

handling techniques are employed in either case, the two methods differ only in form, not in substance. Thus, we can refer to all credit life insurance as a specialized form of group term life insurance.

It is important to point out that, in the vast majority of cases, there is no direct contact between the insurance company and the insured. The creditor controls the sale entirely.

Except in specialized coverages, the cost of credit life insurance is the same regardless of the age of the debtor. The reason for this is primarily administrative convenience. Further, it makes it much easier to insure older persons who otherwise might resist the substantially higher cost.

Credit life insurance is generally single premium term insurance which decreases as the debt is repaid. Sometimes, level term insurance is issued to cover loans repayable in lump sums.

In summary, credit insurance is a form of group insurance sold more or less automatically in connection with credit transactions with a minimum of administrative expense to either the creditor or the insurance company.

It is a vital adjunct to consumer credit for it protects the creditor against loss through the death or disability of the debtor and protects the debtor's family against claims for debts outstanding at the time of the breadwinner's death or disability.

Despite these advantages, credit insurance is subject to widespread abuse, in my opinion, and, with this background information, it is now possible to describe the nature of these abuses and how they arise.

COMPETITION IN REVERSE

Recently I was discussing credit insurance with the president of New York Life who told me his company had recently lost a large bank's credit life program to another insurer whose price was 60% higher than New York Life had bid.

Does this sound like free enterprise gone haywire? Not at all in the credit insurance field. New York Life was simply unwilling to "meet the competition" by raising the price of its product, the cost of which was to be borne entirely by the bank's customers.

Of course, it is quickly realized that the creditor accepts the highest bid rather than the lowest because he gets the difference in kickbacks of one form or another which we will go into later.

Normal competitive forces, then, tend to *raise* the price of credit insurance to the consumer and this phenomenon is known as "reverse competition" in the credit insurance field. The process needs to be described in greater detail.

Credit insurance is offered in either of two ways: (1) without an identifiable charge, its cost being included as part of the finance charge, or (2) the debtor is assessed a separate extra charge for the insurance.

In the first instance, the creditor will wish to minimize his insurance cost so as to maximize his return from the finance charge. If all creditors used this method, we would not be here today for the insurer with the lowest bid combined with the best service would carry the day.

However, most credit insurance is sold as an extra cost item. In this event, the higher the price the greater the return to the creditor. The question arises, "Does not the debtor tend to seek out the lowest cost life insurance?" Commissioner Fletcher in his report to the United States Court of Claims in the *Alinco*³ tax case gives us the answer:

"Due to the method by which credit life insurance is sold, a unique situation has been observed by persons knowledgeable in the industry. Since the premium for credit life insurance is generally paid by the borrower, and since the lender's remuneration is generally a percentage thereof, the higher the gross premium, the greater will be the profit to the lender who procures the policy. Therefore, some lenders (or sellers) in seeking to increase their remuneration for the procurement of such insurance tend to place their business with the insurance company that charges the *highest* gross premium. An experienced lender (or seller) can generally foresee that, since the borrower's (or purchaser's) interest

³ In U.S. Court of Claims No. 77-63 (Filed March 6, 1966)—*Alinco Life Insurance Co. v. the U.S.*—Report of Commissioner to the Court.

I would urge the Subcommittee to study this tax case carefully. Although it was decided against the Government, and in favor of a credit life insurer, it nevertheless offers a penetrating insight into one of the more imaginative ways in which a creditor maximizes his profits from the insurance sale.