

- SUBJECT:** Permitting lenders to require collateral protection insurance
- COMMITTEE:** Financial Institutions — committee substitute recommended
- VOTE:** 6 ayes — Averitt, Solomons, Denny, Grusendorf, Hopson, Menendez
0 nays
3 absent — Marchant, Pitts, Wise
- WITNESSES:** For — Charles Amato, Southwest Business Corporation; Marvin Cook, Southwest Business Corporation/Balhon Insurance Company/American National Insurance Company; Gary Dudley, Credit Union Legislative Coalition; Karen M. Neeley, Independent Bankers Association of Texas; *Registered but did not testify:* John Heasley, Texas Bankers Association.
Against — Rob Schneider, Consumers Union, Southwest Regional Office
On — Leslie Pettijohn, Consumer Credit Commissioner
- BACKGROUND:** Finance Code, sec. 341.302 currently sets certain requirements that creditors must follow if they charge a debtor for the cost of insuring the property that secures a loan (collateral protection insurance).
- DIGEST:** CSHB 540 would repeal Finance Code, sec. 341.302 and replace it with more extensive provisions regarding collateral protection insurance (CPI) in a separate chapter of the code.
Under CSHB 540, insurance purchased after the execution of a loan that protected the property securing the loan and that was purchased by the creditor under the terms of the credit agreement would be considered CPI if the debtor were charged for it. A creditor only could purchase CPI if the loan contract provided for it, and the debtor had not purchased it on his or her own. A creditor's purchase of CPI would be regulated in terms of:
! how much insurance the creditor could buy on the collateral;
! from whom the creditor could purchase CPI;

- ! how long a term of insurance the creditor could purchase;
- ! the repayment schedule that a creditor could use in charging the debtor for CPI; and
- ! how much notice a creditor would have to provide the debtor and co-signors or guarantor regarding the CPI purchase.

The debtor would have to be given both the right to cancel the insurance and the right to a prorated refund of the premiums if the debtor purchased his or her own insurance.

The bill would provide creditors and insurers immunity from liability if they placed the insurance in accordance with the bill's provisions by eliminating all causes of action against anyone related to the placement of CPI. It also would make clear that nothing in the bill would require a creditor to buy CPI for the debtor. Creditors would not act in a fiduciary capacity in placing the insurance but rather would act for themselves.

CSHB 540 would not affect Business and Commerce Code, chs. 1-9 regarding collateral, other Finance Code requirements regarding credit transactions, or the other legal rights, remedies or options of the creditor.

The bill would take effect September 1, 2001, and would apply only to insurance placed by a creditor on or after the effective date.

**SUPPORTERS
SAY:**

By regulating creditors' purchases of collateral protection insurance, CSHB 540 would protect consumers/debtors in many ways, including:

- ! guaranteeing the debtor's right to cancel CPI if the contractual obligation to purchase the insurance were met;
- ! limiting the term and amount of the insurance purchased;
- ! requiring notice of the purchase and all of the related costs to the debtor and any co-signors and guarantors;
- ! requiring that the premium refund be prorated to the date the insurance was canceled; and
- ! making the CPI provisions generally applicable to all lenders, including credit unions.

Because creditor-placed CPI is more expensive than that purchased by the

consumer/property owner, all of these provisions would help ensure that the consumer understood what they were being charged for and had the chance to replace CPI with their own insurance as soon as possible. Moreover, the notice to co-signor and guarantors would protect a group of debtors who are completely unprotected by current law.

As a trade-off for complying with the bill's provisions, the creditor would receive a safe harbor from suits by the debtor. Loan contracts permit but do not require a lender to purchase CPI. Further, creditors only need insure the portion of the property's value equal to the indebtedness, not the full value of the collateral. But some consumers take the CPI provisions in their loan to mean that the lender must purchase the insurance or believe that CPI will protect their equity in the collateral. Lawsuits have arisen when collateral is destroyed, and the debtor claims that the creditor should have insured or fully insured the property. The bill would eliminate these ill-founded suits while discouraging creditors from unscrupulous practices in relation to CPI. In addition, by setting up an industry standard, the bill could make suits against creditors who failed to comply and deceived a debtor easier to prove.

OPPONENTS
SAY:

CSHB 540 is unnecessary because several of the requirements provided for in the bill already are in the current section 341.302. Most others are current industry practice. Since the bill would provide no enforcement mechanism, the bill actually would offer the consumer very little in the way of new protections.

The bill also would eliminate the consumer's causes of action related to the placement of CPI, including suits under the Deceptive Trade Practices Act, against a CPI insurer or against a creditor who substantially complied with the statute. Thus, the consumer protections that the bill would offer are more ephemeral than real, and the bill actually may limit the creditor's and insurer's liability vis-a-vis the debtor.

NOTES:

The committee substitute moved the bill's provisions from ch. 341 to a new ch. 307. It added provisions limiting the term of the insurance coverage that the creditor could purchase, limiting the effective date of the insurance only to dates when the property became uninsured, and limiting the amount of insurance that could be purchased to what was sufficient to cover the unpaid

debt. The substitute changed the time provided for giving notice and would add notice provisions requiring that all co-signors and guarantees on the loan be notified of the purchase of CPI. It also changed the permissible methods of refunding premiums upon cancellation of the insurance.

The companion bill, SB 707 by Carona, passed the Senate by voice vote on March 21 and was reported favorably, without amendment, by the House Financial Institutions Committee on May 3, making it eligible to be considered in lieu of HB 540.