The Value of Disability Payment Protection Programs

Introduction

Payment protection programs like credit insurance and debt protection are facing unprecedented scrutiny from consumer advocates and regulators. Some question the value these programs provide and some even go so far as to claim the programs may be financially detrimental to consumers. Inherent in most opposition is an articulated desire to protect consumers from unnecessary fees and economic strain. If this is the case, these groups should take the time to more closely evaluate the meaningful benefits these programs provide to consumers, particularly in the current economic environment.

Credit insurance and debt protection programs are designed to provide a 'bridge over troubled water' or safety-net for borrowers should the unexpected occur – loss of life, sickness or injury, job loss, or other unforeseen events. These programs help cancel or suspend debt, make monthly payments or pay off the loan, keeping borrowers current with their loan payments, reducing their delinquencies and foreclosures, and ensuring they have one less thing to worry about during a time typically fraught with emotional and economic stress. In 2009, over $2 billion in benefits were paid from credit insurance programs alone.[1] This paper focuses in particular on the value of the disability benefit currently offered in many payment protection programs.

Consumers are Financially Vulnerable

"Tens of millions of once-secure middle class families now live paycheck to paycheck, watching as their debts pile up and worrying about whether a pink slip or a bad diagnosis will send them hurtling over an economic cliff." Elizabeth Warren[2]

The economic security of American households has eroded in the last decade. Many low to middle-income households have experienced a growing gap between their incomes and their day-to-day costs of living, resulting in decreased savings, rising levels of debt, and widespread economic instability. Since the year 2000, many households have attempted to cope with this financial imbalance by relying on credit cards to cover basic expenses not met by their earnings. In addition, cashed-out home equity - $1.2 trillion over the last six years – was used to pay down those debts and cover other costs of living, creating a situation of financial fragility for many consumers.[3] According to a recent Harris Poll, 27% of Americans have no personal savings at all, and 34% of Americans have no retirement savings.[4]

With so many consumers in precarious financial condition, an illness or injury could be an event that pushes them over the edge. A recent study frames it this way: "The current recession has taken a toll on family finances and has left millions of Americans with little or no financial cushion. For those who suffer the misfortune of illness or injury, the toll is even greater…medically indebted households rely more heavily on credit cards to pay their financial obligations…carry higher levels of outstanding credit card debt, have higher rates of interest on their credit cards, and work longer hours and at additional jobs in order to pay off debt. They exhaust savings and imperil their future by drawing against their homes and retirement accounts trying to pay their bills. In spite of their efforts, too many still come up short. [5]
A Life Insurance Foundation for Education (LIFE Foundation) study indicated more than a quarter (27%) of working Americans say they would have trouble supporting themselves financially "immediately"

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1 2009 Credit Insurance Experience Exhibit

2 Warren, E. (December 2, 2009) *The Huffington Post*, "America without a middle class" (Retrieved from www.huffingtonpost.com)

3 Garcia, Jose. (November 2007) *Demos.com* article, "Borrowing to Make Ends Meet – The Rapid Growth of Credit Card Debt in America", (Retrieved from www.demos.com).

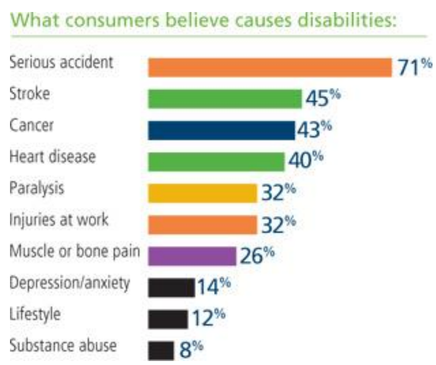
4 Taylor, Humphrey. (Feb. 2, 2011) *Harris Poll #13*. "Number of Americans Reporting No Personal or Retirement Savings Rises". (Retrieved from www.prnewswire.com)

5 Garcia, J. & Rukavina, M. (2010, October) *Demos.com* article, "Sick and in the Red". (Retrieved from www.demos.com)

following a disability that keeps them out of work, while nearly half (49%) would reach that point in a month or less. Three out of four (74%) would face financial trouble within six months. [6] Now more than ever, consumers are vulnerable to a financial setback stemming from a sickness or injury.

Disability Risks - Perceptions and Realities

A recent study by the Council for Disability Awareness indicates consumers do not have a clear understanding of their risks as it relates to becoming disabled and unable to work. Many people believe disabilities are caused primarily by serious accidents[7], but fewer than 1 in 10 long-term disability claims result from accidental injuries. The study outlines consumer perceptions of the most common causes of disabilities in the chart below:



Although the overwhelming majority of consumers believe accidents are the leading cause of disabilities, in reality, 95% of disabilities are caused by illnesses and medical conditions.[8] The chart below illustrates the true underlying causes of disability:

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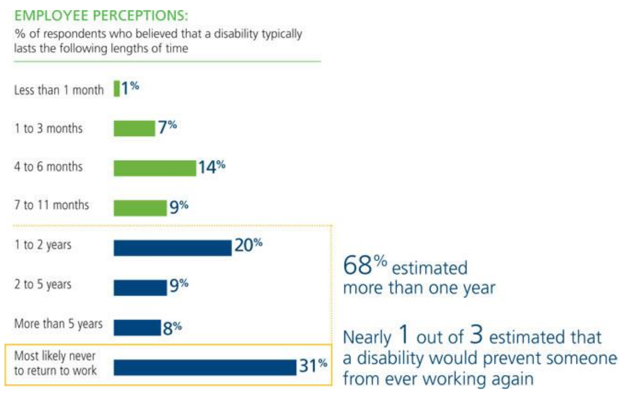
[6] LIFE Foundation. (2009, May)

[7] Council for Disability Awareness (2011). *The Disability Divide: Advisors Study,* "America Without a Middle Class" (Retrieved from www.disabilitycanhappen.org/research/pdfs/ProducerResearchReport.pdf)

[8] Council for Disability Awareness (2011) Long-Term Disability Claims Review.

Musculoskeletal System/Connective Tissue Disorders are currently the leading cause of disability, and include conditions like neck and back pain; joint, muscle and tendon disorders; arthritis; foot, ankle and hand disorders.

When examining perceptions about the duration of most disabilities, the idea that many consumers view disabilities as catastrophic was confirmed. More than two-thirds of consumers believe a disability would keep a person out of work for a year or more - and the largest segment within that group assumes most disabilities are permanent. The average long-term disability duration is about 2.5 years. Perhaps because consumers overestimate the severity of disabilities they also drastically underestimate the chance a disability may occur. Consumers believe their chances of becoming disabled are about one in 100, but the actual odds are as high as one in four.[9]



Consumers Are Underinsured

More than half of American workers have no disability coverage and the percentage is dropping, according to recent research from The Hartford.[10] The study revealed that 49% of workers have short-term disability insurance and 44% have long-term disability insurance, a drop of 6% and 3% respectively from the prior year's survey. Almost 2 million Americans suffered a disabling illness or injury in the first half of 2011, and according to the study only half of those workers would continue to have an income to pay for expenses as they recover from their disability.

70% of employees in the private sector are not covered by any type of private long-term disability insurance.[11] In fact, when offered as a voluntary benefit by their employers, almost 40% of workers do not choose long-term disability insurance; and barely 30% claim to understand it very well.[12]

In a recent survey by the Council for Disability Awareness[13] , when asked how they would get by financially if faced with a disability, the responses were mixed and often did not seem to indicate the respondent understood what would actually be required. Over 40% said they would rely on employer-funded sick leave or vacation pay, but these sources would typically be exhausted within weeks. 36% said they would rely on a partner or spouse's income, but if both incomes are required to meet current expenses, it is unlikely that relying on only one would be sustainable. Taking on additional debt was cited as a solution by 34% of the respondents, but qualifying for a loan when someone is disabled and unable to earn an income to pay the money back would be difficult if not impossible. Credit card debt, also cited as an option, is notoriously expensive, and would be difficult to pay off because of a reduced income and ability to make payments. The responses are outlined in the chart below:

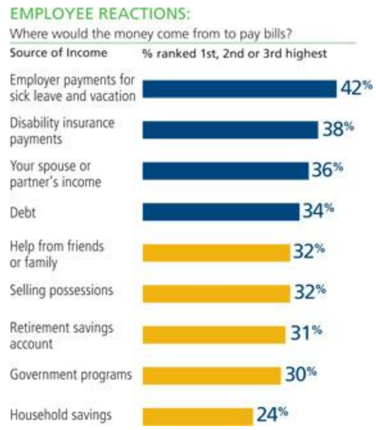
9 CDA (2011) Advisor Disability Study

10 (June 8, 2011) *Insurance Journal*, "Percent of U.S. Workers with Disability Insurance Declines". (Retrieved from www.insurancejournal.com/news/national/2011/06/08/201752.htm)

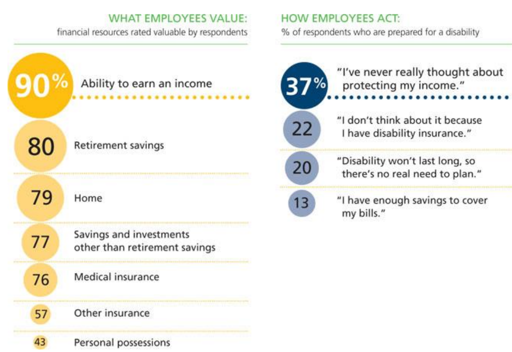
11 Social Security Administration (Jan.31, 2007) Fact Sheet.

12 CDA (2008) Worker Disability Planning and Preparedness Study

13 CDA (2010) Consumer Disability Awareness Survey



In the study, consumers overwhelmingly agreed (90%) their ability to earn an income was more important than other financial resources in achieving their financial goals. But while most readily buy insurance to protect their physical assets (home, car, etc.), far fewer consider protecting their income-earning ability, which they viewed as being significantly more important than their physical assets.



The reasons they provided for this were startling, with 37% indicating "I've never really thought about protecting my income." "I don't think about it because I have disability insurance," was cited by 22% of the respondents, which appears to indicate an additional lack of understanding on the part of consumers, as traditional employer-provided disability coverage will likely fall far short of fully protecting their income in the event they become sick or injured and unable to work.

"People understand the importance of insuring their home. Yet by not protecting their paycheck, consumers are essentially putting their home at risk," according to Richard Gendreau, Executive Vice President of The Hartford. He maintains that losing income for two years can be the financial equivalent of losing a home. [14]

Disability Coverage Options

As the study revealed, many consumers are relying on employer-provided group disability insurance to protect themselves against an unforeseen sickness or injury. But are these plans enough? To keep insurance premiums low, most plans cover only between 40-60% of an employee's income. The plans typically include monthly maximums, so high earners may lose even more of their income. Plans also generally include 60-90 day waiting periods before benefits will be payable. Employer-paid disability

[14] (June 8, 2011) *Insurance Journal*, "Percent of U.S. Workers with Disability Insurance Declines" (Retrieved from www.insurancejournal.com/news/national/2011/06/08/201752.htm)

insurance benefits are taxable, so in addition to losing roughly half of one's income (plus any bonus pay), an additional 20% or more could be lost for taxes. Some plans will pay if the employees are unable to perform in their current profession; others are more restrictive and will pay only if the employee is unable to work at all.

According to the Federal Reserve, over 40% of American families spend more than they earn each year.[15] If consumers are not making ends meet with their entire salaries, how will they survive financially on half the income or less during a time when expenses will likely be increasing for things like insurance deductibles and medication?

Employer-provided disability plans are of course contingent upon one's continued employment. These benefits are never guaranteed, but as unemployment levels remain high, they are even more vulnerable. If a consumer loses his or her job and disability protection while experiencing medical difficulties, obtaining new coverage with a pre-existing medical condition may be difficult or impossible.

For employees injured on the job, Workers' Compensation benefits may be available, but 99% of disabilities happen outside of work and are not covered by the program.[16] If a consumer does qualify for benefits, they may be deducted from the amount they are receiving under an employer plan.

Social Security Disability Insurance (SSDI) is another potential option, but presents its own challenges. 65% of initial SSDI claim applications were denied in 2009, and the appeals process can last up to four years. The average monthly benefit paid by SSDI in June of 2010 was $1,065, and 52% received less than $1,000 per month.[17] Benefits received from SSDI may also be deducted from amounts the employee may be receiving under an employer plan.

Obtaining individual coverage from an outside insurance company or agent is an option, but the application process can be daunting, the options, terms and conditions confusing, and the premiums expensive.

Insurance May Not Be Enough

Even if consumers have comprehensive health insurance and disability coverage through their employer, it may not be enough. 2012 Massachusetts Democratic Party Senate candidate, bankruptcy expert and policy advocate Elizabeth Warren explains "…what people need to understand about the medical problem/financial problem connection is that it's really not just one punch. It's a series of punches. About 3/4 of the families who ended up in bankruptcy in the aftermath of a serious medical problem had health insurance at the onset of the illness or accident that ultimately bankrupted them…even families with health insurance are quite vulnerable to a severe economic reversal if somebody in the family gets sick." [18]

In addition, Harvard University researchers offer a pair of startling findings as their research revealed half of all bankruptcies in the U.S. stem from a medical crisis—and the group hardest hit by these crises is the middle class. "We thought we were going to find these were poor people, uninsured," says Dr. David Himmelstein, the study's lead investigator. "By and large, we found it was the middle class."

More specifically, of the 700,000 households that are driven into bankruptcy each year by medical crises, three-quarters had health insurance at the onset of their illness, more than half were homeowners, and 50% included a member with a college education. "These aren't abstract numbers," says United States Senator Chris Dodd (D-CT), who has long been a champion of health-care reform. "[There are] families

15 Federal Reserve Board (2004) *Survey of Consumer Finances*

16 National Safety Council (2010) *Injury Facts*

17 Social Security Administration, Disabled Worker Beneficiary Statistics, (Retrieved from www.ssa.gov and www.disabilitycanhappen.org/chancesdisability/disabilitystats.asp)

18 Warren, E. & Hinojosa, M. (February 9, 2007). *pbs.org*, "Elizabeth Warren on Debt and the Middle Class" (Retrieved from www.pbs.org)

who are desperately fighting to stay afloat while an undertow of healthcare costs drags them down." Susan Pisano, a spokeswoman for the American Association of Health Plans, says the problem of skyrocketing health costs cannot be blamed on the insurance industry—and urges workers to better prepare themselves for catastrophes. "A lot of us don't have sufficient savings to help during a period of illness or stress," she says.[19]

The Financial Impact of Sickness or Injury

A study in the American Journal of Medicine revealed that 62% of all bankruptcies result from medical bills. The share of bankruptcies attributable to medical problems rose by 50% between 2001 and 2007. [20] Another study suggests that medical disruptions are a major contributor to mortgage default, often striking in combination with other factors. Half of all respondents 49% indicated their foreclosure was caused in part by a medical problem. Altogether, approximately 7 in 10 respondents either self-reported a medical cause of foreclosure, or experienced a medical disruption in the years prior to foreclosure. [21]

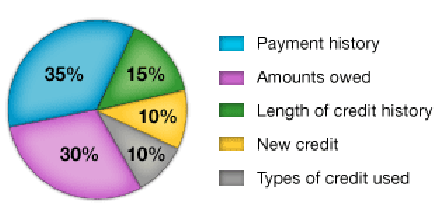
If consumers are fortunate enough to avoid foreclosure or bankruptcy, there is still reason to be concerned about maintaining their monthly payments. Failure to do so can lead to late fees and higher interest rates, which add to existing debt and negatively influence credit scores.

A credit score is a numerical expression of the data contained in an individual's credit report, and provides a tool for measuring an individual's creditworthiness, in addition to income history and employment status. Originally developed by the Fair Isaac Corporation in the 1960's, the FICO score is the best known and most widely used credit score model in the United States.

While a falling credit score is certainly preferable to foreclosure or bankruptcy, it can still have a significant impact on consumers. The FICO scoring scale is between 300 and 850. More than one in four Americans now have a credit score below 600, which is considered low. Statistics released from FICO Inc. show that 25.5% of the 170 million Americans with active credit accounts have scores of 599 or below, based on data from April 2010 consumer credit reports. The data also showed that 2.4 million more people have fallen into the lowest score categories in the past two years.[22]

Late payments, collection accounts, settled accounts, repossessions, foreclosures, and public record items (tax liens, judgments, bankruptcies) can negatively influence a credit score. Even minor late payments, such as 30-day delinquencies, can have an impact, as an individual's payment history makes up the largest part of the score.

Credit Score Factors



An unforeseen sickness or injury could easily cause consumers to become delinquent on a payment or miss one or more payment altogether, causing a negative item to appear on their credit report and

[19] Smolowe, J. (2005). *People Magazine,* "Destroyed by Doctor Bills"

[20] Himmelstein, D.U., Thorne, D., Warren, E., & Wollhandler, S. (2009). *American Journal of Medicine,* "Medical Bankruptcy in the United States 2007: (results of a national study).

[21] Robertson, C. T., Egelhof, R. & Hoke, M. (2008). *Health Matrix*, "Get Sick, Get Out: The Medical Causes of Home Mortgage Foreclosures".

[22] York, Kate. (July 25, 2010) *News and Sentinal*, "Average FICO Score Drops Below 600" (retrieved from www.newsandsentinal.com)

damaging their credit score. Even if a consumer is able to get back to work quickly, negative items will typically remain on a credit report for up to 7 years.

Why is this important? Access to credit and cost of credit are the two primary reasons why credit scores matter. Particularly in a contracting lending climate, if a score is too low, the applicant may not qualify for a loan. Even if the applicant does qualify, the cost of credit could vary greatly depending upon the credit score.

For example, for a 30-year fixed rate mortgage of $185,000, the difference in the APR, monthly payment, and total interest paid over the life of the loan are as follows:

FICO Score	APR	Monthly Payment	Total Interest Paid
760-850	3.976%	$ 881	$ 132,038
700-759	4.198%	$ 904	$ 140,608
680-699	4.375%	$ 924	$ 147,524
660-679	4.589%	$ 947	$ 155,983
640-659	5.019%	$ 995	$ 173,297
620-639	5.565%	$ 1,058	$ 195,868

Those with higher scores will obtain the lowest interest rates, resulting in lower monthly payments. The difference in total interest over the life of the loan for a customer in the highest score bracket versus the lowest is $63,830.

A credit score is also used for evaluating an individual beyond the world of lending. A consumer with bad credit may pay 20% to 50% more in auto insurance premiums than a person with good credit. [23] The credit score also may influence utility deposits, apartment lease applications, and employer hiring decisions. [24]

Payment Protection Benefits Provide Critical Help

Maintaining adequate savings to guard against any unexpected financial difficulties is a sound strategy for consumers. But as a MetLife study revealed, 65% of Americans could not meet their financial obligations three months after losing their job, and 19% could meet them for only two weeks or less. [25] And a recent Harris Poll revealed 27% of Americans have no personal savings at all.[26]The unfortunate reality is, for most consumers, adequate savings just aren't there.

So what are consumers to do? What resources are available for those seeking to protect themselves against unforeseen sickness or injury? Payment protection programs like debt protection and credit insurance are currently one of the only options available for them.

Debt protection is not insurance, but a lending program provided through financial institutions to their loan customers for credit cards, real estate, and other consumer loans. An amendment to the lending agreement is made in which the borrower agrees to pay a fee in exchange for the lender canceling or suspending some or all of their debt upon the occurrence of one or more specified events, typically death, disability and/or job loss. The fee for the protection is included in the borrower's monthly loan payment.

Most payment protection disability programs have simple applications and require no medical exam, nor are they age-rated. As is the case with traditional insurance, these programs generally include some waiting periods and exclusions to protect against anti-selection. For disability benefits, these may be a vesting period (30, 60, 90 days) during which no benefits would be provided, and some exclusions such

[23] BankRate.com (April 1, 2005)

[24] Federal Reserve Bank of Atlanta (2008)

[25] Met Life (April 2010) "MetLife Study of the American Dream: An Uphill Climb"

[26] Taylor, Humphrey (February 2, 2011) *The Harris Poll #13*, "Number of Americans Reporting No Personal or Retirement Savings Rises". (Retrieved from www.prnewswire.com)

as pre-existing conditions, self-inflicted injuries or war. Monthly benefits are also typically capped to a stated monthly maximum. Payment protection disability benefits are most often part of an overall package of benefits, but may be offered on a stand-alone basis as well.

If the borrower qualifies for disability benefits, his or her monthly payment will be cancelled or suspended (depending upon the coverage offered) for the prescribed time period, typically 3-12 months. For a borrower with a $750 monthly home equity loan payment and/or a $350 monthly car payment these benefits can be significant, and could mean the difference between surviving the disability and damaging a credit rating, losing an asset(s), or filing for bankruptcy.

Payment protection benefits are provided regardless of any other coverage the borrower may have. In other words, if the borrower is receiving benefits from an employer-provided, Social Security Disability Insurance, Workers' Compensation, and/or individual disability program, he or she would still be eligible to receive benefits from payment protection programs. The coverage is intended specifically to protect a given loan and does not take the existence of any other general coverage into account when providing benefits.

Consumers Value Payment Protection Programs

Several studies have been conducted over the years testing consumer satisfaction with credit insurance, with favorable results. A survey of consumer attitudes reported by the Federal Reserve Board affirms historically high satisfaction among those who purchase credit insurance and concludes that credit insurance purchasers believe they would be ill-served by any move to restrict credit insurance as an option when they borrow.

The Survey Research Center of the University of Michigan surveyed 1,006 consumers during September and October 2001 for the Credit Research Center of the McDonough School of Business of Georgetown University using a questionnaire designed by Thomas A. Durkin, Senior Economist, Board of Governors of the Federal Reserve System (FRB), and a member of the FRB's Division of Research and Statistics.

The survey confirmed findings of earlier surveys, with up to 90% of credit insurance purchasers responding that they are satisfied with credit insurance and would purchase it again when borrowing, and shows again that consumers receive ample notice that credit insurance is a voluntary option to insure loans when they borrow.

Results and analysis of the survey are reported in an article by Mr. Durkin entitled, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance" [27] that also examines a survey conducted during 2001 concerning consumer attitudes about the use of credit cards and credit disclosures under the FRB's Reg Z governing Truth in Lending.

Concerning credit insurance, Mr. Durkin concluded, "With respect to credit insurance because the views of users and nonusers seem so divergent, it seems important that the views of users be given sufficient weight in considering public policies in this area. According to the views expressed by many users of credit insurance, eliminating this product by regulation could be disadvantageous to them."

The study confirmed the findings of every study conducted during the past 30 years in which consumer knowledge and attitudes about credit insurance have been tested. Uniformly the studies find that consumers value credit insurance, understand it, received ample notice that selection is voluntary, and said they would purchase this valuable financial protection again when they borrow.

The analysis noted that the willingness of consumers who use credit insurance to purchase it again when borrowing "seems to indicate that they feel considerably better about the product than its critics." A clear

[27] Durkin, Thomas A. (2002*) Federal Reserve Bulletin*, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance"

majority in all three categories said they would purchase credit insurance again when borrowing, including 94% of installment borrowers, almost 78% of equity borrowers, and 71% of first mortgage insurers.

Previous landmark surveys and studies of consumer attitudes to credit insurance include a 1973 study by the Ohio University College of Business Administration, 1977 and 1978 surveys for the Board of Governors of the FRB, a 1986 study for the Federal Reserve Bank of San Francisco, and a 1993 study by Purdue University.

Although an industry-wide study has not yet been conducted for debt cancellation or debt suspension agreements, financial institutions often conduct their own surveys specific to their programs, which yield similarly positive results. Since 2005, one large regional bank has been surveying its debt cancellation customers and asks the following questions (with the corresponding results through August 2010):

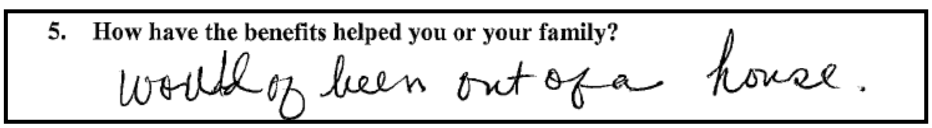
How important was the benefit to you and your customers financially?

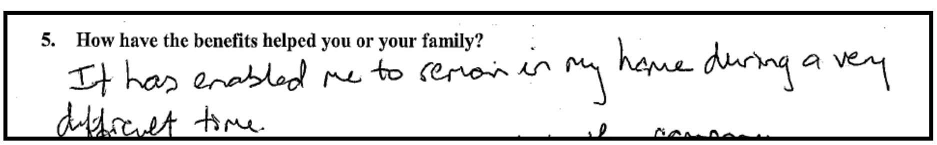
Critically important (wouldn't have gotten by without it)	67.6%
Important (would have gotten by without it, but it would have been difficult)	29.7%
Not important (would have been okay with or without it)	2.7%

How valuable was the benefit to you in relation to the monthly fee paid for the product?

Very	91.9%
Somewhat	5.4%
Not at all	2.7%

The survey also asks for feedback on how the benefits have helped the customers and their families. Below are some of the actual responses the bank received, which are typical of the majority of responses received:


5. How have the benefits helped you or your family?
Would of been out of a house.


5. How have the benefits helped you or your family?
It has enabled me to remain in my home during a very difficult time.


5. How have the benefits helped you or your family?
KEPT US FROM GOING BANKRUPT

What would have happened to these customers had they not purchased the bank's payment protection program? What would the groups and individuals who oppose the concept of payment protection say to these people about the decision they made to include the protection in their loans? In 2009, over $2 billion in benefits were paid from credit insurance programs alone. [28] While there is currently no single source of data for debt protection programs, the benefits they provide would likely increase that number

[28] 2009 Credit Insurance Experience Exhibit

significantly. Where would the recipients of those billions of dollars in benefits have turned for help had they not received them?

Summary

Harvard Law Professor Christopher Tarver Robertson's study [29] on the medical crises that cause home mortgage foreclosures concludes with this recommendation – "One potential response is to create a public or private insurance system to prevent the problem. Such insurance could pay the mortgage during a verifiable medical crisis in the borrowers' household, allowing those with only a temporary problem to overcome it without losing their homes in the process." Credit insurance and debt protection programs have provided *precisely* this type of benefit to consumers for many years.

In study after study, consumers have expressed a high level of satisfaction with credit insurance and debt protection programs. Now more than ever, consumers are experiencing financial concerns such as increasing debt and medical costs, lower home values and savings, and job insecurity. Many consumers have no insurance at all, and still more are underinsured. These factors combined create an environment in which the benefits provided by credit insurance and debt protection programs may be more vital than ever; and one in which the bias against these programs from some organizations and individuals is perplexing.

Traditional insurance and a robust savings strategy are sound options for many people, and are the options those who oppose payment protection plans most often recommend. But obtaining individual disability protection through traditional channels is not always a simple process, and can be confusing and expensive. And the data suggests that many consumers, particularly those in middle to lower income brackets, are not saving, likely because they are already struggling daily to make ends meet. Payment protection programs may not be the perfect solution for every consumer, but they are an ideal solution for many. Before drawing a speedy, uninformed conclusion about the value these programs provide, it would be advisable to take a deeper look at the economic realities most Americans currently face, and the real and meaningful difference payment protection benefits can make to consumers in a time of need.

Lee-Ann Hollister
CCIA Sales and Marketing Committee
February 23, 2012

[29] Robertson, C.T., Egelhof, R. & Hoke, M. (2008). *Health Matrix*. "Get Sick, Get Out: The Medical Causes of Home Mortgage Foreclosures".
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