AN INTRODUCTION TO
CREDIT INSURANCE

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What is Credit Insurance?

Credit insurance is an umbrella term that refers to insurance products offered by or through a lender in conjunction with some form of consumer credit. The lender may be a bank, credit union, seller of goods, or a lending company offering consumer credit in the form of a non-mortgage loan or financing to buy a good.

The purpose of credit insurance is to offer the borrower protection against defaulting on the loan, sometimes by covering payments for a period and in other cases by paying off the balance of the loan. If the consumer can't pay back the lender because of one of several specific events, then the consumer contacts the insurer who in turn will make payments to the lender. Instances when a credit insurance claim can be made:

- If a borrower dies, then a *credit life insurance policy* will pay some or all of the remaining debt.
- If a borrower becomes unable to work due to a disability, then *credit accident and health insurance* will make monthly payments to service the debt. Credit accident and health is sometimes called *credit disability insurance*.
- If the borrower loses his or her job for a reason outside of job performance, then *credit involuntary unemployment insurance* will make monthly payments on the loan.
- If a piece of collateral is lost or damaged, then *credit property insurance* pays to replace the item.

The policies can provide cancellation benefits, where a claim triggers the full repayment of the outstanding debit, or it can offer suspension benefits, where loan payments are not due and do not accrue interest for a period of time. In a declining benefit policy, the amount of the benefit declines with each payment on the associated loan. At the time of a claim event, the benefit is the total of the remaining payments.

When Does a Consumer Buy a Credit Insurance Policy?

When a consumer receives a loan or obtains financing for the purchase of a good, the credit insurance is oftentimes "bought" along with the disbursement of the loan. However, the borrower doesn't actually pay the cost of the premium out of pocket; instead, the lender adds the cost of the premium to the amount of the loan.[1] This increases the amount financed so that the borrower accrues interest on the amount of the loan *plus* the cost of the credit insurance premium(s).

The choice of policy provider is rarely left up to the consumer. With very few exceptions, the insurer has an exclusive contract with the lender. Consumers

1 News Release, National Association of Insurance Commissioners, Credit Insurance: Safety Net or No Net Gain? (November 2008) (*available at* http://www.naic.org/documents/consumer_alert_credit_insurance.htm).

lack for the benefit of a meaningful choice. The lack of choice has an implication for pricing. While a consumer would want to find the lowest priced insurance policy, the lender makes the choice of insurer. Given free rein over policy choice, the lender acts in its own interest. The lender's motivation is thus driven by the value of the commission paid by the insurer. A further benefit to the lender is that the additional cost translates into a higher loan principal and thus into additional interest revenue.

What are Some Concerns About Credit Insurance?

Commissions paid to the lender by the insurance company can inflate the cost to the consumer. The difference is one of degree; while most insurance products are sold with a modest commission (less than ten percent of the premium), credit insurance commissions can be equivalent to as much as half of the overall cost of the policy.

Credit insurance could be interpreted as being more beneficial to the lender than it is for the consumer. In states that collect the data, the sale of insurance products is more than double the number of loans originated, indicating that a single loan can be often stacked with multiple insurance products.[2] Lenders make tremendous revenue off these products while the cost to the borrower out-weighs the products' benefits. Also indicative of these products' purpose as a revenue generating tool is their state-by-state presence: installment lenders tack these credit insurance products onto loans in states that have lower statutory caps on interest, but not in states that allow for higher interest rates.[3]

In extreme cases, consumers may receive no benefit at all from a credit insurance policy. Consumers who receive Social Security benefits are receiving a guaranteed income. As such, they should never buy policies that protect against the loss of income. Similarly, consumers should only buy policies when they are able to make a claim. Thus, consumers with pre-existing medical conditions which would otherwise exclude them from eligibility for making a claim should not be sold credit health or credit life insurance policies.

But even in normal instances, consumers usually do not get their money's worth from these policies. On a dollar-per-dollar basis, claims paid on credit insurance policies fall far below those related to other insurances.

2 N.C. Commissioner of Banks, Consumer Finance Annual Report (2012), *available at* http://www.nccob.gov/public/docs/News/Pub%20And%20Research/2012_Consumer_Finance_Annual_Report.pdf (showing more than 1 million insurance products sold in connection with just over 489,000 loans made in 2012).

3 Paul Kiel, *When Lenders Sue, Quick Cash Can Turn into a Lifetime of Debt*, ProPublica (Dec. 13, 2013), http://www.propublica.org/article/when-lenders-sue-quick-cash-can-turn-into-a-lifetime-of-debt.