

Data Analysis and Rate Recommendation
For
Texas Credit Life and Disability
Presumptive Rates

Christopher H. Hause, FSA
Hause Actuarial Solutions, Inc.
July 16, 2004

Preface

The Texas Department of Insurance (TDI) has requested industry input on recommendations for credit life and disability prima facie rates based on Texas law and regulation and the claim and expense data from 2000 through 2002.

TDI provided a Microsoft Excel spreadsheet and a Microsoft Access database that contained the reported data. This data was provided by individual companies and was consistent with the type of data used in previous presumptive rate derivations. My firm performed no independent audit or verification of the data provided, except for general reasonableness, consistency with previous data, and consistency with earlier similar work performed, as noted below.

The Consumer Credit Insurance Association (CCIA) and the Texas Association of Life and Health Insurers (TALHI) have engaged my firm to perform analysis of the data collected by TDI and to produce a presumptive rate consistent with statutory requirements and sound actuarial principles. CCIA is a national trade association and TALHI is a Texas trade association with some common member insurance companies engaged in credit life and credit accident & health insurance business in Texas.

In developing my recommendation, CCIA and TALHI have specifically asked that I:

- 1) Perform an analysis of the 2000-2002 claim and expense information that has been made available and comment on its completeness, accuracy and utility for making a prima facie rate recommendation.
- 2) Make use of other relevant data, including my general knowledge of the credit insurance market, various forms of coverage, deficiencies in reporting of data and other data and considerations that may have an effect on the development of the final rate recommendation.
- 3) Consider the existing rate structure, its soundness and effect on appropriate formulas and factors.
- 4) Develop recommended Life and Disability prima facie rates utilizing the 2000-2002 Texas data and an appropriate component rate formula.
- 5) Develop rates in aggregate across the six sources of business specified by TDI in its production of data.
- 6) Provide derivation and comments on the methods used to derive the values of the various components.

Where possible, I made use of determinations and methods used in the Official Order of the Commissioner of Insurance dated October 29, 1999 ("Order"). A copy is attached for convenience.

During my 20 years of credit insurance experience, I have been involved in research, calculations and testimony involving prima facie rates. In 2002, I was retained by the State of Colorado to develop prima facie rate scales from data similar to the data

provided by TDI. A summary of my education and work experience is attached.

Analysis of Information Provided by TDI

I would like to comment on several aspects of the data as it was presented. Where wide inconsistencies are noted with past or current experience, it does not necessarily mean that there were errors in compilation or submission. There are wide variations in claim and expense experience among carriers. It is also known that there are differences in expense allocation that can have a profound impact on expense ratios among carriers.

With regard to the data:

- 1) Based on the date that I was engaged to prepare this report and the date it was required to be submitted, there was insufficient time to identify and eradicate potential errors and inconsistencies in the expense data. In addition, as in previous data gathered by TDI, some of the data regarding number of in-force policies appeared to be inconsistent.
- 2) The expense component that would be developed from the data provided would be necessarily based on the assumption that the administrative cost per policy is the same in Texas as the average across all states. This may or may not be true, even generally.
- 3) The expense component that would be developed from the data provided would either give equal weight to all Outstanding Balance policies and Single Premium policies in terms of their expense allocation, or be based on an arbitrary allocation. As I am aware of large and significant variations, even among various markets in expense ratios of various credit insurance plans, any assumption as to an allocation of expenses would be based on limited data and questionable assumptions.
- 4) The considerable expense in complying with the 2000 Texas rate change, implementation and filing and would not be reflected. This would understate the true expenses that contribute to both the credit life and credit disability calculation.
- 5) Given the above shortcomings and the need for a timely recommendation, I made a simplifying assumption to develop the expense components as discussed below.
- 6) Based on the date that I was engaged to prepare this report and the date it was required to be submitted, there was insufficient time to verify that the earned premiums were adjusted to prima facie in a consistent fashion. I am aware that many companies have estimated or completely ignored this adjustment in the past due to lack of sufficient computer capabilities. There may be additional uncertainty for Texas business due to the fact that interest discounts are employed for single premium plans, and that statutes allow for permissible deviation around the published rate. The majority of business written during the time period studied was written at the maximum permissible rate. From the relationship between "actual earned premium" and "earned premium at presumptive rates," it is clear that improper adjustment was made to actual earned premiums to derive presumptive earned premiums. To compensate, I used reasonable approximations to adjust the presumptive earned premiums

*build
in
addition
error
checks*

*give
more
time
in
future*

and loss ratios in order to derive the claim cost components.

- 7) In general, three years worth of experience in a state with sufficient volume will generally provide a credible basis for claim costs. Texas has a sufficient volume of business on which to base a rate calculation.

Derivation of the Credit Life Rates

The formula I would generally use in such a recommendation is shown below. In some previous documents, the term "ROE" has been used for the percentage of premium margin that is necessary to produce an adequate return for risk and use of surplus. The measure that I used for single premium plans is based on Internal Rate of Return. I have replaced the "ROE" term with a more descriptive term, "Profit and Contingency Margin."

$$\text{Claim Costs} + \text{General Insurer Expenses}$$

$$I + \text{Invest. Income} - \text{Prem Taxes} - \text{Compensation} - \text{Profit and Contingency Margin}$$

However, since the rate calculation in use by Texas provides an interest discount in its derivation of single premium rates, and the interest element of Outstanding Balance coverage is negligible, the Investment Income component is removed, and the formula is reduced to:

$$\text{Claim Costs} + \text{General Insurer Expenses}$$

$$I - \text{Premium Taxes} - \text{Compensation} - \text{Profit and Contingency Margin}$$

The Claim Costs and General Insurer Expenses are developed in terms of "cents per \$100 per year," to be consistent with the desired form of the base single premium rate. The source for these components is the data provided by TDI, as corrected and modified by judgment and other relevant factors.

The Premium Tax, Compensation, and Profit and Contingency Margin components are expressed as percentages. The derivation and usage of these components is intended to be as consistent as possible with the Order.

Claim costs were derived by multiplying the three-year Loss Ratio based on Presumptive Rate, adjusted for reporting errors, by the prima facie rate in effect during the study period. After adjusting the presumptive earned premium to reflect the errors in reporting, the loss ratio for all life plans in aggregate was 46.64%. The discounted prima facie rate at each year end was \$.281 per \$100 per year. The resulting claim cost produced an aggregate value of 13.11 cents per \$100 per year.

General Insurer Expenses were calculated in the form of "cents per \$100 per year" based on the data provided. "Nationwide" expenses were converted to "Texas" expenses by taking the ratio of total policies in force at the beginning and end of each calendar year in Texas to the nationwide number of policies in force. These calculations were done by class of business within each individual company, and totals compiled by class of

business. The consistency in the results of this calculation was considerably less than satisfying, with the resulting expense ratios by class of business varying from -17.62% to 42.47%. Due to the questionable reliability of these results, I recommend that the expense component remain unchanged from the 8.02 cents per \$100 per year as determined in the Order.

Compensation was derived by taking the average commission rate actually paid over the three year period from the data provided, which was calculated at 35%.

The premium taxes, licenses and fees were estimated as 2.75% for the purposes of this analysis.

The Profit and Contingency Margin was developed in a different manner from that which the Order employed.

For single premium plans the method used in the Order is insufficient to recognize the surplus strain associated with payment of commissions and reserve establishment, as well as Risk-Based Capital requirements. In addition, the simplified method used in the Order is insufficient for multi-year contracts where recovery of this strain is spread out over several years, and it does not recognize timing differences between statutory and taxable income.

The method that I used to determine the appropriate value for this component was to perform an analysis based on an 11.5% statutory after tax internal rate of return. The value I generated is the gross, pre-tax premium margin that is necessary to produce the target internal rate of return without investment income. The reason no investment income was used is that the single premium rates are discounted at interest and thus, investment income on the single premium is passed along to the purchaser. The assumptions for this calculation are contained in an exhibit. The necessary gross premium margin for single premium credit life is 14.65%.

For Single Premium Life, the rate is derived below.

$$\frac{.1311 + .0802}{1 - .0275 - .35 - .1465} = .44$$

Based on this derivation, I recommend that the single premium life insurance rate be increased from its current level of \$.30 per \$100 per year to \$.44 per \$100 per year.

The corresponding joint life, level term and monthly outstanding balance rates can be derived by formula from the above. The existing relationships between the rates for the various forms of coverage should be examined in light of claim cost relationships and underlying trends. The joint life multiple of 150% is one of the lowest currently in use by any state, and is not adequate. This is commented on more thoroughly below.

Derivation of the Credit Disability Rates

As in life insurance, the formula used for rating methodology is shown below. In previous documents, the term "ROE" has been used for the percentage of premium margin that is necessary to produce an adequate return for risk and use of surplus. The measure that I used for single premium plans is based on Internal Rate of Return. I have replaced the "ROE" term with a more descriptive term, "Profit and Contingency Margin."

Claim Costs + General Insurer Expenses

1 + Invest. Income – Prem Taxes – Compensation – Profit and Contingency Margin

Again, the rate calculation in use by Texas provides an interest discount in its derivation of single premium rates, so the Investment Income component is redundant. The formula reduces to:

Claim Costs + General Insurer Expenses

1 – Premium Taxes – Compensation – Profit and Contingency Margin

The base single premium rate was calculated using the above formula for the 14-day retro, 36 month term. This derived premium rate is divided by the corresponding prima facie rate in effect during the study period and a ratio is developed. I recommend this ratio be applied to the entire prima facie rate schedule to maintain consistency between rates. Other rates may be developed by ratio, or standard formula.

The study period claim cost was derived by multiplying the three-year Loss Ratio based on Presumptive Rate, adjusted for reporting error, by the prima facie rate in effect during the study period. After adjusting the presumptive earned premium to reflect the errors in reporting, the loss ratio for all disability in aggregate was 53.16%. I multiplied the loss ratios by the discounted prima face rate of \$2.573 per \$100. The resulting aggregate claim cost component is \$1.368 per \$100.

General Insurer Expenses were calculated in the form of "cents per \$100" based on the data provided. "Nationwide" expenses were converted to "Texas" expenses by taking the ratio of total policies in force at the beginning and end of each calendar year in Texas to the nationwide number of policies in force. As with the life expense derivation, there was considerable variation. Due to the questionable reliability of the data, method and results, I recommend that the expense component remain unchanged from the 54.57 cents per \$100 as determined in the Order.

Compensation was derived by taking the commission rate actually paid over the three year period, which was calculated at 29%.

The premium taxes, licenses and fees were estimated as 2.75% for the purposes of this analysis.

The method that I used to determine the appropriate value for the profit and contingency component was to perform an analysis based on an 11.5% statutory after tax internal rate of return. The value I generated is the gross, pre-tax premium margin that is necessary to produce the target internal rate of return without investment income. The reason no investment income was used is that the single premium rates are discounted at interest and thus, investment income on the single premium is passed along to the purchaser. The assumptions and details of this calculation are contained in an exhibit. The necessary gross premium margin is 9.85%.

The components and rates for the 36-month 14 day retroactive cell is shown below.

$$\frac{1.368 + .5457}{1 - .0275 - .29 - .0985} = 3.28$$

The corresponding non-discounted prima facie rate in effect during the study period is \$2.79.

Based on this, I recommend the use of an aggregate prima facie rate scale that is 118% (3.28 divided by 2.79) of the premium rate scale currently in use.

Other benefits and premium rate structures for credit disability insurance may be derived by use of suitable ratios or by formula. The joint multiple of 150% is one of the lowest currently in use by a state, and is not adequate. This is commented on more thoroughly below.

Joint Life Multiple Factors

The joint factor utilized by Texas in setting the life and disability rates that are currently in use is 150%. I believe this factor is not sufficient to provide adequate and consistent expense and profit/contingency margins. In work I have done in previous rate derivations, I have determined the appropriate factors to be 1.65 for credit life insurance and 1.75 for credit disability. These factors were derived in a manner consistent with the component formulas above. I recommend the use of these factors for joint coverage.

Respectfully Submitted

A handwritten signature in cursive script that reads "Christopher H. Hause". The signature is written in black ink and has a long, sweeping underline.

Christopher H. Hause, FSA, MAAA
President
Hause Actuarial Solutions, Inc.

Christopher H. Hause, FSA, MAAA
Professional and Biographical Data
July, 2004

Hause Actuarial Solutions, Inc.
7201 W. 129th Street, Suite 310
Overland Park, KS 66213
(913) 685-2200

Personal Data

Christopher H. Hause was born on October 28, 1955 in Detroit, Michigan. He is married and has two children.

Professional Experience

Hause Actuarial Solutions, Inc.
Overland Park, KS 66213

President. From its inception in 2001, Christopher has been the President of Hause Actuarial Solutions, Inc. in Overland Park, Kansas. The company was formed to develop actuarial software programs that assist insurance actuaries in evaluating, pricing and modeling life, health and annuity products. In December of 2001, Hause acquired the consulting practice of William M. Buchanan & Associates, for which Christopher had been Managing Partner. Mr. Buchanan remains on staff as Consultant Emeritus. The firm provides a wide range of consulting services to the insurance industry. Hause recently spearheaded data collection for two nationwide studies and co-authored papers on both. Other assignments include reserve and financial statement work, product development and software development for the insurance and banking industries. He has assisted in shaping insurance regulations and laws through written and oral testimony.

William M. Buchanan & Associates
Overland Park, KS 66213

Managing Partner. From December 1996 through December 2001, Christopher was Managing Partner of William M. Buchanan & Associates in Overland Park, Kansas. The major assignments undertaken have included pricing, filing and implementing a portfolio of products for a start-up company in the Midwest. The products included Term and Universal Life, Deferred Annuities and Immediate Annuities. Buchanan & Associates had significant involvement in credit-based and debt cancellation products, as well as reserve calculations and loss analysis for several companies.

Individual Assurance Company
Kansas City, MO 64108

Senior Vice President and Actuary. From 1984 through 1996, Christopher was Senior Vice President and Actuary of Individual Assurance Company, Life, Health and Accident in Kansas City, Missouri. He was the Appointed Actuary, served on the Board of Directors and chaired the Strategic Planning Committee. During that time, Christopher developed new creditor, ordinary and group products. He was instrumental in analyzing and managing the profitability of each product line. Individual Assurance Company offers credit life and disability, group mortgage life and disability and term life through its client banks in the Midwest. It has a strong and

profitable group life and interest sensitive payroll deduction operation selling primarily Universal Life in the Pacific Islands.

Past work experience includes exposure to a broad range of products and distribution systems. Prior to Individual Assurance Company, Christopher worked at The Pyramid Life Insurance Company in Mission, Kansas; Allianz Life (formerly North American Life and Casualty), and ITT Life Insurance Company in Minneapolis.

Education

Graduated from Cretin High School in St. Paul, Minnesota in 1972. Upon graduation from high school, entered the University of Wyoming at Laramie. Received a Bachelor's degree in Mathematics in 1975.

Professional Designations

Fellow of the Society of Actuaries (FSA) - 1986
Member, American Academy of Actuaries (MAAA) - 1982
Chartered Life Underwriter (CLU) - 1992

Member of several special interest sections of the Society of Actuaries and is a current Chairman of the Council of the Non-Traditional Marketing Section. Currently Chairman of the SOA Credit Insurance Experience Committee. Past president of the Kansas City Actuaries Club.

Publications and Professional Participation

Contingencies - "Credit Insurance -- Peering through the Myths", published May/June, 1991. Also published in several other industry-related publications.

News Direct (publication of the Non-Traditional Marketing section of the Society of Actuaries). "Practical Aspects of Credit Insurance Financial Reporting", Winter 1994-1995 Issue.

News Direct (publication of the Non-Traditional Marketing section of the Society of Actuaries). "Group Mortgage Insurance -- Some Practical Aspects", Summer 1992 Issue.

News Direct (publication of the Non-Traditional Marketing section of the Society of Actuaries). "Credit Insurance Reform -- One Person's Observations", Fall 1991 Issue.

News Direct (publication of the Non-Traditional Marketing section of the Society of Actuaries). "Current Issues and Concerns", Fall 1991 Issue.

Led workshop for the Society of Actuaries Meeting in Chicago, 1994, "Practical Aspects of Credit Insurance Regulations".

Participated in a Panel Discussion at the Society of Actuaries Meeting in New York, 1998, "New Credit Disability Tables".

Gave a speech at the Annual Meeting of the Consumer Credit Insurance Association in Tucson, Arizona in April, 1999, "Credit Insurer Morbidity Study".

Led a Panel Discussion at the Society of Actuaries Meeting in Atlanta, 1999, "Non-Traditional Markets and Uses for Survivorship Life Policies".

Participated in a Panel Discussion at the Society of Actuaries Meeting in Toronto, 2001, "Alternatives to Cash Flow Testing".

Participated in a Panel Discussion at the Society of Actuaries Meeting in New Orleans, 2001, "Experience Tables".

Participated in a Panel Discussion at the Society of Actuaries Meeting in Colorado Springs, 2002, "Debt Protection Products in the Aftermath of Gramm-Leach-Bliley".

Gave a speech at the 2002 Annual Meeting of the National Fraternal Congress of America's Actuaries' Section on "Updated Actuarial Opinion and Memorandum Requirements and 2001 CSO Table."

Participated in a Panel Discussion at the Society of Actuaries Meeting in Washington, DC, 2003, "Debt Protection Update".

Moderated a Panel Discussion at the Society of Actuaries Meeting in Washington, DC, 2003, "Introduction to Voluntary Benefits".

Gave a speech at the Annual Meeting of the Consumer Credit Insurance Association in Santa Barbara, California in May, 2003, "Implications of the New Credit Insurance Experience Exhibit".

Led a Workshop at the Society of Actuaries' 2003 Annual Meeting entitled "Hot Topics in Credit Insurance and Debt Cancellation."

Led a Workshop at the Society of Actuaries' 2004 Spring Meeting entitled "NAIC Model Regulations on Determining Reserve Liabilities for Credit Insurance."

No. 99-1481

RECEIVED
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Official Order
of the
Commissioner of Insurance
of the
State of Texas
Austin, Texas

Date: OCT 29 1999

Subject Considered:

PRESUMPTIVE PREMIUM RATES FOR CREDIT LIFE
AND CREDIT ACCIDENT AND HEALTH INSURANCE

DOCKET NO. 454-98-1807.G

General Remarks and official action taken:

On this day came on for consideration by the Commissioner of Insurance (Commissioner) the setting of presumptive premium rates for credit life and credit accident and health insurance. The Commissioner has jurisdiction over this matter pursuant to the Insurance Code §§ 40.001 - 40.060 (formerly Art. 1.33B) and 3.53 (Vernon 1981 and Supp. 1999).

The Commissioner referred this matter to the State Office of Administrative Hearings (SOAH) for hearing by filing a request for setting of hearing on October 7, 1998. The notice of hearing, issued October 7, 1998, was sent to various potential parties and published in 23 Tex Reg 10724 (October 16, 1998). The hearing for this case was conducted January 26 through January 28, 1999, at the Stephen F. Austin Building, 1700 North Congress, Austin, Texas, before SOAH Administrative Law Judges (ALJs) Wendy Ingham Hunn and Sarah G. Ramos. The following parties participated in the hearing or in prehearing conferences:

PARTY	ACRONYM	REPRESENTATIVE
Consumer Credit Insurance Association	CCIA	Jay A. Thompson, Attorney
Texas Association of Life & Health Insurers	TALHI	Will D. Davis, Attorney
Independent Bankers Association of Texas	IBAT	Karen M. Neeley, General Counsel
The Staff of the Texas Department of Insurance	Staff	David Randell and Bill Bingham, Staff Attorneys
The Office of Public Insurance	OPIC	Rod Bordelon, Public Counsel;

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Counsel		Lanetta M. Cooper, Senior Staff Attorney; and Erin Martens, Staff Attorney
The Center for Economic Justice	CEJ	D. J. Powers, Attorney

The record closed on March 10, 1999, after the parties filed briefs and reply briefs.

Notice and jurisdiction were not contested issues. Aspects of the procedural history, as well as issues pertaining to notice and jurisdiction, are discussed in Findings of Fact Nos. 1-7 and Conclusions of Law Nos. 1-3.

At the hearing or in prefiled documents, the parties presented evidence through the following witnesses:

CCIA	Gary Fagg
TALHI	David Huff
IBAT	Steven Y. Scurlock
Staff	William K. Robinson
OPIC	Allan I. Schwartz
CEJ	Birny Birnbaum

On May 19, 1999, the ALJs made and filed a proposal for decision containing findings of fact and conclusions of law. The proposal was properly served on all parties, and all parties were given an opportunity to file exceptions and replies as part of the record herein. In response to exceptions and replies, the ALJs issued an amended proposal for decision on July 9, 1999.

On September 22, 1999, the Commissioner considered the proposal for decision and the exceptions, briefs, and arguments of the parties in open meeting. The Commissioner, after review and due consideration of said matters, adopts the following findings of fact and conclusions of law. The Insurance Code §§ 40.001 - 40.060 (formerly Art. 1.33B) permits the Commissioner to amend the proposal for decision, including any finding of fact or conclusion of law, but such amendments shall be based solely upon the record made before the ALJs. The Commissioner amended, adopted, or deleted certain proposed findings of fact and conclusions of law, denying all proposed findings of fact submitted by any party hereto not specifically adopted herein.

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REASONED JUSTIFICATION FOR AMENDMENTS TO PROPOSED ORDER

General Remarks and Official action taken:

The citation to the Insurance Code statutory provision which was Art. 1.33B, has been changed to show the citation to the same provision as re-codified. In the listing of parties and their representatives, Bill Bingham's name is added as a representative of TDI staff because he represented Staff in the oral arguments hearing. A listing of the parties and their witnesses was added. The date on which the Commissioner held the open meeting to consider the proposal for decision, the exceptions and replies, briefs, and the oral arguments of the parties in an open meeting is added. An explanation of how the Commissioner may amend the proposal for decision under the Insurance Code §§ 40.001 - 40.060 (formerly Art. 1.33B) is added.

FINDINGS OF FACT

References to amended, renumbered findings are shown by their new number followed by their original number in parenthesis.

Finding Nos. 30 - 33, 34, 35, 37, 38, 40 - 43, 44 - 47, 48, 49, 50 - 77, 79, 80, 82, 83 - 96, 98, 100 - 105, 106, and 107 - 110 are renumbered to Finding Nos. 29 - 32, 37, 40, 33, 34, 41 - 44, 46 - 49, 51, 53, 55 - 82, 83, 84, 85, 87 - 100, 101, 102 - 107, 109, 111 - 114, respectively. Finding Nos. 29, 78, 81, 97 and 99 are deleted; new Finding Nos. 35, 38, 45, 50, 52, 54, 86, 108, 110, and 115 - 117 are adopted; Finding Nos. 11, 16, 20, 21, 23, 32(33), 33(37), 36, 43(42), 51(48), 53(49), 55(50), 56(51), 63(58), 64(59), 66(61), 68(63), 87(83), 89(85), 91(87), 100(96), 101(98), and 107(105) are amended.

Legal Standard for Calculating Rates

Finding No. 11 is amended to indicate that the term "credit disability" will be used in the order to refer to "credit accident and health insurance."

Credit Life Insurance Calculation

Finding Nos. 16 and 21 are amended to correct the sign in front of the profit component in CEJ's formula from a positive to a negative sign, as indicated in Exhibit BB-5, paragraph 2, and in its testimony, and to more accurately describe how compensation should be included in the component rating formula. Similarly, Finding No. 23 is amended by deleting language indicating that the profit component would be handled differently if it was a negative number, when it actually would be handled the same regardless of whether it was

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a negative or a positive number. Finding No. 20 is amended to replace the term "compensation" with "premium" to more accurately describe how the amount of compensation is determined.

Claim Costs

Finding No. 29 is deleted because it is not clear that the two claim costs are derived on a comparable basis and because this finding is not necessary to support this decision. Finding No. 31(32) is amended to correct a grammatical error and to more accurately describe the significance of the credit life claims cost component.

Reverse Competition and Compensation

Finding Nos. 32(33) and 43(42) are amended to correct grammatical errors. Finding No. 33(37) is amended to clarify that the other benefits mentioned are not necessarily always provided.

Finding No. 35 is adopted to amplify the findings in this section consistent with the evidence concerning the nature and existence of reverse competition in the credit insurance industry. Finding No. 36 is amended to conform more precisely with the evidence. Finding No. 38 is adopted to reflect the Commissioner's determination that the impact of reverse competition is probably greater than 6 percent. The Commissioner found the testimony of Mr. Birnbaum and the responses of Mr. Fagg to cross-examination questions persuasive in this regard. Finding No. 45 is adopted to clarify that the finding of a reasonable commission component does not determine the amount an insurer may pay as commissions.

Profit and Investment Income

Finding No. 50 is adopted to clarify that the notice of hearing contemplated that the parties would provide evidence comparing the relative risk of the credit insurance industry with other industries. Finding No. 51(48) is amended to delete the reference to homeowners rate decisions, to conform the finding to the evidence, and to more accurately state the automobile rate decisions' cost of capital. Finding No. 52 is adopted consistent with the evidence and to explain the rationale for determining a rate of return consistent with those determined in other lines of insurance. Finding No. 53(49) is amended to conform the finding to the evidence. Finding No. 54 is adopted to amplify the findings in this section consistent with the evidence on relative riskiness of the credit industry. Finding No. 55(50) is amended to reference the preceding findings of fact rather than actual decisions, because the Commissioner's determination to use 11.5% for cost of capital is based on the evidence contained in these findings, rather than the decisions themselves.

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Finding No. 56(51) is amended to eliminate reference to percentages which are not directly related to the 42 companies referenced in the finding and are not necessary in arriving at a reasonable determination.

Finding No. 63(58) is amended to clarify that the seven percent is seven percent of premium and is a conservative estimate of the investment yield on policyholder-supplied funds. Finding No. 64(59) is amended to eliminate the reference to a total investment income factor of 14 percent. The seven percent yields involved in the calculations are percentages of differing bases and, therefore, cannot simply be added together as if they were percentages of the same bases.

Taxes and Fees

Finding No. 66(61) is amended to clarify that the 1.75 percent premium tax rate is on gross premiums which are greater than \$450,000. Finding No. 68(63) is amended to clarify that the component for taxes and fees is the tax rate, rather than the actual taxes paid. It is also amended to add the term "effective" to account for the tax rate described in Finding No. 66(61) and to correct a typographical error.

Credit Disability Insurance

Finding No. 70(65) is amended to correct the location of the acronym "MOB." Finding No. 73(68) is amended to delete the "investment income" component from the presumptive premium rate formula for credit disability as is consistent with the ALJs' calculations and narrative concerning the same. This amendment also makes the credit disability formula consistent with the credit life formula.

Producer Classes

Finding Nos. 78 and 81 are deleted because they are not necessary and the underlying rationale was not part of the Commissioner's decision-making process. The characteristics of individual debtors are not a consideration.

Finding No. 86 is adopted to clarify that, although the record contains some evidence regarding distinguishing by type and class of business, the Commissioner did not find a persuasive methodology for varying the rates by type and class of business. Finding No. 87(83) is amended to clarify that the Commissioner did not distinguish by type and class of business in this proceeding because the evidence in the record did not adequately support it. However, there may be evidence presented in future hearings which would

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warrant distinguishing by class.

Resulting Rate

Finding Nos. 89(85) and 91(87) are amended to clarify that the presumptive rates described in these findings are the rates prior to the application of a discount factor.

Discount Factor

Finding Nos. 100(96) and 101(98) are amended to clarify that the term "n" in the discount factor represents the number of months of insurance coverage rather than the number of months of the loan. Finding No. 100(96) is also amended to correct the reference to the factor as the "discount" factor, rather than the "selected" factor.

Finding Nos. 97 and 99 are deleted because they are somewhat misleading, since the examples in the findings assume a loan duration of 20 months which is not the average duration. The anticipated loss ratios from credit life and credit disability are more accurately stated in Finding Nos. 108 and 110, respectively.

Reasonableness of Resulting Loss Ratio

Finding No. 107(105) is amended to clarify that the result of the calculation in this finding reflects the anticipated loss ratio prior to the application of the discount factor.

Finding Nos. 108 and 110 are adopted to more accurately describe the anticipated loss ratios with the average policy durations (based on 1996 and 1997 expense data) and average discount factors applied for credit life and credit disability, respectively.

Finding Nos. 115 and 117 are adopted to reference Appendix B containing the converted credit life presumptive rates and Appendix C containing credit disability presumptive rates, pursuant to Finding No. 114(110). Finding No. 116 is adopted to clarify that all current credit disability rates must be multiplied by the ratio stated prior to converting the rates, pursuant to Finding No. 114(110).

CONCLUSIONS OF LAW

Conclusion Nos. 2 and 3 are amended to change the citation to the TEX. INS. Code §§ 40.001 - 40.060 (formerly Art. 1.33B) as that citation has been revised. Conclusion No. 4 is amended to clarify that the rates discussed are the individual rates.

Conclusion No. 12 and the Order are amended to include the effective date determined by the Commissioner.

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Appendices

Appendix A is amended to delete two types of coverage listed that do not have presumptive rates and to include two other types of coverage that should be included in the list.

Appendix B is deleted because this Appendix is not necessary to support the Findings of Fact and Conclusions of Law contained in this order.

Appendices B and C which contain the credit life presumptive rates and the credit disability presumptive rates, respectively, are adopted

FINDINGS OF FACT

Procedure and Jurisdiction

1. The notice of hearing, issued October 7, 1998, was sent to various potential parties and published in 23 Tex Reg 10724 (October 16, 1998).
2. The notice of hearing set the first prehearing conference on November 10, 1998.
3. At the November 10, 1998, prehearing conference, the following persons were designated as parties:

Consumer Credit Insurance Association (CCIA) - represented by Jay A. Thompson, Attorney;

Texas Association of Life & Health Insurers (TALHI)- represented by Will D. Davis, Attorney;

Independent Bankers Association of Texas (IBAT) - represented by Karen M. Neeley, General Counsel;

The Staff of the Texas Department of Insurance (Staff) - represented by David Randell, Senior Staff Attorney;

The Office of Public Insurance Counsel (OPIC) - represented by Rod Bordelon, Public Counsel; Lanetta M. Cooper, Senior Staff Attorney; and Erin Martens, Staff Attorney; and

Center for Economic Justice (CEJ) - represented by D. J. Powers, Attorney.

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4. The hearing, originally set for January 12, 1999, was continued to January 26, 1999, by ALJ order issued December 9, 1999, and sent by facsimile to all parties.
5. All named parties participated in a January 15, 1999, prehearing conference during which the Administrative Law Judges (ALJs) heard arguments on prehearing motions.
6. The hearing convened on January 26, 1999, in the State Office of Administrative Hearings (SOAH) hearing rooms, Suite 1100, Stephen F. Austin Building, 1700 North Congress Avenue, Austin, Texas, before SOAH ALJs. Except for IBAT, representatives for all named parties appeared and participated in the hearing. The hearing continued from day to day until completed on January 28, 1999.
7. The transcript was filed February 11, 1999; initial briefs were due March 2, 1999; reply briefs were due March 10, 1999; and the record closed on March 10, 1999.
8. At the hearing, the ALJs took official notice of the following:
 - a. State Board of Insurance (SBI) Order No. 37495, "Repeal of Rules 059.03.53.001-059.03.53.002 and Adoption of Rules 059.53.01.001 - 059.53.14.002 and 059.53.20.001 - .003," dated July 3, 1980;
 - b. SBI Order No. 58505, "Presumptive Premium Rates for Credit Life and Credit Accident and Health Insurance in the State of Texas Effective October 1, 1991," dated June 27, 1991;
 - c. SBI Order No. 59721, "Presumptive Premium Rates for Credit Life and Credit Accident and Health Insurance in the State of Texas, in Docket No. 1869," dated July 1, 1992; and
 - d. SBI Order No. 59635, "Subchapter FF. Credit Life and Accident Health General Provisions 28 TAC §§3.5001-3.6403," dated June 16, 1992.

Legal Standard for Calculating Rates

9. In 1980, when 28 TEX. ADMIN. CODE (TAC) §3.5202 was adopted, there was no legislative authority for the Department to adopt and promulgate an industry-wide presumptive premium rate for credit insurance.
10. Article 3.53, §8A(3), which gave that authority to the Commissioner, was not

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enacted until a year later, in 1981.

11. Board Order No. 58505, issued on June 27, 1991, set presumptive rates for credit life and credit accident and health (credit disability) insurance in the State of Texas, effective October 1, 1991. In that Order, the Board took official notice of §3.5202, but also found that the presumptive rates established for credit life had a loss ratio of 42.1%.
12. In 1992, the Board considered recommended changes to 28 TAC §§3.5201 and 3.5202, and stated that the language regarding the basic test of reasonableness is appropriate and is essential for the approval of rate deviations and the approval of rates for coverages that do not have presumptive rates established.
13. In this proceeding, the component rating proposals most accurately addressed the rate standards identified in Article 3.53, §8A(3).

Credit Life Insurance Calculation

14. Credit life insurance coverage is divided into the following classes based on the type of business at which the insurance is issued:

Class	Description
A	Commercial Banks, Savings & Loan Assn. & Mortgage Companies
B	Finance Companies, Small Loan Companies
C	Credit Unions
D	Production Credit Associations (Agricultural P.C.A.s)
E	Dealers (Auto & Truck Dealers, Other Dealers, Retail Stores, etc.)
F	Other Than A thru E (Specify)

15. There are also eight different "benefit plans" for credit life insurance, which are classified based on such factors as single life vs. joint lives, single premium (SP) vs. outstanding balance, also referred to as monthly outstanding balance (MOB), revolving account or other than revolving account, and reducing term vs. level term. Those plans are described in Appendix A, which is incorporated in this finding as though set forth in its entirety.

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16. The parties proposed the following formulas be used to calculate the presumptive premium rate for credit life insurance coverage:

CCIA:
$$\frac{(\text{Claim costs})+(\text{General Insurer Expenses})+(\text{Compensation})}{1+(\text{Investment income})-(\text{Taxes})-(\text{Return on equity})}$$

Staff:
$$\frac{(\text{Claim costs})+(\text{General Insurer Expenses})}{1+(\text{Invest. income})-(\text{Commissions})-(\text{Prem. Taxes})-(\text{Fed. Inc. Tax})-(\text{Profit Return})}$$

CEJ:
$$\frac{(\text{Claim Costs})+(\text{Fixed General Expenses})}{1-(\text{Variable Expenses})-(\text{Taxes/fees})-(\text{Profit})-(\text{Commission})}$$

OPIC: (did not propose component rating formula)

TALHI: (did not propose component rating formula)

17. Most parties developed rates for SP life reducing coverage and developed rates for other plans based on the result.
18. CEJ used a component rating method to develop an MOB base, established a SP life reducing coverage rate by converting the MOB rates, and then applied the following interest/mortality/term discount factor:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.045)n}{24}}$$

19. It is reasonable and in accordance with standard industry practice to place only the "claim costs" and "general insurer expenses" components in the numerator of the formula.
20. "Compensation" should not be included in the numerator because it is paid as a percentage of premium, not as a fixed cost. Percentage components should be placed in the denominator.
21. The following components appear in the denominator of the various formulas for calculating credit life insurance rates:

CCIA: $1+(\text{Investment income})-(\text{Taxes})-(\text{Return on equity})$

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Staff: $1 + (\text{Invest. income}) - (\text{Commissions}) - (\text{Prem. Taxes}) - (\text{Fed. Tax}) - (\text{Profit Return})$

CEJ: $1 - (\text{Variable Expenses}) - (\text{Taxes/Fees}) - (\text{Profit}) - (\text{Commission})$

22. Based on the previous conclusion that only the "claim costs" and "general insurer expenses" components belong in the numerator, and on the components included in the denominators by each expert, the following components should be in the denominator: investment income, taxes and fees, profit, and commissions.
23. The components in the denominator will be added or subtracted from the number one, as follows: the tax component will be subtracted; compensation or commissions will be treated as a deduction in the denominator; return on equity or profit will be subtracted; and investment income will be added to the number.
24. Based on the foregoing findings of fact, the following formula best comports with industry practices and statutory requirements for this hearing, and is the basic formula with which to determine the presumptive premium rate for credit life insurance:

$$\frac{(\text{Claim costs}) + (\text{General Insurer Expenses})}{1 + (\text{Investment income}) - (\text{Taxes and Fees}) - (\text{Return on Equity/Profit}) - (\text{Commissions})}$$

Years of Experience

25. The loss ratios across classes of business and benefit plans have been very stable; use of a three-year average versus a four-year average would not create significantly different results.
26. Even though three-year data contains less seven-day retroactive policy information, most of the selected components were all calculated using four years of data.
27. Four years of data should be used in the rate calculation.

Claim Costs

28. Claim costs are reported to the Department by insurers, so are part of the data made available to all the parties.
29. Two methods used to calculate the claim cost value are: (1) multiplying the single premium prima facie rate by the prima facie loss ratio, and (2) comparing incurred losses to mean insurance in force.

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30. The parties' recommendations on the claim costs component varied only slightly, and those differences are based on the formula used to calculate the value and on the portion of the data (single life, single premium experience only versus combined loss experience of all plans) selected for use in that formula.
31. Use of the combined loss experience of all plans results in an average claim cost of 14.4¢ which is reasonable for the credit life claim cost component.

Reverse Competition and Compensation

32. The notice of hearing defines reverse competition as "the act of directing competitive efforts towards the producers of the business rather than the ultimate consumers of credit insurance, which has the effect of raising rather than lowering prices to consumers."
33. Competition in the credit insurance industry raises, rather than lowers, credit insurance costs because competitive efforts are aimed at the producers; insurers pay higher commissions in order to attract more business. They may also provide other benefits, such as training and computers.
34. When credit life claim costs are lower, the savings are not passed along to consumers in the form of lower rates; instead, insurers charge the prima facie rate and producers receive greater compensation.
35. In the credit insurance marketplace, higher rates provide more income that will be shared primarily with producers.
36. A good possibility exists that if a credit insurance rate is excessive, the compensation level will also be excessive.
37. In 1992, Mr. Fagg performed a study addressing reverse competition in the credit insurance market. His study showed that reverse competition inflated expenses about 6%.
38. Other evidence suggests that the effect of reverse compensation may be significantly greater than Mr. Fagg's 6%.
39. There is reverse competition in the credit insurance industry.
40. The level of compensation should reasonably relate to loss experience.

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41. Article 3.53, §8 requires use of reasonable acquisition costs, loss ratios, and administrative expenses.

42. The commission ratio averages for credit life for 1995 through 1997 were:

Banks	35.8%
Finance Companies	2.3%
Credit Unions	20.7%
PCAs	25.6%
Dealers	48.4%
Other	0.9%
Total	38.1%

43. For credit life insurance, it would be unreasonable to set rates using actual commissions (35% of the current 36-cent rate) because of reverse competition.

44. A reasonable commission component for credit life insurance is 25%.

45. The commission component does not fix or limit the amount an insurer may pay in commissions.

Expenses

46. The annual data call did not specify types of expenses that would be appropriate to exclude from rate calculations, such as payments for bad faith settlement practices, administrative penalties, and advisory organization membership.

47. There was no evidence indicating what would be an appropriate percentage of expenses attributable to the types of expenses mentioned in the previous finding.

48. Credit life expenses should be determined as follows:

The average number of Texas policies as a percentage of the average countrywide policies should be determined. The resulting factor should be multiplied times the total countrywide expenses to estimate Texas expenses. The estimated Texas expenses should be divided by the Texas actual earned premium. Expenses per \$100 of coverage per year should be calculated.

49. A reasonable expense component for single premium reducing credit life insurance

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is .0802¢/100.

Profit and Investment Income

50. In the notice of hearing the Commissioner requested evidence on the relative risk of the credit insurance industry as compared to other industries.
51. The Commissioner has recently determined in the automobile (voluntary and Texas Automobile Insurance Plan Association (TAIPA)) rate decisions that 11.25 to 11.75% are reasonable components for cost of capital.
52. Because the Commissioner has determined that a reasonable target cost of capital for automobile insurance in Texas is in the 11.25 to 11.75% range, a comparison of credit insurance to this line to see if credit insurance is more or less risky can provide a basis for determining whether the same range of returns is appropriate for credit insurance.
53. Because credit insurance is characterized by stable losses and expenses, it is probably less risky than other lines.
54. There is no persuasive evidence in this record that credit insurance is any riskier than automobile insurance.
55. Based on Findings of Fact 50 - 54, 11.5% is a reasonable credit insurance cost of capital.
56. For the top 42 companies writing credit insurance business in Texas in 1996, the four-year average of net investment income to premiums for both credit life and credit disability insurance was 15.7%.
57. Because of the investment income the insurer earns in the credit transaction, the insurer can actually have a negative underwriting profit and still make a reasonable overall profit.
58. With an effective tax rate of 30% and a target after-tax return of 11.5%, a before-tax return of 16.43% is needed to arrive at a reasonable return on equity.
59. Seven percent is an appropriate investment yield on surplus to subtract from the before-tax return of 16.43%.

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60. As a result of the preceding calculations, 9.43% must be earned from insurance operations.
61. Texas credit insurers have an actual 2:1 premium to surplus ratio.
62. Based on that ratio, it would take a 4.71% return on premium to obtain the necessary 9.43% return on surplus.
63. Expressed as a percentage of premium, 7% is a conservative investment yield on policyholder supplied funds to deduct from the required return to derive an approximate -2% profit factor (4.71% - 7% = -2.29%).
64. Due to the selection of a profit component calculated in a manner that reflects investment income, the basic formula set forth in Finding of Fact No. 24 will be adjusted to exclude the investment income component. To do otherwise would result in that component being deducted twice. The resulting formula is:

$$\frac{(\text{Claim costs}) + (\text{General Insurer Expenses})}{1 - (\text{Taxes}) - (\text{Profit}) - (\text{Commissions})}$$

Taxes and Fees

65. The parties each estimated a value of 3% of premium for state taxes and fees.
66. Pursuant to Article 4.11, §§5F and 5G, insurers selling credit life and disability insurance pay premium taxes at one-half of 1.75% on the first \$450,000 of gross premiums and pay 1.75% on gross premiums above that amount.
67. Texas allows insurers to recover guaranty funds assessments through offsetting premium tax payments. Article 21.28-D, §13.
68. Based on the actual effective premium tax rate and the lack of evidence regarding substantial additional taxes and fees, 2.75% is a reasonable component for taxes and fees (1.75% for premium taxes + 1.00% for miscellaneous taxes and fees).

Credit Disability Insurance

69. Credit disability insurance is divided into the same six classes as credit life.

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70. Credit disability benefit plans are currently classified based on such factors as single premium (SP) vs. outstanding balance, also referred to as monthly outstanding balance (MOB), revolving account or other than revolving account, and retroactive vs. non-retroactive. Those plans are described in Appendix A, which is incorporated in this finding as though set forth in its entirety.
71. About 61% of the credit disability insurance market is written in single premium 14-day retroactive disability insurance coverage.
72. For the reasons discussed in Findings of Fact Nos. 9-13, pertaining to credit life, the credit disability rates should be set using component rating factors that are then tested by a target loss ratio.
73. The basic formula with which to determine the presumptive premium rate for credit disability insurance will be:
- $$\frac{(\text{Claim costs}) + (\text{General Insurer Expenses})}{1 - (\text{Taxes}) - (\text{Profit}) - (\text{Commissions})}$$
74. An appropriate factor for credit disability claims cost is 1.5857 (the current rate, \$3.21, multiplied by the experience loss ratio, 49.4%).
75. The actual credit disability expense component should be determined by comparing Texas policies to countrywide policies. Based on actual earned premium, the method produces an expense factor of 17% of the current rate (.17 x 3.21 = .5457).
76. For credit disability insurance, investment income as a percentage of premium is about 2% higher than it is for credit life insurance.
77. An appropriate credit disability profit component is -4%.
78. There was no evidence illustrating why the commission rate for credit disability should be higher than the commission rate for credit life.
79. The commission percentage of 25% is reasonable.
80. A reasonable credit disability component for taxes is 2.75%.

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Producer Classes

81. Article 3.53 §8 requires consideration of the type or class of business when setting rates.
82. Loss ratios varied among certain classes of producers, as shown in the following table:

Class of Business	Life Loss Ratios at Current Presumptive Rates	Disability Loss Ratios at Current Presumptive Rates
A - Banks, S & L, Etc.	48.66%	49.32%
B - Finance Companies and Small Loan Companies	40.33%	44.31%
C - Credit Unions	47.29%	67.20%
D - PCAs	65.62%	N/A
E - Dealers	33.32%	43.21%
Other than A - E	72.46%	60.68%
Total	40.13%	49.36%

83. Certain parties proposed setting rates by producer class.
84. There was insufficient evidence to explain differences in class recommendations. For example, Staff recommended a separate rate for Class E only; however, for disability insurance, the loss ratios for Classes A, B, and E are similar, while the loss ratio for Class C is much higher.
85. When the Board set presumptive premium rates in 1991 and in 1992, there were differences between the automobile dealer class (Class E) and the other classes; yet the Board chose to set a single rate.
86. In this record, no party's recommendation as to how credit life and credit disability rate changes should vary by type and/or class of business was persuasive.
87. Based on the evidence in this record, credit life and disability rate changes

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determined in this proceeding should not vary by type and/or class of business.

Resulting Rate

Credit Life

88. When the recommended credit life component values are inserted into the component rating formula, the following base rate results:

$$\begin{aligned}
 &= \frac{(.144) + (.0802)}{1 - (.0275) - (-.02) - (.25)} \\
 &= \frac{.2242}{.7425} \\
 &= .30
 \end{aligned}$$

89. Based on the foregoing Findings of Fact, a presumptive premium rate of \$0.30 per \$100 of coverage is reasonable for a single premium credit life insurance policy, before the application of a discount factor.

Credit Disability

90. When the recommended credit disability component values are inserted into the component rating formula the following base rate results:

$$\begin{aligned}
 &= \frac{(49.4\% \times 3.21 = 1.5857) + (.17 \times 3.21 = .5457)}{1 - (.0275) - (-.04) - (.25)} \\
 &= \frac{2.1314}{.7625} \\
 &= \$2.79
 \end{aligned}$$

91. Based on the foregoing Findings of Fact, a rate of \$2.79 per \$1,000 of coverage is reasonable for a 36-month single premium reducing 14-day retroactive credit disability policy, before the application of a discount factor.

Joint Disability Coverage

92. Although there is no historical experience for joint disability coverage, insurers should realize some expense savings in issuing joint policies.
93. For joint life coverages in Texas, claim costs are about 150% of single life claims

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costs.

94. The weighted average age of credit disability consumers is 38.7 years, and 80% of all business is associated with age 50 or younger.
95. A reasonable value for joint disability coverage is 150% of the rate charged for disability coverage for a single person.

Discount Factor

96. A SP/mortality discount will benefit those persons paying for their entire coverage upon commencement of the policy term.
97. Any discount would necessarily lower the amount an insurer receives for investment.
98. The selected provision for investment income includes investment yields lower than historical yields, and this offsets the discount.
99. The discount factor will directly benefit the person paying for SP coverage, the consumer who actually loses the time value of money.
100. An appropriate discount formula for single premium reducing credit life coverage, where the factor "n" represents the number of months of insurance coverage, is:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.045)n}{24}}$$

101. An appropriate discount formula for single premium credit disability insurance, where the factor "n" represents the number of months of insurance coverage, is:

$$\text{Discount Factor} = \frac{1}{1 + \frac{(.0563)n}{24}}$$

Reasonableness of Resulting Loss Ratio

102. In 1991, the Board established a presumptive rate for credit life that had a loss ratio of 42.1%.
103. In 1992, in Board Order No. 59721, the Board considered loss ratios (Finding of Fact No. 8) and lowered the rate to 36¢. With claim costs at 15¢, the expected loss ratio was again 42%.

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104. The historical experience shows the overall loss ratios across all credit life classes of business and all plans of benefits have been very stable: 40.01% for 1994, 39.47% for 1995, 39.90% for 1996, and 41.01% for 1997. The four-year average for that coverage is 40.09%.
105. Although loss ratios in producer classes have varied, the total disability loss ratios have been relatively stable: 50.7% (1994); 49.1% (1995); 51.2% (1996); 47.2% (1997); and 49.5% averaged.
106. The anticipated loss ratio is calculated by dividing the proposed claim cost by the proposed rate.
107. For credit life, the proposed claim cost is .144 and the proposed rate is .30; thus, for single premium credit life coverage, the anticipated loss ratio is 48% ($.144 \div .30 = .48$), before application of the discount factor.
108. With application of an average discount factor (given the average policy duration of 42 months) the anticipated loss ratio for credit life is approximately 50.5%.
109. For credit disability, the proposed claim cost is 1.5857 and the proposed rate is \$2.79; the anticipated loss ratio for single premium reducing 14-day retroactive 36-month credit disability policy, before application of a single premium discount, is 57%.
110. With application of an average discount factor (given the average policy duration of 41 months) the anticipated loss ratio for credit disability is approximately 60%.
111. The anticipated loss ratios are similar to loss ratios previously determined to be reasonable in prior agency orders and for individual rate deviation requests, as set forth in 28 TAC §3.5202.
112. The proposed loss ratios strike a proper balance between the benefit returned to consumers and the premium charged.
113. There was insufficient evidence presented upon which to make a finding about an appropriate formula to convert the recommended rates to other benefit plans.
114. The proposed SP rates should be converted for use with other benefit plans in the manner TDI Staff has previously converted them for use with other benefit plans, as shown in the 1991 and 1992 Board Orders, referred to in Findings of Fact 8.b. and 8.c.
115. The converted credit life single premium presumptive rates are contained in

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Appendix B, which is incorporated in this finding as though set forth in its entirety.

116. It is reasonable to multiply all current credit disability rates by the ratio of 2.79 (as described in Finding of Fact No. 91) to 3.21 (the prior rate) before converting these rates pursuant to Finding of Fact No. 114.
117. The converted credit disability presumptive rates are contained in Appendix C, which is incorporated in this finding as though set forth in its entirety.

CONCLUSIONS OF LAW

1. The Commissioner of Insurance has jurisdiction over this matter pursuant to TEX. INS. CODE ANN. art. 3.53 (Vernon 1981 and Supp. 1999).
2. SOAH has jurisdiction over all matters relating to the conduct of a hearing, including the preparation of a proposal for decision with findings of fact and conclusions of law, pursuant to TEX. GOVT. CODE ANN. ch. 2003 (Vernon 1999) and TEX. INS. CODE ANN. §§ 40.001 - 40.060 (formerly Art. 1.33B).
3. The public hearing concerning the establishment of presumptive premium rates for credit life insurance and credit accident and health insurance was held in compliance with the provisions of TEX. INS. CODE ANN. §§ 40.001 - 40.060 (formerly Art. 1.33B) and 3.53 and TEX. GOVT. CODE ANN. ch. 2001 (Vernon 1999).
4. The Department's rule, 28 TAC §3.5202, regarding the basic test of the reasonableness of the relation of benefits to the premium charged, is applicable to individual rate and policy form submissions.
5. The Commissioner is not restricted to adopting only rates that agree with target loss ratios of 50% for credit life and 60% for credit accident and health insurance.
6. Article 3.53, §8 does not require adoption of a particular rating methodology but only lists the factors that must be considered.
7. In this proceeding, the component rating method more particularly considered the individual factors listed in the statute.
8. Based on Findings of Fact Nos. 9-13 and Conclusions of Law Nos. 4-7, TEX. INS. CODE ANN. art. 3.53, §§8A(2) and 8A(3), establish the proper factors for determining the presumptive premium rate for credit life insurance and credit disability insurance.

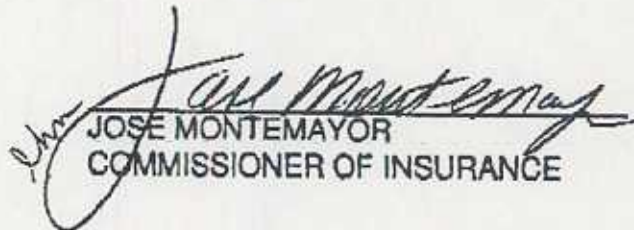
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9. The presumptive premium rates for credit life insurance reflected in the foregoing Findings of Fact and Conclusions of Law just, reasonable, adequate, nonconfiscatory and not excessive to insurers, insureds or agents pursuant to TEX. INS. CODE ANN. art. 3.53.
10. The presumptive premium rates for credit accident and health insurance reflected in the foregoing Findings of Fact and Conclusions of Law are just, reasonable, adequate, nonconfiscatory and not excessive to insurers, insureds or agents pursuant to TEX. INS. CODE ANN. art. 3.53.
11. The presumptive premium rates for credit life and credit accident and health insurance include consideration of reasonable acquisition costs, loss ratios, and administrative expenses, reserves, loss settlement expenses, the type or class of business, the duration of various credit transactions, reasonable and adequate profits to the insurers, and other relevant data pursuant to TEX. INS. CODE ANN. art. 3.53.
12. The presumptive premium rates shall be in force and effect beginning April 1, 2000.

IT IS, THEREFORE, THE ORDER of the Commissioner of Insurance that the above findings of fact and conclusions of law are adopted.

IT IS, FURTHER, ORDERED that the presumptive premium rates for credit life and credit accident and health insurance be established in accordance with the foregoing findings and conclusions.

IT IS, FURTHER, ORDERED that the new presumptive premium rates become effective April 1, 2000 at 12:01 a.m.


JOSE MONTEMAYOR
COMMISSIONER OF INSURANCE

APPENDIX A

Case Terminology

Credit Life pays off the consumer's remaining debt on a specific loan or credit card account if the borrower dies during the term of the coverage.

Credit Disability pays a limited number of monthly payments on a specific loan or credit card account if the borrower becomes disabled during the term of the coverage.

Credit Involuntary Unemployment pays a limited number of monthly payments on a specific loan or credit card account if the borrower becomes involuntarily unemployed during the term of the coverage.

Credit Property pays an amount sufficient to pay off the entire debt on a specific piece of property serving as collateral for the loan if the property is lost or damaged. Unlike the first three credit insurance products, credit property insurance is not directly related to an event affecting a consumer's ability to pay his or her debt.

Single Premium (SP) coverages are typically sold in conjunction with a closed-end, or fixed-term loan and the premiums for such coverages are typically calculated on a gross indebtedness basis.

Outstanding Balance (OB) products are typically sold in conjunction with open-end or revolving loans, such as credit cards. The monthly payments are typically based upon the monthly outstanding balance on the revolving loan or credit card.

Single Life coverages - the insurance pays if the single person covered dies.

Joint Life coverages - the insurance pays if the borrower or co-borrower dies.

Reducing exposure - the exposure to the credit insurer declines over the term of the loan.

Level exposure - the exposure remains the same during the term of coverage and is payable in a single sum at the end of the loan.

Waiting periods for credit disability coverages in Texas are currently 14 and 30 days.

Retroactive coverage - benefits are paid from the first day of disability once the waiting period has elapsed. For example, with a 14-day retro coverage, benefits are paid from the date of disability after the debtor has been disabled for 14 days.

Non-retroactive coverage - benefits are paid from the day after the end of the waiting period.

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Rates are stated in terms of dollars per \$100 of gross initial indebtedness for SP credit insurance and in terms of dollars per \$1000 of outstanding balance for credit insurance.

Gross Indebtedness refers to the total of all principal and interest payments. It includes loan principal, loan interest, credit insurance premium, and credit insurance premium loan interest.

Non-contributory coverage - in the past, lenders purchased a credit insurance policy to provide coverage for the entire portfolio of loans and the cost was absorbed by the lender as a cost of business.

Contributory coverage - at the present time, credit insurance policies only cover borrowers who pay for the coverage.

Reverse competition - insurers compete for the business of lenders by providing higher commissions and other compensation to the lender, which results in higher costs to the consumer.

Presumptive rate - is one determined by the Commissioner to be just, reasonable, adequate, not confiscatory, or not excessive to insurers, the insureds, or agents.

Rate standards - article 3.53 of the Texas Insurance Code and 28 TAC §3.5001 through 3.6403 contain the standards, which include factors to be considered, including: reasonable acquisition costs, loss ratios, administrative expenses, reserves, loss settlement expenses, type or class of business, duration of various credit transactions, reasonable and adequate profits to insurers and other relevant data. The basic test of reasonableness of benefits to premium charges is loss ratios of 50% for credit life and 60% for credit disability coverage. See 28 TAC §3.5202.

Loss Ratio - is the ratio of claims incurred to premiums earned.

[The foregoing definitions were taken from the prefiled testimony of Birny Birnbaum]

Types of Coverage

1. Credit Life Coverages

Single Premium, Reducing Coverage, Single Life
Single Premium, Level Coverage, Single Life
Single Premium, Reducing Coverage, Joint Life
Single Premium, Level Coverage, Joint Life
Outstanding Balance, Revolving Loan, Single Life
Outstanding Balance, Other, Single Life
Outstanding Balance, Revolving Loan, Joint Life
Outstanding Balance, Other, Joint Life

2. Credit Disability Coverages

Single Premium 14-day Retroactive
Single Premium 30-day Retroactive
Single Premium 14-day Non-Retroactive
Single Premium 30-day Non-Retroactive
Single Premium 90-day Non-Retroactive
Outstanding Balance Revolving 14-day Retroactive
Outstanding Balance Revolving 30-day Retroactive
Outstanding Balance Revolving 14-day Non-Retroactive
Outstanding Balance Revolving 30-day Non-Retroactive
Outstanding Balance Other 14-day Retroactive
Outstanding Balance Other 30-day Retroactive
Outstanding Balance Other 14-day Non-Retroactive
Outstanding Balance Other 30-day Non-Retroactive
Outstanding Balance Other 90-day Non-Retroactive

APPENDIX B

CREDIT LIFE INSURANCE PRESUMPTIVE RATES

Plan	Plan Description	Rate
1	Single Premium, Reducing Coverage, Single Life	* \$0.300 per year per \$100 initial insured indebtedness
2	Single Premium, Level Coverage, Single Life	* \$0.576 per year per \$100 insured indebtedness
3	Outstanding Balance, Revolving Loan, Single Life	\$0.480 per month per \$1000 outstanding insured indebtedness
4	Outstanding Balance, Other, Single Life	\$0.480 per month per \$1000 outstanding insured indebtedness
5	Single Premium, Reducing Coverage, Joint Life	* \$0.450 per year per \$100 initial Insured indebtedness
6	Single Premium, Level Coverage, Joint Life	* \$0.864 per year per \$100 insured indebtedness
7	Outstanding Balance, Revolving Loan, Joint Life	\$0.720 per month per \$1000 outstanding insured indebtedness
8	Outstanding Balance, Other, Joint Life	\$0.720 per month per \$1000 outstanding insured indebtedness

* Single premium rates for plans 1, 2, 5, and 6 must be multiplied by the discount factor which is restated as follows:

Discount Factor =

$$1 + \frac{1}{24 \times 0.45 \times n}$$

Where n = The term of the insurance coverage in months

APPENDIX C

CREDIT DISABILITY INSURANCE PRESUMPTIVE RATES

Plan	Plan Description	Rate
10	Single Premium 14-day Retroactive	Multiply rate from Table D times Discount Factor *
11	Single Premium 30-day Retroactive	Multiply rate from Table D times Discount Factor *
12	Single Premium 14-day Non-Retroactive	Multiply rate from Table D times Discount Factor *
13	Single Premium 30-day Non-Retroactive	Multiply rate from Table D times Discount Factor *
14	Single Premium 90-day Non-Retroactive *	\$.13 /year/\$100 Initial indebtedness times Discount Factor *
16	Outstanding Balance Revolving 14-day Retroactive	\$2.00 per month per \$1000 of outstanding insured indebtedness
17	Outstanding Balance Revolving 30-day Retroactive	\$1.48 per month per \$1000 of outstanding insured indebtedness
18	Outstanding Balance Revolving 14-day Non-Retroactive	\$1.74 per month per \$1000 of outstanding insured indebtedness
19	Outstanding Balance Revolving 30-day Non-Retroactive	\$1.30 per month per \$1000 of outstanding insured indebtedness
22	Outstanding Balance Other 14-day Retroactive	Multiply applicable Table D rate by Conversion Formula **
23	Outstanding Balance Other 30-day Retroactive	Multiply applicable Table D rate by Conversion Formula**
24	Outstanding Balance Other 14-day Non-Retroactive	Multiply applicable Table D rate by Conversion Formula**
25	Outstanding Balance Other 30-day Non-Retroactive	Multiply applicable Table D rate by Conversion Form. **
26	Outstanding Balance Other 90-day Non-Retroactive	Multiply Plan 14 SP without discount by Conversion Formula**

* Single premium rates for plans 10 through 14 must be multiplied by the discount factor which is restated as follows:

$$\text{Discount Factor} = \frac{1}{1 + \frac{.0563 \times n}{24}}$$

Where n = The term of the insurance coverage in months

** Conversion Formula is As Follows:

$$= \frac{20}{n+1}$$

Where n = the term of the insurance coverage in months.

* Coverage cannot be less than 6 months

TABLE C OF APPENDIX C

CREDIT DISABILITY SINGLE PREMIUM RATES (PLANS 10, 11, 12, & 13)
BEFORE APPLICATION OF DISCOUNT FACTOR

RATES BELOW ARE PER \$100 OF INITIAL INDEBTEDNESS

***** Benefits Payable After: *****

Original Number Of Equal Monthly Installments	14th day of disability		30th day of disability	
	Retroactive	Non-retroactive	Retroactive	Non-retroactive
3	0.79	0.61		
4	1.06	0.81		
5	1.32	1.01		
6	1.51	1.21	1.10	0.68
7	1.60	1.36	1.20	0.78
8	1.69	1.44	1.29	0.86
9	1.76	1.51	1.37	0.94
10	1.83	1.58	1.45	1.01
11	1.89	1.64	1.50	1.08
12	1.94	1.69	1.55	1.13
13	1.99	1.75	1.58	1.18
14	2.04	1.80	1.62	1.24
15	2.09	1.85	1.65	1.29
16	2.14	1.89	1.68	1.33
17	2.18	1.94	1.71	1.38
18	2.23	1.97	1.74	1.43
19	2.26	2.02	1.76	1.46
20	2.30	2.05	1.79	1.50
21	2.34	2.09	1.82	1.53
22	2.37	2.12	1.83	1.55
23	2.41	2.16	1.86	1.57
24	2.44	2.19	1.88	1.59
25	2.48	2.23	1.89	1.61
26	2.50	2.26	1.93	1.64
27	2.54	2.29	1.95	1.66
28	2.56	2.32	1.96	1.68
29	2.60	2.35	1.98	1.69
30	2.62	2.38	2.00	1.71
31	2.66	2.41	2.02	1.73
32	2.69	2.43	2.03	1.75
33	2.71	2.46	2.05	1.76
34	2.74	2.49	2.08	1.79
35	2.76	2.52	2.09	1.81

Original Number Of Equal Monthly Installments	14th day of disability		30th day of disability	
	Retroactive	Non-retroactive	Retroactive	Non-retroactive
36	2.79	2.55	2.11	1.83
37	2.82	2.57	2.12	1.83
38	2.84	2.60	2.14	1.85
39	2.87	2.62	2.16	1.87
40	2.89	2.64	2.16	1.88
41	2.92	2.67	2.18	1.89
42	2.95	2.69	2.20	1.91
43	2.96	2.72	2.22	1.93
44	2.99	2.74	2.23	1.95
45	3.02	2.76	2.25	1.96
46	3.04	2.79	2.26	1.97
47	3.06	2.81	2.28	1.99
48	3.09	2.83	2.29	2.00
49	3.10	2.86	2.30	2.02
50	3.13	2.88	2.31	2.03
51	3.15	2.90	2.33	2.04
52	3.17	2.92	2.34	2.05
53	3.19	2.95	2.36	2.07
54	3.22	2.96	2.36	2.08
55	3.23	2.98	2.38	2.09
56	3.26	3.01	2.40	2.11
57	3.28	3.02	2.41	2.12
58	3.29	3.05	2.42	2.14
59	3.32	3.07	2.43	2.15
60	3.34	3.09	2.44	2.16
61	3.35	3.10	2.46	2.17
62	3.37	3.12	2.48	2.19
63	3.39	3.14	2.49	2.21
64	3.41	3.16	2.51	2.23
65	3.42	3.17	2.53	2.24
66	3.44	3.19	2.55	2.26
67	3.46	3.21	2.56	2.28
68	3.48	3.22	2.58	2.29
69	3.49	3.24	2.60	2.31
70	3.51	3.26	2.62	2.33
71	3.53	3.28	2.63	2.35
72	3.55	3.29	2.65	2.36
73	3.56	3.31	2.67	2.38
74	3.58	3.33	2.69	2.40
75	3.60	3.35	2.70	2.42
76	3.62	3.36	2.72	2.43

Original Number Of Equal Monthly Installments	14th day of disability		30th day of disability	
	Retroactive	Non-retroactive	Retroactive	Non-retroactive
77	3.63	3.38	2.74	2.45
78	3.65	3.40	2.76	2.47
79	3.67	3.42	2.77	2.49
80	3.69	3.43	2.79	2.50
81	3.70	3.45	2.81	2.52
82	3.72	3.47	2.82	2.54
83	3.74	3.49	2.84	2.56
84	3.75	3.50	2.86	2.57
85	3.77	3.52	2.88	2.59
86	3.79	3.54	2.89	2.61
87	3.81	3.55	2.91	2.62
88	3.82	3.57	2.93	2.64
89	3.84	3.59	2.95	2.66
90	3.86	3.61	2.96	2.68
91	3.88	3.62	2.98	2.69
92	3.89	3.64	3.00	2.71
93	3.91	3.66	3.02	2.73
94	3.93	3.68	3.03	2.75
95	3.95	3.69	3.05	2.76
96	3.96	3.71	3.07	2.78
97	3.98	3.73	3.09	2.80
98	4.00	3.75	3.10	2.82
99	4.02	3.76	3.12	2.83
100	4.03	3.78	3.14	2.85
101	4.05	3.80	3.16	2.87
102	4.07	3.82	3.17	2.89
103	4.09	3.83	3.19	2.90
104	4.10	3.85	3.21	2.92
105	4.12	3.87	3.22	2.94
106	4.14	3.89	3.24	2.96
107	4.15	3.90	3.26	2.97
108	4.17	3.92	3.28	2.99
109	4.19	3.94	3.29	3.01
110	4.21	3.95	3.31	3.02
111	4.22	3.97	3.33	3.04
112	4.24	3.99	3.35	3.06
113	4.26	4.01	3.36	3.08
114	4.28	4.02	3.38	3.09
115	4.29	4.04	3.40	3.11
116	4.31	4.06	3.42	3.13
117	4.33	4.08	3.43	3.15
118	4.35	4.09	3.45	3.16
119	4.36	4.11	3.47	3.18
120	4.38	4.13	3.49	3.20