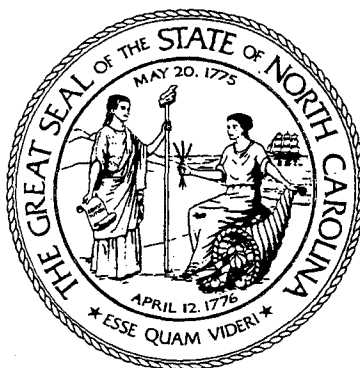


LEGISLATIVE RESEARCH COMMISSION

**CREDIT INSURANCE AND MORTGAGE CREDIT**



REPORT TO THE  
2000 SESSION OF THE  
1999 GENERAL ASSEMBLY  
OF NORTH CAROLINA

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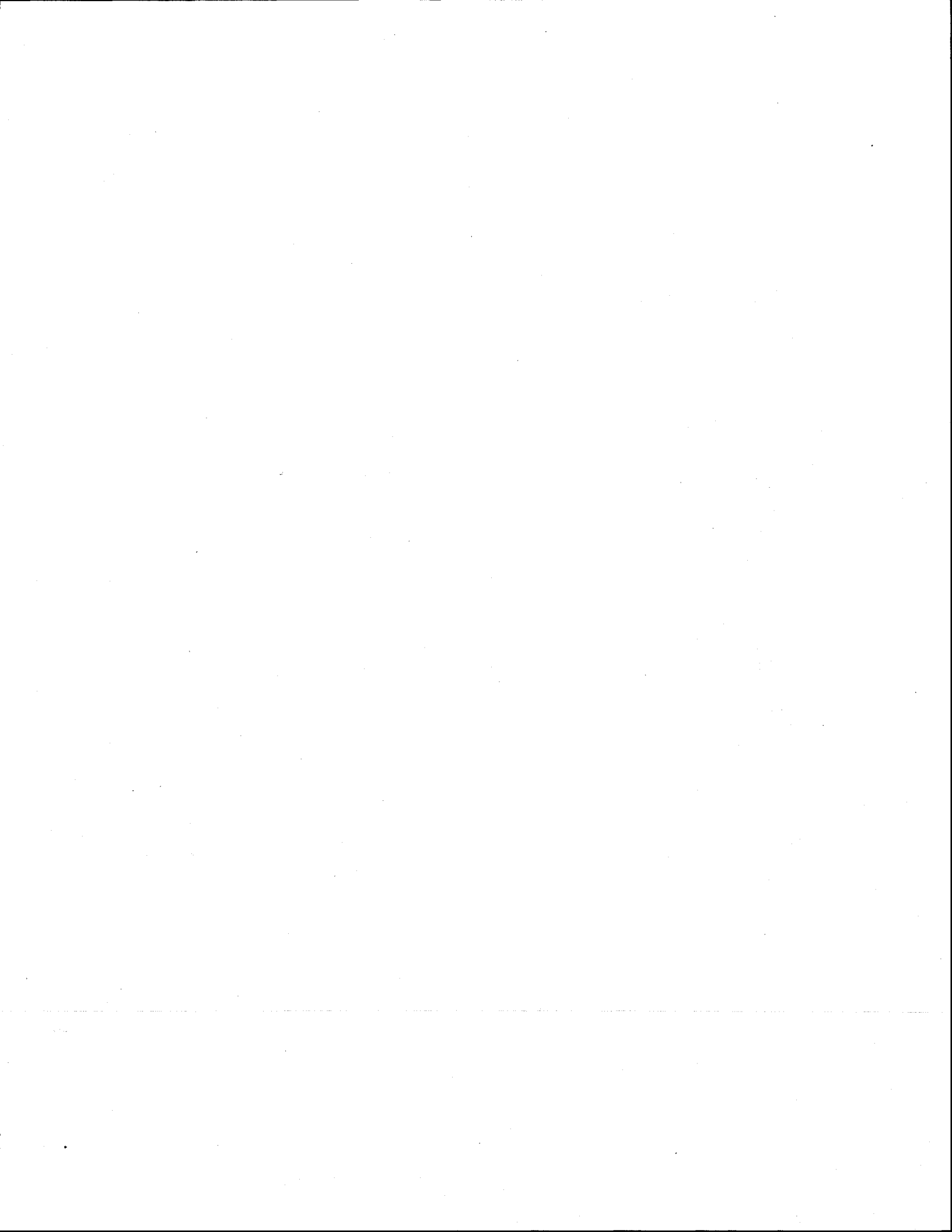
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STATE OF NORTH CAROLINA  
LEGISLATIVE RESEARCH COMMISSION  
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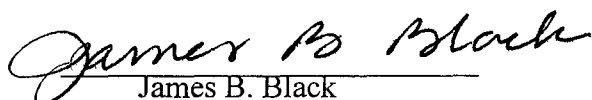



May 4, 2000

TO THE MEMBERS OF THE 1999 GENERAL ASSEMBLY (REGULAR SESSION 2000):

The Legislative Research Commission herewith submits to you for your consideration its 2000 Interim report on credit insurance and mortgage credit. The report was prepared by the Legislative Research Commission's Committee on Credit Insurance and Mortgage Credit pursuant to G.S. 120-30.17(1).

Respectfully submitted,

  
James B. Black  
Speaker of the House

  
Marc Basnight  
President Pro Tempore

Cochairs  
Legislative Research Commission



1999 - 2000

LEGISLATIVE RESEARCH COMMISSION

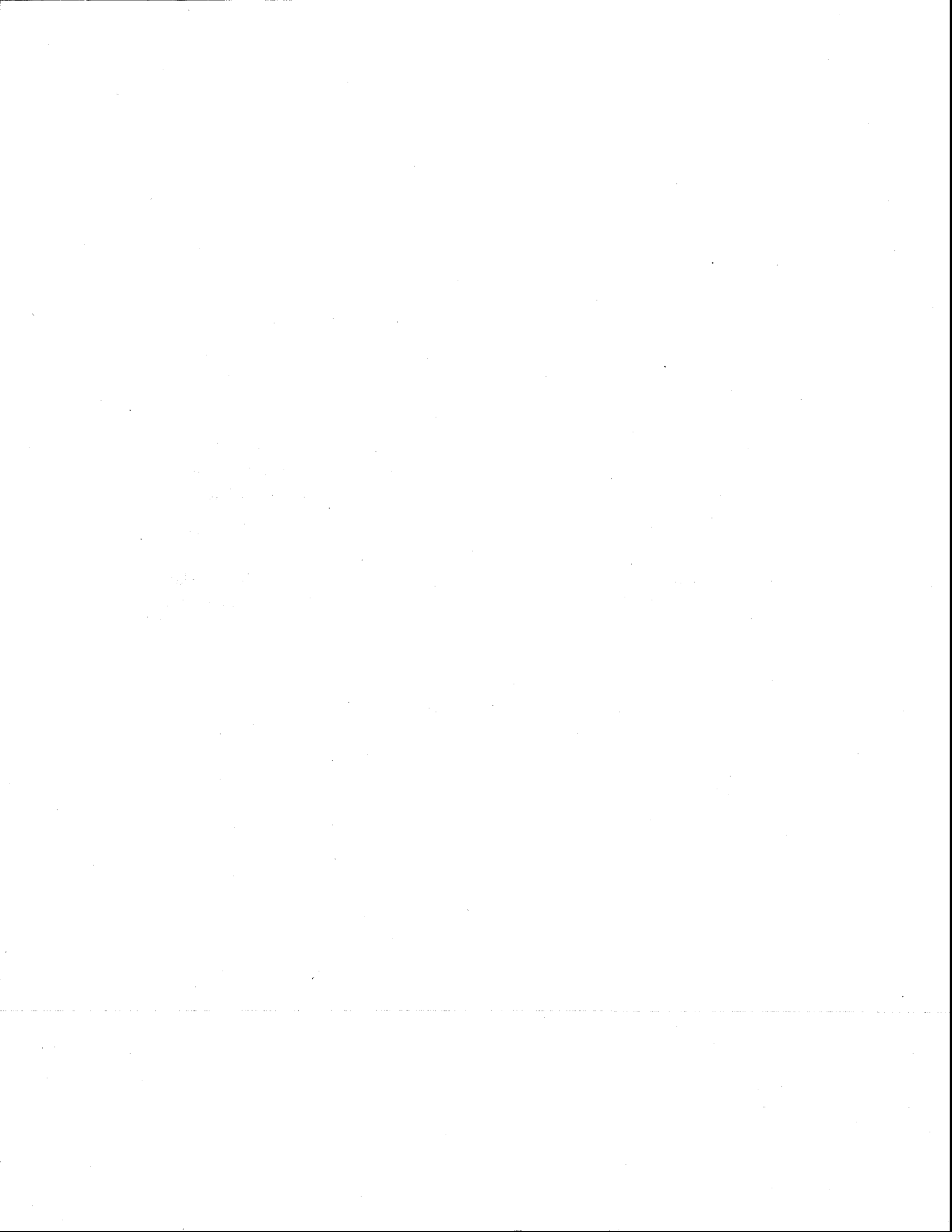
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Rep. Steve W. Wood





## PREFACE

The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is the general purpose study group in the Legislative Branch of State Government. The Commission is cochaired by the Speaker of the House and the President Pro Tempore of the Senate and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

The Legislative Research Commission, prompted by actions during the 1998 Session and 1999 Sessions, has undertaken studies of numerous subjects. These studies were grouped into broad categories and each member of the Commission was given responsibility for one category of study. The Cochairs of the Legislative Research Commission, under the authority of G.S. 120-30.10(b) and (c), appointed committees consisting of members of the General Assembly and the public to conduct the studies. Cochairs, one from each house of the General Assembly, were designated for each committee.

The study of credit insurance and mortgage credit was authorized by Section 2.1(10)(e) of Chapter 395 of the 1999 Session Laws (Regular Session, 1999) and by Section 7(3) of Chapter 332 of the 1999 Session Laws (Regular Session, 1999). The relevant portions of Chapter 395 and Chapter 332 are included in Appendix A.

The Legislative Research Commission authorized this study under authority of G.S. 120-30.17(1) and grouped this study in its Consumer Protection Grouping area under the direction of Representative Beverly Earle. The Committee was chaired by Senator R. C. Soles, Jr. and Representative Walter Church, Sr. The full membership of the Committee is listed in Appendix B of this report. A committee notebook containing the committee minutes and all information presented to the committee will be filed in the Legislative Library by the end of the 1999-2000 biennium.

## COMMITTEE PROCEEDINGS

### First Meeting -- February 22, 2000

At its organizational meeting on February 22, 2000, the Credit Insurance and Mortgage Credit Insurance Committee first reviewed its study charge. Karen Cochrane-Brown, Committee Co-Counsel explained the legislation that authorized this study. The Committee was created as a result of the authorization of the Legislative Research Commission found in the Studies Act of 1999, House Bill 163. The Act authorized the Commission to study credit insurance and mortgage credit, including the licensing, regulation, and examination of mortgage brokers and mortgage lenders, financing of credit insurance premiums, and other aspects of the mortgage market relating to the availability of mortgage credit. These issues may be studied in conjunction with issues required to be studied under Senate Bill 1149 (1999 Session). Senate Bill 1149, the Predatory Lending Law, was enacted in the 1999 Session. That act modified permissible fees which may be charged in connection with home loans secured by first mortgage or first deed of trust, to impose restrictions and limitations on high-cost home loans to revise the permissible fees and practices by mortgage brokers and lenders, and to provide for public education and counseling about predatory lenders. One of the practices prohibited by this law is the financing of single premium credit life, disability, or unemployment insurance or any other life or health insurance premiums. This portion of the law will go into effect July 1, 2000. This Committee is charged to study whether there are specific circumstances in which consumers would benefit from permitting lenders to finance credit insurance premiums which practice is prohibited by the Predatory Lending Law.

Next the Committee heard from Mr. Guy Rohling and Mr. Steve Hamm, representing the Consumer Credit Insurance Association. Mr. Rohling stated that the Association believes that Senate Bill 1149 denies consumers in North Carolina the opportunity to choose which insurance product best suits their financial situation. The Consumer Credit Insurance Association believes this opportunity ought to be provided to the consumers of North Carolina along with adequate and strong consumer and regulatory protections

Mr. Hamm has previously served as Administrator to the South Carolina Department of Consumer Affairs from 1981 - 1994, and currently as a lawyer representing consumer and business interests in a wide range of legal matters in the State of South Carolina. Mr. Hamm stated that he believes that consumers have the right to have all credit insurance products available to them and with the proper regulations in place, the consumers can make an informed decision for themselves. By allowing for proper and consistent disclosure laws, consumers could be protected. Disclosure should be allowed for before the transaction takes place, during the transaction, and after the transaction has been completed. North Carolina now currently has a law in place that allows the consumer 30 days to reject the insurance coverage after the transaction takes place. Broadening the regulatory scope and examination of all those engaged in the real estate market place could also protect consumers. Currently, North Carolina has no such law in place that licenses the mortgage broker. By disallowing single premium insurance, you run the risk of encouraging consumers not to purchase any credit insurance at all. An advantage of single premium insurance is that if the consumer does not make a timely payment, the coverage does not default or disappear. In response to a question, Mr. Hamm stated that currently the "monthly outstanding balance approach" and the "single premium approach" are the two types of payment methods for credit insurance that are offered in the marketplace. He also indicated that the disclosure that he was referring to were not currently being given in North Carolina.

Next the Committee heard from Mr. Martin Eakes, President and CEO of the Self-Help Credit Union and representing the Coalition for Responsible Lending. The Coalition for Responsible Lending is an alliance of 88 organizations and 300 individuals representing 3 million North Carolina citizens dedicated to protecting homeownership by eliminating predatory lending practices. The Coalition was responsible for helping put together the Predatory Lending Bill. This bill, Senate Bill 1149, prohibits prepayment penalties on home loans under \$150,000, the practice of "flipping", financing single- premiums for credit insurance on home loans, and restricts fees and terms on "high-cost" home loans. Mr. Eakes stated that it was critical to build on these reforms by retaining Senate Bill 1149's prohibition on financing single-premium credit insurance, giving the North Carolina Insurance Commissioner the authority to adjust credit insurance rates based on NAIC standards (60% minimum claims payout), and extending prohibition on financed credit insurance premiums to consumer loans made by finance companies. The common goal should be protecting homeowners and their equity. He stated that single-premium financing depletes homeowner's equity. It is difficult for consumers to understand credit insurance and therefore, most consumers cannot make informed purchase decisions. Mr. Eakes argued that single premium credit insurance is not more affordable because monthly payments are only lower because 5 years of coverage is paid over 30 years. Single premiums cost North Carolina homeowners \$50-100 million in lost home equity each year, and even more in interest Mr. Eakes pointed out that credit insurance is sometimes done in the right way and that CUNA Mutual, the largest credit insurer in the nation, writes their credit insurance through credit unions. CUNA Mutual writes virtually all its policies with monthly outstanding balance premiums. It is never in the consumer's benefit to finance the credit insurance on the front end of the loan. Mr. Eakes closed by urging the Committee to build on the reforms made in Senate Bill 1149, give the North Carolina Insurance Commissioner the authority to adjust credit

insurance rates, and to extend the prohibition on financed credit insurance premiums to consumer loans made by finance companies.

The Committee also heard from Mr. Alan Hirsch , Deputy Attorney General with the Consumer Protection Division of the North Carolina Attorney General's Office. Mr. Hirsch spoke briefly concerning the problems with predatory lending in North Carolina. He stated that equity stripping is the single greatest problem that we have. Mr. Hirsch added that North Carolina wanted to do two things; keep the lending market strong and at the same time stop people from losing their homes. He recognized an article that was printed in USA Today that stated that North Carolina has the premier law in America that protects homeowners. Mr. Hirsch, representing the Attorney General's office, stated that in their judgement, financed single-premium credit insurance is the single worst practice in destroying homeownership in North Carolina. Reputable finance companies are willing to give single-premium credit insurance up because they recognize that it is an unfair business practice. Mr. Hirsch concluded that the State of North Carolina had done a very good thing here and we should not consider turning back.

The Committee also heard from Ms. Geraldine Malindis with the Affordable Housing Coalition in Asheville, North Carolina. Ms. Malindis emphasized that she had actually witnessed people lose their homes due to predatory lenders charging the up front fees for credit life insurance. Ms. Malindis urged the Committee to please think about this as if it were their own home.

#### **Second Meeting -- March 24, 2000**

The second meeting of the Committee began with a presentation by Mr. Guy Rohling, representing the Consumer Credit Insurance Association. Mr. Rohling stated that the Consumer

Credit Insurance Association supports legislation that prohibits unscrupulous mortgage lenders from preying upon North Carolina citizens, however they feel that this legislation denies consumers the choice of determining which insurance product best suits their needs. Federal preemption may render the prohibition of this legislation meaningless to many lenders. Mr. Rohling stated that many people believed the prohibition is flawed and that the Committee should take the time to fix it. The Committee should extend the effective date for another year and allow a fuller consideration of the issue..

Next the Committee heard from Mr. Joe Johnson, an attorney representing the North Carolina Financial Services Association, who was asked to speak to the effects of recent federal legislation as it applies to the Act under consideration here. Mr. Johnson spoke about the Gramm-Leach-Bliley Act, U.S. Senate Bill 900, which relates to the repeal of the Glass-Steagall Act regarding the separation of insurance and banking activities. The United States Congress enacted the Gramm-Leach-Bliley Act in 1999 after the North Carolina General Assembly passed the North Carolina Predatory Lending Act. Accordingly, this federal law was not taken into consideration by the General Assembly as part of its consideration of the Predatory Lending Act. The Gramm-Leach-Bliley Act prohibits a State "by statute, regulation, order, interpretation, or other action" from preventing or restricting a depository institution or an affiliate thereof from engaging directly or indirectly, either by itself or in conjunction with an affiliate, or any other person, in certain insurance activities, including credit insurance activities." The Gramm-Leach-Bliley Act appears to preempt the provisions of G.S. 24-10.2(b) of the North Carolina Predatory Lending Act prohibiting the financing of single-premium credit insurance. Mr. Johnson offered a solution by saying the State may regulate the sale of credit insurance through its normal process of examining rates and forms. This is something that the Commissioner of Insurance does for all

admitted insurance in North Carolina and the Legislature can give him the power if he doesn't already have the power to regulate the rates and forms as it relates to credit insurance.

In response to a questions, Mr. Johnson replied by saying that federal deposit institutions are already exempted and that the Gramm-Leach-Bliley Act would expand the exemption to any depository institution that is insured by the FDIC. When asked what his opinion was if the Committee decided not to make a recommendation to delay the prohibition of single-premium financing of credit insurance, Mr. Johnson responded that the only recourse for those people who sell this product would be to seek some kind of declaratory judgement or possibly an injunction of enforcement of the statute.

Next the Committee heard from Mr. Mike Rulison, President of the North Carolina Consumers Council. The North Carolina Consumers Council considers credit insurance to be a problem product. He made a comparison of credit life insurance providing five years of coverage but paid for over 30 years to buying a car that is useable for fifteen years and paying for it over ninety years. He stated that it is not in the consumer's best interest to allow contracts such as these to be written.

The Committee then heard from Mr. Richard Hatch, AARP's North Carolina Coordinator for Economic Security. Mr. Hatch made a statement on behalf of AARP opposing repeal of the provisions of the Predatory Lending Law prohibiting single-premium credit insurance on home loans

The next speaker was Mr. Greg Kirkpatrick, Executive Director for Wake County Habitat for Humanity, who stated that Habitat for Humanity supports Senate Bill 1149 and they hated to



see its effectiveness stripped. Mr. Kirkpatrick would encourage the Legislature to maintain the prohibition against financing single-premium credit insurance.

Mr. Peter Skillern, Executive Director of the Community Reinvestment Association of North Carolina spoke to the Committee. His association is a consumer advocacy organization that works to build and protect wealth in low-income communities. He urged the Committee to continue to support the prohibition.

Mr. Rob Schofield, a lawyer with the North Carolina Justice and Community Development Center, spoke in support of the prohibition and in extension of this prohibition to small non-mortgage loans

The Committee also heard from Mr. Martin Eakes, representing the Coalition for Responsible Lending. He stated that his organization opposed a one-year extension on the beginning date for the prohibition on the sale of single premium credit insurance. He stated that this extension would cost consumers \$100 million in lost equity of their homes. Mr. Eakes said that he had the personal assurance of the CEO's of Fannie Mae and Freddie Mac, the two largest housing home ownership corporations in America, that they would no longer purchase any loans or any securities that had financed credit insurance on the loan. Mr. Eakes felt that this was a very strong precedent and that many more similar prohibitions on financing single premium credit insurance would be coming. Mr. Eakes said that his organization was not trying to eliminate credit insurance but simply wanted it paid for on a monthly basis where there weren't these outrageous interest charges.

Mr. Allan Hirsch, an attorney with the Attorney General's Office, addressed the federal preemption question by saying that his office had reviewed this legislation in great detail while it was being considered in Congress and it is their view that Senate Bill 1149 is not preempted by the Gramm-Leach-Bliley Act. He quoted a statement that United States Senator John Edwards made on the floor of the Senate indicating that the North Carolina Predatory Lending Act was creating legislative history and this federal law would in no way preempt the measures taken by the State of North Carolina. The idea of delaying this prohibition for a year would be a tragic mistake, Mr. Hirsch stated.

Mr. Joe Johnson was asked to respond to the statement that Mr. Hirsch quoted from U.S. Senator Edwards on the preemption issue. Mr. Johnson stated every member of Congress has an opinion and an individual speech does not necessarily qualify as representing legislative intent.

Mr. Bill Hale, a representative of the North Carolina Department of Insurance, was asked if it was correct to assume that payout on credit life insurance was around 40%, whereas other life insurance policies it is around 60%. Mr. Hale said he thought that was correct and he also stated that the Department was shooting for a 60% loss ratio payout on credit insurance based on the most recent legislative change in the statutory rate permitted for credit insurance premiums. Mr. Hale said the Department of Insurance was bound by the statutes and the law was rewritten to hopefully phase up to a 60% loss ratio. The option for the General Assembly would be to give the Department of Insurance the authority to set the rates to get to the 60% ratio. Mr. Hale stated that the Department was already doing it for credit family-leave insurance and involuntary unemployment insurance.

### Third Meeting -- April 7, 2000

The third meeting of the Committee began with the presentation of a bill draft. Karen Cochrane-Brown, Committee Co-Counsel, was asked to explain what the bill was intended to do. Ms. Cochrane-Brown stated that the bill draft was intended as a technical change to the credit insurance portion of the Predatory Lending Bill that was passed during the last session of the General Assembly. She stated that this bill would amend G.S. 24-10.2(b) by deleting two words from the law as it was enacted last year. The two words to be deleted are "calculated and" and it changes the section of the law to read: "Notwithstanding the provisions of G.S. 58-57-35(b), it shall be unlawful for any lender in a consumer home loan to finance, directly or indirectly, any credit life, disability, or unemployment insurance, or any other life or health insurance premiums; provided, that insurance premiums paid on a monthly basis shall not be considered financed by the lender". Ms. Cochrane-Brown stated that the prohibition against financing credit insurance would remain in place. The intention, as staff understood it, is to allow lenders to collect monthly insurance premiums on behalf of the borrower. This would not in any way allow financing which is prohibited by the first part of the sentence in G.S.24-10.2(b). This would just remove the requirements that the insurance premiums be calculated based on the declining balance every month. Ms. Cochrane-Brown said it was her understanding that the way the law currently reads, the words "calculated and paid" imply that you have to recalculate the premium every month based on the declining balance. In order to level the premium out you would need to take out this language and by doing this it gives you the option to average credit insurance payments. This amendment would allow a borrower and a lender to choose to have the premium paid by the declining balance method (recalculated every month) or leveled out and paid in equal amounts every month. By deleting the two words in the current law, either of these methods could be used

Next the Committee heard from Mr. Alan Hirsch, head of the Attorney General's Consumer Protection Division, who stated that he disagreed that this change was just a "technical amendment". Mr. Hirsch stated that by doing this, you repeal the entire provision of the law. Mr. Hirsch added that this change allows the exception to swallow the rule and the result would be that financing single-premium insurance will continue to be permitted in North Carolina. He added that if it was the intention to make a technical amendment to allow monthly earned premiums to be level, that it could be done in the insurance statutes without effecting this protection that has been put in place.

The Committee also heard from Mr. Martin Eakes, representing the Coalition for Responsible Lending, who stated that the position of the Coalition would be to oppose this change because the benefits that the consumer would get in terms of reducing the payment are very negligible over the life of most mortgage loans.

Bill Burfiend, a representative of the Consumer Credit Insurance Association, gave a brief presentation clarifying the two methods of payment of premiums, the declining balance method and averaging out or level premium method.

After discussion, a motion was made to make a report to the Legislative Research Commission that a bill to eliminate the word "calculate and" from G.S. 24-10.2(b) be recommended. The motion passed with a 6 - 3 vote.

#### **Fourth Meeting - April 27, 2000**

The final meeting of the Committee prior to the convening of the 2000 Session took place on April 27, 2000. During the meeting the Committee discussed and approved the interim report to be submitted to the Legislative Research Commission.

## FINDINGS AND RECOMMENDATIONS

### Findings

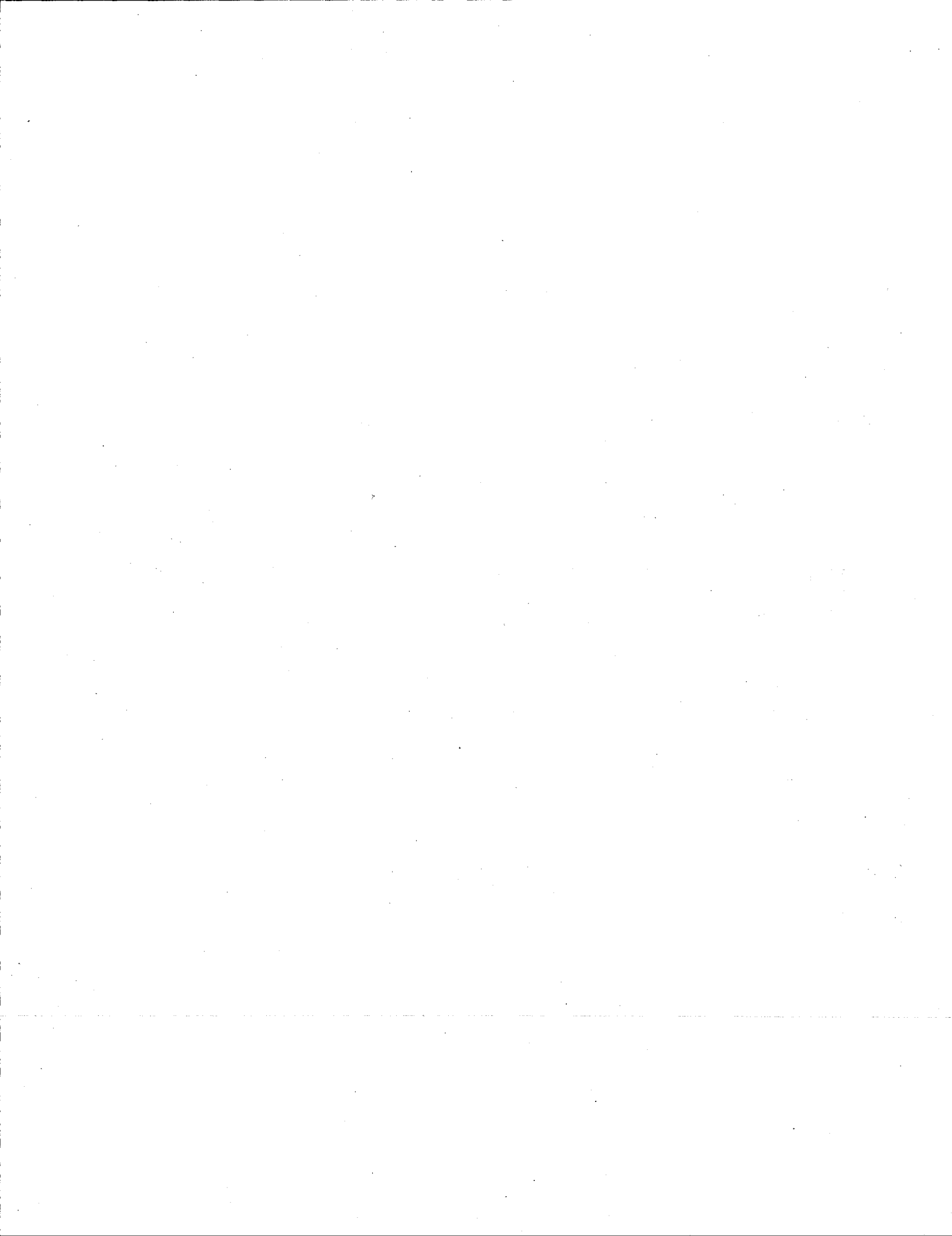
1. North Carolina's Predatory Lending Law is recognized as the most comprehensive and beneficial mortgage lending law for consumers in the nation. Several other states are now using our law as a model to prevent unscrupulous lenders from stripping the equity from homeowners.
2. The Predatory Lending Law specifically prohibited the financing of single premium credit insurance. It is widely believed that while the purchase of credit insurance on a monthly basis may be appropriate in some circumstances, the *financing* of single premium credit insurance provides no benefit to consumers.
3. The current law provides that "insurance premiums calculated and paid on a monthly basis shall not be considered financed by the lender". This language suggests that the only type of credit insurance that will be allowed is that which is calculated monthly based on the declining balance of the loan, and paid in different amounts each month.
4. Consumers would benefit if premiums were leveled over the term of the insurance, and paid on a monthly basis, so long as the premiums are not financed as prohibited by law.

5. The law should allow consumers who chose to purchase credit insurance to pay the premiums either on the monthly outstanding balance basis or on the level charge basis.

### **Recommendations**

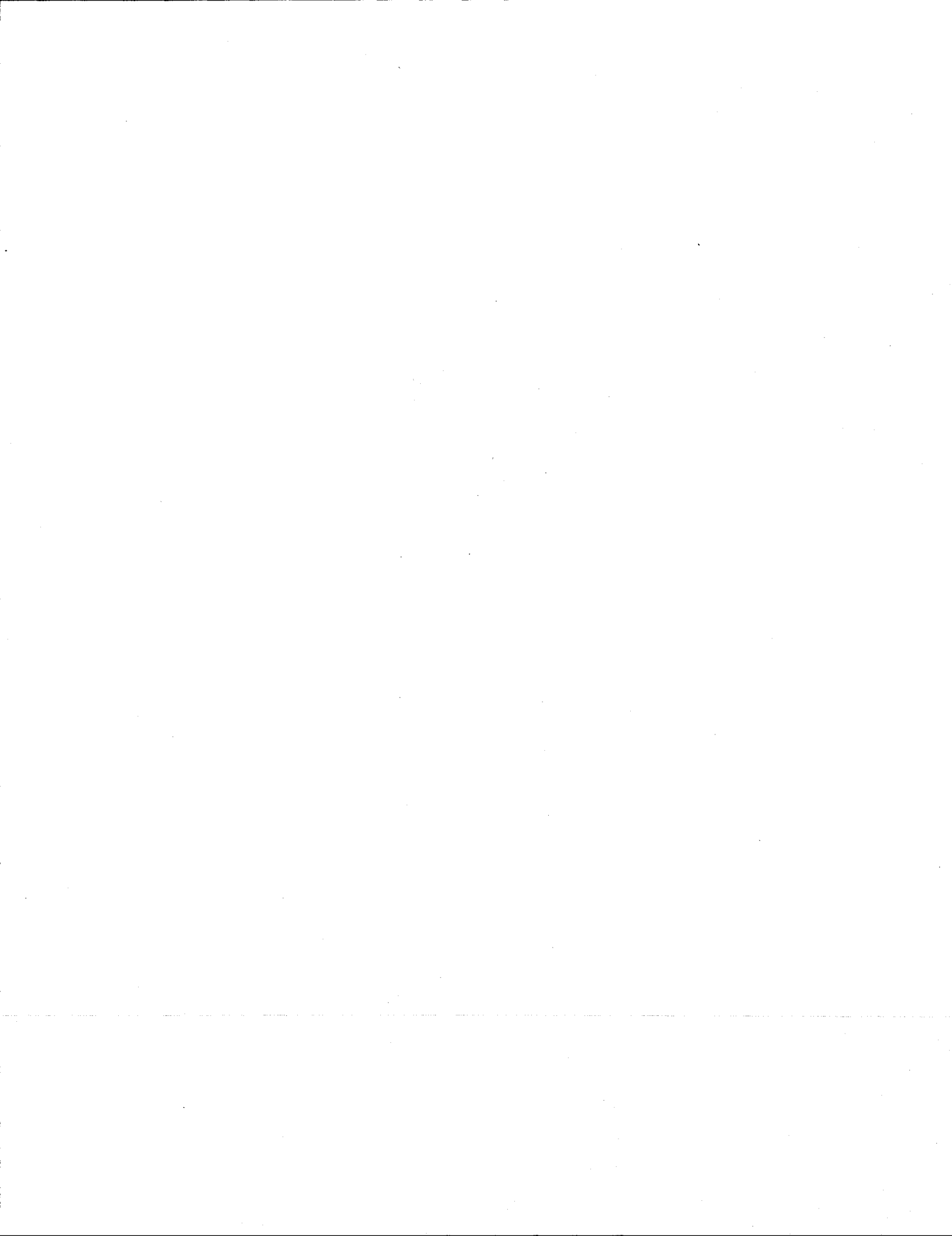
Based on the findings, the Committee recommends the following proposed legislation:

A BILL TO BE ENTITLED AN ACT TO CLARIFY THAT CREDIT INSURANCE MAY BE PAID ON A LEVEL CHARGE MONTHLY BASIS WITHOUT VIOLATING THE LAW RELATING TO CONSUMER PROTECTIONS IN CERTAIN HOME LOANS.





**APPENDICES**



APPENDIX A

CHAPTER 395

1999 Session Laws (1999 Session)

AN ACT TO AUTHORIZE STUDIES BY THE LEGISLATIVE RESEARCH COMMISSION, TO CREATE VARIOUS STUDY COMMISSIONS, TO DIRECT STATE AGENCIES AND LEGISLATIVE OVERSIGHT COMMITTEES AND COMMISSIONS TO STUDY SPECIFIED ISSUES, AND TO AMEND OTHER LAWS.

The General Assembly of North Carolina enacts:

PART I.-----TITLE

Section 1. This act shall be known as "The Studies Act of 1999".

PART II.-----LEGISLATIVE RESEARCH COMMISSION

Section 2.1. The Legislative Research Commission may study the topics listed below. When applicable, the bill or resolution that originally proposed the issue or study and the name of the sponsor is listed. Unless otherwise specified, the listed bill or resolution refers to the measure introduced in the 1999 Regular Session of the 1999 General Assembly. The Commission may consider the original bill or resolution in determining the nature, scope, and aspects of the study. The following groupings are for reference only:

.....

(10) Consumer protection issues:

- .....
- e. Credit insurance and mortgage credit, including the licensing, regulation, and examination of mortgage brokers and mortgage lenders, financing of credit insurance premiums, and other aspects of the mortgage market relating to the availability of mortgage credit. These issues may be studied in conjunction with issues required to be studied under Senate Bill 1149 (1999 Session).

.....

Section 2.2. Committee Membership. – For each Legislative Research Commission committee created during the 1999-2001 biennium, the cochairs of the Legislative Research Commission shall appoint the committee membership.

Section 2.3. Reporting Date. – For each of the topics the Legislative Research Commission decides to study under this Part or pursuant to G.S. 120-30.17(1), the Commission may report its findings, together with any recommended legislation, to the 1999 General Assembly, 2000 Regular Session, or the 2001 General Assembly.

Section 2.4. Funding. – From the funds available to the General Assembly, the Legislative Services Commission may allocate additional monies to fund the work of the Legislative Research Commission.

PART XXIII.-----EFFECTIVE DATE AND APPLICABILITY

Section 23.1. Except as otherwise specifically provided, this act becomes effective July 1, 1999. If a study is authorized both in this act and the Current Operations Appropriations Act of 1999, the study shall be implemented in accordance with the Current Operations Appropriations Act of 1999 as ratified.

In the General Assembly read three times and ratified this the 21<sup>st</sup> day of July, 1999.