NORTH CAROLINA CENTER FOR
PUBLIC POLICY RESEARCH INC.

NEWS RELEASE

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N.C. CENTER FOR PUBLIC POLICY RESEARCH SAYS REFORM NEEDED IN CREDIT INSURANCE

The N.C. Center for Public Policy Research says the state's system of regulating credit insurance is badly in need of reform. "Among the 50 states, North Carolina ranks last in the portion of credit insurance premiums used to pay off policy claims," says Bill Finger, editor of the Center's magazine and author of the research. "In other words," adds Finger, "North Carolinians get less for their credit insurance dollar than do people in any other state."

Finger's research is contained in an article in North Carolina Insight, the quarterly magazine of the N.C. Center for Public Policy Research. The Center points out that North Carolina is one of only nine states that set credit insurance rates by statute. The Commissioner of Insurance used to have this power, but the General Assembly took it away in 1975 during the stormy reign of Commissioner John R. Ingram (1973-85). State statutes now set the maximum rate at 80 cents per $100 of credit life insurance per year.

The maximum rate allowed by statute is generally the going rate. "The majority of credit (life insurance) business is written at 80 cents, the statutory rate," says Dan Boney, senior vice president of Durham Life Insurance Company.

The credit insurance system involves a complex relationship among consumers, the insurance industry, and lending institutions (banks, auto dealers, small loan companies, and merchants). A consumer buys credit insurance from a lender as part of a car loan or an installment purchase of home appliances or furniture. The lender sells the credit insurance policy for an insurance company, functioning like an insurance agent. For making this sale, the lender receives about 50 percent of the premium price as a commission. This commission system results in credit insurance rates being set at the maximum rates allowed by law.

Because lenders make a commission of some 50 percent on every policy, they have a tremendous incentive to sell credit insurance. And the more expensive the policy they can sell, the more money they make on commissions. Consequently, insurance companies compete to offer the most expensive policies to lenders. The National Consumer Law Center and others call this process "reverse competition."

"Normal free-market competition results in lower prices," says Finger. "The credit insurance commission system results in higher prices."

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With such an incentive to sell credit insurance, lenders may try to "tie" the purchase of credit insurance to the approval of a car loan or an installment sale. Despite the protections of federal and state laws, James C. Gulick, director of the state's Consumer Protection Section in the Attorney General's Office, says, "There appears to be some illegal coercion to buy credit insurance in North Carolina. Based on the complaints we have received, such illegal coercion is a live problem."

Proponents of credit insurance say it benefits both the purchasers and society at large. Joel Huber, associate professor at Duke University's Fuqua School of Business presents this viewpoint in a separate article in Insight. "Credit insurance provides protection for both the consumer and his family against the financial hardship that could result from default on a loan due to death or disability," says Huber. Credit insurance also simplifies the credit process by allowing consumers to buy insurance at the time of purchase. Huber has personally conducted four studies of consumers' attitudes toward credit insurance, including one for Montgomery Ward department stores.

Critics of the system want to return the power to regulate credit insurance to the insurance commissioner. Rep. Harry Payne (D-New Hanover) presents this position in a companion article in Insight. "The General Assembly does not set the price of any other kind of insurance. Why should it set the price of credit insurance?" asks Payne.

The Center recommends that the legislature take one of three actions to address the current rate structure in North Carolina:

(1) The legislature could lower the rates in the statutes. Both Tennessee and South Carolina lowered their rates this year. Tennessee Commissioner of Commerce and Insurance John Neff, a Republican, asserts, "Credit insurance is the biggest known ripoff since the beginning of time. There was no reason why Tennessee citizens should be charged a price by the legislature that rips off the public. We pointed out to the public that we had a 32 percent loss ratio in this state (for credit insurance). Under auto and homeowners, the loss ratio was about 65 percent or higher. And health insurance can run up as high as 90 percent."

North Carolina's situation is even worse than that of Tennessee before Tennessee lowered its rates. Companies in North Carolina pay out an average of only 29.67 cents in claims and related expenses for every dollar of premiums earned on credit insurance policies. This "loss ratio" is the worst in the nation for consumers.

(2) The legislature could transfer regulatory authority back to the Commissioner of Insurance. Both Rep. Payne and present Commissioner of Insurance Jim Long favor this option.

"I think credit insurance will be a very significant issue by the 1987 session of the General Assembly," says Long. "The loss ratio is so low because of the reverse competition involved in the commission system. The rate structure definitely needs to be addressed."

(3) The legislature could give the Banking Commission or Insurance Commissioner the authority to require competitive bidding through administrative rules. In Massachusetts, Banking Department rules require state-chartered banks to seek at least three bids from insurance companies and to accept the lowest qualified bid. Under this system, free-market competition in credit insurance is increased. The result has been a reduction in rates by more than 40 percent.