodic premium billing and collection costs on individual borrowers would consume much of the premium collected. Another advantage to the insurer is the investment income earned on the funds during the term of coverage.

Premium rates for joint coverage are a multiple of the single life rate. A multiple of 1.6 is common. Using this multiple, joint coverage for the example would be $3.00 x 1.6, or $4.80.

Prima Facie Rates

Early credit insurers charged $1.00/$100/year, but rates have come down over the years reflecting improvement in mortality rates and other factors. Each state now sets a prima facie rate—the maximum rate that can be charged in the state for credit life insurance unless an insurer can justify the need for a higher rate. Except in the credit union market, credit insurers generally charge the maximum permitted in each state. A wide diversity of prima facie rates
occurs among states, but $0.50/$100/year is a representative rate. If prima facie rates are charged, insurance must be offered to all eligible borrowers (as defined in the policy) who meet the individual conditions of eligibility.

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**JOINT LIFE & 30 DAY RETROACTIVE**

<table>
<thead>
<tr>
<th>INT RATE</th>
<th>MONTHS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>6</td>
</tr>
<tr>
<td>0.25</td>
<td>174133</td>
</tr>
<tr>
<td>0.50</td>
<td>174133</td>
</tr>
<tr>
<td>0.75</td>
<td>174133</td>
</tr>
<tr>
<td>1.00</td>
<td>174133</td>
</tr>
<tr>
<td>1.25</td>
<td>174133</td>
</tr>
</tbody>
</table>

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PREPARED BY CARLETON FINANCIALS, 1901 COMMERCIAL DR. SOUTH MEND, IN 46064

M-7154-100-0L-D-G-W-V-15SAH30R
Chapter Four

Single Premium Credit Disability Insurance on Installment Credit

Important Definition

Credit disability insurance on installment credit is single premium loss of income insurance purchased in conjunction with closed-end installment credit that provides a level monthly benefit while the insured is totally disabled during the term of coverage. The monthly benefit equals the required monthly payment.

Insurance Coverage on Installment Credit

Most credit-related insurance is tailored to provide coverage exactly matching the particular installment credit obligation. Term of coverage is defined by the term of the credit, normally expressed in months. The effective date and the termination date of the insurance are set by the corresponding dates of the credit. Voluntary termination of the credit by early repayment terminates the insurance in most states. On early termination, a premium refund, approximating the cost of insurance for the remaining term and benefits, is paid to the borrower.

Credit disability insurance may be provided as a companion policy to a credit life policy or as a rider benefit to a credit life policy. The companion policy is a group insurance policy where the group is defined in the same manner as in the life insurance policy. The rider form may be attached to an individual or group credit life policy. There are few, if any, differences in benefits provided or premium rates charged.

There are few exclusions. The principal exclusion is for preexisting conditions, which are described later in this chapter. The other common exclusions are for normal pregnancy and for self-inflicted conditions.
Disability insurance is offered only to the primary borrower in most cases. While this practice is a throwback to earlier times when single-income families were the norm, there are practical reasons. Even now, many spouses work at part-time jobs or in avocations, making the determination of disability more difficult. In addition, the cost of disability insurance is such that even coverage on a single life is expensive. The cost for joint disability insurance is prohibitive for many borrowers. It is permitted in about 40 states.

**Conditions of Eligibility**

As with credit life insurance, a number of conditions must be met to qualify for coverage. First of all, the borrower must enter into a consumer credit obligation.

As with life insurance, all eligible borrowers under age 65 must be offered coverage if prima facie rates are charged. There is an actively-at-work requirement, but this is generally a condition of the credit as well.

The borrower must meet the underwriting requirements for life insurance, even if only credit disability insurance is purchased. In addition, potential disability insureds may have to answer an additional question about non-life-threatening conditions that may cause disability, such as back or neck problems.

**Determination of Disability**

To qualify for benefits, the insured must meet the definition of disability specified in the policy. The any occupation definition of disability means that the insured is unable to perform the regular duties of any occupation for which the insured is reasonably suited by reason of education, training, or experience. The own occupation definition is easier to meet and only requires that the insured is unable to perform the essential duties of the insured’s usual occupation.

For many people, there is little difference between the definitions. The distinctions arise in specialized occupations, such as airline pilots or doctors where a relatively minor condition could hamper some activities, or in occupations requiring physical activity. For example, a serious back injury may disable a pipe welder from welding (own occupation) but not from an office job (any occupation).

By practice or regulation, the own occupation definition is generally the criteria for short-term disabilities, but the any occupation test must be met for long-term claims. For example, Texas requires an insurer to apply the own occupation definition during the first 12 months of a claim; to receive more than 12 months of benefit, the claimant must meet the any occupation test also.

**Benefits Provided**

Under installment credit, the monthly benefit is the monthly payment as defined by the credit obligation. Most credit-related insurance policies provide a benefit based on the actual number of days disabled. The daily benefit is one-thirtieth of the monthly payment.
Benefits continue until the disability ceases or until the termination date of the credit, whichever comes first.

**Elimination Period**

All credit disability policies require that the insured remain disabled for a certain number of days before any benefits are payable (the **elimination period**). This practice eliminates short-duration claims, which create as much administrative work as large claims. Eliminating the small claims significantly reduces the premium. The longer the elimination period is, the lower the premium.

Fourteen-day and thirty-day elimination periods are the industry standards. A 14-day elimination period means that the insured must remain disabled more than 14 days before any benefit is payable for a particular disability. Once the elimination period is satisfied, it does not have any other impact on the benefits due under the policy. In prior years, shorter elimination periods were used, notably three days and seven days. A seven-day elimination period is still permitted in some states, but the premium cost is rather high.

**Elimination Period Benefit**

There are two methods used to determine the benefit payable for the time disabled during the elimination period:

1. **Non-retroactive benefit** means that no benefit is payable for the elimination period. Benefits begin to accrue only after the elimination period has elapsed. For a 14-day elimination period, the non-retroactive benefit begins with the fifteenth day of disability.

2. **Retroactive benefit** means that a benefit is payable for the elimination period. Once a claimant has been disabled the required number of days in the elimination period, benefits accrue from the first day of disability.

**Examples of Disability Benefits**

| Coverage: 14-day retroactive benefits |
| Days Disabled: 60 | Monthly Benefit: $300 |
| Disability Benefit: = 60 x ($300 / 30) |
| = $600 |

| Coverage: 30-day non-retroactive benefits |
| Days Disabled: 25 | Monthly Benefit: $300 |
| Disability Benefit: None |
Coverage: 30-day non-retroactive benefits

<table>
<thead>
<tr>
<th>Days Disabled:</th>
<th>60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Benefit:</td>
<td>$300</td>
</tr>
<tr>
<td>Disability Benefit:</td>
<td>( (60 - 30) \times \left( \frac{300}{30} \right) )</td>
</tr>
<tr>
<td></td>
<td>= $300</td>
</tr>
</tbody>
</table>

Pre-Existing Condition Exclusion

Credit-related insurance may be offered to borrowers without inquiry about any existing health problems. To obtain the credit, the applicant is presumably in good health, is actively at work, and possesses the ability to repay the credit. If health questions are asked, they are usually designed for life insurance and relate to serious conditions affecting mortality. There are health conditions that are disabling but not life threatening, such as back problems.

The cost of underwriting and the delays in accepting coverage are not acceptable given the size of the credit-related insurance premium and the amount of coverage. Still, the borrower may have existing impairments that may cause future disabilities. A **pre-existing condition** is an impairment for which the insured has been treated prior to the effective date of the insurance.

Insurers have the option of covering pre-existing conditions or excluding them; most credit disability policies exclude them. If pre-existing conditions are excluded, the standard exclusion is a **six-and-six exclusion**. Under this exclusion, a disability is **not covered** if:

- The insured receives treatment within the six months prior to the effective date of the insurance, **and**
- The insured is disabled due to the pre-existing condition within six months after the effective date of the insurance.

Both conditions must be met. If the last treatment precedes the effective date by more than six months, the disability is covered. If the disability starts more than six months after the effective date, the disability is covered. The following examples illustrate how the exclusion is applied.

<table>
<thead>
<tr>
<th>Date of Last Treatment</th>
<th>Effective Date of Coverage</th>
<th>Date Disability Began</th>
<th>Benefits Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-15-97</td>
<td>6-30-97</td>
<td>9-15-97</td>
<td>No</td>
</tr>
<tr>
<td>3-15-97</td>
<td>6-30-97</td>
<td>3-15-98</td>
<td>Yes</td>
</tr>
<tr>
<td>9-15-96</td>
<td>6-30-97</td>
<td>9-15-97</td>
<td>Yes</td>
</tr>
<tr>
<td>9-15-96</td>
<td>6-30-97</td>
<td>3-15-98</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Figure 4.1 - Application of the Six-and-Six Exclusion
**Premium Rates**

Each state sets prima facie rates for each plan of insurance. They are the maximum rates that an insurer may charge without demonstrating the need for higher rates. Most insurers charge the prima facie rates, except in the credit union market. For credit unions, the claim experience varies significantly depending on the industry of the credit union’s members. When most members are employed in heavy industry, the rates charged may exceed prima facie rates.

A single premium is charged for the full term of protection provided based on a table that varies by plan of benefit and term of coverage. The same premium rate is charged regardless of age, sex, or occupation of the borrower.

<table>
<thead>
<tr>
<th>Term of Coverage</th>
<th>14-Day Retro</th>
<th>14-Day Non-Retro</th>
<th>30-Day Retro</th>
<th>30-Day Non-Retro</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>$2.20</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.15</td>
</tr>
<tr>
<td>24</td>
<td>3.00</td>
<td>2.15</td>
<td>2.15</td>
<td>1.50</td>
</tr>
<tr>
<td>36</td>
<td>3.80</td>
<td>2.90</td>
<td>2.85</td>
<td>2.05</td>
</tr>
<tr>
<td>48</td>
<td>4.30</td>
<td>3.25</td>
<td>3.20</td>
<td>2.35</td>
</tr>
<tr>
<td>60</td>
<td>4.70</td>
<td>3.60</td>
<td>3.55</td>
<td>2.70</td>
</tr>
</tbody>
</table>

*Figure 4.3 - Sample Premium Rates Per $100 of Initial Gross Indebtedness*
The premium for the example on Page 14 under the 14-day retroactive plan is:

<table>
<thead>
<tr>
<th>Term</th>
<th>12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Gross Indebtedness</td>
<td>$600</td>
</tr>
<tr>
<td>Premium Rate (14R, 12 months):</td>
<td>$2.20</td>
</tr>
<tr>
<td>Premium</td>
<td>= $2.20 x ($600 / $100) = $13.20</td>
</tr>
</tbody>
</table>

**Claim Filing**

Once disabled, an insured must file a claim to receive benefits. A claim form is obtained from the creditor or directly from the insurer. The insured, the insured’s physician, and the insured’s employer must complete portions of the form. This information is returned to the insurer, who reviews the form and determines whether the insured qualifies for benefits.

Many claims are **first and final** payments. The insured waits until the disability is over and files a claim for the entire period of disability. These are usually short-duration claims.

On longer claims, the insured must complete a **Continuance of Disability** form monthly. These forms are simpler than the initial form and serve to establish that disability has continued. For severe disabilities, insurers may have special procedures requiring less paperwork.
Chapter Five

Monthly Premium Insurance on Open-End Credit

Important Definitions

Open-end credit is a consumer credit under which the amount of credit extended may be increased at any time by additional borrowing up to the account’s credit limit. The term of the credit is not fixed. The borrower makes monthly payments in any amount ranging from the creditor’s required minimum payment up to the outstanding balance of the credit.

Credit life insurance on open-end credit is monthly premium, monthly renewable term life insurance purchased in conjunction with open-end credit that provides a benefit if death occurs during the month. The benefit is the outstanding balance of the credit on the date of death.

Credit disability insurance on open-end credit is monthly premium, monthly renewable loss of income insurance purchased in conjunction with open-end credit that provides a level monthly benefit while the insured is totally disabled, up to the limits specified in the policy. The monthly benefit equals the minimum monthly payment due under the open-end credit obligation on the initial date of disability.

Credit involuntary unemployment insurance (IUI) on open-end credit is monthly premium, monthly renewable loss of income insurance purchased in conjunction with open-end credit that provides a level monthly benefit while the insured is involuntarily unemployed, up to the limits specified in the policy. The monthly benefit equals the minimum monthly payment due under the open-end credit obligation on the initial date of involuntary unemployment.

Open-End Credit

The use of open-end credit in the consumer marketplace continues to exhibit steady growth. Credit card borrowing is the primary example of this type of consumer credit. If the card is valid, consumers can borrow cash or charge purchases up to their credit limit. The amount of
Monthly Premium Insurance on Open-End Credit

can be increased at any time up to the credit limit. Retailers’ revolving charge cards operate on the same principles but cash advances are not permitted and all purchases must be made from the retailer. Most credit union credit is structured as open-end credit. Some finance companies structure their credit as open-end credit.

A minimum monthly payment is required, based on the outstanding balance of the account and the terms of the credit obligation. Each month, the borrower makes a payment ranging from the minimum payment up to the outstanding balance of the account. The minimum monthly payment is a specified percentage of the outstanding balance on the billing date, such as 3%. If the outstanding balance is $1,300, the minimum monthly payment is $39. Most agreements specify a minimum dollar amount also, such as $20. Using 3%, the calculated minimum monthly payment on a $600 balance is $18, but a $20 payment would be required. Revolving charge cards often vary the percentage based on the level of the outstanding balance, such as 10% of the first $200, then 8% of the next $300, then 5% on the remainder of the balance, with the total amount subject to a $15 minimum.

Figure 5.1 Sample Credit Card Monthly Balances and Minimum Monthly Payments over a Year. For example, in April the outstanding balance was $1,300 and the minimum monthly payment was $39 (3% of $1,300).

In the 1970s, banks introduced the concept of a personal line of credit. This was comparable to a credit card with a higher limit. Once the line of credit was established, the borrower could use the credit at any time up to the approved limit. Early lines of credit were established based on the borrower’s net worth. Lines of credit were not widely used until the mid-1980s when home equity lines of credit became popular. A homeowner applies for a line of credit based on the equity in the borrower’s home. Equity is the value of the property in excess of any indebtedness (generally a first mortgage). The property is pledged as collateral. Once the line of
credit is approved, the borrower may use the credit at any time for any purpose, up to the approved limit. Banks, credit unions, and finance companies now extend a significant portion of their consumer credit under home equity lines of credit.

### Insurance Coverage on Open-End Credit

In most states, the typical credit card or revolving charge card insurance program is a package of life, disability, and involuntary unemployment insurance coverages. Cardholders are offered the opportunity to enroll during the credit application process, by mail solicitation, or by telemarketing. After enrollment, coverage is automatically renewed each month, unless the card privilege or the insurance is terminated.

All types of open-end credit share the characteristic of variability. An upper limit is established, and the outstanding credit can vary daily from zero to the full credit limit. Credit-related insurance regulations were designed for installment credit and limit the amount of insurance that can be sold to the amount of indebtedness at any point in time.

<table>
<thead>
<tr>
<th>Producer</th>
<th>Type of Credit</th>
<th>Typical Insurance Offered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>Credit Card</td>
<td>Life, Disability, IUI, Family Leave</td>
</tr>
<tr>
<td>Bank</td>
<td>Personal Line of Credit</td>
<td>Life</td>
</tr>
<tr>
<td></td>
<td>Home Equity Line of Credit</td>
<td>Life</td>
</tr>
<tr>
<td>Retailer</td>
<td>Revolving Credit Card</td>
<td>Life, Disability, IUI, Property</td>
</tr>
<tr>
<td></td>
<td>Credit Card</td>
<td>Family Leave</td>
</tr>
<tr>
<td>Credit Union</td>
<td>Member Share Accounts</td>
<td>Non-Contributory Life or</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Member-Pay Life; Member-Pay Disability</td>
</tr>
</tbody>
</table>

Given the variability of the conditions of open-end credit, a single premium was not appropriate, so an alternative premium method was used—**monthly outstanding balance (MOB)**. The premium is collected monthly on each monthly billing date. MOB premium rates are expressed per $1,000 of insurance in force in most regulations, but per $100 of outstanding balance in practice.

Each month, the MOB rate per $100 is multiplied times the appropriate outstanding balance—either the outstanding balance of the account on the account’s billing date, or the average of the daily credit balances during the previous month. This amount is included in the charges for the month on the borrower’s monthly bill. The creditor totals the premiums from all insured borrowers and remits the premium to the insurance company.

For example, if the MOB premium rate is $0.60 per $100 per month ($0.60 /$100/month) for the package of life, disability, and IUI, and a borrower has an outstanding balance of $1,250, the monthly premium is:

\[
($0.60 \text{ per } $100) \times \left(\frac{$1,250}{100}\right) = $7.50
\]
Credit Life Insurance

The life insurance product is monthly renewable term life insurance. Where the credit limit is under $10,000, the death benefit is usually the outstanding balance of the account on the date of death.

For accounts with credit limits in excess of $10,000, the definition of the death benefit has been modified in recent years because of anti-selection. Anti-selection is the tendency of a borrower to select against the insurer, based on the borrower’s knowledge of the borrower’s health or employment status, when making the decision to purchase insurance. For example, a borrower could learn of a serious or terminal health condition and immediately exercise the full credit line. To protect themselves from anti-selection, insurers may impose conditions on the determination of the death benefit on open-end credit. For example, some policies impose a life pre-existing condition exclusion. An advance is not covered if the insured dies within six months following the advance for a condition that the insured was treated for during the six months preceding the advance.

An alternative is a setback provision. The death benefit at all times is the balance of the account 90 days prior to the date of death.

Virtually all credit life insurance is sold at the same premium rate throughout a particular state. One rate is charged for all ages and both sexes. Ordinary life rating distinctions—age, sex, smoker/non-smoker, and occupation class—are not reflected in the premium rate charged for the product. In recent years, a few age-banded products have been introduced for home equity lines of credit.

Premium rates vary by state reflecting the variation in state prima facie rates. A typical rate is $0.08/$100/month for single life coverage and $0.13/$100/month for joint life coverage. Some programs insure both the cardholder and a co-cardholder (if any); the premium rate is a blended rate reflecting the expected percentage of cards with two cardholders.

Credit Disability Insurance

The insurance is monthly indemnity, monthly renewable loss of income insurance. Thirty-day retroactive coverage is the most common plan. A benefit begins after 30 days of disability, and benefits are retroactive to the first day of disability. Fourteen-day retroactive coverage and lump sum benefits are also offered.

The disability benefit equals the minimum monthly payment as defined in the credit obligation. In recent years, some creditors have reduced the minimum monthly payment percentage to a level just sufficient to cover the required interest and insurance charges. To provide a more substantial benefit, some insurers provide a monthly benefit that is the greater of: a) the minimum monthly payment, or b) the balance times a stated percentage, such as 5%.

This level monthly benefit continues until a maximum benefit is reached, generally defined as the outstanding balance on the date of disability or a stated number of monthly benefits. For example, consider a credit obligation that has a minimum monthly payment of 5% and a claimant that has a balance of $1,000 on the date of disability. The disability benefit is $50.00 per month. A claimant can earn up to 20 benefits before the maximum ($1,000) is reached.
In most cases, the definition of disability and the claim adjudication process are comparable to the standards used for installment credit. Benefits are paid as a direct credit (or reduction) on the card billing statement. The cardholder may continue to use the card, but purchases after the date of disability are not usually covered.

Premium rates vary by state reflecting the differences in state prima facie rates. A typical rate is $0.20/$100/month.

An alternative seen in the retail market is 90-day lump sum coverage. If the insured remains disabled for 90 days, the outstanding balance on the date of disability is paid as the benefit. The coverage is more expensive than monthly indemnity, about $0.50/$100/month.

**Involuntary Unemployment Insurance**

Involuntary unemployment insurance pays a monthly benefit if the insured becomes involuntarily unemployed. The cause of unemployment must be involuntary, such as layoff, strike, termination for cause, or business closing.

The coverage often matches the credit disability coverage. Thirty-day retroactive coverage is the most common plan. A benefit begins after 30 days of involuntary unemployment, and benefits are retroactive to the first day of involuntary unemployment. Fourteen-day retroactive coverage and lump sum benefits are also offered.

The involuntary unemployment benefit equals the minimum monthly payment as defined in the credit obligation. In recent years, some creditors have reduced the minimum monthly payment percentage to a level just sufficient to cover the required interest and insurance charges. To provide a more substantial benefit, some insurers provide a monthly benefit that is the greater of: a) the minimum monthly payment, or b) the balance times a stated percentage, such as 5%.

This level monthly benefit continues until a maximum benefit is reached, generally defined as a stated number of monthly benefits or the outstanding balance on the date of involuntary unemployment. IUI plans are more likely than disability insurance to have a stated maximum number of benefits, such as twelve.

In most cases, qualification for benefits only requires proof that the insured qualifies for state unemployment benefits. Proof of continued unemployment must be submitted monthly. Benefits are paid as a direct credit (or reduction) on the credit card billing statement. The cardholder may continue to use the card, but purchases after the date of involuntary unemployment are not usually covered.

Only a few states have promulgated prima facie rates for IUI. In most states, the insurer must file a rate and provide actuarial justification that the rate is reasonable. A premium rate of $0.39/$100/month is common.

An alternative seen in the retail market is 90-day lump sum coverage. If the insured remains involuntarily unemployed for 90 days, the outstanding balance on the date of disability is paid as the benefit. The coverage is more expensive than monthly indemnity, about $1.00/$100/month.
Credit Property Insurance

Credit property insurance on open-end credit is monthly premium, monthly renewable property insurance purchased in conjunction with open-end credit insuring consumer products that are bought (or pledged as collateral) against specified loss occurrences causing damage to, or disappearance of, the property. The benefit is repair or replacement of the property. It is also called MOB credit property insurance.

Revolving charge cards offered by retailers, such as furniture or department stores, are the primary vehicles for this coverage. Credit cards and open-end credit obligations used exclusively for the purchase of consumer products are also possible candidates for the sale of MOB credit property insurance. In a typical program, credit property insurance is sold as a part of a package of life, disability, and involuntary unemployment coverage. This coverage is not available under most credit cards, since many of those purchases do not involve consumer products.

If a consumer product is purchased from a retailer using a revolving charge card, insurance protection is usually provided for a stated period, such as 36 months from the date of purchase. A claim will be paid if any of 19 standard perils occur, including burglary and damage by fire. At the insurer’s option, the damaged consumer product is repaired or replaced. Insurance protection is from the first dollar, or is subject to a small deductible, such as $25.

Another opportunity for MOB credit property insurance is open-end credit that is secured by property. A consumer finance company offering open-end, general purpose credit that is secured with a collateral asset is one example.

About 25 independent credit insurers offer the product to unaffiliated retailers or finance companies. In other cases, the credit insurer is an affiliated corporation owned by a retailer, such as J. C. Penney, or a finance company.

Only a few states have promulgated prima facie rates for MOB credit property insurance. In most states, the insurer must file a rate and provide actuarial justification that the rate is reasonable. A premium rate of $0.29/$100/month is common.

Family Leave Insurance

Family leave insurance on open-end credit is monthly premium, monthly renewable loss of income insurance purchased in conjunction with open-end credit that provides a level monthly benefit during an unpaid leave of absence resulting from specified causes, up to the maximum benefit period. The monthly benefit equals the minimum monthly payment due under the open-end credit obligation on the date that the leave was requested.

In 1993, the Family and Medical Leave Act was enacted requiring large employers to offer an unpaid leave of absence for up to 90 days in the event of certain family situations—sickness of a family member, birth, and adoption. Insurers began to file policies or riders providing benefits for events closely resembling the situations covered under the act. It is not necessary for an insured to be covered under the Family and Medical Leave Act to qualify for the insurance benefit.
To qualify for the benefit, the insured must take an unpaid leave of absence from work. The employer must provide a written statement that the unpaid leave has been taken. The leave must be associated with one of the following events:

- Birth of a child
- Adoption of a child
- Sickness of an immediate family member—spouse, child, or parent

Some insurers include leave associated with living in a federal disaster area or being recalled for active military duty.

The insurance is monthly indemnity, monthly renewable loss of income insurance. Thirty-day retroactive coverage is the most common plan. A benefit begins after 30 days of unpaid leave, and benefits are retroactive to the first day of leave. Insurers have offered plans with maximums of three monthly benefits and six monthly benefits.

Anti-selection appears to be a concern, but several cost containment measures are in place. The provision that the leave must be unpaid acts as a severe deterrent to taking a leave just for insurance benefits of $20-$50 per month. In addition, benefits are limited to three or six months, greatly reducing the exposure.

Credible loss experience has not emerged, so pricing has been based on a high degree of judgment. Current rates are about $0.12/$100/month for the three-month benefit and about $0.16/$100/month for the six-month benefit.
CONSUMER CREDIT INSURANCE is Bought by MILLIONS because PAID IN FULL.

IT PROVIDES SECURITY WHEN IT'S NEEDED MOST.

CONSUMER CREDIT INSURANCE is Fastest Growing Type of Insurance Coverage.

In 1951:

Credit life insurance was 12.8 per cent of all life insurance sold.

The $5,700,000,000 of credit life insurance sold represented a gain of 60 per cent over 1950 sales, while the total of all life insurance sold decreased 6 per cent.

More than 10,000,000 separate policies were purchased by average Americans to provide both life insurance and disability insurance on money they borrowed or goods they bought on installments.

Because

Americans want security. Credit insurance provides security when they need it most.

More and more people are using their credit to buy the things they need. They want to eliminate the risk in pledging future income. Consumer credit insurance provides security and eliminates risk.
Credit-related insurance is offered to the borrower at the place where the credit is extended (on installment credit) or by subsequent direct marketing solicitations of the portfolio of borrowers (on open-end credit). Thus, the primary producers are credit institutions. Most credit institutions offer or provide credit-related insurance. These institutions include banks, credit unions, finance companies, and farm credit banks. Credit-related insurance is also offered in conjunction with installment sale contracts for the sale of consumer products or services. These businesses include automobile dealers, mobile home dealers, and recreational vehicle dealers, and retail outlets.

Very few of the published statistics provide a distribution of the business by producer, but data from Ohio statistical reports provide the following picture of Ohio business.

**Ohio Business by Class of Producer**

![Bar chart showing the distribution of credit-related insurance business by class of producer in Ohio. The chart compares production years 1993-1995 and 1977-1979. The categories include Credit Union, Automobile Dealer, Bank, Finance Company, Farm Credit/Other, Other Sales/Finance, and Other. The chart indicates the percentage of total business for each category.]
Producers of Credit-Related Insurance

Banks

Since banks extend the widest range of credit products, they offer a variety of credit-related insurance products. The principal credit categories are:

- Consumer Credit
- Credit Cards and Personal Lines of Credit
- Home Equity Credit

**Consumer Products Credit.** Most bank consumer credit is generated by automobile sales, since many consumers obtain automobile financing at their bank. Prior to 1960, many banks provided non-contributory credit life insurance as a part of the credit package or did not offer insurance products at all. Bankers were reluctant to offer insurance, but their attitude gradually changed. Today, nearly all banks offer the product as an option to the borrower, who pays an identifiable charge for the insurance.

For installment credit, life and disability insurance is usually offered on the single premium plan for full coverage benefits. Banks use a variety of disability plans. Fourteen-day retroactive and thirty-day non-retroactive disability coverages are the most frequently selected plans.

**Credit Cards and Personal Lines of Credit.** Individual banks offer their own Visa and MasterCard credit cards. In addition, banks offer lines of credit. A personal line of credit may be provided by allowing a high limit on a credit card or by pre-authorized credit that can be exercised by writing a check. Credit-related insurance is offered at the time that these accounts are established, by subsequent mail solicitation, and by telemarketing. The consumer agrees to permit the bank to include a charge for credit-related insurance. A monthly outstanding balance premium is charged on the monthly billing date. The premium is based on the average daily balance of the account for the prior month or the balance on the date of the billing date. Benefits of the insurance products are based on the outstanding balance of the account on the date of death, disability, or involuntary unemployment.

These forms of credit differ from home equity credit in that the credit is unsecured. The bank’s collateral is simply the earning power of the borrower.

**Home Equity Credit.** While home equity installment credit is similar to consumer credit, the term of the credit tends to be longer and the amounts higher. Home remodeling and major purchases, such as appliances, swimming pools, and vacation homes, generate the demand for home equity credit, also called second mortgages. The credit is secured by the equity in the borrower’s home; a second mortgage lien is placed on the home.

Originally, the related coverages were the traditional single premium, closed-end installment credit products. The term of the credit was usually seven to fifteen years, but credit was often repaid prior to maturity. Sale of the collateral, in addition to the normal percentage of borrowers who repay credit early or refinance, produced early terminations. The high amounts and long terms produced high single premiums and exposure to long-term disability claims. To counteract these characteristics, limited coverage plans (see Chapter Eight) may be offered instead of standard plans. This structure is still common.
In the 1980s, the home equity line of credit was introduced. At the credit inception, a line of credit is established based on the customer’s equity. The credit may be exercised at any time for an amount up to the pre-approved limit. Open-end credit life insurance products are sold to cover this type of credit.

Credit Unions

The growth of credit unions in the 1970s led to additional opportunities for insurers to write credit-related insurance. Credit unions traditionally provided non-contributory life insurance protection as a part of the credit package. In a few cases, a total and permanent disability benefit was also included as a rider (or additional benefit) to the life insurance policy. Total and permanent disability coverage was used, because it was considerably cheaper than the standard plans of disability insurance. These non-contributory coverages were purchased from insurers with monthly premiums based on the member’s account balance.

Many credit unions either: a) did not provide the disability insurance, or b) offered monthly indemnity disability insurance on a contributory (member-pay) basis. Thirty-day non-retroactive coverage became the standard member-pay coverage. The premium mode was usually monthly outstanding balance, since open-end credit was far more prevalent in credit unions than in other financial institutions.

CUNA Mutual Life Insurance Society specialized in credit unions from its inception and has always been the dominant insurer in this market. As credit unions began to offer contributory disability insurance, other insurers entered the credit union market. Sometimes, one insurer provided the non-contributory life insurance while another insurer provided the disability product. This is one of the few situations where a producer used different insurers for the two product lines.

Today credit unions provide credit insurance in every form: non-contributory MOB credit life insurance and member-pay MOB credit insurance are the most common forms, but they no longer dominate the market. Increasingly, credit life insurance is member-pay. Single premium products represent a small but growing share of the market. Other plans of disability insurance are now seen.

Finance Companies

Finance companies began as independent cash loan creditors. The industry consolidated in the 1950s. Today, large nationwide and international corporations dominate the industry. These corporations own widely-licensed credit insurers. Some finance company-affiliated insurers now write credit-related insurance for other producers, and a few have entered ordinary insurance product lines.

Customers of finance companies often have a long, continuous borrowing relationship. Borrowing in the small credit market is often for day-to-day expenses, financial problems, and appliances, rather than for automobiles or luxury purchases. Credit obligations are often refinanced. While each purchase is a separate transaction, a credit relationship may continue for many years.
Finance companies offer standard credit-related insurance products. Their penetration rates are the highest in the credit industry, probably because credit officers are encouraged to offer credit-related insurance in connection with the credit obligation. This practice is not to the consumer’s detriment, since small finance company borrowers are the most underinsured segment of the borrowing population.

When credit cards replaced many cash loans in the 1970s, the finance companies pursued upscale credit markets, by moving into the home equity credit market. They have led in the development of new credit-related insurance products to cover long-term, high-limit credit. Some finance companies now own affiliated banks that issue credit cards.

**Farm Credit Banks**

Farm Credit Banks are a unique form of credit institution that exist to extend credit to farmers. Prior to planting time, the farmer gets a credit commitment for the year. During the year, the commitment is exercised to pay the expenses of the farm year. At the end of the year, the income from the harvest is used to repay the credit. At the same time, a new credit commitment is made for the next season. Interest is charged on the amount of credit used. Banks extend agricultural credit on the same basis.

This market is an exception to the rule that credit-related insurance cannot exceed the outstanding indebtedness. Level term credit life is sold for the full amount of the credit commitment. The logic is that the full commitment will be needed to produce the year’s crop.

**Other Credit Institutions**

A few states have hybrid, state-chartered institutions. In Washington state, there are mutual savings banks. Governed by special sections of state law, the mutual savings banks are free to pursue any insurance activity.

Mutual savings banks in Connecticut, New York, and Massachusetts were formed in the early 1900s to provide low-cost credit, generally for small amounts. Affiliated mutual life insurance companies are permitted to sell a limited set of ordinary plans and credit-related insurance.

Manufacturers of vehicles and other costly consumer products have formed financing corporations, called acceptance corporations, to facilitate the financing of the purchase of their products. Manufacturers of trucks, farm implements, and other durable products provide financing through subsidiaries. Automobile acceptance corporations are the largest and include:

- Chrysler Credit Corporation
- Ford Motor Credit Corporation, and
- General Motors Acceptance Corporation

In a typical arrangement, the dealer or retailer sells the product under an installment sale contract and finances the purchase itself. Prior to delivery of the product, the borrower’s application for credit is forwarded to the acceptance corporation for approval. If approved, the acceptance corporation buys the credit from the dealer by paying the dealer the discounted value
of the installment payments. The interest rate used to discount the installment payments produces a profit to the dealer for arranging the financing.

Some acceptance corporations are affiliated with a widely licensed insurer that is owned by the acceptance corporation or the parent corporation. A dealer may offer the credit-related insurance program affiliated with the acceptance corporation or may arrange for a program through an independent insurer. A widely-licensed affiliated insurer is needed, since most manufactured products are sold nationwide. Alternatively, the parent corporation or the acceptance corporation may arrange with an independent insurance company to offer credit-related insurance along with the financing assistance.

### Automobile, Mobile Home, and Recreational Vehicle Dealers

Automobile dealers are clearly the most colorful producers of credit-related insurance. The product is sold wherever cars are sold, from the smallest used car lots to the largest new car dealerships. Some dealerships produce $500,000 or more of credit-related insurance premiums annually. Standard single premium, full benefit plans are sold. Most disability coverage is sold on the 14-day retroactive plan.

While some automobile dealers sell credit-related insurance offered by an affiliate of their acceptance corporation, many use an independent insurer. Since automobile dealerships are independently owned and geographically diverse, the business is spread among many credit insurers. Dealer business requires attention and personal contact, yet the majority of dealerships do not write the volume of premium needed to justify the involvement of home office sales personnel or the development of widespread regional sales offices. Therefore, insurers often solicit automobile dealer business through general agents.

Sales of mobile homes and recreational vehicles require credit for large amounts and for long terms. The term and amount of this credit dictate that only credit life insurance is offered. The pricing is difficult, since mobile home buyers are often young people starting a home or older people looking for smaller accommodations after the children have left the home. The result is an unusual age distribution as compared to a typical block of credit-related insurance business.

### Retail Outlets

Wherever consumer products are financed, a market opportunity for credit-related insurance exists. Large nationwide retailers have revolving charge accounts for consumer purchases. The insurance coverage parallels the bank credit card market. Several national retailers own widely-licensed credit insurers that provide credit-related insurance products to their customers.

Furniture, consumer electronic, and appliance stores generate installment sale contracts using a process similar to the one used by automobile dealers. Single premium credit-related insurance is offered, but the volume in this market is relatively small. Many purchases are for small amounts, and the credit term is often two years or less.
The Insurer-Producer Relationship

The producer of the business is the actual customer of the insurer providing the credit-related insurance products. For a particular type of credit, a producer will only offer the product of one insurer and usually uses the same insurer for all credit types. An insurer will solicit new producers using a salaried staff, general agents, or a combination of the two.

Salaried sales staff are employees of the insurer and solicit producers only for the particular insurer. The salesperson is compensated primarily by salary, but incentive sales compensation plans are common. These representatives have the responsibility to service current producers also. Salespeople may operate from the home office or from regional offices, depending on the geographical range of the insurer’s operations.

General agents are independent contractors who represent more than one insurer. They usually offer a variety of life and P&C insurance products. For each product, a general agent will operate under the terms of an agency contract with the insurer that specifies the agent’s authority, responsibilities, and compensation. General agents usually operate within a limited geographical area and often specialize in one type of producer, such as banks or automobile dealers. Compensation is a percentage of the premiums generated by the producers who are signed up by the general agent for the insurer.

To entice a producer to use a particular insurer, the insurer provides sales literature, rate calculation material, training, and compensation for the business sold. Sales literature usually consists of generic brochures that extol the value of the coverage and emphasize the need for the insurance protection. Rate calculation materials include printed rate charts, factor cards, handheld calculators, and personal computers.

Training is important. The person presenting the product to the borrower must be convinced of the value of the protection to the borrower and the producer. Insurers and general agents conduct training schools that hone selling skills and provide the producers with a strong understanding of the products.

Automobile dealerships often assign one individual the responsibility of completing the sale by offering a financing package. These finance and insurance specialists (F&I people) are trained in the completion of the paperwork of the transaction. If the sale is financed, credit-related insurance is offered.

Compensation to producers is a percentage of the premiums collected. Front compensation, which may be called a commission or a service fee, is a flat percentage of the premium collected. It is deducted from the amount collected from the borrower before the net amount is remitted to the insurer. When a credit obligation is terminated prior to maturity, the borrower receives a refund of the unearned premium. There is a chargeback to the producer for the unearned front compensation. A producer or a general agent may also receive retroactive compensation. This compensation is paid by the insurer based on the actual profitability of the business generated by the producer.
Chapter Seven

The Case for Credit-Related Insurance

The amount of credit life insurance in force has grown consistently for more than 80 years. The post-war years, from 1945 to 1970, were a period of spectacular growth for the industry. Currently, more than $175 billion of credit life insurance is in force, representing more than 48 million policies and certificates. Credit disability insurance in force grew slowly until 1970, then experienced 15 years of strong growth. Its annual premium volume now exceeds the life insurance products (about $2 billion each). In the last decade, involuntary unemployment insurance has grown to more than $900 million in annual premium income. The growth rate and amount of credit-related insurance in force are clear evidence of the value of these consumer products.

Consumer acceptance can be traced to three properties of the product:

- The products satisfy a real need.
- The products are conveniently available.
- The cost of the products is reasonable.

The Need for Credit-Related Insurance

Americans and Canadians have long recognized the need for insurance protection. Few people are without some form of life or health insurance. A natural time for considering additional insurance protection is when a consumer is assuming additional credit. Arthur Morris founded the first credit-related insurance company with the motto “No man’s debt should live after him.” CUNA Mutual’s early gender-neutral motto, “The debt shall die with the debtor,” may be more accurate for today’s two-income families. These statements are as valid today as they were in the early part of the century.

The death of a borrower or co-borrower can be a serious financial event. If the death is preceded by a prolonged or serious illness, the financial strain can be even more pronounced. Credit is usually incurred because a family’s assets are not sufficient to meet the demands of a specific expenditure. Repayment depends on the continued earning power of the borrower. A prudent
borrower makes a provision for the possibility that earning power may be reduced or eliminated by death, disability, or involuntary unemployment.

Disability insurance is also valuable. Some workers still face the situation of “no work, no pay.” Others have only short-term sick pay with no provision for salary continuation after a few weeks of disability. Social Security provides some protection from long-term disability, but it requires a five-month waiting period. All workers face the problem of medical costs that must be met in addition to regular living expenses. While most employees have some form of health insurance, deductibles and co-insurance payments can represent a major financial burden.

Credit disability insurance eases the stress. Its short waiting period produces benefits during the early period following a disability. If the producer knows the consumer is protected, there is unlikely to be pressure for payment when the need for cash flow is critical. This prevents situations such as the repossession of a family automobile when the spouse may need it the most. For long-term disabilities, benefits will continue until the credit is repaid.

In open-end credit, IUI has proven popular. Consumers under age fifty view the short-term probability of death as remote and disability as unlikely, but unemployment has to be considered. Although unemployment rates dropped during the 1990s, the level of employment security seemed to drop also.

Today’s consumer faces a vast array of essentials and luxuries vying for a portion of the consumer’s budget. The growth of two-income families demonstrates that financial demands stress available financial resources. Single-parent families, which represent a substantial percentage of the population, face difficult financial decisions. When basic needs are not fully met, the purchase of insurance can easily be delayed or ignored. Therefore, consumers using credit for basic needs are more likely to be underinsured.

Another reason that consumers are underinsured is the propensity of insurers to sell whole life or universal life insurance. While these products have merit, a major portion of the premium dollar is really forced savings. In many cases, a consumer would be better off applying the entire insurance budget to purchase term insurance. For instance, young families with children need all the insurance protection they can afford. Credit-related insurance is pure insurance protection—the life product is term life insurance.

The Convenience of Credit-Related Insurance

A major element of the success of credit-related insurance is people’s dislike for discussing death, disability, or involuntary unemployment. Good insurance agents realize the problem, but even a successful agent is out of luck if the consumer anticipates an unpleasant discussion and will not even let the agent in the door. Once inside, the ordinary life insurance agent has an array of products, often confusing to the consumer. Even knowledgeable consumers have difficulty comparing ordinary life products and costs. Comparison shopping means talking to more agents.

After the selection, the consumer is faced with completion of an application with medical questions. A paramedical examination or a full medical examination may be required. Questions abound in the consumer’s mind about how much to tell a stranger about personal conditions of financial and physical health. Few consumers would describe the purchase of insurance as an
enjoyable experience, particularly if the alternative purchase were a new television or satellite dish.

The typical sales pitch for most credit-related insurance on installment credit is simple and quick: “If you die, your credit is paid off. If you are under age 65 and do not have a serious health condition, you qualify. Insurance on your spouse is available if your spouse is a co-borrower. Disability insurance is available to fulfill your monthly payments in case you are disabled. You must remain disabled for 14 days before you receive any benefits. The cost of the insurance is shown on this form. It will be added to the amount you borrow and will be financed. Your monthly payment including insurance is this amount. If you wish the insurance, just sign in the blocks marked.”

The presentation is simple and easy to understand. The product meets the immediate need of the consumer in a convenient manner without the anticipation of a prolonged discussion of death or disability. Most consumers are aware of their underinsured situation; they just do not want to do anything about it. Faced with a convenient opportunity to quickly and simply fulfill part of their insurance needs, consumers opt for credit-related insurance. Since the cost is included in the monthly payment, the consumer does not have to make separate premium payments. Ordinary insurance requires periodic payments, and every premium due notice is an opportunity to discontinue the insurance for other needs or desires.

For open-end products, the solicitation is usually by mail. The consumer can elect the insurance by signing a simple form or calling a toll-free number. Health questions are usually not required. The process is the simplest method used to offer insurance products.

The Cost of Credit-Related Insurance

Most credit-related insurance purchasers perceive its cost as reasonable or inexpensive. The total dollar amount of premium involved is usually small. In obtaining credit, consumers are primarily concerned about their ability to meet the monthly payments. Credit life insurance adds such a small amount to the monthly payment that most consumers elect the coverage. Credit disability insurance is more costly, so fewer consumers elect the coverage, although the need is just as pressing.

Credit-related insurance is often more expensive than ordinary term insurance. It can be compared to shopping at a convenience store for groceries—a loaf of bread costs more than at a warehouse grocery, but convenience outweighs the small additional cost involved. The time and aggravation involved with ordinary insurance can outweigh the small savings. Also, it is difficult to find comparable ordinary insurance products to cover only the approximate credit incurred. Consumer credit obligations are generally under $25,000. Few ordinary life insurance agents want to take the time to write a term insurance policy of this size. Ordinary insurers do not pursue this market because of the fixed costs for underwriting and administration. The cost to the consumer of a $25,000 ordinary term policy is not significantly different from that of credit-related insurance, since standard insurance policies require a policy fee that can be a high percentage of the premium on a $25,000 term insurance policy.

Premium rates for credit life insurance have moved steadily downward since 1950. In some states, the current rates are one-third of the 1950 rates. For older consumers, the product is
a real bargain anywhere, since one rate is charged for all ages; credit-related insurance is actually less expensive than the alternatives available in the ordinary insurance marketplace. Many consumers who would be classed as substandard by an ordinary insurer receive a very competitively priced product without the hassle of full medical underwriting and the embarrassment of being rated or rejected by an insurer.

Advantages to the Producer

The purchase of credit-related insurance by the consumer offers advantages to the producer as well. Credit-related insurance is offered in practically all situations where consumer credit is extended. Producers have found that consumers want the product, and great numbers of them will elect to purchase the insurance. In addition, the producer:

- Has added security on repayment of the credit
- Avoids the collection process from the spouse in a time of crisis, and
- Receives compensation for marketing and administration.

When a consumer elects credit-related insurance, the family is protected from the financial stress present at the time of death, disability, or involuntary unemployment. The loss of income coverages are particularly important because most borrowers have few financial resources beyond their ability to earn an income.

Public relations play an important role in encouraging the producer to offer an insurance program; no credit officer relishes the thought of repossessing consumer products from a widow or widower. Credit-related insurance provides a real social value by easing the financial burden on a surviving spouse.

Producers generally receive service fees, commissions, or other compensation for offering the products to the consumer. Some consumer advocates feel the producer should not receive compensation for offering a service that benefits the producer, but this position is counter to the whole fabric of American society. Producers do incur expenses in offering the product—credit officers must take time to present and explain the coverage; premiums and refunds must be processed; assistance must be given in the filing of claim forms. Therefore, a producer must be satisfied that the return on the time and effort is satisfactory. The expense margins and profit objectives of the producers vary, but the insurance industry must provide compensation to the producer sufficient to guarantee that this socially valuable product is available to the consumer.

Consumer Attitudes

Nothing is a better indicator of consumer satisfaction and acceptance than the prolonged growth of the amount of credit-related insurance in force. Studies of consumer attitudes conducted periodically over the last 40 years reveal a strong desire for the products.

In 1994, the Credit Research Center of Purdue University released a study of consumer attitudes toward credit-related insurance, *Credit Insurance: Rhetoric and Reality*. Among its findings were:
• 63% of surveyed borrowers bought credit life insurance, while 43% of surveyed borrowers bought credit disability insurance or IUI.

• The primary reason cited for buying was to prevent the credit from being a burden to others (81%). Other reasons cited included: cost (34%), convenience (33%), and insufficient insurance (29%).

• 66% of the credit life insurance buyers would either “definitely or probably” buy the product again.

• Awareness of coverage had significantly increased from prior studies (81% versus 61% that was found in a 1976 study).

• There was no evidence of significant coercive sales practices; 63% were offered insurance after the credit was approved.

Credit-related insurance products have a proven track record of providing essential benefits to borrowers. Consumers desire the products and elect the coverages in great numbers. The products are an essential component of the consumer borrowing process that has done so much to produce the highest standard of living in the world.
Growth of credit-related insurance in force can also be traced to the responsiveness of the industry to a diverse consumer credit environment and changing credit products. The industry has moved forward to offer products capable of meeting consumer needs, often overcoming regulatory constraints in the process. Regulations written in simpler times have not been updated to meet a rapidly changing financial world. In spite of these constraints, credit-related insurers have offered more new products in the last 20 years than were introduced in the preceding 60 years.

Net payoff life coverage, truncated life and disability coverages, and critical period disability coverage respond to the need for less costly alternatives on long-term credit. Level life coverage and lump sum disability coverage meet the needs for certain specialized credit situations. Closed-end MOB coverages reflect the unique philosophy and practices in the credit union market.

P&C products have evolved to mirror the benefits provided by standard P&C products, while containing modifications to fit the credit environment. Credit property insurance can be loosely described as homeowners insurance on a particular consumer product, such as a refrigerator purchased with credit. Creditor-placed insurance products provide limited forms of automobile collision and comprehensive insurance or homeowners insurance for the situation in which the borrower fails to maintain the coverages as demanded by a credit obligation. Involuntary unemployment insurance provides a unique opportunity for borrowers to insure against this contingency.

Net Payoff Life Insurance

As described in Chapter Three, gross coverage means that the amount of insurance is the outstanding gross indebtedness of the credit. Uniform decreasing term life insurance is the
resulting plan of insurance for installment credit. The amount of insurance in force begins at the initial gross indebtedness. Each month, the amount of insurance in force decreases by the amount of one monthly payment.

Net payoff coverage means that the amount of insurance is only the outstanding net indebtedness of the credit plus any interest that has accrued between the date of the last payment and the date of death. The calculation of premiums, refunds, reserves, and the amounts payable at death is much more complex than for gross coverage. For closed-end installment credit, the insurance is decreasing term, but the monthly decrease is not uniform. The annual percentage rate and other credit practices determine the pattern of decrease. (All open-end credit is insured with net payoff coverage, since the amount of insurance is the outstanding balance on the date of death.)

A few states (including California and New York) require that all credit life insurance offered in those states be net payoff coverage. Other states require the use of net payoff coverage for credit exceeding specified terms, usually 60 months. Most credit union business is net payoff coverage. When an option exists, the producer usually selects the type of coverage offered to a borrower. Most single premium credit life insurance offered is gross coverage, except in the credit union market. In recent years, some single premium credit life insurance has been offered using net payoff coverage, particularly insurance covering large credit amounts or credit with terms of more than five years.

Net payoff coverage is also used for variable interest rate credit. Most coverages insure the balance of the credit at death and extend the term of coverage if the credit term is extended due to an increase in the interest rate. The extension of the amount of insurance is often limited to two monthly payments. The insurance term extension is usually limited to two months. If the interest rate decreases and the credit is repaid early, a premium refund is paid.

Level Life Gross and Net Payoff Coverage

Some consumer credit does not require installment payments but is single payment credit. A single payment, which includes the principal and interest, is due at maturity. This credit is for short durations, usually 12 months or less. Credit life insurance is available to insure this credit.

For single payment credit, level term life insurance is sold with a benefit equal to the amount due at maturity. If a claim occurs, the creditor receives the amount necessary to pay off the credit and the excess goes to the second beneficiary.

All other aspects of credit life insurance apply. A single premium is charged, and joint life insurance is available to a co-borrower. The standard disability product is not available, since no installment payments are involved, but a lump sum product (described later) is occasionally offered.

Although single payment credit is usually insured by level term life insurance for an amount equal to the initial gross indebtedness; it may be insured with net payoff coverage. In this case, net payoff coverage results in increasing term insurance, since the net indebtedness increases as the interest accrues.
Other Credit-Related Insurance Products for Installment Credit

Combination Products

For a number of credit situations, a combination of level and decreasing coverages is appropriate; balloon credit is the traditional situation. Credit is structured with installment payments and a lump sum payment (the balloon) at maturity. Gross decreasing life insurance protects the installment payments, while gross level life insurance protects the balloon. Standard disability products are sold, but only the installment payments are insured.

The most popular use today for this combination of coverages is in the automobile lease market. The lease payments represent the installment portion, and the amount that is needed to purchase the automobile at the end of the lease is the “balloon” portion. In lease terminology, the installment portion is the stream of payments, and the balloon portion is the lease-end value or residual value. In most states, both portions may be insured with gross coverage credit life insurance. Due to the high dollar cost for both coverages, insurers offer stream of payment coverage that only insures the remaining lease payments. Disability products insure only the stream of payments. Since a lease payment is due at the beginning of a month, the term of decreasing life insurance and disability insurance is one month shorter than the term of the lease.
If a borrower is delinquent in one or more monthly payments, net payoff coverage may not be sufficient to pay off the entire indebtedness. To mitigate this situation, a few states permit some additional coverage to be sold.

For example, Minnesota regulations permit the insurance to equal the net indebtedness plus one monthly payment; North Carolina law permits the net indebtedness plus three monthly payments.

**Truncated Life and Disability Insurance**

Until the mid-1970s, the coverage period of the insurance exactly matched the term of the credit. This situation still holds for most credit-related insurance policies.

As the term of some consumer credit began to exceed 60 months, the cost of single premium insurance became prohibitive. As the dollar outlay rose, borrower resistance caused more consumers to decline the coverage. This resistance was addressed by selling less insurance. Net payoff coverage replaced gross coverage; however, more reduction was needed.

One alternative is to reduce the term of coverage. **Truncated coverage** is any credit-related insurance product with an insurance term that is less than the credit term. **Truncated life insurance** is net payoff coverage for the full outstanding net indebtedness, but death must occur
during the term of the insurance coverage. On credit of ten years or more, the coverage period offered is usually five years or less. One-year to three-year coverage periods may be offered on shorter-term credit. Since long-term credit is often repaid prior to maturity, the coverage period is sufficient for most credit. Some insurers offer a renewal option at the expiration of the coverage if the credit is still in effect. Truncated life insurance may be written using gross coverage, but it provides more insurance and has a higher dollar cost.

**Truncated disability** coverage provides the same benefits as standard products. However, disability must occur during the insurance term. All benefits cease at the end of the insurance term even if the credit continues.

**Critical Period Disability Insurance**

Another solution to reduce the cost of disability insurance is to offer coverage for the full term of the credit, but to limit the number of monthly benefit payments to a specific number of months (or the remaining term if less). Since the period immediately after a disability occurs is the most crucial financially, the product is called **critical period coverage**. The advantages are a reasonable total dollar outlay and essential protection for the borrower.

For example, a two-year benefit period may be sold insuring a ten-year credit obligation. A disability is covered if it occurs anytime during the ten years, but the maximum number of benefit payments is 24, regardless of the duration of the disability. If the disability occurs during the last two policy years, the maximum benefit is limited to the remaining number of months.

Critical period policies are usually offered for credit with terms of 60 months or more. Initially, the benefit period offered was 36 months. The trend in recent years has been toward 12-month and 24-month benefit periods. These shorter benefit periods reduce the total premium charge compared to standard plans.

**Lump Sum Disability Benefits**

The original form of credit disability insurance provided a lump sum benefit sufficient to pay off the credit if the insured was totally and permanently disabled. This product is still offered on some open-end credit and on single payment credit.

The benefit provided is a single payment (the **lump sum**) after total and permanent disability is established. The benefit is the outstanding balance of the credit on the original date of disability plus accrued interest. The definition of total disability is restrictive. Insurers may consider any disability that lasts 90 or 180 days as meeting the requirements.

**Closed-End Monthly Outstanding Balance**

For many years, credit unions provided credit life insurance to all borrowers. The credit union paid non-contributory premiums for the insurance on a monthly basis. The premium was calculated on the sum of the insured credit balances on the premium billing date. Over time, some credit unions began to offer credit life insurance as an optional purchase. Historically, credit unions have not charged a single premium, even on installment credit. Credit was closed-
end, but the insurance premiums were charged monthly based on the net indebtedness at the beginning of the month. The borrower still pays a level monthly payment; the unlevel monthly insurance charge just affects the amortization of the credit.

Later, some credit unions offered credit disability as an optional coverage. A premium was charged each month based on the outstanding balance at the beginning of each month. Although single premium rates vary by the credit term, credit union insurers often developed a single composite rate that was representative of its mix of terms.

**Single Premium Credit Property Insurance**

When purchasing a consumer product, such as a sofa or a television, a buyer often pays for the purchase with installment credit. It is common for the sofa or television to be the collateral that secures the credit. In other installment credit situations, borrowers pledge personal property in order to collateralize the credit. In such instances, the credit proceeds are used for some purpose other than the purchase of the collateral.

In either case, the pledged property represents collateral. Consequently, the creditor has a legitimate interest in protecting the value of the property. At a minimum, the creditor wants the property’s actual cash value to exceed the borrower’s credit obligation at each point in time during the term of the credit. This goal cannot be achieved if the property is damaged, destroyed, or stolen unless it is adequately insured.

Credit laws permit creditors to require that the borrower insure the collateral against physical loss. The borrower can comply with this insurance requirement by adding a loss payee endorsement to an existing homeowners or tenants insurance policy. Adding such an endorsement can be a cumbersome process, and the borrower may not be fully protected. Homeowners policies contain deductibles and exclusions for common risks, such as flood and hurricane. Standard homeowners coverage does not reimburse losses on a replacement cost basis. Moreover, many borrowers do not have homeowners or tenants insurance. The need for first dollar, primary insurance coverage of the collateral used in securing credit obligations can be conveniently satisfied with credit property insurance.

Credit property insurance provides protection for the creditor and the borrower in the event of a covered loss occurrence. A covered loss occurrence is defined by the credit property insurance policy, but, in general, protection is provided against perils such as fire, collision, and theft. Some policies provide a benefit up to the outstanding balance of the credit, while others provide benefits up to the replacement value of the damaged good.

Retailers sell this insurance product at the time that appliances, electronics, and other consumer products are purchased and by finance companies in conjunction with non-real-estate secured credit. About 25 independent credit-related insurers offer this specialized insurance product for these credit obligations. Several producer-owned, direct-writing insurers offer similar programs.
Creditor-Placed Programs

Most closed-end installment credit is secured by collateral. If the borrower defaults on the credit, the creditor has the right, via the credit obligation, to seize the collateral and sell it on the open market. The proceeds of the sale are applied to reduce the balance of the defaulted credit.

Creditors extending installment credit have an economic interest in protecting the collateral so that it retains its market value. Credit obligations generally require the borrower to insure the collateral against physical damage caused by an accident, fire or natural disaster and other events, such as theft. This requirement ensures that if the collateral becomes impaired, there will be sufficient insurance proceeds to repair or replace it. Proof of insurance must be presented for the credit obligation to be consummated.

The insurance plays an important role in today’s economy. Without it, creditors would not accept the collateral that secures most of their credit, such as automobiles, boats, or homes. Without this security, many credit extensions would not be made, and economic activity would be sharply reduced.

For non-titled consumer products, such as a television or VCR pledged as collateral, the insurance requirement can be fulfilled by a loss payee endorsement to an existing homeowners policy or a tenants policy. The retailer or creditor may offer credit property insurance as one convenient alternative to fulfill the insurance requirement.

For titled property, such as an automobile or a home, the amount and term of the credit result in a cost for credit property insurance that overcomes the convenience of the product. For automobile credit, the borrower must provide proof of collision and comprehensive insurance; standard liability insurance is not acceptable, since it only protects against physical damage to the other party and bodily injury. For real-estate-secured credit, the borrower must present proof of homeowners insurance.

Sometimes borrowers fail to maintain the insurance on the titled collateral securing their credit. Creditors have three options relating to this contingency:

- The creditor can absorb the risk and reflect the loss cost in higher interest rates.
- The creditor can purchase insurance covering all borrowers who fail to maintain adequate insurance (generally called blanket insurance) and pass a relatively small charge on to all borrowers.
- The creditor can canvass its credit portfolio and place relatively expensive insurance, generally called collateral protection insurance (CPI), on the few borrowers who allow their insurance to lapse. Since the creditor makes the decision to put the insurance in place, it is referred to as creditor-placed insurance.

Creditor-placed insurance is P&C purchased unilaterally by the creditor at some point subsequent to the date of the credit obligation. The creditor is named as the insured. CPI provides coverage against loss or damage to collateralized property as a result of fire, theft, collision or other occurrence that either impairs a creditor’s interest or adversely affects the value of collateral. CPI is purchased according to the terms of the credit obligation when the borrower fails to provide the required physical damage insurance. Cost of the coverage is charged to the borrower.
Non-Filing Insurance

Asset-backed credit, or secured credit, is credit that is secured by something of value. The asset is the collateral securing the credit. For credit under $3,000, the securing asset is typically household goods. If a borrower wants to borrow $100 from a creditor, the borrower must have an asset with a market value of $100 to protect the interest of the creditor. The borrower and creditor agree that if the borrower cannot meet the repayment obligations, the borrower will transfer ownership and possession of the asset to the creditor. The creditor will sell the asset and use the proceeds to repay the credit. The document stating that the creditor can take possession of the collateral under certain circumstances is called the security agreement. There are many types of security agreements, such as chattel mortgage, conditional bill of sale, conditional sales contract, chattel trust deed, trust receipt, deed of trust, and bill of sale.

The creditor has a security interest in the collateral. To fully protect its rights, the creditor must file public notice of the security agreement with the government to document its security interest in the collateral. Filing, or recording, the security agreement makes it part of the public record.

The filing process is time consuming and costly. Many creditors, especially small credit specialists, do not record liens. By not filing, the creditor may have difficulty taking possession or receiving payment in a default situation. In other situations, a third party may assert a conflicting claim on the collateral that has a higher legal priority because of the creditor’s failure to file.

Without filing, the creditor is exposed, and there is a need for insurance. The insurance most commonly used in these cases is non-filing insurance (NFI), also referred to as non-file insurance, or non-recording insurance. Creditors often prefer NFI because it:

- Saves time
- Reduces costs
- Eliminates the administrative overhead needed to file and release a notice of the security agreement with public authorities

In general, NFI insurance pays a benefit to the creditor in the event of a default where:

- The creditor is unable to repossess the property.
- The creditor is unable to obtain the proceeds from the sale or other disposition of the collateral.
- The creditor cannot enforce its rights for other reasons.

In all situations, the loss must be a result of the creditor’s failure to file its security interest. The benefit is equal to the creditor’s monetary loss, up to the lesser of: the actual cash value, the outstanding principal balance, or the policy limits.

The premium charged for this coverage is always less than or equal to the state filing fee that could otherwise be passed on to the borrower. Premiums range from $3 to $30, depending on the state. The borrower does not see any difference between paying the fee to have the lien filed or paying the NFI premium.
Single Premium Involuntary Unemployment Insurance

Credit involuntary unemployment insurance (IUI) on installment credit is single premium loss of income insurance, purchased in conjunction with installment credit that provides a level monthly benefit while the insured is involuntarily unemployed, up to the limits specified in the policy. The monthly benefit equals the required monthly payment.

Consumers use finance companies to obtain unsecured cash credit, to borrow money for the purchase of specific consumer products, and for borrowing secured by a lien against the borrower’s equity in real estate. They also arrange for the financing of the purchase of many consumer products from the retailer selling the consumer products under an installment sales contract.

This product is sold by finance companies in conjunction with non-real estate credit and real estate secured credit, and by retailers on the purchase of appliances, electronics, and other consumer products. About 15 independent credit-related insurers market a specialized insurance package for these credit obligations. Several producer-owned, direct-writing insurers offer similar programs.

The primary market is installment credit of 36 months or less with an initial gross indebtedness of $5,000 or less, but a growing market segment insures real estate secured credit for larger amounts. The product is occasionally available in the automobile dealer market, but its primary use is in conjunction with lease transactions. Single premium credit life and disability insurance is often offered at the same time, but each purchase is an independent decision; products are not packaged.

This product is purchased with a single premium based on the initial gross indebtedness of the credit obligation. The premium is typically financed; the total amount financed includes the principal, increased by the amount of the IUI premium and other insurance premiums. Rates are expressed per $100 gross indebtedness and are less strictly regulated, as compared to credit life and credit disability rates.

Thirty-day retroactive coverage is common. A benefit begins after 30 days of involuntary unemployment, and benefits are retroactive to the first day of involuntary unemployment. Fourteen-day coverage is also offered.

The term of insurance coverage generally equals the term of the credit, but the maximum number of benefit payments is limited. The maximum number of benefits often varies by term of coverage. If the insured satisfies the conditions of involuntary unemployment and the waiting period, a monthly benefit is paid equal to the scheduled monthly payment. If involuntary unemployment continues, benefits continue until the maximum number of benefits is reached or the term of coverage expires.

Qualification for a claim only requires proof that the insured qualifies for state unemployment benefits in most cases. Proof of continued unemployment must be submitted monthly. Benefits are paid to the creditor.
Prima Facie Rates

State life insurance laws and regulations do not permit an insurance commissioner to regulate rates. Credit life and disability insurance laws and regulations, however, permit a commissioner to disapprove a policy form if the benefits provided are not reasonable in relation to the premium charged. For credit-related insurance, the practical result is the establishment of prima facie rates, which are the maximum rates an insurer may charge in a particular state without demonstrating a need for higher rates.

The underlying assumption of a prima facie rate is that an insurer charging a rate less than or equal to the prima facie rate is presumed to have provided reasonable benefits for the premium charged. In theory, the prima facie rates are determined by measuring the actual claim costs and dividing them by the benchmark loss ratio. The benchmark loss ratio is the ratio of the benefits to premiums, expressed as a percentage, which is deemed reasonable to provide a fair return to the borrower. Most states specify a benchmark loss ratio in law or regulation—a 50% benchmark is common. If the benefits paid are 50% or more of the premiums charged, the benefits provided are judged reasonable. If a state studies the claim costs and finds them to be $0.24/$100/year, the prima facie rate would be ($0.24) / (.50) = $0.48/$100/year. In practice, prima facie rates are set in the political arena and may reflect the art of negotiation as much as the art of actuarial science.

Prima facie rates are not absolute maximum rates. If an insurer can demonstrate that some or all of its business is producing a loss ratio in excess of the benchmark loss ratio, the insurer may request an upward deviation. The insurer files the loss experience and requests permission to charge a deviated rate in excess of the prima facie rate. Many states accept deviations with proper actuarial justification. Deviated rates are primarily found in credit disability rating, particularly credit union business.
Insurers are permitted to charge less than the prima facie rates; however, most credit-related insurance is sold at the prima facie rate of the state where the policy is issued. Non-contributory credit union life business is a specific market segment where the prevailing rates charged are below prima facie rates. For this reason, non-contributory business is often exempt from prima facie rate regulation. A few states require insurers to periodically file their experience and make adjustments in the rates charged to produce a loss ratio equal to or greater than the benchmark loss ratio. If a rate reduction is required, the adjustment is called a mandatory downward deviation. If an upward adjustment is indicated, the insurer usually has the option of whether or not to implement the rate increase.

The most glaring aspect in the premium calculations is the lack of data about the specific insured. In charging prima facie rates, an insurer must accept certain conditions.

In most states, an insurer must accept all eligible borrowers except:

- Borrowers who do not meet the underwriting requirements,
- Borrowers who are over age 65 at inception of the credit, or whose credit does not expire before age 66, and
- For disability insurance, persons who are not gainfully employed or actively at work for at least 30 hours per week.

Claims may only be denied if:

- Death is caused by suicide within a specified time (from six months to two years), or
- Disability occurs within six months after the effective date relating to a condition for which the insured was treated within six months prior to the effective date (commonly referred to as the six-and-six exclusion). Insurers are permitted to charge an additional 10% of prima facie rates in several states if the policy covers pre-existing conditions.

All of the ages and time periods cited above vary from state to state.

Rates are unisex and uni-age for single coverage—one rate for all ages and both sexes. Joint life multiples reflect that one of the insureds is usually a female with different mortality and morbidity costs. The joint life multiples vary by state from 140% to 180%. Joint disability multiples tend to be higher. The rate calculations do not include any adjustment to reflect that the age of the insured increases during the term of the credit. Since the term of credit-related insurance policies is short, the yearly increment in the mortality or morbidity costs is usually not material.

Prima facie rates in certain states reflect variations in claim costs and expenses among market segments. They may vary by class of producer, volume of credit-related insurance sold by a producer, or average policy size. The rates may also reflect an interest or mortality discount.

**Life Insurance Premium Formulas**

Prima facie rates are stated as a single premium rate per $100 per year or as a monthly outstanding balance rate per $1,000 of insurance in force for the month, abbreviated MOB. The two rates are related by the general formula:
### Premium Rates

\[
SP_n = \frac{1}{10} \times (MOB)_n \times \sum_{t=1}^{n} (In\ force)_t
\]

where \( SP_n \) = the single premium per $100 of initial insured indebtedness for credit of \( n \) months \\
\( n \) = the term of credit in months \\
\( (MOB)_n \) = the MOB rate per $1,000 in force at term \( n \) \\
\( \sum_{t=1}^{n} \) = summation of the (In force), for \( t = 1 \) to \( t = n \) \\
\( (In\ force)_t \) = the amount of insurance in force, in $100s, during month \( t \)

The factor 1/10 is included to convert the monthly rate (which is normally expressed per $1,000) to the single premium rate (which is normally expressed per $100). This formula does not include any interest or mortality discount. In other words, the single premium is the undiscounted sum of the monthly premiums.

For decreasing gross coverage, the summation of the amounts in force can be solved by the Rule of 78, and the formula reduces to:

\[
SP_n = (MOB)_n \times \frac{(n + 1)}{20}
\]

### Disability Insurance Premium Formulas

Disability premium calculations are much simpler than those for life insurance. They are usually single premiums per $100 of initial gross coverage as specified in the prima facie rates for the state. Rates are specified by term for each plan permitted in the state.

### Involuntary Unemployment Insurance Premium Formulas

For IUI, only a few states have adopted prima facie rates. Insurers decide what premium to charge, but must justify rates when a new policy form is filed. Single premium rates are often not term specific, since the benefit period varies by term of credit. A rate of $5.00 per $100 of initial gross indebtedness is common. A common MOB rate is $3.50/$1,000 per month.

### Premium Refunds

Installment credit is often terminated before the scheduled maturity date. Consumer products may be sold to another party, thereby terminating the credit. For automobile credit, the automobile may be involuntarily sold as a result of an accident or repossession. General borrowing for vacations or temporary economic pressures is often refinanced or rolled over into new credit. Finance company clientele may carry credit for many years by periodically refinancing the credit. Many credit obligations are simply repaid early.
If credit-related insurance was purchased with a single premium charge, the unearned portion of the single premium applicable to the unused policy term on early termination is refunded to the consumer. The refund is equal to the gross unearned premium. In practice, the refund is a part of the credit closing calculation and is used to reduce the payoff amount. Refunds for decreasing life insurance and disability insurance are usually gross unearned premiums based on the Rule of 78, but other formulas are required in a number of situations. Insurers recover the unearned compensation from the producers.
Chapter Ten

Home Office Operations

This chapter describes the home office operations of credit-related insurance companies in marketing and administering the products. The common industry practices, methods, and procedures are presented to give a general picture of the operations. There is no implication that these practices are the way things must be done, or even that they are the way things should be done. The diversity of products, producer practices, and insurer practices results in a wide range of valid approaches.

Sales

In a credit-related insurance company, the sales area plays a critical role, often extending beyond the usual responsibilities found in other lines of insurance. In addition to soliciting new producers, the sales force performs many service functions. Salespeople often train the producers’ personnel, work as liaisons with the producers when problems arise, and implement rate changes and product modifications. The sales force may monitor the profit or loss experience of the producers and initiate corrective action. A separate sales administration area often handles day-to-day administrative details.

For a credit-related insurer, the sales effort is directed at the producer of the business, rather than the ultimate insured. Since each market segment requires a different approach, insurers tend to direct their efforts toward one or two primary markets, while individual salespeople often market to just one particular segment. Given the vast number of producers and their wide geographical spread, many insurers augment the home office sales staff with independent general agents.

The primary responsibilities of the home office sales staff include soliciting new producers and servicing existing accounts. The marketplace for credit-related insurance is mature. Virtually all of the potential producers of the product already have a credit-related insurance program in place. In most situations, compensation to producers has risen to the point where further in-
Increases of any magnitude are difficult to offer. Therefore, the sales effort generally promotes the insurer’s range of products and service abilities.

Many insurers offer promotional material and training to the producer’s staff. This helps the insurer secure new producers and achieve more sales from existing producers. Consumer literature is usually limited to generic brochures extolling the value of credit-related insurance. The brochure describes what the insurance covers and emphasizes the security of knowing the credit is insured. A wider range of material is available aimed at the individual presenting the product to the consumer. Sample sales presentations, slide and movie shows, and motivational meetings are designed to convince the presenters that the product has value for the consumer and the producer.

In the automobile dealer market, credit-related insurers have developed and promoted the concept of a specialist within the dealership to handle the finance and insurance elements of the automobile sale. Most dealerships now have one or more individuals whose primary function is to prepare the paperwork of the sale, to explain the financing options, and to offer credit-related insurance. If the consumer wants to finance the purchase and buy the insurance, all of the paperwork can be done at the dealership. Insurers and general agents conduct finance and insurance schools to train the F&I people. Some insurers even help the dealership find qualified personnel for the job.

Successful promotion of the product at the producer level depends on management commitment. If the producer’s top management does not take an active role in stressing the importance of the product’s sale, the lack of interest filters down through the organization. One tool for management review is a penetration report. The penetration rate is the percentage of eligible borrowers who purchase credit-related insurance. It is useful to analyze penetration rates based on number of borrowers and size of credit. Reports show the penetration rate for each credit officer with summaries by branch or location. The mere compilation and publication of a penetration report improve awareness of the importance of the product. Since the data required to produce the report includes information on all credit, the producer usually prepares penetration reports. Insurers assist in designing and evaluating the report; some insurers provide computer programs.

Many credit-related insurers are regional insurers operating within a limited geographical area. For these insurers, the internal sales staff may be adequate to meet the desired production goals. Insurers operating on a wider scale may have regional sales offices; however, a widely licensed insurer often receives a portion of its business through independent general agents who operate within a limited geographical area.

The role of the general agent is to provide local sales and service functions. The independent agent is particularly valuable in the automobile dealer and credit union market segments, which consist of thousands of relatively small producers. Travel and overhead costs prevent an insurer from using company personnel unless the insurer commits to a large staff with many locations. Home office staff may be available to assist the general agent in the solicitation of large producers.

Service functions of the sales staff and general agents include the responsibility of maintaining contact with existing producers. Each producer should be contacted at least once a year to insure that operations are running smoothly. A new product or sales material available from
the insurer provides the salesperson with an opportunity to meet with the producers. The meeting can also serve as a forum to determine changes in a producer’s products and markets. A new credit product can mean additional credit-related insurance sales.

The sales force is also responsible for discussing and implementing program changes. Several states require periodic rate changes. In other situations, the loss experience of a producer may require the implementation of a rate change. In any case, the reason for the change must be explained to the producer. Materials used to calculate rates must be replaced and an implementation date coordinated. Where rate changes are not feasible, unfavorable loss experience may require a switch to a more restrictive policy form or a different plan of insurance; for example, changing from a 14-day retroactive disability plan that covers pre-existing conditions to a 30-day non-retroactive plan that excludes pre-existing conditions. A review of the producer’s credit practices may determine the source of the adverse experience, or the compensation rate may require adjustment. The sales force must convey the need for the changes and attempt to retain the producer while correcting the profitability situation.

Sales Administration

A separate section of the sales department is dedicated to handling the administrative functions and maintaining contact with the producer on day-to-day operational matters. This permits the sales force to concentrate on personal contact and new sales.

A primary sales administration function is the initial setup work for a new producer. Insurers maintain a master file containing the producer information that is needed to process all administrative and operational aspects of a producer’s business. Data are entered into a computer file to provide automated editing of premium reports. Sales administration keeps the information in the file up-to-date.

Each new producer is supplied with reporting procedures and forms, policy forms, and rate calculation material. Reporting procedures specify the reporting requirements, including the timing of reports and the materials that must be submitted. Reporting forms with instructions for their use and procedures for refund and claim handling are also provided.

The insurer supplies the policy forms. A group policy must be prepared and certificates supplied to producers who sell credit-related insurance through a group plan. If the producer is writing individual policies, the individual policy forms are supplied along with policy applications, if applicable. Certificates and individual policies are usually sequentially numbered for control purposes, and a record is maintained of the numbers supplied to each producer. Producers are required to return voided forms, and to return unused certificates or policies if the relationship with the insurer is terminated.

Insurers also provide the producer with the material for rate calculation. Some producers still use rate charts or factor cards, but programmable calculators or personal computers are the norm today. New charts must be printed if none of the insurer’s existing charts fit the new producer.

Sales administration has on-going service requirements. Changes in procedures, policy forms, rates, and compensation are implemented and documented. Information files must be updated to retain their usefulness. This area works with the producers on operational problems.
and makes follow-up calls when producers are late in reporting. Sales administration also responds to procedural questions from the producers.

Compliance with agent licensing requirements may be a part of sales administration’s responsibilities. Although a separate department usually handles the actual licensing process, sales administration oversees the process to insure that all necessary licenses are in place. This includes the licensing of general agents and appropriate licensing at the producer level.

## Agent Licensing

State laws and regulations require that only licensed agents may solicit insurance in the state. Most states have specific provisions that simplify or eliminate most licensing requirements for credit-related insurance. These simplifying licensing rules were developed for credit life and disability insurance. Gradually these simplified rules are being applied to IUI and other credit-related P&C products.

Licensing must be considered for three “persons”—the individual who presents the product to the borrower, the group policyholder, and possibly a general agent. The applicable rule often depends on whether a person is directly compensated for the sale of the product. “Directly compensated” generally means a payment that is a percentage of the insurance premium charged. A straight salary, or a salary plus a modest incentive compensation program, is not considered as being “directly compensated.”

If the presenter of the product is not directly compensated for the sale of the product, two simplified alternatives exist. Whenever possible, credit-related insurers use the group exemption permitted by many states—a person does not need to be licensed to “enroll” insureds under a group policy. A group credit insurance policy is issued to a producer. An unlicensed employee of that producer may then enroll borrowers under the group policy, provided the employee is not directly compensated for the enrollment. Other states require each presenter to be licensed, but only require a limited credit insurance license. The requirements to obtain a limited license are not demanding. In many states, no examination is required.

Any person or corporation receiving commissions for the sale of credit-related insurance must be licensed. Commissions can be paid directly to a corporation in most states, but the corporation must obtain a license. At least one employee of the corporation must fulfill all of the agent requirements and be the active agent for the corporation. In most states, the agent requirements can be satisfied by a limited credit insurance license. The creditor or automobile dealership is licensed whenever a state permits corporation licensing. An individual must be licensed in states without corporation licenses. These states generally permit an assignment of commission where the individual agrees to assign the commissions to the corporation.

In states with a group exemption, even the corporation does not have to be licensed if no commissions are paid. Service fees for specific administrative activities are not considered commissions. Credit unions usually fall into this category.

Credit-related insurers often use independent general agents to solicit accounts. Override commissions are paid to the general agent for the acquisition and service of producers. Independent general agents must fulfill the same requirements as soliciting agents. Salaried home office employees do not need a license to solicit accounts, since commissions are not paid.
Once licensed, an agent is appointed to represent specific insurers. An agent must be appointed by each insurer that the agent represents. After the appointment is complete, the agent can solicit or place insurance for that insurer.

Licenses must be renewed every one or two years, depending on the state requirements. Renewal is the responsibility of the agent, not the insurer. An insurer, however, must determine that all of its agents have properly renewed their licenses. The renewal process is simple—a renewal application or a portion of the first-time application is completed. The insurer must also renew the appointment of its agents.

The following material describes the procedure for a full line agent license. An agent must be licensed in the agent’s state of residency. In that state, the agent is a resident agent. Many states permit an out-of-state resident to solicit insurance in the state if the agent obtains a non-resident license. The non-resident agent only needs to provide proof of home-state licensing, complete an application, and pay the fee.

Each state specifies the requirements for the licensing of agents and the scope of their activity. As with most aspects of state regulation, uniform provisions have not been adopted.

First-time agents must complete an application for licensing in their home state. Each state specifies general requirements concerning the moral character of a potential agent. References, fingerprints, and a photograph may be required. Insurers are often required to attest to the character of the agent. To fulfill this requirement, insurers may order an inspection report using investigative services such as Equifax.

Having completed the application, a first-time agent must also pass a written examination. Some states require pre-examination schooling. The agent’s desired line of business determines which examination is required. As with other aspects of state insurance regulations, separate requirements generally apply to obtain a license to sell life insurance versus property and casualty insurance.

The renewal and appointment processes described above for the limited license also apply for a full line license. The renewal of a full line license may include a requirement for continuing education. Only a few states require continuing education for a limited license, and fewer hours are required.

**Premium Processing**

Each producer submits monthly reports regarding the business processed for the month. One reporting arrangement is known as report and remittance. The producer summarizes the business issued and the refunds made. Remittance for the gross premium minus refund premium, less any deducted compensation, is sent to the insurer along with supporting documentation.

For single premium business, supporting documentation usually consists of a copy of the group certificate or individual policy. Supporting paper documentation must be keyed into a format suitable for computer entry into the in force system. Most insurers now have on-line systems. A growing percentage is reported on electronic media.

The policy data and the report summary pass through an edit system that addresses the producer’s master file. The master file contains information concerning policy limits, approved
plans of insurance, and premium rates. These parameters are tested against the policies submitted. Policy data are checked for accuracy of the calculations and compliance with policy provisions. An exceptions listing is then produced.

Insurers usually book the business as received. A producer is sent a correction notice if necessary, and adjustments are made in subsequent reports. If a policy is unacceptable, the producer will be notified to cancel the insurance. If age or term is missing, an assumed age or term is coded, but a request is sent to obtain the correct information.

A different reporting method is used by some insurers—the billing method. An application for insurance is completed by the proposed insured. At the end of the month, the applications are forwarded to the insurer. Applications are keyed into the data processing system and a billing is prepared which is sent to the producer. The producer must remit the net amount due the insurer within a specified time, usually 30 days.

Monthly outstanding balance business is much simpler, since there are few items to audit. The account supplies the amount in force on each insured on electronic media. The premium rate is applied, and the compensation deducted. Any errors found are corrected in a subsequent report.

Remittance can take several forms, but payment by check is most common. Where depository arrangements are negotiated, the producer deposits the amount directly into the appropriate account. In the financial institution market segment, premiums are often deposited directly into a checking, savings, or money market account. The deposit slip is sent to the insurer.

Claim Administration

The claim procedures and administrative systems accommodate the specialized nature of the products. As with other operating departments, the claim department must be organized to handle a relatively high volume of transactions. Standardized procedures and forms, generally simpler than comparable ordinary life and disability insurance items, are necessary. Consistency of claim handling, timeliness of processing, and adherence to policy provisions are the guiding principles.

Records are entered and updated using an on-line entry system. Within the department, individual claim folders are maintained for each claim to hold the physical paperwork.

Claim departments have an administrative unit and an examination unit. The principal goal of this separation is to ease the paperwork on examiners, so they can concentrate on the evaluation (or adjudication) of the claim itself. Administrative unit personnel open the mail, do basic data entry, and assemble the claim files and supporting documentation. After the claim has been examined, these personnel will assemble form letters and payments for mailing, and file the material.

Examiners are classified by level of experience and training. Examiners often have a maximum payment they may authorize without approval, especially on life claims. Life claims may be paid by a separate set of examiners, but the number of life claim examiners is small compared to the number of disability claim examiners. In a typical department, about 90% of the time and resources is dedicated to disability claims. Each examiner is provided a set of policy
forms, or a digest of the provisions and exclusions of each form. Supervisory personnel oversee
the process for consistency of treatment and for approval of large claims.

**Death Claims.** Claim processing on credit life policies is relatively simple, so payments are
usually made within ten working days after receipt of all required material. The usual require-
ments are a completed claim form, a certified copy of the death certificate, and a copy of the
evidence of insurance. A copy of the credit obligation and the payment history may be required
from the producer.

Claim forms can be obtained from, and returned to, the producer. Some producers do pre-
liminary screening for accuracy of information and completeness of data. In most cases, the
producer sends claims to the insurer for processing. Some producers have draft authority up to
specified limits, but the insurer must periodically review the claims. Claim forms can be ob-
tained from, and filed directly with, the insurer.

The claim form is straightforward. Basic data on the insured is requested along with the
specification of any secondary beneficiary. The producer enters the credit balance. A certified
copy of the death certificate is required, but a newspaper obituary or other proof may be ac-
cepted in unusual circumstances. Also, a copy of the individual policy, group certificate, or
group enrollment card is needed. Where missing, verification from the insurer’s in force files or
the producer’s files is made.

The examiner must verify that the deceased is the insured. The death certificate is verified
for its seal of certification and absence of irregularities. The name and age of the deceased are
compared to the evidence of insurance to avoid father/son, mother/daughter confusion. The
effective date and expiration date of the insurance are compared with the date of death.

Policy provisions are reviewed. Age on the death certificate is compared with the attained
age calculated from the evidence of insurance. The policy may be rescinded if the insured’s age
was misstated at issue, and the insured’s actual age exceeded the maximum issue age of the
policy.

If suicide is the cause of death, the benefit may be limited to a return of premium. The lim-
ited benefit applies only if the claim occurs during the time specified in the policy’s suicide
provision. Investigation may be needed if suicide is suspected, but not listed, as the cause of
death.

If an application contained underwriting questions, answers to certain questions concern-
ing the cause of death may be required if the death occurred during the **contestable period**. The
contestable period is the time specified in the contract (usually two years) during which mis-
statements by the insured may be used as a basis for not paying the claim. An authorization to
release medical information is common on the claim form used for an underwritten policy. When
the investigation reveals that the insured would not have been eligible for the insurance if the
accurate facts were known, the insurance is rescinded and all premiums are returned. Techni-
cally, the claim is not denied, since valid insurance was never in force.

After all necessary facts have been gathered, the claim will be approved or denied by the
examiner or the insurance will be rescinded. Supervisory personnel generally review large
claims denials and rescissions. If approved, checks will be issued. One check is usually sent to
the producer, who sends any excess over the credit balance to the second beneficiary. Where
required by state law, insurers draw two checks and mail them separately, one to the producer to extinguish the unpaid balance and one to the secondary beneficiary for any excess.

**Disability Claims.** The review process for disability claims is more complicated and time-consuming. New claims require research for compliance with policy forms that contain more exclusions than credit life forms. Decisions on disability claims are more subjective than on life claims. An examiner must judge the validity and severity of a claim. Since claims usually continue for more than one payment, ongoing review and processing are necessary.

Claim files are segregated between open and closed files. **Open claims** are classified as continuing claims in the payment status or pending claims still under development and investigation. Open claim files are maintained within easy access of the examiners and the administrative units. **Closed claims** are claims for which the final payment has been made because of termination of disability, expiration of the coverage, or denial. Notice of termination is not received on some claims; the claimant just stops sending in Continuance of Disability forms. A procedure is established to close these open files after a period of inactivity, usually two to six months. Most insurers notify the claimant that the file is being closed and the reason for the closure. Closed files are maintained in central records and warehoused after a few years.

The producer usually supplies the form used for the initial filing of a disability claim. Sections are completed by the insured, the producer, and the insured’s physician. An employer’s statement may be required or may only be required on a case-by-case basis, depending on the insurer’s practices. Questions are directed at establishing the existence of a disability and verification that the claimant’s condition prevents gainful employment. An authorization to release medical records and information is required.

When a new claim form is received, it is date-stamped and assigned a claim number. A search of disability files is made to determine whether the claimant has had a prior claim or has a duplicate file in process. Insurers may maintain a separate file, in alphabetic order by name, showing only the name of the insured and the claim number to speed up the search process.

When the producer information is complete and evidence of insurance is submitted, further in force verification is unlikely, but insurers with individual in force files check the status on the insurer’s records. If the producer reports a zero credit balance, the credit may have been repaid and the insurance policy canceled. The date of cancellation is obtained to determine whether the policy was in force on the date of disability. All forms and prior claim files are gathered and assigned to an examiner.

The first question is one of eligibility for coverage. Disability policies often contain an actively-at-work clause. In order for the insurance to be effective, the insured must have been working for a certain period of time prior to the effective date. The insured cannot be disabled on the effective date even if pre-existing conditions are covered. Compliance with these provisions and with the maximum age provision is also checked.

The statements of the insured and the physician are reviewed to determine the diagnosis. Standard medical reference publications may be reviewed to judge the reasonableness of the statements made. The inability to work is determined. An employer’s statement, if obtained, is reviewed to verify that the claimant has been out of work.
The date disability was incurred is compared to the effective date and the expiration date of the insured’s coverage. If a refund has been paid, the incurred date must precede the cancellation date. Age of the insured on the evidence of insurance is compared to the claim forms to substantiate that the insured is the claimant.

An examiner reviews the evidence of insurance and the policy form to determine the conditions and exclusions of the claimant’s coverage. The most demanding aspect of claims examination is the determination of pre-existing conditions.

The other policy exclusions are checked for compliance. Disability caused by normal pregnancy is the only frequently used exclusion. Other exclusions include intentionally self-inflicted injury and disability resulting from aviation on non-scheduled flights.

If the insured’s application contained medical questions, the insured’s responses are reviewed. The claim diagnosis is compared to the conditions addressed in the insured’s statements to see if misrepresentation has occurred. When the investigation reveals that the insured would not have been eligible for the insurance if the accurate facts were known, the insurance is rescinded and all premiums are returned. Technically, the claim is not denied, since valid insurance was never in force.

Investigation takes many forms. Forms and form letters are available to cover practically all variations of inquiry. Phone inquiry may be used when written documentation is not required. This method has gained popularity due to delays in mail time and the cost of sending a letter. Examiners are required to keep a phone record of each call. Investigations may be ordered from investigation companies. These are primarily used to determine claimants’ activities—whether they are working at other jobs or doing strenuous work or play.

Senior personnel in claims usually review denials and rescissions. In rare instances, legal staff may be asked for an interpretation of policy wording, but the claim department makes the final decision.

Once a claim is approved, the examiner will specify the date the next medical examination is required and will authorize the claim payment. The completed, approved file is sent to the administrative unit for claim payment and refiling.

Disability claims may involve more than one payment, with some claims extending several years. Approximately one-third of the claims are first and final; the initial claim represents the total claim. Other claims require a periodic certification of continued disability by the insured and the attending physician. When a payment is authorized, a check is sent to the producer. The claimant is sent a notification of the payment and a form to submit if disability continues. A date on the form specifies when the form is to be completed. This Continuance of Disability form must normally be completed every 30 days. Intervals from 60 days to six months may occasionally be permitted, depending on insurer practice, diagnosis, and physician comments. The claimant is told to wait the required time before completing the form, unless disability ends before the specified period is completed.

When the Continuance of Disability form is received, it is date-stamped and forwarded with the claim file to an examiner. The examiner’s job is straightforward—to determine whether the disability has continued. A review is made of the expiration date of the coverage and the expected duration of the claim. Continuing claims can be processed and approved quickly.
Simplified procedures may be used for long-term disability claims that are expected to last beyond the expiration date of the coverage. Automatic pay systems are designed for the convenience of the claimants and for administrative efficiency. The claimant must certify continued disability periodically, but a Physician’s Statement is only required every six months.

Proper handling of claims and fair treatment of claimants is a concern for the insurer and state regulators. Corporate management, internal and external auditors, and state regulators closely review the work of the examiners and the claim department. Time of service and quality of work are measured and reviewed.

The training of claim personnel is continuous, both from feedback of audits and from seminars on medical terminology, letter writing skills, and time management. A formal training program is available through the International Claims Association, which gives four professional examinations.

Involuntary Unemployment Insurance Claims. The claim process for IUI claims generally follows the disability claim process, but the steps are more straightforward. The administrative systems and file organization are quite similar, since the policy benefits are similar; only the contingency is different.

When a claim is received, the initial eligibility requirements are reviewed along with the effective date of coverage and other requirements to receive benefits. Proof of claim is generally satisfied if the claimant qualifies for state unemployment benefits as a result of involuntary unemployment. Continuance of unemployment forms must be completed monthly.

Investments

Investment departments try to match the terms of invested funds with the terms of the underlying liabilities. The short-term nature of credit-related insurance products dictates a commitment of a large portion of the invested assets to short-term and medium-term investments. If an insurer is active in the financial institution market segment, the number of checking accounts, savings accounts, and certificates of deposit is large. Automated systems are needed to keep records updated. Bank statement reconciliation requires a significant amount of time.

Insurers active in the bank market segment often agree to maintain deposits to obtain the bank’s credit-related insurance program. This may be a certificate of deposit or a savings account. It may, however, involve leaving funds on deposit in accounts that do not pay interest. When an insurer has money on deposit that earns less than market interest rates, the deposits are called compensating balances. This practice is not permitted in a number of states.

Policy Form Filing

Policy forms must be filed and approved in each state where an insurer desires to issue the form. Forms must meet the credit-related insurance regulations of the state where approval is desired. While different forms are not required for each state, minor variations in state regulations make it difficult for a single form to be widely used. The process of developing a policy form and obtaining insurance department approval is a long and tedious one.
An initial review is made for compliance with state regulations where the policy is to be filed. A master policy filing manual is referenced. Certain filing requirements, such as filing fees and required forms, are compiled by various insurance company trade associations. Filing manuals are annotated based on experience from prior filings.

The majority of states now require credit-related insurance forms to comply with readability standards. The Flesch scoring method is used to assess the readability of forms. This method judges the document’s difficulty of comprehension by counting the syllables in the words used, and the number of words in a sentence. The method is not perfect, but it produces an objective standard of readability.

States specify a minimum size print to eliminate the fine print used in earlier days—ten-point type is acceptable to all states. Legal staff and policy filing staff review the draft, and a final version is prepared.

Wherever possible, certain policy form information is filed on a variable reference basis. **Variable references** are items that are left blank in the filing, although the insurer may specify in a cover letter any absolute limits. This material includes maximum terms, amounts, and ages. The insurer may also specify that the layout of the insurance information (name, age) may be varied somewhat to fit the requirements of the producer’s data processing system. This helps in reducing repeat submissions caused by minor revisions.

Rates must be filed. If the rates do not exceed the maximum rate permitted in the state, actuarial assistance is often unnecessary. Non-standard rates must be proven to be in compliance with maximum rate standards. Actuarial justification is needed for age-rated policies, critical period coverage, and monthly outstanding balance disability plans. In most states, maximum rates are not specified for these plans—there is just a general requirement that the rates are actuarially equivalent to the maximum rates.

A package is assembled for submission to each state where approval is desired. Two copies of the form are completed using “J. Doe” information. A cover letter describes the submission. Approval is quicker if the form represents only a few changes to an existing approved form. Flesch score results and certification, along with any additional certifications, are included. If required, a check for the filing fee must be enclosed.

Long delays sometimes occur during the approval process. Most states are able to respond to the initial filing in 30-45 days, but 90 days is possible. If the department has an objection to particular language or clauses, the approval time can be drawn out. Each written response can take another 60-90 days. Many states have a **deemer provision** in their laws and regulations that provides that a filing is deemed approved unless the department objects within a specified period of time. The period is usually 30 days, but departments are changing their regulations to provide for longer periods. If the department submits an objection within the deemer period, the deemer provision does not apply.

Average time from the draft stage to final approval is six months, but it may take 12-18 months for unusual filings. Once approved, forms can be printed and put into use quickly. Insurers maintain a file of all approved policies and a summary for use by the sales, underwriting, policy issue, and claim departments.
Chapter Eleven

Actuarial Considerations

The primary actuarial work in credit-related insurance is the calculation of proper reserves and the determination of loss ratios based on actual experience. Reserves are necessary for statutory and GAAP financial statements, tax returns, and valid loss ratio calculations. As with all reserves, the calculation is based on a specific point in time—the accounting date.

The need for reserves is clear in single premium credit-related insurance. The insurer receives the entire premium on the first day of the policy and agrees to pay all benefits incurred during the policy term. Given a block of insurance policies in force on a particular accounting date, the insurer must establish a liability for all future claim payments. These payments arise from two events.

First, active life reserves are an insurer’s liability for the benefits estimated to be paid after the accounting date on insureds who are in good health on the accounting date. Most insureds are in good health on the accounting date, that is, they are “active” lives (the term applies to life, disability, and involuntary unemployment insurance). A provision must be made for the likelihood that some of them will incur a claim after the accounting date but before the end of the policy term.

Second, claim reserves are an insurer’s liability for the benefits estimated to be paid after the accounting date, on claims that have occurred prior to the accounting date. On the accounting date, some claims have occurred, but the claim has not been paid. A simple example is a life claim that occurs shortly before the accounting date. At some point after the accounting date, it will be reported to the insurer and ultimately paid. On disability and IUI claims, provision must also be made for benefits that will be earned after the accounting date on claims in progress on the accounting date.
Active Life Reserves for Single Premium Life Insurance

For life insurance, active life reserves are either unearned premium reserves or mortality reserves. Both types attempt to estimate the future claims, but the method of estimation is different. Mortality reserves are normally used for statutory financial statements and federal income tax returns. Unearned premiums are used for all other accounting purposes.

Unearned premium reserves are based on the assumption that the portion of the original premium applicable to the remaining term and amount of insurance will be adequate to pay future claims. Gross premiums are used, so the method includes the portion of the premiums to be used for claims and the portion to be used for expenses. If the business is profitable, the estimate contains an element of conservatism equal to the expense element.

The reserve is calculated by multiplying the original gross premium times an unearned premium factor. Factors are developed which represent the proportion of the remaining coverage compared to the total coverage provided over the entire term of insurance.

The standard methods used to calculate the factors for single premium life insurance are:

Decreasing gross coverage: Rule of 78
Level gross coverage: Pro rata

In preparing reserve factors for both bases, insurers generally assume that all policies are issued on the 15th of the month. Since most valuations are as of the end of a month, this results in a half-month correction factor. Factors for Rule of 78 and pro rata unearned premiums are:

<table>
<thead>
<tr>
<th>Rule of 78 unearned premium factor</th>
<th>Pro rata unearned premium factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \frac{(t-.5) \times (t+.5)}{n \times (n + 1)} )</td>
<td>( \frac{t-.5}{n} )</td>
</tr>
</tbody>
</table>

Where

- \( n \) = the original term in months
- \( t \) = the number of full or partial months remaining from the valuation date to the expiration of the policy
  = \( n - [12 \times (\text{valuation year - issue year}) + (\text{valuation month - issue month})] \)

Other formulas and factors must be developed for net payoff coverages, truncated coverages, and all other coverages with a pattern of insurance that is not uniformly decreasing or level.

Mortality reserves approach the problem from another standpoint. A mortality table is a set of probabilities. The probabilities are applied to each policy based on the amount of insurance in force, the age of the insured, and the remaining term. Reserve factors are calculated which reduce the actual reserve computation to a simple process.
Mortality tables are produced from inter-company studies of actual claim experience. Only limited age-rated studies of credit life mortality rates have been done, so a mortality table of credit life insurance experience has not been adopted by the NAIC. Instead, prior studies of ordinary life or group life claim experience are used. The most widely used table is the 1958 Commissioners Extended Term table (1958 CET), which is a study of mortality experience under an ordinary life non-forfeiture option called extended term insurance. The table was based on a study of 1950-54 experience. What does this have to do with credit life insurance today? Nothing. However, the table is judged to be a conservative estimate of credit life insurance experience. Other tables used are the 1958 Commissioners Standard Ordinary table (1958 CSO), 130% of 1958 CSO, the 1960 Commissioners Standard Group table (1960 CSG), or 130% of 1960 CSG. For ages relevant to credit life insurance, the 1958 CET table is equal to 130% of the 1958 CSO table. 1980 CSO and 1980 CET tables have been developed and are accepted by a growing number of states. A 2000 CSO table is now available.

Since claims are to be paid in the future, the expected payments are discounted for interest. The insurer’s actuary determines the interest rates used in the calculation of the reserve factors. For statutory reserves, states specify a maximum rate, usually 4.5%. Insurers may use any rate less than or equal to the state maximum. A separate set of interest rates and factors may be used for federal income tax reserves. The short policy terms make the choice of an interest rate of little significance. An increase of 1% in the interest assumption results in approximately a 1.5% decrease in the reserves.

For joint life insurance, the reserve factors are often a multiple of the single life factors. A few insurers simply double the in force amount, resulting in a multiple of two; however, most insurers use a multiple of the single life reserve factors, generally from 1.60 to 2.00. Alternatively, an age setback may be used. Although the actual age of the joint insured is rarely used, an assumption is made that the second insured is three to six years younger than the primary insured.

Actual reserve valuations may be on a policy-by-policy (seriatim) basis or a group basis. Most insurers maintain an individual in force file and apply a reserve factor to each policy. Some larger companies use grouped in force files that do not retain policy data on an individual basis. For example, policies may be grouped by five-year (quinquennial) age bands. Reserve factors are developed which are appropriate to the valuation method used.

Since unearned premiums are based on the original gross premiums, identical policies will have different reserves depending on the gross premium charged. Mortality reserves will be the same for identical policies. One cannot easily predict which basis will produce the larger reserves. In states where the gross premium rates are low, mortality reserves will exceed the unearned premium reserves. In high-rate states, the reverse is true. Overall, 1958 CET mortality reserves will approximately equal the unearned premium reserves if the gross premium rate is $0.60/$100/year. The actual relationship will depend on the particular mix of ages, terms and proportion of joint business.

**Active Life Reserves for Single Premium Disability Insurance**

Disability active life reserves are held on a gross unearned premium basis. Again, the concept is to hold back the remaining proportion of the original risk as of the accounting date.
Unfortunately, there has not been a definitive study to establish the proper basis to earn disability premiums. Investigation of this matter has led to many debates but no resolution.

For life insurance the rate of mortality is approximately level over the short term of insurance. During the policy term, the ratio of the remaining exposure to the original exposure is a good representation of the proportion of original risk that remains. Disability is different—the maximum amount of a claim can be affected by the remaining term. Under a 48-month term policy, the insured can earn one to 48 benefit payments depending on the timing and duration of the disability. Most claims do not last for the full remaining term. Claimants who recover may have subsequent disabilities.

For single premium credit disability, Rule of 78 unearned premium reserves may understate the proportion of remaining risk to original risk. Pro rata unearned premiums overstate the remaining proportion. In recent years, a move to use the arithmetic mean, or average, of the two bases has gained wide acceptance. Generally, the mean is considered the proper basis unless an insurer can demonstrate the validity of some other basis.

Another recent approach is the Rule of Anticipation, also called the Single Premium Method. The unearned premium is the gross single premium for the remaining term and remaining benefits. These unearned premiums are close to the mean of Rule of 78 and pro rata.

It is also possible to prepare a morbidity table, the disability counterpart to a mortality table. The last study of credit disability experience was published in 1974, and its findings were never recognized as being valid.

Active Life Reserves for Monthly Outstanding Balance Insurance

For MOB business, the active life reserve may be zero if all premiums are due on the first of the month. At the end of a month, the coverage has expired. Since the actual premiums are not received by the insurer until 15-45 days after the end of the calendar month, most insurers do not hold an active life reserve, regardless of the premium due date. This process applies to life, disability, and IUI.

Some insurers hold a half-month reserve. The reserve held is one-half of the premiums reported in the prior month. This practice stems from the traditional assumption that all policies are issued in the middle of the month and that reserves are calculated at the end of the month.

Types of Claim Reserves

The critical actuarial work relating to claim reserves is to produce an appropriate estimate of the total payments after the accounting date on all claims that have occurred on or before the accounting date. For various reasons, the total is separated into three categories. While an accurate separation into the categories is desired, the adequacy of the total is the crux of the matter.

Incurred But Not Reported (IBNR) claims are those claims that occur on or before the accounting date, but have not been reported to the insurer on the accounting date. After the accounting date, they will be reported, processed and paid.
Claims in Course of Settlement (CCS or ICOS) are those claims that occur and are reported to the insurer on or before the accounting date, but have not been paid. These would normally be the claims received shortly before the accounting date. The claims are in process, but the final payment has not been made.

IBNR and CCS are the only claim reserves that apply to life insurance, since only a single payment is involved. For disability and involuntary unemployment insurance, a series of future payments may be involved. These payments are classified as accrued benefits and unaccrued benefits. IBNR and CCS amounts are technically benefits relating to the period between the date of disability or involuntary unemployment and the accounting date. These benefits are accrued by the claimant—the insured event has occurred, and the claimant has been on claim for a period of time. The benefits are already earned, only the paperwork needs to be completed.

Unaccrued benefits provide for the payments that will be earned after the accounting date if the claimant remains on claim. IBNR and CCS claimants can earn these benefits (where the first payment has not been made) as well as claimants who already are receiving benefits. The technical term for these benefits is present value of future unaccrued benefits, but they may be called present value reserves, continuing claim reserves, or various other terms. For example:

<table>
<thead>
<tr>
<th>Plan:</th>
<th>14-day retroactive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Benefit:</td>
<td>$100</td>
</tr>
<tr>
<td>Date of Disability:</td>
<td>December 1, 2003</td>
</tr>
<tr>
<td>Date Reported:</td>
<td>January 15, 2004</td>
</tr>
<tr>
<td>Estimated Period of Disability:</td>
<td>Six months</td>
</tr>
<tr>
<td>Accounting Date:</td>
<td>December 31, 2003</td>
</tr>
</tbody>
</table>

This is an IBNR claim. The IBNR reserve is the accrued benefit from December 1 to December 31 (or $100). The unaccrued amount is $500, which is the present value reserve.

Claim Reserve Methods

Active life reserves are calculated on a policy-by-policy basis using specified tables or formulas. Using this method, the calculation produces a precise number, but the answer is still an estimate.

An actuary rarely gets a feeling of precision when working with claim reserves. Indeed, it is sometimes difficult to feel secure that the answer is even in the ballpark. All methods of claim reserving involve the application of prior experience and subjective judgment. Conditions change, so methods that worked in the past may no longer give good results. Both art and science are used to arrive at the final estimate.

The remainder of this section discusses methods of claim reserving that are used in practice. There is no implication that the methods discussed are the best methods or that they are
Actuarial Considerations

always appropriate in the situations described. Setting of claim reserves is difficult and requires good professional judgment and knowledge of the business being evaluated. No method is perfect. Even the most sophisticated methods may fail to produce proper reserves when changes are occurring in the underlying business or in the conditions affecting the duration or reporting of claims. Development of reliable factors depends on the availability of credible past experience that can be expected to apply to the business being evaluated. Although actuarial knowledge is useful in many aspects of credit-related insurance, this is one area where qualified actuarial expertise and judgment are required.

Five methods are used by insurers to set claim reserves. The common practices in credit-related insurance are shown in parentheses:

- Factor method (Life-IBNR, Disability, IUI)
- Lag triangle or completion method (Disability, IUI)
- Case reserve method (Disability, IUI)
- Direct tabulation method (Life-Claims in Course of Settlement)
- Loss ratio method (Where reliable runoff data are not available)

The factor method is widely used. Prior claim payment experience is studied to determine the actual experience during some time period in the past. The experience is related to a base quantity that will be available on the accounting date in question.

Some commonly used bases are 1) life insurance in force, 2) disability or IUI exposure measured by the sum of monthly benefits in force, 3) claims paid during the prior 12 months.

For example, a study may show that an appropriate life IBNR factor is 75¢ per $1,000 of insurance in force. The factor is multiplied times the life insurance in force on the accounting date to estimate the life IBNR reserve.

The lag method is often used for disability insurance and IUI. A spreadsheet is set up for the calculation of the claim reserves. When the historical data is entered into the spreadsheet in the proper manner, it forms a triangle. Using statistical methods, the historical data is used to project the future payments in the missing half of the triangle. The sum of these projected payments is the claim reserve at that point in time. For this reason, the process is often called the lag triangle method or the triangle method.

The same historical claim data can also be used to develop completion factors. Prior experience is studied to estimate the average remaining period of claim after the accounting date. Factors are then developed based on the time the insured has been disabled or unemployed on the accounting date.

For example, a study may show that claimants who have been disabled 90 to 119 days remain disabled for four additional months on average. On the accounting date, the sum of the monthly benefits on all claimants who have been disabled for this period is tabulated. The reserve is this sum times the factor of four. Factors are adjusted if the remaining policy term is less.

Under the lag method and the completion factor method, more than one prior accounting date is studied. Generally, studies are made of each prior year using a December 31 accounting date. For example, factors are developed by tracking the experience of open disability claims on
December 31, 1990. Then separate factors are developed by tracking the open claims on December 31, 1991, and so on. The experience of the different accounting dates is reviewed for consistency and trends. The final factors are a blend of the studies from several different accounting dates.

The **case reserve method** is the easiest to understand and apply but can only be used for known disability and IUI claims. A knowledgeable claim person reviews each reported claim and estimates the remaining time of the claim. The reserve is the product of the remaining months of claim times the claimant’s monthly benefit. Case reserves must be tested by the type of experience data used for the factor or lag method. The runoff from prior years is studied to judge whether prior years’ reserves were adequate.

A senior claims person can review each claim and set the reserve. Small companies may find this method appropriate, but the method becomes impractical as the volume of claims grows. Problems arise when different claim personnel set the reserves on their claims. Consistency is lost, and the level of expertise will vary. One problem facing all claim personnel is the quality of data available to judge the severity of a claim. A noticeable decrease in the time spent by doctors or their staff in completing claim forms has been evident in recent years. Ultimately, an insurer must resort to the lag method or completion factors.

The **direct tabulation method** can only be used in a few situations. The most common use is for calculating life claims in course of settlement. On the accounting date, the claim department totals the benefits payable on claims that have been received but not paid.

The **loss ratio method** is occasionally used where the data are not present to apply the other methods. If the incurred claim/earned premium loss ratio is known, the incurred claims can be calculated as the product of the loss ratio times the earned premium. Subtracting paid claims from incurred claims gives the claim reserves in total. However, the experience loss ratio cannot now be calculated, because the relationship is circular. This method is implemented in practice by assuming a loss ratio. The results are only as good as the assumption.

For each of these methods, a life insurer has the option of discounting the future payments with interest. The short-term nature of the future payout reduces the necessity for such discounting. For the life insurance reserves, the effect would be negligible. Using an interest discount for disability or IUI reserves can reduce the reserves 5%-8%, depending on the interest rate selected. An estimate of these claim reserves may have a margin of error of 5%-10%. Many insurers forego discounting for interest and just consider the omission an element of conservatism.

## Loss Ratios

The profitability analysis used for most credit-related insurance business is the loss ratio approach, since most elements of the premium dollar can be expressed as a percentage. The only proper basis of calculating loss ratios is the ratio of incurred claims to earned premiums. This is called the **incurred loss ratio** or **incurred/earned loss ratio**.
Incurred Claims =
- Paid Claims
- claim reserves at the beginning of the period
+ claim reserves at the end of the period

Earned Premiums =
- Gross premiums collected - refunded premiums
+ unearned premiums at the beginning of the period
- unearned premiums at the end of the period

Incurred Loss Ratio = Incurred claims / Earned premiums

With proper reserves, this loss ratio will be the best estimate of the ultimate loss ratio on a block of business.

Other loss ratios may be demonstrated based on paid data, for example, the ratio of paid claims to written premiums (paid loss ratio) or the ratio of paid claims to earned premiums (paid-earned loss ratio). Either of these ratios will understate the ultimate loss ratio. Figure 11.1 shows the development of the incurred loss ratio and the paid-earned loss ratio on an actual block of disability business from inception to expiry.

![Comparison of Loss Ratio Methods](image-url)
Chapter Twelve

Producer-Owned Reinsurance

Producers of credit-related insurance control the business and decide which insurer to use. For the sale, premium collection, and policy delivery, the insurer pays the producer a front commission or service fee. As the size of a producer’s book of business grows, the producer may wish to participate in underwriting risk. Since the sale of credit-related insurance is a sideline to a primary line of business, such as automobile sales or extending credit, the producer may not want to divert resources to the formation and operation of a direct-writing insurance company. Also, the functions of a direct writer require expertise and adherence to rather stringent laws and regulations.

Initially, a producer may negotiate retroactive compensation. The past experience of the producer’s business is evaluated periodically, considering all elements of underwriting income and expense. If the business has been profitable, the direct writer shares the underwriting profit with the producer. This could be called “one-sided reinsurance,” because the producer has the potential for additional compensation but no downside risk—the retroactive compensation cannot be less than zero. None of the regulatory complications of operating an insurance company are present.

As a producer’s volume grows, the loss experience becomes more predictable. The producer may want all of the underwriting profit and the investment income. When the producer is ready to accept the downside underwriting risk and certain regulations, a producer-owned reinsurer is formed.
In return for an administration fee, often called retention or ceding fee, the direct writer (the insurer whose name is on the policy) agrees to reinsure the producer’s business into the producer’s reinsurance company. Part of the direct writer’s administration may include management of the reinsurer. In theory, the direct writer becomes a service company, and the risk is reinsured (or ceded) to the reinsurer. Unfortunately, more than one direct writer has learned the hard way that it remains responsible to the insured. The direct writer, not the claimant, has the problem of receiving reimbursement from a reinsurer. A direct writer must never forget whose name is on the policy.

Formation

Forming a reinsurance company offers the simplest method of assuming the underwriting risk. The direct writer retains the burden of compliance with policy form regulations, agent licensing requirements, and statistical reporting. As a part of its usual administrative functions, the direct writer must prepare premium, compensation, claim information, and the monthly cession (accounting report). The reinsurer simply receives a monthly accounting of all financial items relating to its business. It must account only for its monthly cessions and its investment portfolio transactions.

The fact that a reinsurance company can be formed and licensed in only one state is particularly advantageous to a producer operating its primary business on a multi-state basis. Such a producer would need to have a direct-writing insurance company licensed in each state. Compliance with the regulations of each state requires time, effort, and expense. Certain states have
encouraged the formation of producer-owned reinsurers by establishing low capital requirements and streamlining formation procedures.

Arizona dominates as the state of domicile for credit-related reinsurers because a domestic Arizona life reinsurance company can be formed with only $100,000 capital and $50,000 surplus. An Arizona reinsurance company can only assume business from other insurers. It cannot issue policies directly without meeting the higher capital and surplus requirements specified for an Arizona direct writer. The Arizona Department of Insurance is well organized for formation and supervision of credit-related insurance reinsurers. The formation process can be accomplished in less than six months. Formation costs are about $10,000. Annual filing fees and costs are $10,000-$20,000. The administrative offices of the reinsurer can be located outside of Arizona. Arizona now has a second category, an unaffiliated credit life and disability reinsurance. It offers a simplified regulatory structure and more limited financial reporting requirement.

Arizona and most other states limit the risk that an insurer or reinsurer can accept on any one life to 10% of the capital and surplus. If the company has $150,000 of capital and surplus, it can accept up to $15,000 of risk on any one life. Since most credit-related insurance policies are for amounts under $15,000, the limitation does not usually pose any significant problem for credit-related insurers or reinsurers.

Sites for reinsurers are not limited to the 50 states. Offshore reinsurers are popular in the automobile dealer market. Offshore reinsurers are subject to far less regulation and have the potential for lower operating costs. One often thinks the reason for going offshore is to avoid taxes. This is not the case; most offshore credit-related reinsurers make a voluntary election to be taxed under the U. S. tax code as any other U. S. taxpayer.

Bermuda and the Cayman Islands are the more substantial offshore sites for reinsurers, since the capital requirements are not trivial—$350,000 and $240,000 respectively. Regulation is achieved by the requirement of an annual independent audit by a certified public accountant (CPA). An on-island management firm is required. As a result, operating costs are high—at least $50,000 per year.

In contrast to Bermuda and Cayman are Nevis, the Turks and Caicos Islands, and the British Virgin Islands. For about $6,000 in formation costs, one can be the owner of an insurance company. Annual operating costs are about $6,000; this cost includes the regulatory renewal fee and the cost of preparation of a simplified statutory financial statement and a U. S. federal income tax return.
Administration

Direct writers active in producer-owned reinsurance must prepare an array of information to cede the business to the reinsurer. Insurers provide monthly or quarterly accountings on the business processed.

A reinsurance cession, or ceding statement, is prepared that lists the cash transactions. Cession statements are provided about 20 days after the end of the accounting period. A positive balance of the gross premiums minus refunded premiums, less claims, compensation, and the ceding fee is remitted to the reinsurer along with the cession. Included with the cession is a report of the required reserves at the end of the period.

At year-end, the direct writer supplies all of the information the reinsurer needs to complete its statutory annual statement and federal income tax return. Cash transactions for the year are summarized. The December reserve statement provides the year-end reserves. A policy exhibit showing the transactions based on number of insureds and amount in force is provided. Most direct writers provide an actuarial opinion of the reserves. Insurers also provide a separate set of reserves for tax calculations. Some insurers prepare the annual statement and federal income tax return for the reinsurer.

The reinsurer must establish a trust account for the protection of the direct writer. The funds in trust must equal the amount of the ceded reserves. Alternatively, the direct writer may hold the funds in a “funds withheld” account.
NOTE: Definitions in this glossary provide meanings applicable to credit-related insurance. Some words also have broader meanings.

Acceptance Corporation. A finance corporation formed by a manufacturer of consumer products to provide financing through the seller of its products, typically automobiles and other expensive machinery or equipment.

Accounting Date. The as of date on which an accounting statement is prepared, generally the last day of the accounting period.

Accrued Benefit. An insurance benefit that has been earned but has not yet been paid. For example, a person disabled on December 1 has 30 days of accrued benefit as of December 31 if the claim has not been paid.

Active Life Reserve. An insurer’s liability for the benefits estimated to be paid after the accounting date on insureds who are in good health on the accounting date. This liability is called an unearned premium reserve. For life insurance, there is a second type called mortality reserve.

Actively-at-Work Requirement. A policy requirement that the borrower must have worked thirty or more hours per week for one or more months prior to the effective date of the insurance in order to qualify for the insurance coverage.

Actual Cash Value. In property insurance, the market value of property.

Actuarial Justification. In policy filing work, the process of demonstrating that proposed premium rates meet the regulatory standards for fairness and reasonableness.

Adjudication. The process of determining the validity of a claim for insurance benefits and establishing the amount payable under the claim.

Age-Banded Product. A credit-related insurance product with premium rates that vary based on the issue age of the insured, normally using 5-year or 10-year age bands.

All Risk Coverage. In credit property insurance, coverage insuring all causes of loss, except for certain specifically excluded events, and subject to specific exclusions.
Annual Percentage Rate (APR). The effective annual rate of interest contained in a credit obligation.

Anti-Selection. The tendency of a borrower to select against the insurer, based on the borrower’s knowledge of the borrower’s health or employment status, when making the decision to purchase insurance.

Any Occupation (“Any Occ”) Disability. A disability that causes a claimant to be unable to perform the essential duties of any occupation for which the claimant is reasonably qualified by training, education, or experience.

Appoint an Agent. A process by which an insurer notifies the state insurance department that a licensed agent will solicit insurance on the insurer’s behalf.

Asset-Backed Credit. Credit secured by collateral.

Assignment of Commission. An agreement used in states where a corporation cannot be licensed to sell insurance. The employee-agent assigns the commissions from the sale of credit-related insurance to the employing corporation.

Assuming Reinsurer. An insurance company that accepts the risk on insurance policies written by another insurance company.

Automated Tracking System. In collateral protection insurance, a data processing system that canvases a credit portfolio for borrowers who have not maintained the required insurance protection on collateral.

Balloon Credit. A credit obligation in which repayment consists of a series of installment payments and a final larger payment.

Bank Holding Company. A corporation that owns other legal entities, including at least one bank.

Benchmark Loss Ratio. In state laws and regulations, the presumed loss ratio on which prima facie rates are based. Also, the loss ratio used to determine whether the benefits provided are reasonable in relation to the premium charged.

Beneficiary. The party that will receive the benefits from an insurance policy.

Bill of Sale. A written agreement between two parties calling for the buyer to pay a certain amount of money for an item owned by the seller.

Borrower. A consumer entering into a credit obligation by receiving cash or purchasing a consumer product.

Case Reserve Method. Disability or IUI claim reserves set by a knowledgeable claim person who reviews each reported claim and estimates the remaining duration of the claim. The reserve is the product of the estimated remaining months of claim times the claimant’s monthly benefit.

Cash Advanced. Principal of the credit.

Cash Credit. The borrower receives cash for the purchase of consumer products or for other expenditures in return for entering into a credit obligation.
**Cede.** To transfer the risk under an insurance policy from one insurance company to another insurance company.

**Ceded Premium.** The premium paid to the assuming reinsurer by the ceding insurer for the assumption of an insurance risk.

**Ceding Fee.** The percentage of ceded premium retained by the ceding insurer in a reinsurance transaction for the ceding insurer’s general expenses, premium taxes, and profit.

**Certificate of Insurance.** The document issued to the insured borrower by the insurance company under a group policy.

**Cession.** A periodic report provided by the ceding insurer to a reinsurer showing the cash transactions of the accounting period. The accounting period may be monthly or quarterly.

**Chattel Mortgage.** A legal instrument under which personal property stands as security for the credit. The borrower maintains possession of the property as long as there is no default.

**Claimant.** A borrower covered by an insurance policy who files a claim for a loss covered by the policy.

**Claim In Course of Settlement (CCS, CICS, ICOS).** The component of claim reserves for a claim that has occurred and has been reported to the insurance company prior to the accounting date but has not been paid on that date. Also called *pending claim.*

**Claim Reserves.** An insurer’s liability for the benefits estimated to be paid after the accounting date, on claims that have occurred prior to the accounting date. Categories of claim reserves are: *incurred but not reported claims, claims in course of settlement, and continuing claims* (disability and involuntary unemployment insurance only). In property and casualty insurance terminology, they are called loss reserves.

**Closed-End Credit.** Credit for a specified amount and a fixed term.

**Closed-End Monthly Outstanding Balance Insurance.** Credit life and disability insurance for closed-end installment credit that is sold using monthly outstanding balance premiums instead of single premiums, typically only found in the credit union market.

**Co-Borrower.** A second borrower who is obligated under a credit obligation.

**Collateral.** Assets pledged by a borrower to secure credit.

**Collateralize.** The process of pledging security.

**Commercial Credit.** Credit extended to a business which may be guaranteed by an individual, typically the owner of the business.

**Commission.** The amount of money paid to the producer of insurance business, usually a percentage of the premiums that are produced for the insurer.

**Commissioners Extended Term Table (1958 CET, 1980 CET).** The 1958 CET is a mortality table based on a study of 1950-54 experience under an ordinary life insurance non-forfeiture option called *extended term insurance.* The table is still used to calculate mortality reserves for credit life insurance policies. More recent versions, the 1980 CET and the 2000 CET, are now available and becoming more widely used.
Commissioners Standard Group Table (1960 CSG). A mortality table based on a study of group mortality experience published in 1960. The table is occasionally used to calculate mortality reserves for credit life insurance policies.

Commissioners Standard Ordinary Table (1958 CSO, 1980 CSO, 2000 CSO). The 1958 CSO is a mortality table based on a study of 1950-54 ordinary life insurance experience. The table is occasionally used to calculate mortality reserves for credit life insurance policies. For the ages applicable to most credit life insurance business, the 1958 CET equals 130% of 1958 CSO. A more recent version, the 1980 CSO is now available for use.

Compensating Balance. A deposit in a financial institution by an insurer on which the interest paid is less than market rates, usually in a non-interest bearing checking account.

Consumer Credit. A financial transaction in which a borrower receives cash, or purchases a consumer product, by agreeing to repay the amount advanced by the creditor.

Consumer Credit Insurance Association (CCIA). A national organization of more than 180 insurance companies providing life, disability, unemployment, and property coverage in connection with consumer credit obligations. CCIA is dedicated to preserving and enhancing the availability, utility, and integrity of insurance products delivered through financial institutions or in conjunction with financial transactions.

Contestable Period. A period, usually two years, following the effective date of the insurance during which a misrepresentation made by the insured in an application for insurance may be used as a reason to deny a claim. After the contestable period, a valid claim may not be denied because of misrepresentation, except in case of fraud.

Contingent Commission. See retroactive compensation.

Continuing Claim Reserve. For disability and involuntary unemployment insurance with monthly benefits, the component of claim reserves for a claim that has occurred prior to the accounting date and for which a claimant has received at least one disability or IUI benefit payment. The reserve is the estimate of the benefits that will be earned and paid after the accounting date.

Contributory Premium. Insurance where the borrower has the option to purchase credit-related insurance by paying an identifiable premium.

Coverage. A contingency insured under an insurance policy.

Credit Accident and Health Insurance (A&H). Another term for credit disability insurance.

Credit Card Borrowing. A credit obligation where the purchaser receives cash or purchases a consumer product by agreeing to repay the amount charged to the account.

Credit Disability Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a benefit in the event of total disability during the term of coverage.

(Lump Sum) Credit Disability Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a single payment after an insured is totally disabled for the specified time, often 90 days, during the term of coverage. The benefit equals the outstanding balance on the credit.
(Monthly Indemnity) Credit Disability Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a level monthly benefit while the insured is totally disabled. The monthly benefit equals the required monthly payment.

(Monthly Indemnity) Credit Disability Insurance on Installment Credit. *Single premium* loss of income insurance purchased in conjunction with *closed-end installment credit* that provides a level monthly benefit while the insured is totally disabled *during the term of coverage*. The monthly benefit equals the required monthly payment.

(Monthly Indemnity) Credit Disability Insurance on Open-End Credit. *Monthly premium, monthly renewable* loss of income insurance purchased in conjunction with *open-end credit* that provides a level monthly benefit while the insured is totally disabled, *up to the limits specified in the policy*. The monthly benefit equals the minimum monthly payment due under the open-end credit obligation on the initial date of disability.

Credit Involuntary Unemployment Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a benefit in the event of involuntary unemployment.

(Lump Sum) Credit Involuntary Unemployment Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a single payment after an insured is involuntarily unemployed for the specified time, often 90 days, during the term of coverage. The benefit equals the outstanding balance on the credit.

(Monthly Indemnity) Credit Involuntary Unemployment Insurance. Loss of income insurance purchased in conjunction with a credit obligation that provides a level monthly benefit while the insured is involuntarily unemployed. The monthly benefit equals the required monthly payment.

(Monthly Indemnity) Credit Involuntary Unemployment Insurance on Installment Credit. *Single premium* loss of income insurance purchased in conjunction with *closed-end installment credit* that provides a level monthly benefit while the insured is involuntarily unemployed, *up to the limits specified in the policy*. The monthly benefit equals the required monthly payment.

(Monthly Indemnity) Credit Involuntary Unemployment Insurance on Open-End Credit. *Monthly premium, monthly renewable* loss of income insurance purchased in conjunction with *open-end credit* that provides a level monthly benefit while the insured is involuntarily unemployed, *up to the limits specified in the policy*. The monthly benefit equals the minimum monthly payment due under the open-end credit obligation on the initial date of involuntary unemployment.

Credit Life Insurance. Term life insurance purchased in conjunction with a credit obligation that provides a benefit in the event of an insured’s death during the term of the coverage. The benefit is equal to the indebtedness of the credit.

Credit Life Insurance on Installment Credit. *Single premium* term life insurance purchased in conjunction with *installment credit* that provides a benefit in the event of an insured’s death during the term of the coverage. The benefit is equal to the scheduled indebtedness of the credit.

Credit Life Insurance on Open-End Credit. *Monthly premium, monthly renewable* term life insurance purchased in conjunction with *open-end credit* that provides a benefit if the death
occurs during the month. The benefit is the outstanding balance of the credit on the date of death.

**Creditor-Placed Insurance.** Insurance purchased unilaterally by the creditor, subsequent to the date of the credit obligation, providing coverage against loss to collateralized property as a result of fire, theft, collision or other risks that would either impair a creditor’s interest or adversely affect the value of the collateral. It is purchased according to the terms of the credit obligation when the borrower fails to provide required insurance. The cost of the coverage is charged to the borrower.

**Credit Property Insurance.** Property insurance purchased in conjunction with a credit obligation insuring consumer products that are bought (or pledged as collateral) against specified loss occurrences causing damage to, or disappearance of, the property.

**Credit Property Insurance on Installment Credit.** *Single premium* property insurance purchased in conjunction with *closed-end installment credit* insuring consumer products that are bought with the credit proceeds (or pledged as collateral) against specified loss occurrences causing damage to, or disappearance of, the property.

**Credit Property Insurance on Open-End Credit.** *Monthly premium, monthly renewable* property insurance purchased in conjunction with open-end credit insuring consumer products that are bought (or pledged as collateral) against specified loss occurrences causing damage to, or disappearance of, the property.

**Credit-Related Insurance.** Insurance sold in conjunction with consumer credit, where the policy terms and benefits are related to the specific consumer credit obligation.

**Credit Union.** A non-profit institution that provides savings and credit services for members who share a common bond, such as the same employer.

**Critical Period Coverage.** Disability and involuntary unemployment insurance in which the benefit period is a stated number of months, rather than the full remaining term of the credit.

**Decreasing Term Life Insurance.** Term life insurance in which the amount of insurance decreases during the term of the policy.

**Deemer Provision.** State law or regulation specifying that a policy filing is approved unless the insurance department objects within a specified period of time.

**Deviated Rate.** Any premium rate different from the state’s prima facie rate.

**Direct Tabulation Method.** A method of setting claim reserves, usually claims in course of settlement, under which the claim department totals the benefits payable on claims that have been received but not paid on the accounting date.

**Direct Writer.** The insurer issuing an insurance policy.

**Disability Insurance.** A form of accident and health insurance for loss of income protection that provides a benefit in the event of total disability during the term of coverage.

**Early Termination.** Termination of a closed-end credit obligation prior to the scheduled maturity date.
**Earned Premium.** Premium dollars collected (or written) for the accounting period, plus the unearned premium at the beginning of the period, minus the unearned premium at the end of the period.

**Effective Date (of Coverage).** The day insurance coverage begins.

**Eligibility Requirement.** A condition within an insurance policy that a borrower must meet in order to qualify for coverage.

**Elimination Period.** In a disability or UII policy, the specified time period a claimant must remain disabled or unemployed before any benefits are payable. Also called the *waiting period*.

**Equity.** In real estate, the value of the property in excess of the remaining credit.

**Evidence of Insurance.** The individual policy or group certificate provided to the insured stating the term, amount of insurance, premium, coverage, exceptions, limitations, and restrictions.

**Exclusion.** A contingency not insured by an insurance policy.

**Experience Refund.** See *retroactive compensation*.

**Factor Card or Factor Chart.** Printed material used by a credit officer to calculate a credit-related insurance premium.

**Factor Reserve Method.** A method of setting claim reserves by which prior claim experience is studied to determine the actual experience during a past time period. A factor is developed from the prior experience that can be applied to a known quantity on the current accounting date to estimate future claims.

**Family Leave Insurance.** Loss of income insurance under which a benefit is paid if the insured takes an unpaid leave of absence for up to 90 (or 180) days in the event of certain family situations, such as sickness of a family member, birth, or adoption.

**Farm Credit Bank.** An organization that provides credit to farmers.

**Finance and Insurance (F&I) Specialist.** An individual employed in an automobile dealership who is trained to handle the financing and insurance matters of an automobile sale.

**Finance Company.** A company that lends money to consumers or businesses. Deposits are not accepted. Funds are obtained from banks, financial institutions, and other sources.

**First and Final Payment.** A disability or involuntary unemployment insurance claim in which the initial claim payment represents the total claim.

**Flesch Scoring Method.** An objective method for assessing readability of text material that judges the document’s difficulty of comprehension by counting the syllables in the words and the number of words in a sentence.

**Front Commission.** See *front compensation*.

**Front Compensation.** Compensation paid to the producer that is a flat percentage of the premium. If installment credit is terminated prior to maturity, the borrower receives an unearned premium refund, and there is a chargeback to the producer for the unearned front compensation.

**General Agent.** A licensed and appointed agent representing an insurer, but not as an employee of the insurance company.
Generally Accepted Accounting Principles (GAAP). The principles of accounting that apply to the preparation of financial statements for most U.S. corporations.

Good Health Statement. A simple form of underwriting where the borrower signs a statement representing that he or she is in good health to the best of his or her knowledge and belief.

Gross Coverage. Credit-related insurance plans that insure the gross indebtedness of the credit.

Gross Indebtedness. The total amount owed under a closed-end credit. It includes principal and interest.

Gross Unearned Premium. The portion of the original gross premium representing the value of the unexpired insurance. The portion can be determined using a number of methods, including the Rule of 78, Pro Rata, or the Rule of Anticipation.

Group Exemption. In states with the group exemption, an individual does not need to be licensed to enroll insureds under a group policy.

Group (Master) Policy. An insurance policy issued to a producer, in which the group is defined as borrowers obtaining credit from the producer. The insured borrower is enrolled in the group and receives a certificate of insurance as evidence of insurance.

Home Equity Line of Credit. A pre-approved borrowing limit based on the equity a homeowner has in the home.

In Force. The amount of insurance currently in effect.

Increasing Term Life Insurance. Term life insurance in which the amount of insurance increases during the term of the policy.

Incurred But Not Reported (IBNR) Claim. The component of claim reserves for a claim that has occurred prior to the accounting date but that has not been reported to the insurance company on that date.

Incurred Loss Ratio or Incurred/Earned Loss Ratio. The ratio of incurred claims to earned premiums, normally expressed as a percentage.

Indebtedness. The amount owed.

Individual Insurance Policy. An insurance contract directly between the insurance company and the person insured. The insured receives an individual policy as evidence of insurance.

Initial Gross Indebtedness. Under a closed-end installment credit obligation, the initial net indebtedness plus the scheduled interest charges over the term of the credit.

Initial Net Indebtedness. The total amount advanced under closed-end installment credit, which normally includes the principal of the credit plus the insurance premium.

Installment Credit. Consumer credit where the borrower agrees to repay the credit in substantially equal monthly payments. Typical transactions are cash credit and installment sale contracts.

Installment Sale Contract. Credit where the purchaser receives a consumer product in exchange for entering into a credit obligation requiring periodic payments.
**Glossary**

**Involuntary Unemployment (IU).** An event beyond the control of the employee that results in the termination of current employment. Examples include layoff, firing, lockout or strike.

**Involuntary Unemployment Insurance (IUI).** Loss of income insurance that provides a benefit in the event of involuntary unemployment during the term of coverage.

**Joint Coverage.** A credit-related insurance policy insuring two borrowers who are both obligated under the credit obligation.

**Joint Premium Multiple or Joint Multiple.** A premium rate for joint coverage that is expressed as a percentage of the single coverage rate.

**Lease.** A contract granting use of real estate, equipment, or a vehicle during a specified period of time for a specific amount of money. Ownership of the asset never transfers to the user of the asset.

**Lending Institution.** A corporate entity extending credit. Also called the creditor or financial institution.

**Letter Cycle.** In creditor-placed insurance, a series of letters produced by a tracking system to notify a borrower of insufficient insurance. The borrower is informed of the action and timing of the action that is required of the borrower, and the action the creditor will take if the borrower does not comply.

**Level Gross Coverage.** Level term life insurance insuring the gross indebtedness of the credit that is repaid in a single payment.

**Level Term Life Insurance.** Term level insurance in which the amount of insurance stays constant during the policy term.

**Liability.** An obligation to pay money or an estimate of an amount of money that will become payable.

**Licensed Agent.** A person soliciting insurance must obtain a state license to conduct a solicitation in that state.

**Life Savings Insurance.** In the credit union market, non-credit life insurance providing benefits related to the balance in the credit union member’s share account.

**Limited Credit-Related Insurance License.** A less demanding and more restrictive form of agent licensing that is permitted in some states. An examination for this type of license is not as comprehensive as an examination for a full insurance license. Some states do not require an examination.

**Line of Credit.** Open-end credit with a pre-approved limit.

**Loss Ratio.** The ratio of claims to premiums, normally expressed as a percentage.

**Loss Reserves.** The property and casualty insurance term for claim reserves. See claim reserves.

**Lump Sum Coverage.** Disability or involuntary unemployment insurance in which the benefit is paid in a single sum.

**Mandatory Downward Deviation.** A reduction in premium rates required by state regulation when the loss ratio is less than the benchmark loss ratio.
Mean Unearned Premium. A formula for calculating the portion of the original premium that has not been exposed to risk, where the unearned premium is the mean (or average) of the Rule of 78 unearned premium and the pro rata unearned premium.

Member-Pay Insurance. Credit-related insurance in the credit union market with contributory premiums.

Minimum Monthly Payment. The amount a borrower must pay on a credit card, a revolving charge card, or a line of credit to maintain the availability of the credit.

Monthly Benefit. An amount paid monthly during the continued disability or unemployment of the insured. Also called monthly indemnity benefit.

Monthly Outstanding Balance (MOB) Insurance. A credit-related insurance product having monthly premiums that are calculated as a function of the outstanding balance of the credit.

Monthly Payment. The amount due each month from the borrower to reduce the amount of the credit.

Morbidity Cost. The cost of insurance benefits provided under a disability insurance policy.

Morbidity Table. A set of values showing the probability of disability at given ages. The most common tables used for credit disability insurance are the 1964 Commissioners Disability Table (1964 CDT), the 1968 Credit Disability Table, the 1974 Credit Disability Table, and the 1985 Commissioners Individual Disability Table A (1985 CIDA).

Morris Plan Bank. A type of bank formed during the early 1900s under a franchise arrangement conceived by Arthur J. Morris. The concept first enabled a working class borrower to obtain bank credit using earning power as collateral.

Mortality Reserve. A life insurance reserve that is calculated based on a mortality table and an assumed rate of interest, normally used only for statutory accounting financial statements and federal income tax reserves.

Mortality Table. A set of values showing the probability of death at given ages. The most common table is the 1958 CET, but other tables include the 1941 CSO, 1958 CSO, 130% of the 1958 CSO, the 1960 CSG, the 1980 CSO and 1980 CET.

Mortgage. Credit secured with real property.

Mysterious Disappearance. In property insurance, burglary, theft, or vandalism without clear evidence that a crime occurred, other than the reported disappearance of the item.

Named Peril Coverage. In credit property insurance, coverage that insures only the specific perils that are itemized in the policy.

Net (or Net Payoff) Coverage. Credit life insurance with a death benefit equal to the scheduled net indebtedness of the credit.

Net Indebtedness. The amount due under a credit obligation at a specific point in time.

Net Plus One (or Plus Two or Plus Three). Credit life insurance with a death benefit equal to the scheduled net indebtedness of the credit plus one monthly payment (or two or three).
**Non-Contributory Premium.** Credit-related insurance provided to all borrowers with the premium paid by the creditor.

**Non-Filing Insurance (NFI).** Insurance that protects a creditor in the event that the creditor suffers a loss as a result of its failure to perfect its security interest in the collateral by not filing a lien against the security with government authorities. The cost of the insurance, which is less than or equal to the state filing fee, is passed on to the borrower. Also called *non-file insurance* or *non-recording insurance*.

**Non-Resident Agent License.** An insurance license permitting an out-of-state agent to solicit insurance in the state.

**Non-Retroactive Benefit.** Under a disability or involuntary unemployment insurance policy, coverage where benefits are not payable for the time the insured is disabled or unemployed during the elimination period.

**Open Claim.** A claim that is under investigation or in a benefit-paying status.

**Open-End Credit.** Consumer credit under which the amount of credit extended may be increased at any time by additional borrowing up to the account’s credit limit. The term of the credit is not fixed. The borrower makes a monthly payment in any amount ranging from the creditor’s required minimum payment up to the outstanding balance of the credit.

**Outstanding Balance.** The amount due under a credit obligation at a specific point in time. Also called the *net indebtedness*, *outstanding net indebtedness*, and the *outstanding principal balance*.

**Override Commission.** Compensation paid to a general agent on the business produced by that agent, normally expressed as a percentage of net written premium. It is paid over and above the compensation paid to the actual producer, e.g., a bank.

**Own Occupation (“Own Occ”) Disability.** A disability that causes a claimant to be unable to perform the essential duties of the claimant’s usual occupation.

**Paid-Earned Loss Ratio.** The ratio of paid claims to earned premiums, normally expressed as a percentage.

**Paid Loss Ratio.** The ratio of paid claims to collected (or net written) premiums, normally expressed as a percentage.

**Penetration Rate.** The percentage of eligible borrowers who purchase credit-related insurance.

**Personal Line of Credit.** A pre-approved borrowing limit that is not secured by collateral.

**Policyholder.** The individual or entity who is the owner of an insurance policy.

**Pre-Existing Condition.** An impairment for which the insured has received treatment prior to the effective date of the insurance.

**Premium.** The consideration paid for insurance.

**Premium Rate.** The price of a unit of insurance.

**Premium Refund.** The unearned portion of the original insurance premium that is paid to the borrower when closed-end, single premium credit-related insurance is terminated prior to the scheduled maturity date. Also called *refunded premium* or *refund*. 
Present Value of Unaccrued Benefits. A life insurance term for the component of claim reserves for the monthly indemnity benefits that will be earned by the claimant after the accounting date on claims that have occurred prior to the accounting date. Also called present value reserve or the present value of amounts not yet due.

Prima Facie Rate. A maximum premium rate for credit-related insurance that is set by state law or regulation. The rate may be used by an insurer without further justification of its reasonableness within a particular state. The rate is judged on its face to produce a reasonable benefit in relationship to the premium charged.

Primary Borrower. The first-named borrower on a credit obligation.

Principal (of a credit obligation). The cash advanced to the borrower or the portion of the product’s purchase price that is financed.

Producer. The entity making the credit-related insurance presentation to the borrower, such as an automobile dealership, a bank, a credit union, a finance company, or a retailer.

Producer-Owned Insurance (or Reinsurance) Company. An insurance company owned or controlled by a producer for the purpose of insuring, or reinsuring, the credit-related insurance sold by the producer.

Programmable Calculator. A hand-held calculator or personal computer programmed to calculate the premium for credit-related insurance.

Pro Rata. There are two meanings, the most common being “in equal proportions.” The second meaning is “in proportion to.”

Pro Rata Unearned Premium. A formula for calculating the portion of the original premium that has not been exposed to risk, where the portion is the remaining term divided by the original term. For example, if the remaining term of coverage is nine months and the original term is twelve months, nine-twelfths or 75% of the original premium is unearned.

Rate Chart. Printed material used by a credit officer to calculate a credit-related insurance premium.

Refund. See premium refund.

Refunded Premium. See premium refund.

Reinsurance. The transfer of risk from one insurance company, the ceding insurer, to a second insurance company, the reinsurer.

Reinsurance Treaty. The contract defining the reinsurance relationship between the ceding insurer and the reinsurer.

Reinsurer. An insurance company that accepts the risk on insurance policies written by another insurance company. Also called the assuming reinsurer.

Report and Remittance. A monthly report submitted by a producer of credit-related insurance to the insurer regarding the business issued and refunds made during the month. Remittance for the gross premium minus refund premium, less any deducted compensation, is sent to the insurer along with the supporting documentation.
**Reserves.** An estimate of the future claim payments that will be paid after the accounting date on business that is in force on the accounting date.

**Reserve Valuation.** A periodic calculation of the reserves for a group of in force insurance policies.

**Resident Agent.** An agent licensed in the agent’s state of residency.

**Residual Value.** In a lease agreement, the value of the consumer product, normally an automobile, at the end of the lease term.

**Retention Fee.** The ceding fee charged by a ceding insurer under a reinsurance arrangement.

**Retroactive Benefit.** Under a disability or involuntary unemployment insurance policy, a benefit that is payable from the first day of disability or unemployment if the claimant remains disabled or unemployed for the required waiting period.

**Retroactive Compensation ("Retro").** Compensation to the producer that is paid only if the business is profitable. Also called contingent commission or experience refund.

**Revolving Charge Account.** Open-end credit extended by a department store or other retailer of consumer products solely for the purchase of products from the card issuer.

**Rider.** An additional policy provision that becomes a part of the insurance contract. A rider can provide a supplementary benefit, increase the base policy benefit, or limit a policy’s coverage.

**Rolling Six-and-Six Pre-Existing Condition Exclusion.** In credit disability insurance for open-end credit, the portion the monthly benefit relating to a particular charge to the card or cash advance is excluded if the insured becomes disabled from a pre-existing condition within six months after the charge or advance, if any treatment for that pre-existing condition occurred within the six months prior to the charge or advance.

**Rule of Anticipation Unearned Premium.** A formula for calculating the portion of the original premium that has not been exposed to risk, where the unearned premium equals the gross single premium for a policy having the same benefits and term as the unexpired coverage. Also called single premium method.

**Rule of 78.** A mathematical formula for calculating the sum of the digits from one to any specified number (n). The formula is:

\[
\frac{n \times (n + 1)}{2}
\]

The sum of the digits from 1 to 12 equals \([(12 \times 13) / 2]\) or 78. Also called the sum of the digits.

**Rule of 78 Unearned Premium.** A formula for calculating the portion of the original premium that has not been exposed to risk, where the unearned portion is calculated using the Rule of 78 to determine a ratio of the remaining term to original term. The unearned premium is this ratio times the original premium.

**Secured Credit.** Credit secured by collateral.

**Second Mortgage.** Credit secured by equity in the borrower’s home that is in excess of a first mortgage lien.
Security Agreement. A document stating that the creditor can take possession of the collateral under certain circumstances.

Service Fee. A flat percentage of the insurance premium that is paid to the producer as compensation for the administrative services provided by the producer.

Single Life Coverage. Credit-related insurance that provides protection on only one life, the primary borrower. The term “life” does not imply life insurance, just one insured.

Single Premium (Insurance). Insurance purchased with a single payment at the inception of the coverage.

Single Premium Decreasing Gross Coverage. Credit life insurance insuring the gross indebtedness, paid for with one premium that is charged at the inception of the coverage. The amount of insurance decreases each month by the amount of one monthly payment, commonly used for closed-end installment credit.

Single Premium Decreasing Net (or Net Payoff) Coverage. Credit life insurance insuring the net indebtedness, paid for with one premium that is charged at the inception of the coverage. The benefit is equal to the scheduled outstanding net indebtedness, commonly used for variable interest rate installment credit, for long-term credit, and where mandated by law or regulation.

Single Premium Level Gross Coverage. Credit life insurance insuring the gross indebtedness on single payment credit, paid for with one premium that is charged at the inception of the coverage.

Six-and-Six Pre-Existing Condition Exclusion. A disability is not covered if the insured becomes disabled from a pre-existing condition within six months after the effective date, if any treatment for that pre-existing condition occurred within the six months prior to the effective date.

Statutory Accounting Principles (SAP). Accounting principles, embodied in state statutes, that are the basis of the statutory financial statements filed with the state insurance departments by all insurance companies.

Stream of Payments. In a lease transaction, the monthly lease payments that come due during the term of the lease.

Telemarketing. A form of direct response marketing where consumer products are sold directly to consumers via the telephone.

Termination Date. The last day insurance coverage is scheduled to be in force.

Term of Coverage. The length of time insurance coverage is scheduled to be in force, normally expressed in months.

Total and Permanent Disability. A disability meeting the “any occupation” disability test that is expected to continue for life.

(Lump Sum) Total and Permanent Disability Benefit. A disability benefit that is paid in a single sum once the total and permanent definition of disability is satisfied.

Truncated Coverage. Any credit-related insurance product in which the term of coverage is less than the term of the credit.
Truncated Disability Coverage. Credit disability insurance with a term of coverage shorter than the term of the credit. Disability benefits terminate when the insurance coverage terminates.

Truncated Life Coverage. Credit life insurance with a term of coverage shorter than the term of the credit.

Unaccrued Benefit. A monthly indemnity benefit that may be earned after the accounting date on a claim that has occurred prior to the accounting date under disability and involuntary unemployment insurance.

Underwriting. In ordinary life and P&C insurance, the process of obtaining information from an applicant and determining whether the applicant qualifies as a standard risk, must pay additional surcharges, or is declined. In credit-related insurance, the process is far more limited and could be better described as screening. Risks are either accepted or rejected.

Underwriting Condition. A requirement an applicant for an insurance policy must meet in order to qualify to purchase the insurance.

Underwriting Question. A question used to determine whether an applicant for insurance fulfills an underwriting condition.

Underwriting Statement. A representation signed by the borrower regarding the borrower’s prior and current health condition.

Unearned (Gross) Premium. The portion of the original gross premium representing the value of the unexpired insurance. The portion can be determined using a number of methods, including the Rule of 78, Pro Rata, or the Rule of Anticipation.

Uni-Age Premium Rate. A premium rate that is the same for all issue ages.

Uniform Decreasing Term Life Insurance. Term life insurance where the amount of insurance decreases by an equal amount each month during the term of the policy.

Unisex Premium Rate. A premium rate that is the same for both sexes.

Unsecured Credit. Credit extended solely on the borrower’s promise to repay.

Upward Deviation. A premium rate in excess of the state’s prima facie rate.

Variable Reference. An item that is left blank when a policy is filed with a state insurance department, such as maximum term, maximum amount, or maximum age.

Voluntary Termination (of Credit). Repayment of credit prior to the scheduled maturity date.

Waiting Period. See elimination period.

Written Premiums. Gross premiums collected from the insureds on new insurance less the premium refunds paid to those who terminate coverage prior to maturity.
Common Abbreviations

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<tr>
<td>A&amp;H</td>
<td>Accident and Health (Insurance)</td>
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<td>ACV</td>
<td>Actual Cash Value</td>
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<td>APR</td>
<td>Annual Percentage Rate</td>
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<td>Consumer Credit Insurance Association</td>
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<td>CSO</td>
<td>Commissioners Standard Ordinary (Mortality Table)</td>
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<td>CUNA</td>
<td>Credit Union National Association</td>
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<td>F&amp;I</td>
<td>Finance and Insurance</td>
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<td>GAAP</td>
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<td>IBNR</td>
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The publication of a book requires the effort of so many people that it is difficult to express all of the appropriate thanks. Most of all, thanks are due to the people in this industry who continue the traditions of its founders. We provide a worthwhile product that has withstood the test of time and has proven its continued value. This can only occur where the people in the industry strive to produce a quality product on a daily basis. I have always been proud to be a part of this industry and hope this book serves to help train the next generation of credit insurance personnel.

The industry and I owe a special thanks to Robert Steele, a credit insurance general agent at the Robert Steele Agency, Inc. in Brownburg, Indiana and Reuben Darr. At a cocktail party, Bob met Mr. Darr, who mentioned that he had worked with Arthur Morris prior to his retirement. Bob gave Mr. Darr his business card. Several weeks later Mr. Darr showed up at Bob’s office with a box. As it turns out, Mr. Darr had ghost written a paper for Mr. Morris on the origins of credit insurance and had collected early policies and other mementos. He entrusted Bob with the box, and Bob has generously passed the material on to us. Several of the illustrations in this edition came from that collection. The illustration on Page 7 is the front page from the earliest known credit life insurance policy.

About the Author

A 1972 graduate of the University of North Carolina, Gary first worked as a consulting actuary and lecturer at Booke and Company—an actuarial consulting firm primarily known for its seminars on annual statement preparation and taxation. From 1977-83 and 1987-90, he served in various senior management capacities at The Credit Life Insurance Company. From 1984-86, he primarily provided consulting services to the industry through Credit Life’s subsidiary, CLICO Management. From 1982-88 he owned and operated a successful Arizona reinsurance company. He now operates Credit Reassurance Corporation, Ltd., a Nevis reinsurer.

Gary has been involved in all areas of credit insurance operations, with particular emphasis on measurement of loss experience, producer-owned reinsurance, acquisitions and the development of various training programs. He also has extensive experience in providing expert testimony, testifying at regulatory hearings, and serving as an arbitrator.

As a well-known writer and lecturer, he is recognized as an industry leader. He has served on numerous industry advisory committees, including work for the NAIC and the states of Ohio, Pennsylvania, and Rhode Island. He has served on both the Actuarial Committee and the Board of Directors of the CCIA.
About CREDITRE

CREDITRE is a managing general underwriter of debt protection products (debt cancellation contracts and debt suspension agreements) and an actuarial, accounting, and management consulting firm for all credit protection products. We serve financial institutions, insurers, producers, and producer-owned reinsurers underwriting debt protection products, GAP, and credit-related insurance.

Our goal is to provide services that enhance the availability of credit-related protection products. The central focus is providing assistance and training to the home office staffs of the insurers offering and administering these products. In addition, we assist the producers through direct advice to the producers and management services to producer-owned reinsurance companies.

Publications

These other books are all available as free downloads from our website www.creditre.net.

*Credit-Related Property and Casualty Insurance. (1997)* This 280-page hardback book co-authored with Joe Fairchild is the definitive text for the property and casualty products marketed in conjunction with credit transactions. Its topics cover all aspects of the various products, including disability and involuntary unemployment insurance, credit property insurance, creditor-placed insurance, non-file insurance, GAP, and other coverages.

*A Study Guide for Credit Life and Disability Insurance. (1991)* This 192-page workbook accompanies the text of *Credit Life and Disability Insurance*. Each section has a list of key words, a text outline, examples of calculations, and review questions.

*Money on the Table. (1993)* This 260-page hardback book co-authored with Steve Mailho provides an objective description and evaluation of compensation in the automobile dealer market segment. It is an excellent source of information about producer-owned reinsurance programs for all market segments.

*Credit Life and Disability Insurance. (1986)* This 576-page hardback book is the definitive textbook for the industry. Its topics cover all aspects of the products that are sold and describe the home office operations relating to the products.