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Consumer Experiences With Credit Insurance: Some New Evidence

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Credit insurance is a product that has been steeped in controversy for many years. This article examines several issues surrounding the marketing and sale of credit insurance through a recent survey on consumer experiences with the product. Survey findings indicate that credit insurance is purchased frequently, that consumers generally do not feel pressured into buying the product, and that consumers view credit insurance quite favorably. Past abuses in the marketing and sale of credit insurance therefore may have been overstated or have declined in recent years.

The sale of credit insurance in connection with extensions of consumer credit has been a controversial subject for many years. Sold by various types of financial institutions and some retailers, credit insurance is designed to repay a borrower's debt in the event of his death or disability. Credit insurance has been controversial because of its alleged high cost in many states and because of allegations of abusive marketing and sales practices. The credit insurance industry has responded to such criticisms by arguing that rates are reasonable in view of the circumstances under which credit insurance is sold. Also, while acknowledging the existence of some abusive practices in the past, industry representatives argue that most abuses have been eliminated in recent years.

Credit insurance will likely remain a controversial product. A strong rise in consumer debt during the 1980s has caused both consumer advocates and some governmental authorities to take note once again. Recently, the Federal Reserve's Consumer Advisory Council, an advisory group consisting of 30 financial industry, regulatory, and consumer representatives, expressed interest in credit insurance practices and the attitudes of borrowers toward them. Also of late, mandatory competitive rate bidding (for credit insurance) in Massachusetts has been the object of intense scrutiny by industry observers.[1] Pressures for greater banking deregulation and attempts by some banking organizations to gain permission to conduct specific new insurance activities, such as underwriting and selling home mortgage insurance, also have called attention to insurance practices.[2]

Finally, considerable discussion has arisen concerning an amendment to the Federal Reserve System's Regulation Y. This amendment eliminates a longstanding requirement that bank holding company subsidiaries proposing to engage in the underwriting of credit insurance demonstrate public benefits in the form of a rate reduction (see Box).

In view of the continuing interest in credit insurance, it seems worthwhile to examine the nature of this product and to review some of the issues surrounding it. This paper also reports some new evidence on the frequency of credit insurance pur-

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Credit Insurance and Regulation Y

Regulation Y of the Federal Reserve System governs bank holding company activities permitted under the Bank Holding Company Act of 1956 as amended. In 1970, Regulation Y was revised in several important ways. One of the most important was to allow bank holding companies to engage in certain nonbanking activities.

In deciding which activities were to be permissible, the Federal Reserve Board was to apply a two part test: new activities had to be both "closely related to banking" and "a proper incident thereto." The "closely related" test requires an examination of any proposed activity in light of past usual and reasonable banking practices. The "proper incident thereto" test requires a finding that, after an assessment of all potential benefits and adverse consequences, the activity will result in "net public benefits."

Although not on the original "laundry list" of new permissible nonbanking activities, the underwriting of credit insurance was quickly proposed as a new activity for bank holding companies. In 1972, the Board determined that the underwriting of credit insurance was closely related to banking but that the activity involved potentially serious adverse effects. These effects included the potential for excessive charges to consumers and excessive underwriting profits, incentives for bank holding companies to pressure borrowers into buying unnecessary or inferior credit insurance, and the use of credit insurance effectively to raise the interest charges on loans covered by state usury laws.

To ensure the presence of "net public benefits," the Federal Reserve Board, since 1972, has required bank holding companies to offer credit life insurance at rates slightly below the maximum rates permitted by state laws, based on a sliding scale. In general, the Board has required a 15 percent rate reduction in states with relatively high ceiling rates (for example, $1.00 per hundred dollars of single credit life insurance) and as little as a 2 percent rate reduction in states with relatively low ceiling rates (for example, $0.50 per hundred dollars of insurance). Also, bank holding companies generally have offered a 5 percent premium rate reduction from state-assigned rates on credit accident and health insurance to meet the Board's public benefits test.*

The Board's requirement has always been controversial. Consumer advocates, who desire lower credit insurance rates for borrowers, and insurance industry representatives, who have opposed the entry of banking organizations into the insurance industry, generally favor it. The banking industry generally opposes the requirement because it limits the price that banking organizations can charge for credit insurance.

In November 1983, the Federal Reserve Board invited public comment on a proposal to eliminate the rate reduction rule. The proposed elimination was prompted by public comments received in connection with the 1983 revision of Regulation Y. On June 25, 1986, the Board voted to rescind its longstanding rate reduction requirement, citing the incongruity of imposing pricing restrictions on credit insurance underwriting activities but not on other nonbanking activities, and the lack of evidence of the adverse effects cited in its 1972 ruling.

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*The Board has also been willing to accept a combination of rate reductions and increased policy benefits for the necessary public benefits.

chases, borrower perceptions about lender recommendations to buy credit insurance, and overall borrower attitudes toward this product. Based upon these survey results, some inferences are drawn as to the likely validity of some of the criticisms levied at the sale of this insurance product.

Section I describes the nature and primary types of credit insurance. Section II focuses on various marketing and sales abuses (including tie-in sales) that have been alleged by some industry critics. The third section presents an analysis of the results of the 1985 Federal Reserve Board survey of borrower experiences with credit insurance. These results are compared to those found in a similar Board-sponsored survey conducted in 1977.

Two important conclusions emerge from the consumer surveys. First, consumers believe that creditors base their decisions to grant credit on factors other than consumer decisions whether to purchase credit insurance. Second, consumers who purchase credit insurance believe it is a valuable product and would be inclined to purchase insurance in the future. The final portion of the paper summarizes the findings.

I. Credit Insurance

Credit insurance typically is sold to borrowers in connection with the extension of credit by a lender, usually a financial institution or retailer. It is designed to ensure the repayment of a borrower's debt in the event of death, disability or loss of property. The types of credit extensions that are usually covered include automobile loans, personal loans, and installment purchases of appliances as well as other consumer goods[3]. Generally, credit insurance is sold to a lender by an insurance underwriter on a group basis. The lender holds the policy and issues a certificate of insurance to any borrower who purchases credit insurance. The lender is named beneficiary and directly receives any payments made on submitted claims.

There are three basic types of credit insurance: credit life, credit accident and health, and credit property insurance. Credit life is the most commonly purchased type of credit insurance and provides for the repayment of a loan in the event of the borrower's death. Credit life insurance first appeared in the early 1900s to insure automobile loans. It typically is written as declining term insurance, that is, coverage decreases as the loan is repaid. At the beginning of 1985, there were nearly 66 million credit life policies in existence in the U.S. with in-force coverage of $190 billion.[4]

Accident and health insurance (A&H) is also known as credit disability insurance. A&H credit insurance is designed to repay a borrower's debt in the event of a loss of income due to illness or injury. A&H credit insurance entails greater risk of loss to the underwriter and is more difficult to administer than credit life. Consequently, it is more costly to offer than credit life insurance. Borrowers may be required to be employed at the time that coverage is extended and usually face restrictions concerning pre-existing health conditions. Frequently, A&H policies feature a "retroactive" clause that requires a borrower to be disabled for a specified time before insurance payments begin. Once this time requirement is met, however, insurance payments are made retroactively to the first day of disability.

A third type of credit insurance is credit property insurance, which provides coverage for personal property purchased with a loan. It may also insure collateral property.

Credit insurance policies are written by various types of insurance companies. Those that deal primarily in credit policies are known as "specialty" companies and are the largest issuers of credit insurance policies. A second type of credit insurer is a "captive" insurer — a firm that is owned by a single creditor or group of creditors through a second company, usually a "reinsurer." A third type of credit insurer is the general or full-line life insurance company.

II. Credit Insurance — Consumer Issues

Credit insurance, particularly credit life insurance, has characteristics that distinguish it from other types of insurance. For example, unlike regular life insurance, it is made available in small amounts of coverage, and its premium rate does not depend on the insured's age or health (although credit life insurance is usually not made available to borrowers over the age of 65). It is usually sold by the creditor directly at a premium rate that is constant regardless of the size of the loan or its maturity. Generally, no proof of insurability is required, and credit insurance usually cannot be cancelled. As a result of these characteristics, credit insurance may offer important advantages to certain borrowers who find it to be a convenient and economical way to purchase protection against debt default.

Industry critics, however, contend that while credit insurance offers borrowers some advantages, its sale has often been associated with abusive and even illegal practices. Their criticism has centered on several issues including the cost of credit insurance and the manner in which credit insurance has been marketed and sold. These issues present difficult questions, and they warrant further discussion.

Credit Insurance Rates

One important concern of industry critics is that credit insurance is relatively expensive, particularly in comparison with other types of insurance such as term life insurance. Lenders and insurers have responded by arguing that the circumstances in which credit insurance is sold justify higher premium rates. They argue that the administrative costs of providing credit insurance are high compared to other forms of insurance. Indeed, the small average size of credit insurance policies and the presence of some fixed costs in administrating and servicing policies suggests that there may be some validity to this point. Also, they argue that credit insurance sales are subject to an "adverse selection" process that permits purchasers of varying ages to obtain credit insurance at the same premium rate. Typical term life policies account for variations in risk by charging different rates to individuals with different risk profiles (for example, different ages, health, sex, marital status, or different personal habits such as smoking or nonsmoking.)

The cost issue does not lend itself to an easy resolution. Most observers agree that credit insurance rates should be set at a level that will allow for the payment of claims, provide reasonable lender compensation, and ensure normal profits to insurance underwriters. To achieve these goals, the National Association of Insurance Commissioners recommends that states set *prima facie* maximum rates at levels that will generate a target "loss ratio" (ratio of premiums paid out to premiums collected) of 60 percent. Maximum allowable rates for credit life insurance (and actual loss ratios), however, vary widely, ranging from as much as $1.00 per hundred dollars of insurance in some states to as little as $0.28 per hundred dollars in others.

Wide variations in maximum allowable credit insurance rates among states, moreover, are not well explained by what are believed to be only minor differences in the costs of providing insurance in different states. Rather, industry critics contend that the allegedly high *prima facie* rates found in certain states result from several factors, including a lack of organized consumer pressure for lower rates, a low level of concern by state insurance regulators, strong industry lobbies that seek to maintain existing rate structures, and market conditions that are perceived as conducive to noncompetitive pricing behavior.

The level at which legal maximum rates are set is a concern because in most states lenders tend to charge the highest rate permitted. This practice exists because lenders are typically compensated for credit insurance sales by receiving a portion of the collected premiums (up to 60 percent in some states). Although state laws generally limit the size of this commission and prohibit lenders from marking up the cost of insurance to borrowers, lenders (by sharing in the premiums collected) as well as insurers profit from charging higher premiums.

Lenders have the ability to charge maximum allowable rates only when borrowers have an inelastic demand for credit insurance since revenue to the lender would then increase as price rises to the state

ceiling rate. This demand inelasticity might derive from several sources. Borrowers may be unaware of alternative sources of credit insurance or of substitute products (such as increasing existing life insurance coverage). Inelastic demand also could be the result of a desire to minimize search costs for alternative sources of credit insurance — especially since the cost of credit insurance typically accounts for a small proportion of total loan costs.

Tying Arrangements and Credit Insurance

A second major issue that surrounds credit insurance is that of "tie-in" sales between the granting of credit and the sale of credit insurance. Tie-in sales or "tying arrangements" occur when the purchaser of some product (the tying good) agrees or is required to purchase a second good (the tied good) from the seller as a condition to the purchase of the first good. Involuntary tie-ins through explicit contractual arrangements are generally prohibited under various federal laws including Section 3 of the Clayton Act, Section 1 of the Sherman Antitrust Act, and Section 106 of the Bank Holding Company Act.

The economic rationale for tying arrangements has been explored thoroughly in the antitrust literature by such authors as Singer, Scherer, and Edwards.[5] This literature argues that tying arrangements may accomplish several objectives for the seller. One, firms may realize sales economies by distributing tied products together. Two, tying arrangements have been used to protect the reputation of a firm's products by ensuring that compatible joint inputs are used in production processes. Three, tying arrangements have been used to circumvent price controls such as usury restrictions on consumer finance rates.[6]

In the case of credit insurance, much of the debate over tie-ins centers on whether the tying of credit and credit insurance is due to a lack of competition. That is, under what conditions can lenders coerce borrowers into purchasing credit insurance by threatening, either explicitly or implicitly, to withhold credit unless the borrowers also buy credit insurance? Eisenbeis and Schweitzer have argued that such coercion is likely to be more successful in markets where lenders enjoy some degree of monopoly power in the granting of credit.[7] An example of such a market might be one that exhibited high concentration, had few lenders, maintained restricted entry conditions, and presented high search costs for alternative sources of credit.[8]

Other Consumer Issues

Some industry observers have criticized other aspects of the marketing and sale of credit insurance. They argue that the extent of coverage has frequently been misrepresented to consumers. In addition, they allege that consumers have suffered from fraudulent and deceptive claims practices (such as not being provided a copy of the insurance policy or being subject to an extremely narrow definition of "disability"). They also argue that credit insurance often is sold in excessive amounts, such as when creditors base the amount of coverage on the sum of monthly payments ("gross coverage") rather than the outstanding principal balance ("net coverage"). At present, few states require coverage to be made on a net basis.

Critics also argue that coverage sometimes is sold for periods that exceed the term of the loan and that unearned premiums often are not refunded when loans are prepaid or refinanced. These and other abuses have been discussed more extensively in a number of previous studies of credit insurance practices.[9] While the extent of these practices has always been a matter of intense debate, examples from several recent court cases provide some evidence that they exist.[10]

III. Studies of Credit Insurance

Credit insurance has been discussed widely but has been the subject of relatively few empirical studies. Important studies of credit insurance include efforts by the National Association of Insurance Commissioners (NAIC, 1970), Hubbard (1973), Huber (1976), and Eisenbeis and Schweitzer (1979).[11] The NAIC study surveyed state insurance regulators and reported on the frequency of consumer complaints arising from coercive selling practices. A more comprehensive study conducted at Ohio University (Hubbard) attempted to determine consumer attitudes toward credit insurance and the extent to which consumers may have been pressured into buying it. A consumer survey was used to identify consumer perceptions about tie-in sales of credit insurance. Huber, in an examination of the sale of credit insurance by retailers, focused on the demand for credit insurance and how it varies by different groups of consumers.

The most comprehensive empirical study of credit insurance tie-in sales was the 1979 study by Eisenbeis and Schweitzer. Using the results of two surveys — one of consumers and the other of bank holding companies — the authors constructed an analytical framework that enabled the existence of tie-in insurance sales to be revealed by a high proportion of joint purchases of credit and credit insurance, by borrower perceptions of and resentment at being forced to make insurance purchases, and by creditor conduct that is thought to promote tying arrangements.

The study found that a relatively high proportion of borrowers purchased credit insurance but that these high penetration rates probably did not indicate coercion. Their conclusion was based upon generally favorable consumer perceptions of credit insurance and the low reported incidence of survey responses that indicated that credit insurance had been required or strongly recommended. In addition, an examination of insurance selling practices by bank holding companies revealed procedures that seemed to make coercive selling practices unlikely.

Table 1

Proportion of Borrowers That Had Credit Insurance and the Proportion That Did Not Know Whether They Had Credit Insurance in 1977 and 1985, by Institutional Source*

(Percent)

	Had Insurance		Did Not Know	
Source	**1977**	**1985**	**1977**	**1985**
Retailer, dealer, contractor	41.4	52.4	11.3	*
Bank or savings and loan	63.0	66.9	4.0	1.9
Finance company	76.8	69.7	6.6	*
Credit union	71.8	60.5	7.1	4.0
Other	28.6	62.3	*	1.3
Total	63.9	64.7	6.0	2.2

*Includes only the most recent loan with regular monthly payments of at least $25 for each family. Excludes mortgage loans and credit card debts.

**Less than 0.5 percent.

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

The 1985 Survey

The Eisenbeis-Schweitzer study (1979) was based primarily on the results of the *1977 Consumer Credit Survey.* Sponsored by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, that survey collected detailed information on the credit insurance experiences of approximately 2,500 families selected to be representative of all families residing in the United States.

In December 1985, the Federal Reserve Board, at the request of the Consumer Advisory Council (CAC), sponsored credit insurance questions on the University of Michigan monthly Survey of Consumer Attitudes. The CAC request was based on a perception that substantial changes may have taken place in the credit insurance market in recent years. The 1985 survey examined consumer experiences with credit insurance and contains the responses of 652 representative U.S. families reporting at least one nonmortgage closed-end loan.[12]

This paper reports the results of the 1985 survey and compares some of those results to those of the 1977 survey. The analytical approach used to investigate the seriousness of consumer abuses in the sale of credit insurance is the same as that developed in the Eisenbeis-Schweitzer study. In this approach, the presence of excessive costs or unfair or abusive sales practices, including coercive tying arrangements, would be revealed by adverse consumer experiences and attitudes of resentment toward credit insurance.

Within the Eisenbeis-Schweitzer framework, consumer surveys help to determine whether credit insurance is purchased even though it is viewed

Table 2

Credit Insurance Penetration Rates by Family Characteristics

(Percent of Borrowers in Each Subgroup)

	Have Insurance		Do Not Know	
Characteristic	**1977**	**1985**	**1977**	**1985**
Income				
Less than $15,000	64.5	75.3	5.4	1.1
$15,000-$24,999	64.2	65.2	4.7	1.1
$25,000-$34,999	64.2	78.2	4.3	2.4
More than $35,000	62.2	49.4	7.9	3.1
Education (highest grade)				
Some high school or less	68.1	84.8	7.3	*
High school diploma	65.5	65.3	5.7	1.7
Some college or more	59.1	59.7	5.1	2.9
Race				
White	63.1	65.1	5.1	2.3
Nonwhite	65.8	62.8	10.5	*
Age (years)				
Under 35	62.6	55.6	7.4	2.7
35 - 54	64.8	74.9	3.9	1.6
55 and over	63.6	66.1	7.1	1.6

*Less than 0.5 percent.

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

TABLE 3

Specific Source of Credit Insurance and Reason for Selection of Source, 1985

	Percent
Specific source	
Lender	89.9
Other firm	10.1
Total	100.0
Reason for selection of lender*	
Required	8.2
Was available from lender	28.6
Convenience	30.1
Automatically included with loan	14.1
Cost	4.1
Other	14.9
Total	100.0
Reasons for selection of source other than lender*	
Cost	13.6
Familiarity	36.4
Other	50.0
Total	100.0

*First reason cited for selection by respondent.

SOURCE: University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

TABLE 4

Consumer Perceptions of Recommendations by Creditor About Purchasing Credit Insurance in 1977 and 1985

(Percent Distribution of Families)

	Families with credit insurance		Families without credit insurance	
Responses	**1977**	**1985**	**1977**	**1985**
Never mentioned	7.1	14.8	51.6	45.2
Mentioned but not recommended	15.0	44.7	22.6	35.5
Recommended	33.1	16.4	17.0	12.9
Strongly recommended	13.2	6.3	2.3	2.6
Required	26.1	13.8	n.a.	n.a.
Other*	3.5	**	0.6	**
Don't know	2.1	3.9	5.9	3.9
Total	100	100	100	100

*Includes respondents who said they requested insurance.

**Less than 0.5 percent.

n.a. not applicable

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

unfavorably. Moreover, high sales penetration rates among borrowers may be a signal that involuntary tying is occurring if it is accompanied by consumer perceptions of coercion. The following, therefore, specifically examines the frequency of credit insurance purchases, borrower perceptions of creditor recommendations to buy insurance, and consumer attitudes toward credit insurance.

Frequency of Credit Insurance in Consumer Loan Transactions

The December 1985 survey indicates that slightly less than two-thirds (64.7 percent) of all borrowers purchased credit insurance to cover their most recent closed-end consumer loan with regular monthly payments of at least $25 (see Table 1).[13] The percentage of credit insurance buyers compares to a nearly equivalent 63.9 percent in 1977, and indicates that consumers continue to be frequent buyers of credit insurance.[14]

As indicated by the smaller proportion of "don't know" responses, borrowers in the 1985 survey also seemed to be more aware of whether they actually purchased credit insurance than their 1977 counterparts. Critics frequently argue that the sale of credit insurance often is "buried" within loan documentation to such an extent that consumers do not know that they are purchasing credit insurance. In 1985, only 2.2 percent of all borrowing families reported that they did not know whether they had credit insurance coverage on their outstanding loan. This contrasts with nearly 6 percent of borrowers in 1977. The explanation for this statistically significant improvement in awareness is a matter of speculation, but it could be related to efforts by consumer advocacy groups and state insurance regulators to promote more open marketing practices. It could also be attributable to the effects of Regulation Z which requires borrowers to sign a statement indicating their desire to purchase credit insurance.[15]

An important issue regarding credit insurance has been that of penetration rates — the percentage of qualified borrowers who actually purchase credit insurance. Concern has focused on the possibility that high penetration rates may indicate successful coercion. Both the 1977 and 1985 surveys collected information on penetration rates by type of creditor, and found that the purchase of coverage was most common for loans obtained from finance com-

TABLE 5

Consumer Perceptions of Recommendations by Creditor About Purchasing Credit Insurance, by Type of Lender in 1985*

(Percent of Families with Credit Insurance)

Responses	Bank	Finance company	Credit union	Retailer, dealer, contractor	Other
Creditor never mentioned insurance	13.4	21.7	8.9	**	20.2
Mentioned but not recommended	42.5	43.5	64.4	54.5	38.2
Recommended	14.9	**	8.9	45.5	21.3
Strongly recommended	9.7	**	4.4	**	4.5
Required	14.9	21.7	6.7	**	15.7
Don't know	4.5	13.0	6.7	**	**
Total	100	100	100	100	100

*Consumers with credit insurance.

**Less than 0.5 percent.

SOURCE: University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

panies. In 1985, for example, 69.7 percent of finance company borrowers were covered by some type of credit insurance. Penetration rates for commercial banks and savings institutions were nearly as high at 67 percent. Credit insurance sales appear to be less frequent for credit unions (61 percent) and for retailers, dealers, and contractors (52.4 percent), probably because fewer such lenders offer credit insurance.

One of the more interesting aspects of credit insurance is the tendency of penetration rates to vary according to income class and education (Table 2). The 1985 data indicate that higher income ($35,000 or more) and better educated (at least a high school diploma) borrowers were less likely to have credit insurance than other borrower groups. These findings seem reasonable given that individuals with more education and higher annual incomes typically have greater net worth on which to rely in emergencies and are more likely to have other forms of insurance.

For example, information obtained from the *1983 Survey of Consumer Finances*[16] indicates that only 55 percent of families with incomes below $15,000 in 1983 were covered by some type of life insurance plan. In contrast, 94 percent of families with incomes above $35,000 had such coverage in that year. High income individuals may also be perceived as better credit risks, and thus may be subject to less pressure to purchase credit insurance.

Most borrowers who buy credit insurance obtain it from their lender. In 1985, 90 percent of borrowers with credit insurance reported that they obtained the insurance from the lender (Table 3). Among such borrowers, the two most frequently cited explanations for this selection were convenience and availability. Among borrowers who obtained insurance from a source other than the creditor, the principal reason cited for their choice was familiarity (prior experience) with that insurer. There was a small but statistically significant increase from 2 percent in 1977 to 10.1 percent in 1985 in the proportion of borrowers who reported that they obtained credit insurance from someone other than the creditor. This suggests that borrowers have developed a greater awareness of alternative sources of credit insurance.

Recommendations to Buy Credit Insurance: Borrower Perceptions

Credit insurance industry critics claim that the strong tendency for borrowers to purchase credit insurance from their lender is evidence of coercion. To evaluate this claim, the 1985 survey collected information on consumer perceptions of creditor recommendations on the purchase of insurance.

The 1985 survey (Table 4) indicates that 20.1 percent of borrowers with credit insurance have the impression that credit insurance was either required or strongly recommended by their creditor. In marked contrast, 39.3 percent of credit insurance purchasers in 1977 thought that the creditor either required or strongly recommended the purchase of credit insurance.[17]

Requiring credit insurance, however, does not necessarily indicate the existence of illegal behavior. In many states, creditors may legally require the purchase of credit insurance as a condition to receiving credit. They may not, however, require that such insurance be purchased from a particular source (especially the creditor). Furthermore, the cost of credit insurance must be reflected in the calculation of the loan's annual percentage rate.[18]

Table 5 suggests that customers of finance companies more frequently believed credit insurance to be required than borrowers obtaining credit elsewhere. Comparison of these data with the 1977 survey indicates virtually no change in the proportion of finance company borrowers who reported that the purchase of credit insurance was required (data not shown in tables).

To gain further insight into the question of whether borrowers are subjected to undue pressure by creditors to purchase insurance, survey respondents were asked whether they felt their decision to purchase credit insurance made a difference in whether the creditor would grant the loan (borrowers who reported that credit insurance was required were not asked this question). In 1985, borrowers with credit insurance and those without it, held similar views. Overwhelmingly (approximately 95 percent), borrowers expressed the belief that their decision regarding the purchase of credit

TABLE 6

Consumer Perceptions of Whether Taking Credit Insurance Made A Difference in Obtaining the Loan in 1977 and 1985

(Percent Distribution of Families)

Importance of taking insurance*	Families with credit insurance		Families without credit insurance		Families with credit insurance from a finance company
	1977	1985	1977	1985	1985
Made a difference	12.4	3.9	6.9	3.8	**
Irrelevant to loan decision	80.3	94.2	91.0	96.2	100
Don't know	7.2	1.9	2.1	**	**
Total	100	100	100	100	100

*Excludes those who said credit insurance was required.

**Less than 0.5 percent.

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

TABLE 7

Consumer Attitudes Toward Credit Insurance in 1977 and 1985

(Percent Distribution of Families)

Responses	Families with credit insurance		Families without credit insurance	
	1977	1985	1977	1985
Good	86.7	89.9	59.8	56.4
Good with qualifications	8.6	2.9	18.9	8.3
Neither good nor bad	2.1	1.9	9.1	6.4
Bad with qualifications	*	*	2.7	2.6
Bad	2.2	5.2	9.5	26.3
Total	100	100	100	100

*Less than 0.5 percent.

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

insurance had no effect on the creditor's decision to grant the loan (Table 6). These results strongly suggest that most borrowers did not feel pressured by lenders into purchasing credit insurance as a condition for obtaining credit. Moreover, comparisons between the two consumer surveys indicate that significantly fewer borrowers in 1985 than in 1977 believed that the creditor's decision to grant credit was affected by their choice of whether or not to purchase credit insurance (Table 6).

Borrower Attitudes Toward Credit Insurance

As noted, survey findings that the purchase of credit insurance was required by some creditors do not provide direct evidence of the existence of illegal tying practices. Nonetheless, survey information can be used to explore whether respondents perceived that lenders exerted pressures to engage in involuntary tying. Specifically, since coercive pressures are likely to generate resentment by borrowers

TABLE 8

Favorable Attitude Toward Credit Insurance Among Selected Groups of Credit Users in 1977 and 1985

(Percentage of Families in Each Subgroup)*

Characteristic	Families with credit insurance		Families without credit insurance	
	1977	1985	1977	1985
All families	95.3	92.8	78.7	64.7
Income				
Less than $15,000	96.0	88.6	75.6	68.2
$15,000-$24,999	93.3	98.3	82.3	50.0
$25,000-$34,999	97.1	93.8	79.2	73.9
More than $35,000	95.7	91.4	81.4	65.4
Education (highest grade)				
Some high school or less	97.6	96.0	87.5	44.4
High school diploma	96.1	97.4	82.4	59.7
Some college or more	92.4	88.3	72.2	70.8
Race				
White	94.9	92.2	78.4	63.3
Nonwhite	96.6	100	82.5	81.3
Age (years)				
Under 35	95.7	92.7	81.9	62.0
35-54	94.7	94.4	72.0	68.9
55 and over	95.2	87.8	86.0	68.4
Source of loan				
Bank, savings and loan	93.8	95.7	75.6	68.0
Credit union	93.8	95.7	75.6	68.0
Finance company	95.7	87.0	82.6	80.0
Retailer, dealer, contractor	94.6	100	88.5	80.0
Other	100	91.7	100	42.9
Amount financed				
Less than 300	100	**	88.2	**
300-999	93.2	100	87.5	69.2
1,000 or more	95.3	91.5	74.9	63.4

*Includes families that responded that purchase of credit insurance was a "good idea" or "good with qualifications."

**Less than 0.5 percent.

SOURCE: Durkin and Elliehausen, *1977 Consumer Credit Survey* and University of Michigan, Survey Research Center, Survey of Consumer Attitudes, December 1985.

toward credit insurance, survey responses could reveal such adverse reactions. Adverse reactions also might be expected if borrowers felt that the cost of credit insurance was excessive, or if lenders engaged in any of the abusive sales practices cited earlier.

Borrowers were questioned about their general attitude toward the purchase of credit insurance in both the 1985 and 1977 surveys. Both sets of responses indicate that about 90 percent of all borrowers who were covered by credit insurance thought buying the insurance was a "good idea" (Table 7). Only 5.2 percent of borrowers who had credit insurance in 1985 thought that it was a "bad idea" to purchase such insurance. Even among borrowers without coverage, 56 percent in 1985 stated that its purchase was a "good idea."

A cross-tabulation of consumer attitudes toward credit insurance with selected family characteristics indicates that few differences exist in responses among different subgroups of families (Table 8). In nearly all categories, 90 percent or more of the respondents with credit insurance exhibited a favorable attitude toward the purchase of credit insurance.

Finally, to evaluate further consumer perceptions about the purchase of credit insurance, each borrower with credit insurance was asked whether they would be inclined to purchase credit insurance in the future. Ninety-four percent of the respondents indicated that they would be inclined to purchase credit insurance again (Table 9). The most frequently cited reason (mentioned by 83 percent of respondents) for such a preference was that credit insurance serves a valuable purpose.

TABLE 9

Willingness of Families with Credit Insurance to Purchase Such Insurance at a Future Time

(Percent)

Characteristic	Inclined to purchase again	Inclined not to purchase again	Total
Percent of families	94.3	5.7	100
Primary reason for inclination			
Cost	*	28.6	100
Provides valuable service	82.9	—	100
Don't think they need it	—	28.6	100
Other	16.7	42.9	100
Total	100	100	100

*Less than 0.5 percent.

SOURCE: University of Michigan, Survey Research Center, *Survey of Consumer Attitudes*, December 1985.

IV. Summary and Conclusion

This study has reviewed some of the issues that surround credit insurance, including claims of excessive cost and abusive marketing and sales practices, such as tie-in sales. While the study provides no direct evidence on the validity of such criticisms, it does provide evidence on recent borrower experiences with, and attitudes toward, credit insurance. It is reasonable to assume that the presence of excessive costs or abusive selling practices would be reflected in borrower expressions of dissatisfaction with or resentment toward credit insurance.

The study is based primarily on evidence from the University of Michigan Survey of Consumer Attitudes that was conducted in December 1985. This survey provides information on the frequency of borrower purchases of credit insurance, borrower perceptions about lender recommendations to buy credit insurance, and overall borrower attitudes toward credit insurance. Results from this survey were analyzed and compared to those of a similar 1977 survey sponsored by the Federal Reserve Board.

The results of the 1985 survey indicate that nearly two-thirds of families that borrow, purchase credit insurance; furthermore, most purchasers view credit insurance favorably. The survey reveals that about one-fifth of borrowers who purchased credit insurance believed such coverage was required or strongly recommended by the creditor. However, excluding borrowers who said they were required to purchase credit insurance, few believed that their decision to purchase or not to purchase credit insurance had any effect on the lender's decision to grant credit.

The 1985 survey found that the large proportion of borrowers who were aware that they had purchased credit insurance has not changed in recent years. However, significantly fewer borrowers surveyed in 1985 were unaware of whether they actually purchased credit insurance than were in 1977. The decline in the number of such unaware borrowers may help alleviate concerns about the alleged sales practice of "burying" credit insurance within the loan document.

The 1985 survey also found a significant decline in the proportion of borrowers with credit insurance who felt that the insurance was either required or strongly recommended. Although this decline must be interpreted with caution (some states permit creditors to require the purchase of credit insurance), it may be evidence of fewer involuntary credit insurance tie-in sales. This conclusion is supported by additional survey results that indicate that in 1985, 94 percent of borrowers with credit insurance felt that their decision to buy credit insurance had no effect on the creditor's decision to grant credit. This compares to 80 percent in 1977.

Finally, the 1985 survey revealed that nine-tenths of borrowers who bought credit insurance thought the purchase was a "good idea," and would buy it again. Among borrowers who purchased credit insurance, there was little change in attitudes toward the desirability of credit insurance between 1977 and 1985. These findings are consistent with the view that creditors in general do not subject borrowers to undue pressure to purchase a product (credit insurance) that they do not want.

Overall, the 1985 survey results suggest that the widespread abuses alleged by industry critics are not perceived by most borrowers as important concerns. Thus, although this study does not contend that all past criticisms of the credit insurance industry were unwarranted, it suggests that the prevalence of such abuses has declined or may have been overstated.

FOOTNOTES

1. On May 10, 1984, the Massachusetts Banking Department implemented Regulation 209 CMR 2.00 (Mass. Reg. No. 415). This regulation requires state-chartered savings banks, cooperative banks, credit unions and trusts to seek at least three bids from insurers and to accept the lowest qualified bid for the provision of credit insurance to loan customers. Federally chartered banks, finance companies, and automobile dealers are exempt from this regulation.

2. Application by Citicorp, New York, New York, pursuant to section 4(c)(8) of the Bank Holding Company Act, to engage in the underwriting of home mortgage redemption insurance; approved by the Board of Governors of the Federal Reserve System (March, 1986).

3. Credit insurance is available for virtually all kinds of consumer credit. However, unlike credit insurance for consumer installment loans, which usually is sold directly by the loan officer or retail merchant, credit insurance for home purchase loans and credit cards typically is solicited by mail by parties unrelated to the creditor.

4. Credit life insurance is a relatively small segment of the life insurance industry. At the beginning of 1985, credit life insurance policies accounted for approximately 17 percent of the number of all life insurance policies (issued and in force in the U.S.) but only three percent of the amount of coverage in force. Similarly, premium receipts from credit life insurance policies accounted for only four percent of total life insurance premiums.

5. See, for example, Eugene Singer, *Antitrust Economics: Selected Legal Cases and Economic Models* (Englewood Cliffs, N.J.: Prentice Hall, 1968); Frederick Scherer, *Industrial Market Structure and Economic Performance* (Chicago: Rand McNally, 1970); and Franklin R. Edwards, "Economics of 'Tying' Arrangements: Some Proposed Guidelines for Bank Holding Company Regulation," *Antitrust Law and Economics Review,* Vol. 6, 1973.

6. See Scherer for a discussion of the advantages of tying arrangements, pp. 505-507.

7. Robert A. Eisenbeis and Paul R. Schweitzer, "Tie-Ins Between the Granting of Credit and Sale of Insurance by Bank Holding Companies and Other Lenders," *Staff Study,* 101, Board of Governors of the Federal Reserve System (February 1979).

8. It is not clear, however, that the monopoly extension argument provides a satisfactory explanation for the apparent tying of credit and insurance. In the case where a lender has some degree of monopoly power in the market for, say, consumer loans, it is questionable that the lender could increase profits by "forcing" borrowers to pay an above-market price for insurance which otherwise is supplied competitively. One reason is that such an arrangement would reduce the demand for loans and, thus, the interest rate on loans would have to be lower. It is by no means a straightforward proposition that the higher income on credit insurance would more than offset the reduced income from lending. (For a firm with monopoly power, tying arrangements could comprise a convenient means of price discrimination according to the difference in demand for the monopolized good. In such a case, there could be gains if the tied good is otherwise competitively supplied. Critics of credit insurance tying arrangements, however, have not argued that lenders have used credit insurance to price-discriminate among borrowers.)

The more likely situation that would be consistent with the Eisenbeis-Schweitzer position is that the conditions that lend themselves to a less competitive loan market also result in some degree of monopoly power for providers of credit insurance. If this were the case, the provision of credit and credit insurance by the same firm could be accounted for by cost advantages connected with the joint production of the two services. That is, it is cheaper for one firm to provide credit and insurance to a customer than to have the customer contract with two different firms.

To the extent that there are cost advantages to jointly producing credit and certain insurance services (e.g., insurance brokerage services), they should apply regardless of the degree of competition in a given market. Thus, even in highly competitive markets, credit and insurance brokerage services could be supplied by individual firms. Indeed, given these efficiencies, we would expect to observe borrowers obtaining credit and insurance services from the same firms. Explicit or implicit enforcement of tying arrangements would not be needed. The cost advantages of joint production, however, do not rule out the possibility that the market for credit insurance itself necessarily will be competitive. Therefore, the earlier discussion suggesting higher-than-competitive rates on credit insurance coverage is consistent with the existence of efficiencies in the joint provision of credit and credit insurance.

9. See, for example, National Association of Insurance Commissioners, "A Background Study of the Regulation of Credit Life and Disability Insurance," (Milwaukee: Executive Secretary of NAIC, 1970). Also, Joel Huber, "Credit Insurance on Retail Purchases: What Does the Public Feel?" *Cambridge Reports,* Second Quarter, 1976; Charles L. Hubbard, ed., *Consumer Credit Life and Disability Insurance* (Ohio University, College of Business Administration, 1973); Tracy Dobson, "Credit Insurance: The Hidden Insurance," *Michigan Bar Journal,* February 1986.

10. Recent evidence of credit insurance abuses is provided by a June 1985 settlement agreement between Thorp Loan and Thrift Company and the state of Minnesota. The agreement required the finance company to refund nearly $7 million in premiums to borrowers who were subjected to abusive marketing practices in which insurance coverages were added to consumers' loans without their knowledge or consent.

11. See footnote 8.

12. The respondents were selected in a way that ensures that they are representative of all U.S. families residing in the 48 contiguous states. Telephone interviews were conducted with the family member determined to be most financially knowledgeable.

13. The survey excludes mortgage loans, credit card debts and other loans with irregular payment schedules. In 1985, 17.6 percent of borrowers reported they only had credit life insurance coverage, 1.6 percent had only credit accident or health insurance, and 43.4 percent of borrowers stated they had both types of coverage.

14. The small increase in the proportion of families with credit insurance between 1977 and 1985 is within the associated sampling error. Therefore, it cannot be concluded that the proportion of consumers with such insurance in 1985 is greater than the comparable proportion in 1977.

15. Regulation Z of the Federal Reserve requires that a borrower sign an affirmative written request whenever a borrower purchases credit insurance from a lender who does not require such insurance (12 CFR S226.4d).

16. Robert B. Avery and others, *1983 Survey of Consumer Finances,* Board of Governors of the Federal Reserve System: Washington, D.C., forthcoming.

17. Hubbard (see footnote 9) reported that 19.7 percent of borrowers (who purchased credit insurance) surveyed in 1970 state that its purchase was required by the creditor.

18. Title 1 of the Consumer Credit Protection Act of 1968; also known as the Truth-in-Lending Act (15 USC 1605B).

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