**Comments of the Center for Economic Justice**

**On Proposed Texas Credit Life and Disability Rates and Regulations**

**December 20, 2004**

The proposed prima facie rates are demonstrably excessive and do not satisfy the statutory requirement that credit insurance premiums be reasonable in relation to benefits provided. The loss ratios that underlie the proposed prima facie rates, that trigger upward deviations and that are proposed as a standard of reasonableness of premiums in relation are far too low to satisfy statutory standards.

The loss ratios fail the basic test of common sense reasonableness. A credit insurance policy that is expected to pay out only 41 cents on each dollar of premium paid is simply not reasonable to consumers. Were insurers and agents required to disclose the amount of expected benefits and the amount of producer compensation associated with a credit insurance policy, consumers would simply not purchase such low-benefit products. The abusive sale of credit insurance is fostered by a lack of disclosure by agents and insurers and poor insurance regulation of the type proposed by Milliman and staff.

The proposed rates and deviation standards are abusive to consumers. These abusive proposed rates are a result of a gravely flawed actuarial analysis by Milliman that fails to understand the reverse competitive nature of credit insurance markets and, consequently, applies a component rating analysis which never considers the reasonableness of the actual historical experience values of the various non-claim rate components.

Our comments are summarized as follows:

1. Rates must be established at 1/1.3 of reasonable prima facie rates.
2. The proposed prima facie rates are excessive because the following components are excessive:
   a. The profit provision is grossly excessive and not based on any analysis of actual historical investment gains.
   b. The general expense provision is excessive because of an arbitrary decision by Milliman to discount the most recent actual expense experience.
3. Rates must be developed separately for Class E versus all other Classes and further developed separately for single premium and MOB products.
4. The minimum loss ratios to trigger an upward rate deviation should be established at 60%.
5. The joint life multiplier should be reduced to 125%. The Milliman proposal provides no analysis for its recommendation.
6. The definition of average lives is unclear

## 1. Relevant Statutory Provisions

We cite the following Texas credit insurance statutory provisions as references for our comments.

*Sec. 1153.053. DISAPPROVAL OF FORM. (a) Not later than the 60th day after the date an insurer files a form under Section 1153.051, the commissioner shall disapprove the form if:*
***(1) the benefits provided are not reasonable in relation to the premium charge; or***
***(2) the form contains a provision that:***
***(A) is unjust, unfair, inequitable, misleading, or deceptive;***
***(B) encourages misrepresentation of the coverage; or***
***(C) is contrary to this code or a rule adopted under this code.***

*Sec. 1153.103. PRESUMPTIVE PREMIUM RATE.*
*(a) After notice and a hearing, the commissioner by rule may adopt a presumptive premium rate for various classes of business and terms of coverage. An insurer that does not file a different rate under Section 1153.105 or 1153.106 shall file the presumptive rate adopted by the commissioner.*
*(b) Except as provided by this chapter, any hearing conducted or order adopting a presumptive rate under this subchapter shall be held in accordance with the rulemaking provisions of Chapter 2001, Government Code.*
*(c) In the commissioner's order adopting a presumptive rate, the commissioner shall set forth findings and conclusions on all material issues presented at the hearing.*
*(d) In determining the presumptive premium rate, the commissioner shall consider any relevant data, including* ***reasonable*** *acquisition costs, loss ratios, administrative expenses, reserves, loss settlement expenses, the type or class of business, the duration of various credit transactions, and reasonable and adequate profits to the insurers.*
*(e) In determining the presumptive premium rate, the commissioner may not set or limit the amount of compensation actually paid by a company to an agent but may request from an insurer or agent any relevant data relating to the presumptive premium rate, including information relating to compensation paid for the sale of credit insurance, expenses, losses, and profits. An insurer or agent shall provide the requested information to the commissioner in a timely manner.*
***(f) The commissioner may not adopt a presumptive premium rate that is unjust, unreasonable, inadequate, confiscatory, or excessive to the insureds, the insurers, or the agents.***

## 2. The prima facie rates must be set at 1/1.30 of the reasonable rates to harmonize the various provisions and requirements of the credit insurance statute.

### 2.1 Reverse Competition

We have previously explained how credit insurance markets – in Texas and other states – are characterized by reverse competition. The gist of reverse competition is that competition among credit insurers to sell group policies to lenders – upon whom credit insurers depend for the sale of credit insurance to the ultimate borrower / consumer – drives up credit insurance expenses and lender / producer compensation. A credit insurer that wanted to charge a rate of, say, $1.00 would lose business to other credit insurers who charged a rate of $1.30. This occurs because the lenders will choose the insurer with the higher rate which, in turn, producers greater lender compensation. We are submitting for the record our 2002 statement, which describes the nature and operation of reverse competition in great detail.

The latest demonstration of the harm caused to consumers from reverse competition in credit insurance markets is the experience resulting from the file and use 30% deviations from HB 2159. We are submitting for the record the deviation filings of credit insurers following the enactment of HB 2159. The filings show that every non-credit union credit insurer filed for the maximum 30% upward deviation – regardless of the credit insurers claim experience. In response to the Department's request for the reason or reasons for the upward 30% deviation filing, the following explanations were common:

> *American Bankers: "The rate increase is needed to offset . . . higher acquisition costs."*
>
> *American General: "Our experience suggests that the higher rates are needed to remain competitive in this Texas insurance marketplace.*

These explanations reveal reverse competition. Every credit insurer took the 30% deviation to charge the highest possible rate because lenders demanded more compensation ("higher acquisition costs" for the credit insurer). A credit insurer that sought to charge a lower, more-reasonable-to-the-consumer rate would not be "competitive in this Texas insurance marketplace."

Explanations <u>not</u> found in the insurers' responses are a need to raise rates because of higher-than-expected claim costs. The HB 2159 deviations are conclusive evidence that market forces in credit insurance markets do not protect consumers and, instead, lead to prices that do not meet the statutory requirement that benefits be reasonable in relation to premium. The file and use deviation provision HB 2159 was a $120 million windfall to credit insurers and lenders at the expense of the most vulnerable consumers who are the target of credit insurance sales.

2.2 Set Prima Facie Rates at 1 / 1.3 of the Reasonable Rate.

The existence of reverse competition in Texas insurance markets – as repeatedly demonstrated over the years in a variety of ways in addition to the 30% upward deviation filings by all insurers – means that whatever the Commissioner establishes as the prima facie rate, the *de facto* prima facie rate is 30% higher. If the commissioner sets the prima facie rate at, say, $1.00, the Commissioner is really setting a prima facie rate of $1.30 because of the file and use deviation provision.

However, the addition of the file and use deviation provision of up to 30% did not change the general rate requirement that benefits be reasonable in relation to premium or that the Commissioner may not adopt a presumptive premium rate that is unjust, unreasonable, inadequate, confiscatory, or excessive to the insureds, the insurers, or the agents.

Let us assume, for the sake of illustration, that the reasonable loss ratio and associated prima facie rate for a particular class and plan of business are 50% and $1.00, respectively. If the Commissioner establishes the prima facie rate at $1.00, then the rate actually charged by all insurers without prior approval will be $1.30 and will produce a loss ratio of 50/130 or 38.5%. Consequently, by establishing the prima facie rate at the amount and loss ratio that satisfy the reasonableness standard, the Commissioner is actually establishing a rate and loss ratio that do not meet the reasonableness standard because the Commissioner knows – because of reverse competition – that all insurers will charge 130% of the prima facie rate.

Stated differently, because of reverse competition and the file and use 30% deviation provision, establishing the prima face rate at a level that meets the basic reasonableness test will create significantly excessive rates that do not meet the basic reasonableness test.

Setting the prima face rate at a level that meets the reasonableness test fails to satisfy the statutory requirements for credit insurance because the rates will clearly be unfair to insureds.

**The only way for the Commissioner to harmonize the various provisions of the credit insurance statute to produce fair, reasonable, not excessive and not inadequate rates is to establish prima facie rates at 1/1.30 of the reasonable rates by class and plan of business.**

While setting prima facie rates at the level of reasonable rates clearly produces excessive rates and rates that are unfair to insureds, setting prima facie rates at 1/1.30 of reasonable rates is fair to consumers, insurers and agents. By definition, the rate the Commissioner deems reasonable is fair to consumers, insurers and agents. By establishing the prima facie rate at 1/1.30 of the reasonable rate, the Commissioner is actually establishing the reasonable rate as the maximum rate that can be used without prior approval because all insurers will file the 30% deviation.

For example, let us continue to assume that the reasonable rate for a particular class and plan of business is $1.00, based upon a 50% loss ratio as the measure of reasonable benefits in relation to premium. If the Commissioner establishes the prima facie rate at 1/1.3 of $1.00, or $0.77, then every insurer can – and will – file for a 30% deviation to allow them to use a rate of 1.3 * $0.77, or $1.00, without prior approval. This is fair to insurers and agents because the Commissioner has determined that a rate of $1.00 is fair to insurers and agents. And it is fair to consumers because it sets the maximum rate at the reasonable rate and not 30% higher.

## 2.3 The Milliman Analysis and Discussion is Inaccurate and Inadequate

The discussion of these issues in the Milliman was inaccurate and inadequate. Regarding reverse competition, the Milliman discussion consists of the following:

"One way to minimize reverse competition is to impose a cap on compensation. Texas law specifically prohibits this."

Milliman's failure to either understand or recognize the importance of reverse competition in evaluating the reasonableness of actual historical non-claim experience discredits their entire analysis. Reverse competition inflates insurer expenses and well as commissions. And the way to minimize reverse competition is to establish overall rates that include reasonable and not excessive components and to establish rates by class and plan of business so that low-claim classes of business cannot take advantage of a rate that is based on aggregate loss experience.

Further, Milliman dismisses the 1/1.30 proposal as "inconsistent with the intent of the law." The fact is that Milliman's proposals do not comply with actuarial standards. Milliman's proposals will produce rates that demonstrably excessive. By ignoring reverse competition and fact that all non-credit union insurers will file and use rates of 130% of prima facie rate, Milliman has engaged in a robotic process that ignores every fact that would is contrary to the insurer and agent interest.

Milliman has also proposed rates that fail to meet the statutory rate standards. The proposed loss ratios are too low to provide benefits reasonable in relation to premium and are unfair to insureds.

## 3. Milliman Erred on Profit and Expense Provisions

### 3.1 Profit Provision

Milliman proposes, and the proposed prima facie rates and reasonable loss ratios reflect, a profit provision of 5.75%. This is increase of 7.75% percentage points from the -2.0% provision in the 2000 rate order. While Milliman discounts recent expense experience because it is significantly lower than older expense experience, Milliman does not even discuss the fact that its profit provision is a massive increase from the 2000 order.

Milliman's profit provision is overstated because Milliman dismisses, without any analysis, the impact of investment income. Actual historical data show that investment income exceeds 15% of premium for credit life and disability insurance. Yet, Milliman calls this "negligible." Milliman also dismisses consideration of investment income by claiming any investment income is already reflected in the single premium discount provision. There is no analysis to support this claim, despite the fact that that the 2000 order and proceedings established that a profit provision of -2.0% still left enough unaccounted-for investment income to cover the single premium discount.

The Milliman profit provision should be rejected because there is no data or analysis to support it and because actual historical data demand a much lower profit provision.

Finally, any argument that so-called "surplus strain" associated with single premium credit insurance products demands a higher profit provision must be rejected. Insurers and lenders should not be rewarded for choosing to offer only the single premium product that is so unfavorable to many consumers.

### 3.2 Expense Provision

The most recent expense experience was rejected by Milliman and staff with the following explanation:

*Because the general insurance expense component of the formula should reflect a trend over the past and current studies, this component was determined by using a weighted average expense ratio, applying a 25% weight to the current study period data and a 75% weight to the prior study period.*

The premise in this statement is clearly incorrect. The purpose of the expense component is to reflect the reasonable general expense costs associated with the delivery and servicing of the policies to be issued when the rates will be effect. There is no goal or actuarial standard defining an expense component as trend.

By giving only 25% weight to the recent expense experience, Milliman not only violated actuarial principles which demand that more current experience be given greater weight, Milliman effectively dismissed the most recent expense experience without explanation. Milliman provided no discussion or explanation why it thought the older expense experience better reflected future expense experience. On its face, Milliman's proposal to give more weight to 1999 and earlier expense experience than to 2000 and later expense experience is wrong because it uses very old experience as a predictor of future experience.

It is logical that expenses should have declined from the 1990s to the 2000s because there has been considerable consolidation in the credit insurance business creating much greater economies of scale in what is essentially a fixed cost business. The two largest credit insurers – American Bankers and American Security merged to form Assurant. And smaller insurers either left the business or were merged into larger insurers. This demonstrable consolidation of the credit insurance industry justifies the use of the more recent expense experience without any use of the older expense experience.

Absent any explanation why the current expense experience is not a good predictor of future expense costs, there is no basis for the Milliman expense proposal.

**4. Rates must be developed separately for Class E versus all other Classes and further developed separately for single premium and MOB products.**

Just as the claims experience for Class E is significantly different than for other classes, the claims experience for single premium and MOB business are significantly different. Consequently, the same logic that dictates separate rates for Class E versus other Classes applies to single premium versus MOB products. That is, plans and classes of business with significantly different claims experience warrant different prima facie rates. Milliman has incorrectly ignored the substantially different claims experience for single premium credit life and MOB credit life.

**5. The minimum loss ratios to trigger an upward rate deviation should be established at 60%.**

While a component rating analysis is part of the overall evaluation of whether rates are reasonable or not, there must be some broader evaluation of the loss ratio to determine if the results of the component rating analysis do, in fact, produce rates with benefits that are reasonable in relation to premium. In the 2000 hearing, the staff's witness did this and explained that rates producing loss ratios less than 50% were not reasonable.

Milliman provided no such overall reasonableness evaluation. Rather, Milliman regurgitated the results of their flawed component rating analysis. By Milliman's logic, even if claims dropped to zero, a component rating analysis would still produce a reasonable rate – an expected loss ratio of 0% could be reasonable. This is clearly absurd.

Worse, Milliman's strict component rating approach will lead to lower and lower loss ratios over time. At every hearing, claim costs have dropped and, with a strict component rating analysis, insurers have incentive to continue to drive claims costs down with stricter underwriting and unfair claims settlement practices and spend greater amounts on expenses. This occurs because Milliman's strict component rating approach rewards such behavior with lower loss ratio standards in each new set of rates.

The NAIC models for credit insurance establish 60% as the baseline for rates producing reasonable benefits in relation to premium. We recommend a minimum loss ratio of 50% for credit life and 60% for credit disability.

**6. The joint life multiplier should be reduced to 125%.**

Milliman notes that the joint life loss ratio is only 143%, but concludes that the 150% joint multiplier remains appropriate – without any analysis or explanation.

Milliman employs a strict component rating analysis to establish single life rates, but somehow when it comes to joint life rates, the component rating analysis is nowhere to be found. This is another example of Milliman departing from its stated procedure when it benefits insurers and agents and harms consumers.

Let's assume that claim costs are 50% of single life rates. That means claim costs per dollar of premium for joint life is 143% of 50 cents or about 72 cents. If we add on the 50 cents of non-claim expenses, we get a multiplier of about 125%. While this is not a precise calculation because some non-claim expenses vary with claim costs, it is clear that a component rating analysis for joint life will produce a significantly lower joint life multiple than 150%.