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TERM LIFE VERSUS CREDIT LIFE INSURANCE

Within the discussion of the role of credit life insurance in providing loan protection, industry critics often argue that credit life premium rates are “too high” and consumers would be better served by purchasing a level term life insurance policy to cover their loan protection needs.

These same critics also argue that credit life insurance provides “low consumer value” because the historical loss ratio is lower than some other types of insurance. Since the alternative being advocated is a level term life policy, one would assume these advocates believe that the level term policy provides a better consumer value, in terms of loss ratio, than a credit life policy.

However, the facts do not support either of the above positions. While the demonstration below is not an exhaustive study nor does it purport to recommend a course of action for any given borrower, the conclusion is that, relative to individually underwritten term life insurance, credit life is a reasonably priced product and – if loss ratio is in fact a valid measure of consumer value – credit life actually provides a better value to policyholders than level term insurance.

Premium Cost Comparison

Credit life insurance critics frequently support the price argument by making a comparison between a credit life policy and a level term policy issued to a healthy, non-smoking, 25 year old, female who can often purchase much more coverage than actually needed to protect a new consumer loan for the same premium cost.

The primary fallacy in the argument is that the scenario is based upon the best possible risk classification on one side compared to a contract that spans many traditional risk classes on the other side. While level term life insurance premiums vary by age, gender, smoking and health status, credit life is rated the same across a much broader range of health and age groups. With the credit life insurance, the premium rate is the same for all applicants regardless of age, gender, or health conditions and the amount of coverage is designed to meet the incremental protection needs of a new loan. So while level term insurance cost per thousand dollars of coverage may be lower for young healthy females, level term insurance generally costs more for older and less healthy males.

The other fallacy in the argument is that Credit life insurance is sold in amounts restricted by regulation to only cover the exposure created by the consumer loan for which the coverage is sold. Conversely, level term insurance is purchased at larger face amounts where the cost per thousand dollars of coverage can be lower. But the concept of increased pricing efficiency with increased volume is not unique to term insurance. My analysis suggests that if term insurance providers made level term insurance policies available at the same low face amounts at which credit insurance is purchased, their premium cost for level term life would actually be higher than credit life policies sold today.

While the numerical relationships vary by age and gender, all comparisons suggest that credit insurance is an efficient vehicle for providing small amounts of life insurance.

The Procedure

To perform the comparison, I compiled the ten year level term rates of fifteen large writers of term insurance and took an average of them by age and underwriting class. Ten year level term was chosen because it is the shortest term for which rates are available from a large number of companies. The premium rates were obtained from a commercial website maintained for the purpose of comparing term insurance quotes.

Since none of the term insurers offer individual level term in an amount as small as the average credit life policy issued in 2013 of $5,600[1], I extrapolated the rates for a $50,000 policy down to what the cost would be for a $10,000[2] ten year level term life policy. I accomplished this extrapolation by separating the premium into the average policy fee and the rate per $1,000 of coverage. Taking an average across ages and underwriting classes, I then calculated a credit equivalent cost per $100 per year, which is the basis for credit life rates and allows direct comparisons of rates for the two products.

The Graphical Results

The results are illustrated on the graphs in the attached Comparison Exhibits. Exhibit I illustrates the credit life equivalent rates for the 15 providers of level term insurance. The credit life equivalent cost per $100 for term policies would vary from a low of about $.51 to a high of about $.64 with an average of $.57. Based on this average, the overall cost of the term plan would be about $.08 higher than the nationwide average for credit life insurance of $.49 per $100[3]. This first graph illustrates that credit life is actually more efficient than other term life insurance products at providing coverage for small face consumer loans.

[1] Source is the American Council of Life Insurers (ACLI) 2014 Life Insurer Fact Book with data derived from the Association of Insurance Commissioners (NAIC) data.

[2] I chose the $10,000 face amount since it still exceeds the average credit life policy issued today while representing a reasonable target coverage amount for consumers requiring a basic life insurance policy. Comparisons using the actual average policy size of $5,600 would be even more favorable.

[3] National average credit life rate as documented in "The Fact Book of Credit-Related Insurance" for 2014 as published by the Consumer Credit Industry Association.

Exhibit II illustrates the comparisons between the average credit life rate and the average credit life equivalent term insurance rates from the same fifteen companies at various issue ages. The results are as expected; the non-age rated credit life rates are higher than the term rates at the younger ages and lower at the higher ages. With aging demographics, credit life will continue to compare favorably against term life for providing coverage at a reasonable cost.

Policyholder Return Comparison

Critics of insurance in general – and credit life insurance in particular – often maintain that the value of an insurance policy to the consumer can be measured solely in terms of the aggregate amount of premium returned to policyholders in the form of claims, i.e., the loss ratio. The minimum acceptable value for such loss ratio (the benchmark loss ratio) is oftentimes chosen without consideration for specific product characteristics, reasonable margins for the distribution and administration of the insurance product, or other consumer decision making criteria.

Industry critics have stated that the loss ratios reported for credit life are simply too low based upon their chosen benchmark loss ratio. We show in Exhibit III that when the credit life insurance value is measured against term life insurance using the loss ratio approach, credit life insurance actually provides a much better return to policyholders. So, if these critics are correct and loss ratio is the measure of consumer value, then credit life insurance actually provides a better consumer value than level term life insurance.

The Procedure

I used the same premium data for the ten year level term rates of fifteen large writers of term insurance and selected the average rates by gender and age using three underwriting classes (preferred nonsmoker, standard nonsmoker and standard smoker). I then developed reasonable mortality assumptions for each class and age using the 2008 Valuation Basic Table, which is a recent table of insured life mortality published by the Society of Actuaries.

I then calculated a loss ratio over a typical credit insurance term of five years, ignoring policy lapses and without discounting for interest. This is the measure of loss ratio which is most comparable to the methodology used to calculate credit life loss ratios.

I calculated the term insurance loss ratios using ten year level term rates for a face amount of $50,000. This is obviously higher than the $5,600[4] average size for credit life or the

[4] Source is the American Council of Life Insurers (ACLI) 2014 Life Insurer Fact Book with data derived from the Association of Insurance Commissioners (NAIC) data.

$10,000 policy used in the rate comparisons but more consistent with the recommended approach promoted by those who might recommend buying a larger term life insurance policy to address the consumer's insurance needs.

The Graphical Results

The graphical results are illustrated in Exhibit III. The average term loss ratio for a $50,000 face amount is 19.8%, versus 47.5% for credit life for calendar years 2013-2014. The loss ratio for credit life is significantly higher than the loss ratio for level term insurance across all ages, genders, and underwriting classes confirming that credit life insurance would be considered a better consumer value.

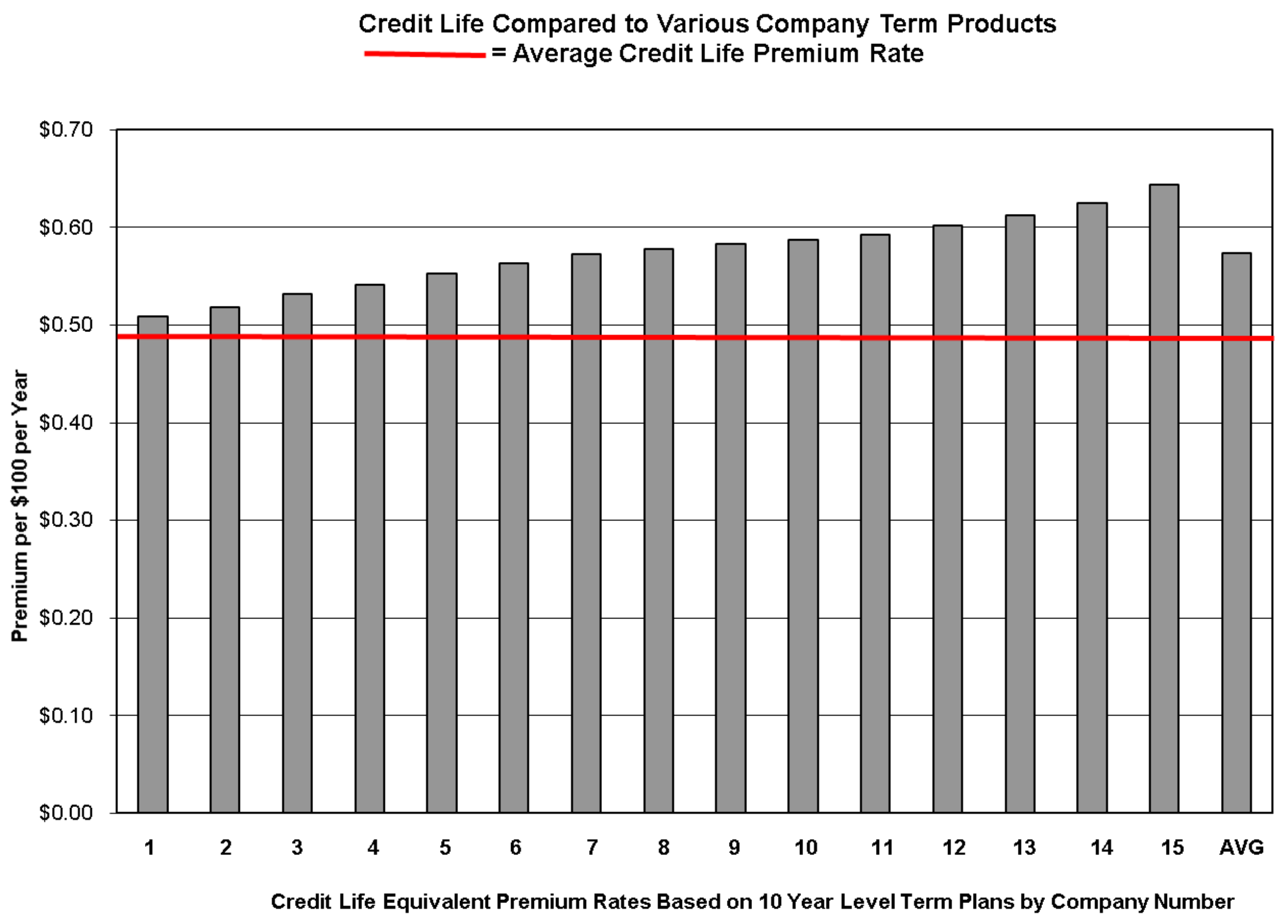
The question as to whether level term insurance is a better buy than credit life insurance relative to rates and loss ratio is certainly one worth debating; however, the supposed superiority of term life in providing value to the policyholder based upon loss ratio is not consistent with the facts.

Christopher H. Hause, FSA, MAAA March, 2016

About the Author

Christopher Hause is the President of Hause Actuarial Solutions, Inc. in Overland Park, Kansas. Hause Actuarial is an actuarial consulting firm providing a wide range of consulting services to the insurance industry including product design/pricing, policy and claim reserves, financial statement opinions, regulatory advocacy, and actuarial software programs that assist insurance actuaries in evaluating, pricing and modeling life, health and annuity products.

Exhibit I



Credit Life Compared to Various Company Term Products
= Average Credit Life Premium Rate
$0.70
$0.60
$0.50
$0.40
$0.30
$0.20
$0.10
$0.00
Premium per $100 per Year
1
2
3
4
5
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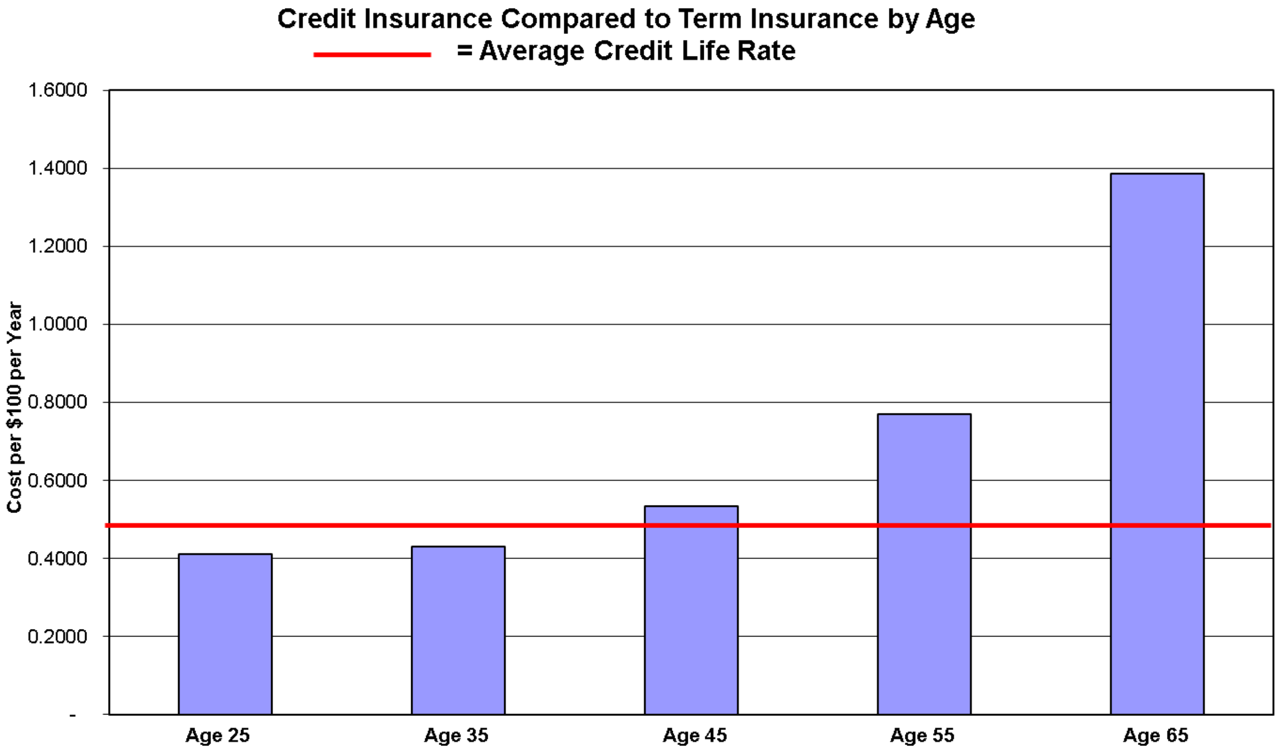
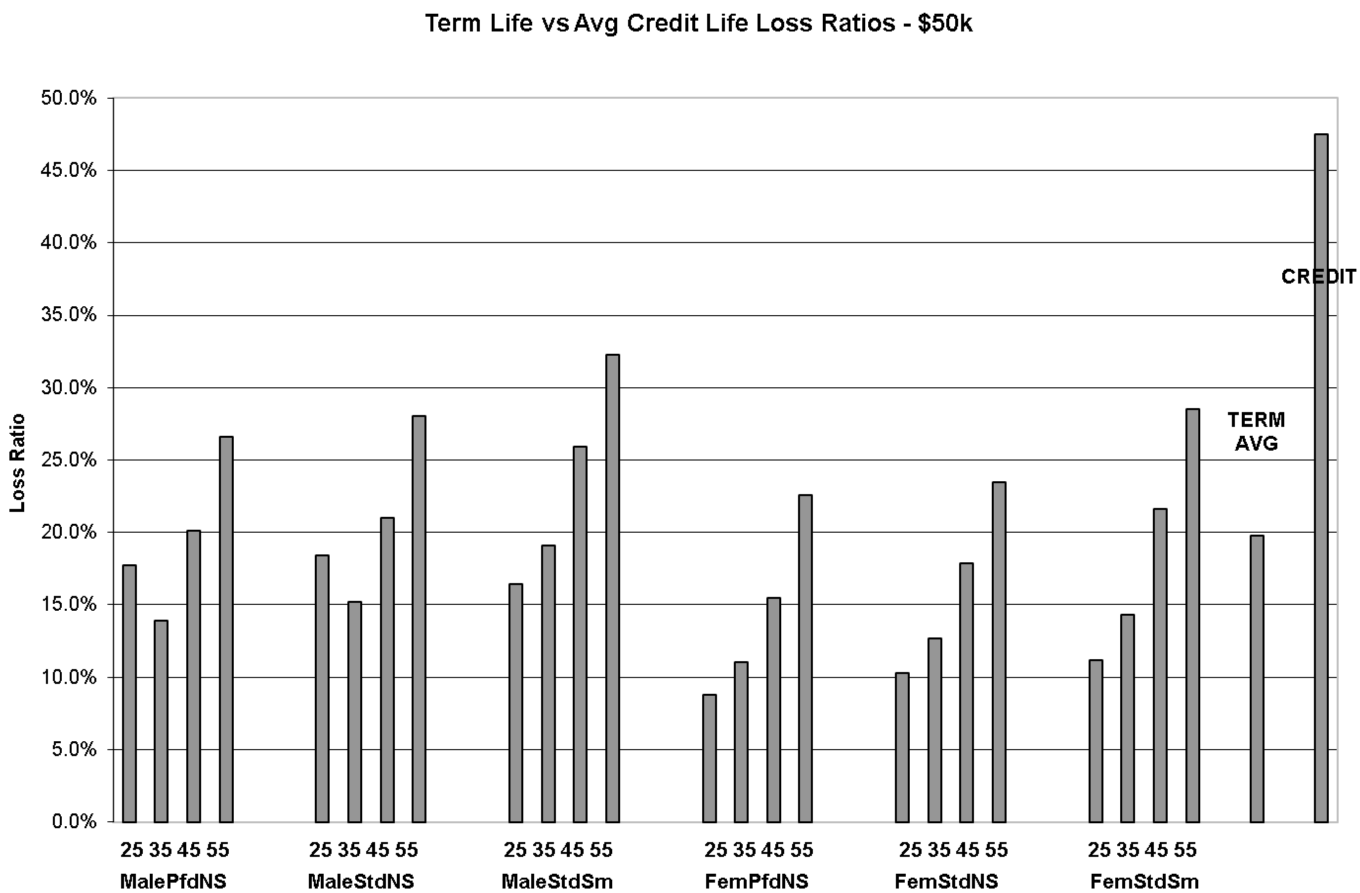
AVG
Credit Life Equivalent Premium Rates Based on 10 Year Level Term Plans by Company Number

Exhibit II



Credit Life Equivalent Rates Based on 10 Year Level Term Plans
Average Rates by Issue Age

Exhibit III



Term Life vs Avg Credit Life Loss Ratios - $50k
Loss Ratio
50.0%
45.0%
40.0%
35.0%
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
CREDIT
TERM AVG
25 35 45 55
MalePfdNS
25 35 45 55
MaleStdNS
25 35 45 55
MaleStdSm
25 35 45 55
FemPfdNS
25 35 45 55
FemStdNS
25 35 45 55
FemStdSm