

SUBJECT: Reg. Z: Financing Credit Insurance

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INTRODUCTION

This release applies to all credit unions, both state and federal. It describes Truth in Lending regulations (Reg. Z) that prohibit lenders from financing any premiums or fees for credit insurance (which includes debt suspension or cancellation agreements) in connection with most home loans and home equity lines of credit.

EXECUTIVE SUMMARY

Reg. Z prohibits credit unions from financing any premiums or fees for credit insurance in connection with most home mortgage loans for which the credit union receives an application on or after Jan. 10, 2014. (The rules do not affect credit insurance in force before that date.) The rules do not apply if credit insurance premiums are calculated and paid in full on a monthly basis.

Credit unions *must* work with their credit insurance vendors to determine whether and how these rules apply to their products.

The rules apply to a consumer loan (regardless of lien position) that is secured by a dwelling (in the case of closed-end loans) or by a principal dwelling (in the case of home equity lines of credit or HELOCs). Mobile homes, boats and trailers are dwellings if they are in fact used as residences – whether or not the residence is real property.

"Credit insurance" means credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract. Credit unemployment insurance is excluded in some circumstances.

Under Reg. Z, credit insurance premiums are "financed" (and thus violate the rules) if a creditor allows the consumer to defer payment of the premium past the month in which it is due. The CFPB has described various scenarios to help illustrate when and how "financing" may occur.

The rules apply to both single-premium credit insurance and insurance with premiums that are payable monthly. A premium is not "paid in full on a monthly basis" (and thus excluded from the rules) merely because the contract requires the premium to be paid monthly.

Some creditors add premiums to a consumer's principal balance before the premium is due from the consumer, even though funds are not advanced on the consumer's behalf at that time, and interest accrues on the increased principal until the consumer's subsequent payment is credited to the account. This does not necessarily violate the rules, but the CFPB intends to monitor this practice. It advises creditors to credit any accrued interest back to the consumer on a timely basis, to mitigate consumer protection concerns.

These rules do not apply if premiums are "calculated and paid in full on a monthly basis." A premium is calculated on a monthly basis if it is "determined mathematically by multiplying a rate by the actual monthly outstanding balance" (e.g., the loan balance following the consumer's most recent monthly payment) and declines as the consumer pays down the outstanding principal balance.

The rules do apply to credit insurance with "levelized" premiums (which remain the same, even as the consumer pays down the loan's outstanding balance). Credit unions can offer such insurance but cannot "finance" the premiums or fees.

PROHIBITION ON FINANCING CREDIT INSURANCE

As of Jan. 10, 2014, Reg. Z §1026.36(i) prohibits creditors from financing any premiums or fees for credit insurance in connection with most home loans. The rules do not apply if credit insurance premiums are calculated and paid in full on a monthly basis.

Under Reg. Z, credit insurance premiums are "financed" if a creditor allows the consumer to defer payment of the premium past the month in which it is due. Reg. Z also describes what it means for credit insurance premiums to be "calculated and paid on a monthly basis." Finally, the rules explain how the rules apply to "level" premiums, when the monthly premium is the same each month rather than decreasing along with the loan balance. Each of these topics is addressed in more detail in a separate section of this release.

Importance of working with insurers

Credit unions must work with their credit insurance vendors to determine whether and how these rules apply to their products. Payment methods vary from vendor to vendor (and from insurance product to insurance product.) Only the insurer can give your credit union definitive guidance on compliance with these rules for its products.

Loans the rules cover

The rules apply to a consumer loan (regardless of lien position) that is secured by a dwelling.

A "dwelling," does not necessarily need to be real property. The Commentary to Reg. Z says that mobile homes, boats and trailers are dwellings if they are in fact used as residences – whether or not the residence is real property under state law.

For closed-end loans, the rules apply regardless whether the home securing the loan is the consumer's principal residence. Vacation homes, for example, are subject to the rules. However, the rules apply to a home equity line of credit (HELOC) only if it is secured by the consumer's *principal* dwelling.

"Credit insurance"

"Credit insurance" means credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract.

Credit unemployment insurance is excluded if three criteria are met:

- The premiums are reasonable,
- The credit union gets no direct or indirect compensation in connection with the premiums, and
- The premiums are paid under a separate contract and not to an affiliate of the credit union.

Effective date

The rules apply to mortgage loans for which the credit union receives an application on or after Jan. 10, 2014. The rules do not affect credit insurance in force before that date.

WHEN PREMIUMS ARE CONSIDERED "FINANCED"

Credit insurance premiums are "financed" (and thus violate the rules) when the creditor treats premiums as amounts owed and lets the consumer defer paying the premiums "beyond the period in which they are due." (Reg. Z §1026.36(i)(2)(ii).)

A creditor violates the rules if, at the close of the monthly period in which the premium or fee is due, the creditor includes the premium or fee in the amount owed by the consumer – and thus treats it not as a monthly charge that could be cancelled prior to being due, but as a "debt" that is owed by the consumer to the creditor, which the consumer then would have a right to pay at some later date. (Reg. Z Comment 36(i)-1.)

When the CFPB published these rules, it described several scenarios that illustrate how the rules work:

- Suppose a consumer fails to pay an insurance premium or fee. "If the total amount the consumer owes has not increased by the amount of the premium at the close of the monthly period (after accounting for principal payments),

then the creditor has not advanced funds or treated the premium as an addition to the consumer's 'debt.'" But if the creditor treats the premium as an addition to the consumer's debt, such as by communicating that the consumer must pay it to satisfy the obligations under the loan or by charging interest on the premium, then the creditor has financed the premium.

- Suppose a creditor allows some period after a premium is due for the consumer to decide whether to continue the coverage. The creditor has financed the premium if it treats the premium as a debt that is due and gives the consumer a right to defer payment. However, if the creditor does not advance the funds for the payment on the consumer's behalf and then requires that the consumer pay the creditor, then the creditor has not financed the premium.
- Suppose consumers are offered forbearances, modification agreements, or are otherwise delinquent on their monthly payments. If the creditor effectively pays the monthly premium on the consumer's behalf and then treats that amount as a debt that is owed to the creditor beyond the month in which it is due, then the creditor has financed the premium.

Single-premium & monthly-pay insurance

The CFPB's Commentary to Reg. Z clarifies what it means to "finance" single-premium credit insurance and insurance where the premiums are paid monthly:

In the case of single-premium credit insurance, a creditor violates these rules by adding the credit insurance premium or fee to the amount owed by the consumer at closing. In the case of monthly-pay credit insurance, a creditor violates these rules if, upon the close of the monthly period in which the premium or fee is due, the creditor includes the premium or fee in the amount owed by the consumer

Thus, credit unions must remember that these rules do not apply *only* to single-premium credit insurance. They can apply to premiums that are payable monthly, too. A premium is not "paid in full on a monthly basis" (and thus exempt from the rules) merely because the contract requires the premium to be paid monthly. In the case of monthly-pay insurance premiums, the credit union must not finance the premiums – treat them as amounts owed and let the consumer defer paying the premiums "beyond the period in which they are due," as discussed earlier.

Accrual of interest

Some creditors add credit insurance premiums to a consumer's principal balance before the premium is due from the consumer, even though funds are not advanced on the consumer's behalf at that time, and interest accrues on the increased principal until the consumer's subsequent payment is credited to the account. The CFPB explained that this accrual of interest does not necessarily violate the rules against financing credit insurance premiums but that it does raise consumer protection concerns and may not be appropriate. The CFPB wrote:

The fact that imposing interest on a premium before it is due does not constitute "financing" the premium does not mean that such practices comply with other Federal or state requirements. The Bureau intends to monitor this practice in the future and may address this issue at another time, whether by rulemaking or other means.

The CFPB said it recognizes that credit unions' data processing systems may have limitations when it comes to this practice, and they advise that creditors should credit any accrued interest back to the consumer on a timely basis, to mitigate consumer protection concerns.

"CALCULATED AND PAID IN FULL ON A MONTHLY BASIS"

The rules do not apply if credit insurance premiums are "calculated and paid in full on a monthly basis."

A premium is calculated on a monthly basis if it is "determined mathematically by multiplying a rate by the actual monthly outstanding balance" (e.g., the loan balance following the consumer's most recent monthly payment). The premium or fee must decline as the consumer pays down the outstanding principal balance. A straightforward example would be "monthly outstanding balance" or M.O.B. insurance.

A premium is not "paid in full on a monthly basis" merely because the contract requires the premium to be paid monthly.

Level premiums

Credit insurance may have "level" or "levelized" premiums, meaning that the premiums remain the same, even as the consumer pays down the loan's outstanding balance. Such insurance does *not* automatically fit the exclusion for premiums that are "calculated and paid in full on a monthly basis." So, such premiums remain subject to these rules.

Credit unions can offer such insurance but not "finance" the premiums or fees, as explained earlier in this release. So, the analysis must focus on whether the creditor treats the premiums as amounts owed and lets the consumer defer paying them "beyond the period in which they are due."

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Legal Affairs Department

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