HOUSE RESEARCH ORGANIZATION bill analysis 5/10/2003

HB 1380
Thompson, et al.
(CSHB 1380 by Flynn)

SUBJECT: Noncredit insurance and service contracts financed by consumer loans

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 5 ayes — Solomons, Flynn, Gutierrez, Hopson, Paxton

0 nays

2 absent — Christian, Wise

WITNESSES: For — Douglas Libertore; *(Registered, but did not testify):* Mandy Balch, American Traveler Motor Club, Inc.; Deborah Polan, Texas Financial Services Association; Mark Vane, Gardere Wynn Sewell

Against — Robert Doggett; Rob Schneider, Consumers Union

On — Leslie Pettijohn, Consumer Credit Commissioner

BACKGROUND: Finance Code, sec. 342.402, authorizes a lender to offer a borrower credit life insurance, credit health and accident insurance, and involuntary unemployment insurance at the time a non-real property loan subject to Finance Code, ch. 342, subch. E, is made. The purpose of credit insurance is to insure the amount of the loan in the event the borrower is unable to repay it due to an unforeseen occurrence.

DIGEST: CSHB 1380 would add sec. 342.4021 to the Finance Code to permit a lender to offer non-credit insurance and certain other products either contemporaneously with or subsequent to a non-real property loan made under Finance Code, subch. E. The loan would be subject to all applicable insurance laws of the state. A lender would have to give the borrower the option of purchasing the product separately and could not require its purchase as a condition for loan approval. A lender could offer:

- life insurance;
- disability income insurance;
- accident insurance;
- loss of income insurance;

- mechanical breakdown insurance;
- home security plans and club memberships;
- automobile security plans and automobile club memberships; and
- service contracts.

A lender could charge a borrower for a product only if the lender complied with certain requirements. The lender would have to obtain written acknowledgment of the borrower's intent to purchase the product, and any benefit payable as a result of owning the product would have to be paid directly to the borrower. The borrower also would be entitled to cancel the purchase and receive a full refund of purchase price within 30 days or, for a service contract, within 10 days if the service contract was delivered at time of sale, or 20 days if the service contract was mailed. Additionally, the borrower would receive a separate notice stating that the product was not credit insurance, nor a condition for loan approval, that the borrower would pay a finance charge on the cost of the product if financing the purchase, and that the borrower had a right to cancel the purchase under the parameters described above. The notice would be required to state the mailing address of the insurance company or vendor offering the product and would have a detachable component that could be returned to cancel the purchase and receive a full cash refund.

The lender could include in a non-real property loan contract the cost for a product offered under these provisions, but could not charge a borrower for a product not specified in this section. The bill also would establish that the cost of a product and any gain or advantage received by the lender as a result of a product's sale would not be considered a further charge, other charge, or amount received in connection with a loan made under Finance Code, Ch. 342.

The bill would require the Consumer Credit Commissioner to adopt rules providing for a version of the disclosure information in Spanish and establish a disclosure form meeting statutory requirements for plain language and readability. In addition, the bill would make conforming changes to Finance Code, sections 342.410 and 342.502(b).

The bill would take effect on September 1, 2003.

SUPPORTERS SAY:

Many low-income individuals do not have life, disability, or accident insurance because they cannot afford to make lump sum payments for these products or to finance them with credit cards. Lenders currently are able to sell these products, but not to finance them. This bill would allow a regulated lender to finance these and other products as part of a loan for a non-real property purchase, such as an automobile or consumer appliance. This would give consumers, particularly lower income consumers, the opportunity to finance the insurance products they need, and the peace of mind and material benefit that comes from having proper levels of insurance.

The bill would only apply to authorized lenders, who still would be subject to existing insurance laws, and would not authorize these products to be offered in conjunction with payday loans or pawn transactions. This bill would protect consumers who felt pressured to buy products or later realized that they had purchased products they did not want or need by allowing borrowers to cancel an insurance policy within 30 days for a full pro-rated refund. The bill would also make it easier for a borrower to cancel a policy by requiring that a loan notice come with a tear-off portion that easily could be detached and mailed to the company for a refund.

Borrowers would not feel pressured to buy a product to help their loan approval or lower the interest rate. The bill specifically would prohibit a lender from requiring a product purchase for loan approval or an interest rate and would require the lender to inform the borrower of this restriction. In addition, this bill would give consumers all the information they needed to make informed decisions about what was in their best interests. It would be patronizing to assume that consumers would be unable understand the information contained in a notice, and no regulation could help a consumer who simply did not bother to read the disclosure information. The bill merely would give consumers access to products through financing that they otherwise might have been unable to afford; it would not force them to buy any product they did not perceive as a good value.

OPPONENTS SAY:

By allowing insurance products and service contracts to be offered simultaneously with a loan so they could be financed, this bill would put lenders in a position to pressure consumers into buying other products under the impression that it might aid in loan approval or secure a lower interest rate. The loan approval portion of a purchasing decision often is the most stressful for consumers and the point at which they are most vulnerable. While the bill would require that the loan or interest rate not be contingent upon a product purchase, vendors make large commissions on most of these products, and the bill's disclosure requirements would be insufficient to reverse the incentive of salespersons to apply pressure to buyers.

Existing notice and disclosure requirements for other insurance products have not stopped predatory lending. Lenders may indeed provide written notice and disclosure, but that does not assure that borrowers understand or read it, or that this information is sufficient to protect buyers from the misleading claims and pressure tactics employed by some salespeople. This bill's disclosure requirements likely would be no more successful in protecting consumers.

The bill would allow cancellation of a policy within 30 days, which would be helpful, but insufficient. Consumers should be allowed to cancel at any time with a full refund, including the price of any unwanted add-ons that borrower's might not even have been aware they purchased.

This bill should not authorize the financing of non-insurance products, such as service contracts, home security plans, and auto club memberships, that are not currently regulated. While vendors of these products are required to register with the government, there is no oversight of the relationship between the benefit of such a product and its cost, as there is for insurance products.

NOTES: The committee substitute differs from the bill as introduced by removing the option for a lender to offer insurance products in conjunction with second mortgage loans under Finance Code, Ch. 342, subch. G. It would also prohibit a lender from requiring the purchase of a product as a condition for loan approval. The substitute added provisions governing cancellation of a service contract and would remove language referencing the Consumer Credit Commissioner's authorization of a product not specified in this bill.