

New Statutory Valuation Standards for Credit Life and Disability

Chris Hause, FSA, MAAA

The logo for HAUSE features the word "HAUSE" in a bold, white, sans-serif font. The text is centered within a dark green, irregular, brush-stroke-like shape that has a textured, hand-drawn appearance.

HAUSE

Actuarial Solutions

Credit Disability

- ◆ Unearned Premiums were the only measure
- ◆ Rule of 78 was the minimum
- ◆ Pro-rata was considered too much – benefit decreases
- ◆ Most companies held Mean of R78 and Pro-rata

The 1998 Credit Disability Study

- ◆ Compared actual industry experience to a blended 1985 CIDA
 - Male – Female
 - Four occupation classes
- ◆ Found reasonable margin overall
- ◆ Some anomalies existed, due to market

NAIC Adoption of the 1985 CIDA

- ◆ Uses 112% of table
- ◆ 14-day table used for 30-day waiting periods – due to anomaly
- ◆ Blended table is used due to lack of data
- ◆ Gross unearned requirement in Model A&H Valuation Reg. is removed

NAIC Adoption (Cont.)

- ◆ SSAP 59 also changed
 - Allows for morbidity-based reserves
 - Consistency with Appendix A-010 (mirrors Model A&H Valuation Regulation)
- ◆ SSAP 59 still requires aggregate credit reserves to be at least the net refund liability (after recoverable commissions)

State Adoption

- ◆ State-by-state basis
- ◆ Most states do not have specific standards
- ◆ Revert to APP Manual
- ◆ Then to NAIC model

Implementation of 1985 CIDA

- ◆ New procedures are necessary
- ◆ SOA Fortran diskette is of limited use
- ◆ Blended table
- ◆ Daily functions
- ◆ Interest in C, M and R values
- ◆ Advancing age
- ◆ Discount to valuation date

Credit Life

- ◆ 1958 CET was the standard
- ◆ Some companies held by state of issue
- ◆ Some companies held by state of domicile
- ◆ Made “state of filing” language dicey

The 1998 Credit Life Study

- ◆ Compared actual industry experience to 2001 CSO Male Composite Ultimate
- ◆ Compared to tables in use
- ◆ Found absurd margin in current tables
- ◆ Reasonable margin in 2001 table
- ◆ Made recommendation to NAIC

NAIC Adoption of the 2001 Table

- ◆ Uses male for all insured lives
- ◆ Uses the older age for joint coverage
- ◆ Dynamic valuation interest rates
- ◆ CRVM is method, but inapplicable to Single Premium
- ◆ Applies to all Credit life
 - MOB is unearned mortality cost

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- ◆ Most states do not have specific standards
- ◆ Revert to NAIC model

Banks as Distribution Channels for Protection Products

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Actuarial Solutions

Credit Insurance Products

- ◆ Life
- ◆ Disability
- ◆ Involuntary Unemployment
- ◆ Property
 - Personal property
 - Blanket
 - Creditor-placed

Life Benefits

- ◆ Cancellation
- ◆ All Causes Only

Disability Benefits

- ◆ Cancellation of Monthly Payment
- ◆ All Causes Only
- ◆ Pre-ex of “6 and 6” is common
- ◆ “Critical period” on longer term notes

Involuntary Unemployment Benefits

- ◆ Cancellation of Monthly Payment
- ◆ Initial eligibility waiting period is common
- ◆ “Critical period” only
 - Fixed period
 - Depends on loan term

Credit Personal Property

- ◆ Actual cash value up to outstanding loan amount
- ◆ Fire and Extended Coverage
- ◆ Pays some risks that homeowners excludes

Creditor-Placed Property

- ◆ Also called “Forced-Place”
- ◆ Used only on large items, such as home or automobile

GAP Coverage

- ◆ Actual cash value is paid by primary insurance
- ◆ Difference between ACV and outstanding loan amount is the GAP
- ◆ Primarily sold through auto dealers

Debt Protection Products

- ◆ Life
- ◆ Disability
- ◆ Involuntary Unemployment
- ◆ Marriage
- ◆ Divorce
- ◆ Hospitalization

The Products (continued)

- ◆ Long Term Care Confinement
- ◆ College Enrollment
- ◆ Birth or Adoption
- ◆ Leave of Absence
- ◆ You Name It...

Life Benefits

- ◆ Cancellation
- ◆ Finance Charges
- ◆ Monthly Payment
- ◆ All Causes or Accident Only

Non-Life Benefits

- ◆ Waiver of Payment (Finance Charges Accrue)
- ◆ Finance Charges
- ◆ Minimum Monthly Payment
- ◆ Cancellation after specified duration
 - X months' disability or confinement
- ◆ Cancellation on Total and Permanent
- ◆ Waiver of Debt Protection Premiums

Benefit Limitations

- ◆ Specified benefit period
- ◆ Maximum Monthly Benefit
- ◆ Maximum Total Benefit
- ◆ Accident Only
- ◆ Pre-Existing Exclusions
- ◆ Eligibility Waiting Periods

Benefit Limitations

- ◆ Benefit Waiting Periods
- ◆ Age Limitations

Underwriting

- ◆ How much is allowed?
- ◆ If no underwriting, how does that affect benefits?
 - Accident Only
 - AO above a certain age
 - Use of waiting, eligibility periods more important

Benefit Cost Calculations

- ◆ Credit Insurance Experience
 - SOA Mortality
 - CCIA Disability
 - Credit Insurance Experience Exhibit
- ◆ Bureau of Labor Statistics
- ◆ Statistical Abstract of United States
- ◆ Geographical Variations Studies

Claim Cost Calculation

- ◆ For new or unusual benefits, remember:
 - Incidence
 - Severity
 - Variance
- ◆ Use the data you can gather to develop tables you can utilize
 - Unemployment incidence and continuance, for example

Adjusting the Results

- ◆ Smooth out “bumps”
- ◆ Other anomalies noticed, eradicated
- ◆ Collect into central ages
- ◆ Collect into specified terms
- ◆ Combine all data into one matrix

Rate Schedules

- ◆ Outstanding Balance
- ◆ Issue Age OB
- ◆ Level Premium OB / Percent of Payment
- ◆ Single Premium
- ◆ Traditional Credit Insurance Rate Schedule
- ◆ By age, gender or aggregate

Final Pricing

- ◆ “Cost Plus”
- ◆ Loss Ratio
- ◆ Competitive Analysis


Rating Tools

- ◆ Spreadsheets
- ◆ Customized Programs
- ◆ Competitive Position

Special Market Considerations

- ◆ Over-age market
- ◆ Industry-oriented groups
 - Bank “Clubs”
 - Credit Unions
 - Small market dominated by a single industry

Implementing the Results

- ◆ Rate system must balance equity with simplicity
 - ◆ Limitations of existing computer systems
 - ◆ Third Party administrators for claim development
 - ◆ Use of CLP's for risk management
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Additional Thoughts

- ◆ Institutions become “retailers” and buy from the best “wholesalers”
- ◆ This new market calls for discipline in pricing, compensation, competition
- ◆ Consumerists hate us...again

Debt Cancellation – To Date

- ◆ Credit card issuers
- ◆ Mortgage
- ◆ Installment???
- ◆ Home Equity

What About Installment?

- ◆ Law created the opportunity
- ◆ Regulation killed it
 - Monthly alternative


State Insurance Department Approach

- ◆ History of regulation at the transaction level
- ◆ Specific list of what an insurer can do
- ◆ May not allow things not on the list
- ◆ Long list of what an insurer cannot do
- ◆ Regulation at the detail level

General Regulatory Philosophy – DCC

- ◆ OCC Regulations address major issues
- ◆ Focus on:
 - Consumer protection through disclosure
 - Safety and soundness
- ◆ Commentary expands on rationale
- ◆ Examiners have broad power to investigate specific issues

Significant Features

- ◆ Codifies position as banking product
 - ◆ Establishes consumer safeguards
 - ◆ Harmonizes consumer protections with other federal laws and regulations
 - ◆ Standard disclosures that accommodate widely-used methods of marketing
 - ◆ Require appropriate risk management
- 

§37.5 Method of Payment

Monthly or Single Fee

- ◆ Monthly fees generally
- ◆ Single fee only if:
 - Not real estate secured loan
 - Bona fide option of paying monthly
 - Disclose refund rules

Comments:

Bona fide option: not deliberately priced to deter consumer from selecting that option.

§37.8 Safety and Soundness Requirements

Bank must establish and maintain effective risk management and control processes.

DCC Implementation – The Upside

- ◆ Debt cancellation has had better participation than SP credit insurance
- ◆ Roll-out of debt cancellation can and has actually helped credit insurance sales

DCC Implementation – The Downside

- ◆ Systems issues can delay implementation
- ◆ Too many product variations at point of sale can confuse staff and lead to lower participation
- ◆ “Full coverage” product can have too high a cost

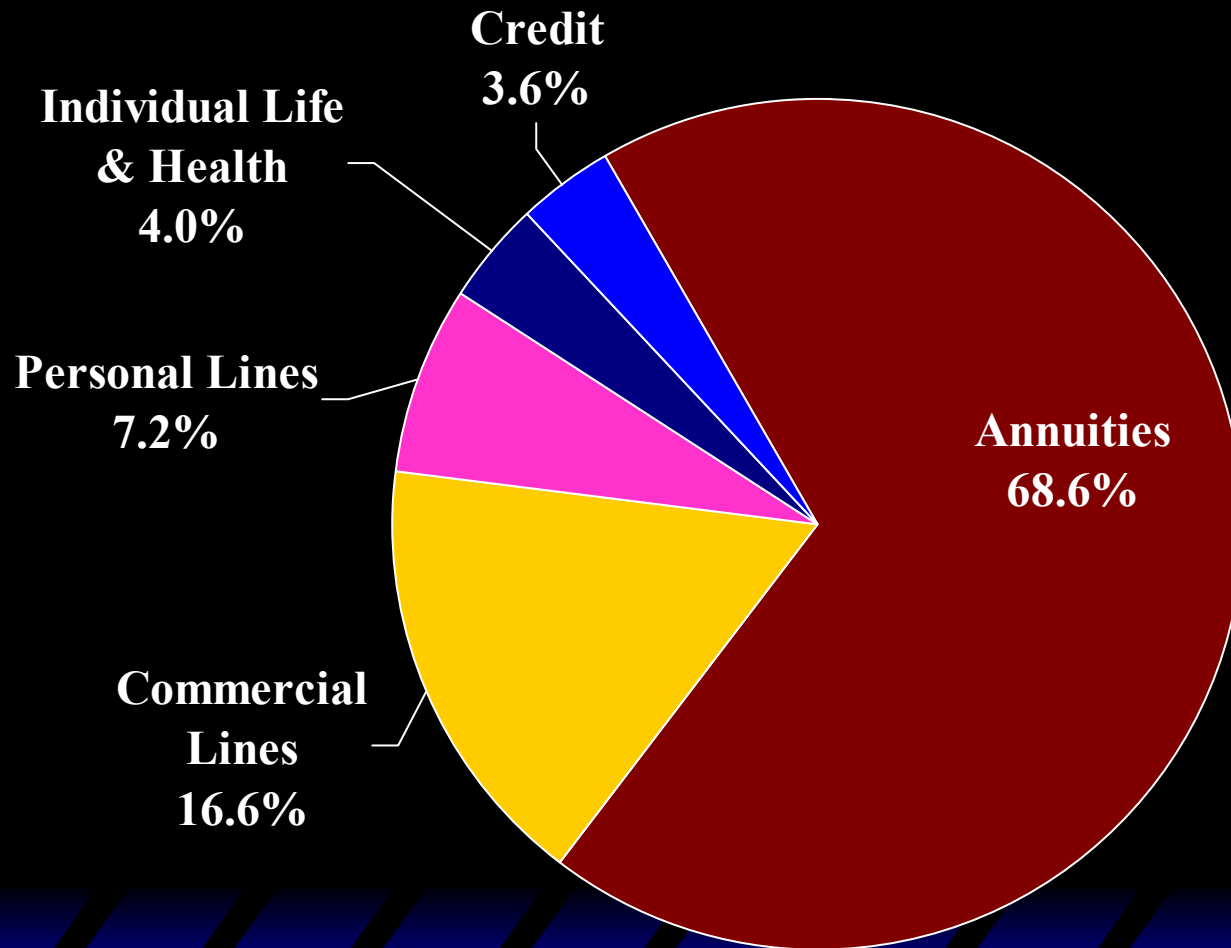
Points to Remember

- ◆ Insurance sales, including debt cancellation, requires commitment
- ◆ Insurance sales requires training
- ◆ Insurance sales requires monitoring and flexibility

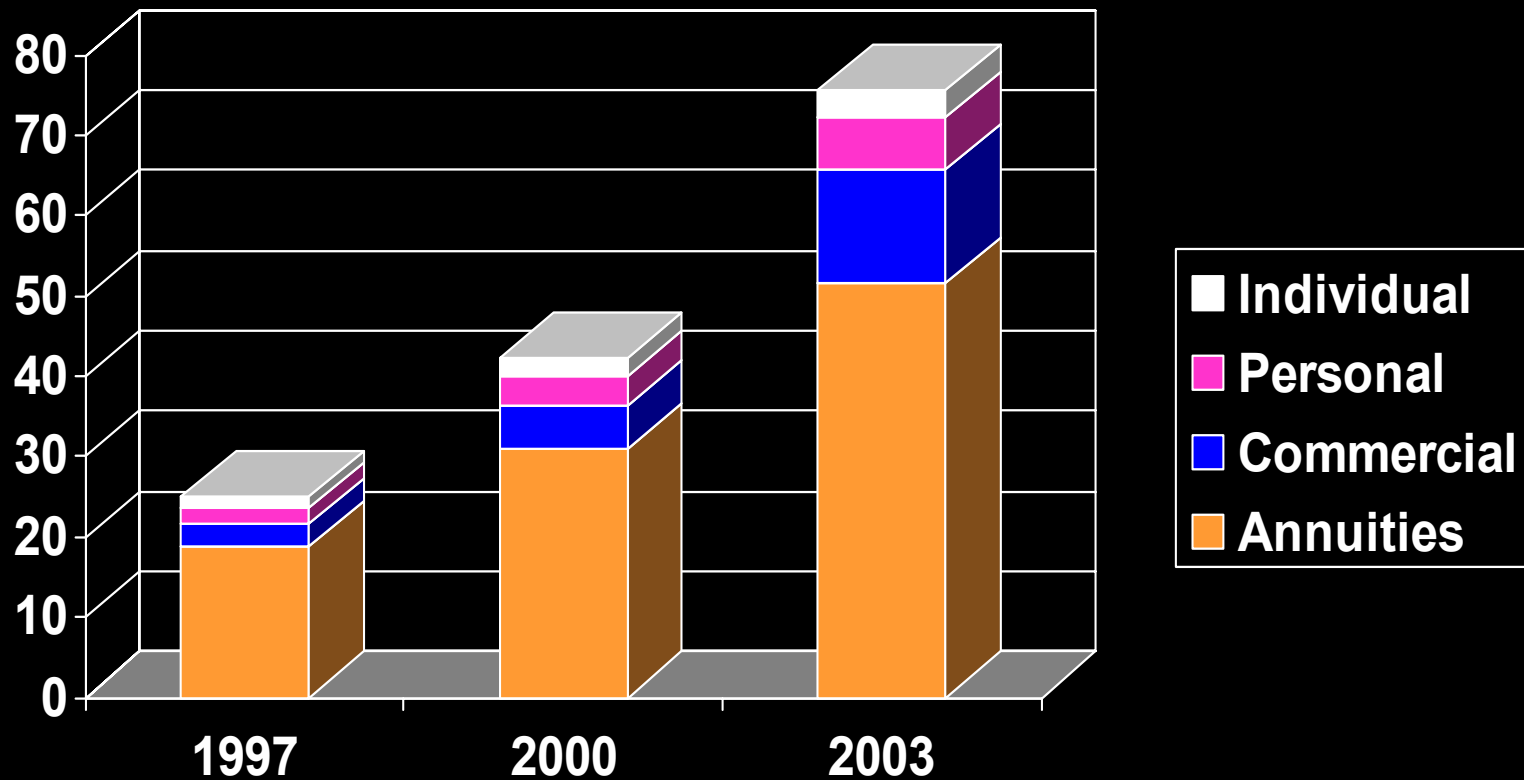
Sales Powers Increased

- ◆ Individual life & health insurance
- ◆ Annuities
- ◆ Personal lines
- ◆ Commercial lines

Bank-Insurance Premiums Composition




Non-Credit Bank Insurance Premiums by Year (\$B)



Regulation of Insurance

- ◆ National banks' affiliates may sell insurance to anyone from any place
- ◆ States still regulate insurance underwriters
- ◆ But, debt cancellation is not “insurance”

How a Bank Can Sell

- ◆ Acquisition of carrier
 - ◆ Acquisition of distributor
 - ◆ Joint venture with distributor
 - ◆ Hire representatives
 - ◆ Retrain employees
- 

Personal Lines Models

- ◆ **Broker – Startup versus Established**
 - Speed to market, Fee Based income
 - Licensing Issues, Credit Risk
- ◆ **Underwriter and Broker**
 - Additional Income, Formalized Assumption of Credit Risk
 - Risk is assumed, Catastrophe Risk must be managed
- ◆ **Full Service**
 - Offer competitive rates, control customer experience
 - Company Licensing, Claims Administrator, Highest Expense Model

Case Study – Attempt #1

- ◆ Bank contracted with a nationally known P&C company to offer Auto and Homeowner's Insurance in Branch offices.
- ◆ Local Agents were placed in the branches, and Bank received a small fee for business written.
- ◆ Not successful
 - Only having one underwriter available damaged customer relationships when the applicant was rejected.
 - There was no solid referral process.
 - The sales process was not optimized.

Case Study – Attempt #2

- ◆ **Bank recognized the problems from attempt #1, and decided to develop a licensed call center.**
- ◆ **Several insurers were approached to offer auto (and homeowner's policies).**
- ◆ **Loan Associates were instructed to offer the Bank's Insurance option when underwriting auto loans.**
- ◆ **Issues:**
 - High startup costs
 - 50 state licensing for call center agents
 - Difficult to find A-rated insurers in larger states (FL)
 - Privacy Regulation controls ability to share data
 - Strong leadership and commitment needed

BHC Owning Insurers

- ◆ Citicorp – Travelers
 - Major impetus for GLB
 - Is coming unraveled
- ◆ No major trend – why?
 - ROE differential
 - No operational efficiencies

Failure to Reach “Middle America”

- ◆ Cultural differences
 - Non-standard
 - Delay in delivery
 - Sales versus service
 - High maintenance
- ◆ Customer behavior

Bank Customer Behavior

- ◆ Drive-through banking
- ◆ ATM's
- ◆ Neighborhood (decentralized) branches
- ◆ Stay out of our lobby!

Consumer Privacy and Protection

- ◆ GLB
 - Anti-tying
 - Disclosure
- ◆ HIPAA
- ◆ “Do Not Call”

Where are We Headed?

- ◆ Banks will distribute and not underwrite insurance
- ◆ Insurance products will become more “bank friendly” – but the middle market will remain underserved
- ◆ Debt cancellation will replace credit insurance (long-term)