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FDIC Consumer News

Summer 2003

Credit Protection: What to Consider Before You Buy

Lenders offer insurance or similar products that would make your loan payments if you die, become ill or unemployed, but there are costs and limitations. Here's a guide for evaluating this coverage.

Think about the last time you applied for a new loan or a credit card. Did the lender ask if you'd like to buy something called "credit insurance" or a similar credit protection product that would make your loan payments if you die, become ill or unemployed? And after you got the loan or credit card, did your lender continue to offer credit protection programs in mail solicitations or telemarketing calls? Chances are you answered "yes" to these questions. But it's also likely that you have your own questions, such as: Do I really need this insurance? And, how can I tell if this coverage is a good deal?

FDIC Consumer News wants to help you answer these questions. Why? Because we know that applying for a loan, particularly

on a major purchase such as a home or a car, can be confusing for many consumers. And we realize that it's possible that many consumers may buy optional credit protection without evaluating whether they need it, how much it will cost, or if they can get a better deal elsewhere. We've also heard about instances in which some consumers have fallen prey to high-pressure sales pitches or purchased high-cost credit protection that they really didn't need or understand.

"We're all prone to focus on the benefits of an offer, written in bold, without evaluating the conditions and exclusions," says Deirdre Foley, an FDIC senior policy analyst. "You should review your financial situation and weigh the costs and benefits before deciding if this type of coverage makes sense for you."

Here's an overview of what credit protection is and what you need to know to protect *yourself* from high-cost or unnecessary coverage.

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INSIDE

What Are Credit Insurance, Debt Cancellation and Debt Suspension Programs?

Credit insurance is offered with certain kinds of financing, such as some home loans, credit cards, and loans offered by department stores or auto dealers. In general, credit insurance is a type of life, accident, health, disability or unemployment insurance that will pay off a debt if the borrower dies or make monthly payments if the borrower becomes ill, injured or unemployed.

For the most part, each state government regulates credit insurance sales in that state, and the insurance department enforces the state laws and regulations governing pricing, disclosures to buyers, minimum insurance benefits, and other consumer protections.

Moreover, most types of credit insurance are voluntary. An important exception is property or hazard insurance. A creditor may require that you maintain this kind of insurance to cover the costs of repairing or replacing property (such as your home or auto) that serves as collateral for a loan. And in those instances in which insurance is required, a bank cannot condition approval of the loan on the purchase of insurance from the bank or an affiliate.

In addition, some depository institutions (such as banks and credit unions) sell "debt cancellation" and "debt suspension" programs under various names. In general, debt cancellation eliminates the debt if the borrower dies or cancels the monthly payment if the borrower becomes disabled, unemployed or suffers some other specified hardship. Debt suspension is different. It temporarily postpones all or part of the monthly payment while the borrower is facing a specified hardship — the borrower is still expected to make the suspended payments in the future. These programs are similar to credit insurance products in terms of their function, but fees and other features may be significantly different. Debt protection programs are offered by depository institutions directly, not by insurance companies. These programs are subject to regulation by the appropriate federal or state depository institutions supervisor.

The Pros and Cons

Credit protection products may provide borrowers peace of mind and security, and can be a good deal for certain consumers. Providers of credit protection also advertise the product as "easy to buy" because, unlike traditional life or disability insurance, it often does not require a physical examination, premiums are the same regardless of your age or health, and coverage can be purchased in small dollar amounts. Credit protection programs may be the best or only coverage for some older consumers, people who smoke or are ill, or workers concerned about making loan payments if they lose their job.

Also, other types of life and disability insurance may carry higher minimum-coverage amounts than those for credit insurance, which is based on the size of the consumer's debt. This means, for example, that instead of buying a traditional life insurance policy for $50,000, a consumer would obtain credit insurance based on the loan balance, which may be much less.

However, despite these benefits, credit insurance and debt cancellation or debt suspension programs typically cost far more than a comparable term life insurance policy (which provides protection for a specified period) and perhaps other insurance not sold with a loan. These credit protection programs also can only be used for one purpose — to repay a specific debt.

Let's say you buy credit insurance or debt cancellation/suspension coverage to pay off a credit card debt if you become sick or die, and you consistently carry a card balance of $4,000. Various sources indicate that you'd likely pay between $150 and $350 a year for credit protection. For that money, you might be able to buy a much larger term life insurance policy or add to your emergency savings, both of which could be used to pay off *any* obligations, not just the credit card debt.

> *Most types of credit insurance are voluntary. And in those instances in which insurance is required, a bank cannot condition approval of the loan on the purchase of insurance from the bank or an affiliate.*

Other restrictions, limitations or costs may apply to the various credit protection programs. Examples:

- Some debt cancellation programs limit death benefits only to *accidental* death — a relatively infrequent occurrence compared to death because of illness, disease or natural causes. In contrast, credit insurance providing a death benefit is rarely limited to accidental death.

• The typical credit insurance policy covering disability or unemployment will make the borrower's monthly payment on a loan during the benefit period. In contrast, a debt suspension program only puts loan payments on hold.

• If you become ill or unemployed and you apply for benefits under a debt suspension program for a credit card or a home equity loan, the contract probably will indicate that you cannot continue using the card or equity loan. "If you're unaware of this restriction, you may be cutting off an important source of emergency cash just when you need it the most," according to April Breslaw, Chief of the FDIC's Compliance Examination Support Section.

• Some creditors offer single-premium credit insurance, which means that the premium is paid in a lump sum up front instead of monthly or annually. The one-time payment typically is so large that consumers add the fee to their loan amount and then must pay interest on it each month. This adds significantly to the monthly loan payment and the overall cost of the loan. Moreover, even though the premium may be added to the loan balance and paid for 15 to 30 years, it's possible that the insurance may only cover the first five to 10 years of the loan.

How to Protect Yourself

Here are a few steps you can take to evaluate credit protection plans and decide what's best for you.

1. Remember that most credit protection is optional. If you are asked to purchase credit protection before your loan closes, find out whether your lender *requires* that you purchase it, and why. Don't assume that credit protection is required. When in doubt, contact the appropriate state or federal regulator for more information. If you obtain optional credit protection and later decide you don't want it, you may have a right to cancel the coverage and obtain a refund for up-front payments.

2. Evaluate your family's insurance costs, coverage and needs annually. You could be under-insured in certain areas or over-insured in others. Talk with your insurance agent or financial adviser about your situation, including any questions about credit protection. You may, for example, have enough savings to cover your minimum loan payments due, the amount generally covered by these programs, if you become sick or unemployed.

3. Before purchasing a credit protection product, consider if you already have, or would be better off with, traditional insurance. For many people, especially those in good health, they probably can get traditional insurance that can meet their needs at a more reasonable price than a credit protection plan. But for some people, especially those who are elderly, have a serious health problem, or are concerned about making loan payments if they lose their job, credit protection may be the best or only coverage they can obtain.

If you're considering a credit protection program, understand what is covered, what isn't, and whether the costs and restrictions outweigh the benefits. For example, remember that credit insurance and debt cancellation programs only apply to a specific debt. In many situations, you and

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If You Have a Question or Problem

First contact the company that offered or sold you the credit insurance or debt protection program. If you're not satisfied with the outcome or you want basic information about your rights as a consumer, consider contacting the appropriate government regulator (see below).

Your state insurance regulator may be your best source of government information and assistance about an insurance product and your consumer rights. To locate your state insurance department, look in the state government pages of your local phone book or check the Web site of the National Association of Insurance Commissioners (NAIC) at www.naic.org. State insurance departments and the NAIC also have useful consumer information posted on their Web sites or available upon request.

The FDIC and the other federal banking regulators listed on Page 7 may be able to answer your questions or concerns about a depository institution's sale of credit insurance or a debt cancellation or debt suspension program. You may call the FDIC's toll-free consumer assistance line at 877-ASK-FDIC, which is 877-275-3342, to obtain the name of the appropriate federal or state regulator for a particular institution.

your family might be better served with the proceeds from a traditional insurance policy that can be used to pay off *any* debts and expenses as you see fit, not just that one loan.

"Consumers who do not read the terms and conditions of these programs may be unaware of the limitations and as a result, they might pay more for less coverage than they expect," cautions Tim Burniston, FDIC Associate Director for Compliance Policy and Examination Support.

4. Pay attention to loan documents and monthly statements from your lender and question any unusual charges or fees. For example, if you fail to maintain the required property or hazard insurance coverage or you forget to give the lender evidence of your coverage, the creditor typically reserves the right to purchase the insurance and charge you for it, perhaps as part of your loan payment. If you're not monitoring your payments, you could be paying for a property insurance policy purchased by the lender that is more expensive and more limited than what you could obtain by shopping around.

5. Try to resolve problems as soon as possible. First contact the creditor or insurance company. If you're not satisfied with the outcome, contact your state insurance commissioner (Page 3) or, in the case of a debt cancellation/suspension contract, the appropriate federal or state regulator (Page 7). Also, retain copies of your loan documents and related credit protection policies, terms and conditions. You may need to refer to this information if you have a question, a concern or an insurance claim.

Credit Protection and the Laws Protecting You

Your state is likely to have laws governing credit insurance and debt protection coverage. These laws may cover premiums, rates and the insurance claims process. For information about how to contact the appropriate office in your state government, see the box on Page 3.

The federal Bank Holding Company Act prohibits a banking institution from tying the approval of a loan to the purchase of credit insurance from the bank or an affiliate. Federal regulations governing debt cancellation/suspension programs contain similar prohibitions.

The federal Truth in Lending Act (TILA) requires that lenders disclose the terms and costs of a loan. Depending on the specific circumstances, the TILA says that the terms and costs of voluntary credit insurance (such as credit life or disability insurance) and property or hazard insurance (often required) must be disclosed by the creditor before a loan is consummated.

The Gramm-Leach-Bliley Act prohibits depository institutions and their insurance sales representatives from engaging in coercive or misleading practices. The law also requires certain advertising and disclosure requirements. For example, a bank or a company selling insurance for the bank must disclose that its insurance products are not insured by the FDIC against loss.

The Real Estate Settlement Procedures Act helps consumers understand the costs of a mortgage transaction and be "smarter" shoppers for services. For example, when someone applies for a mortgage, the lender or loan broker must provide a "good faith estimate" of the individual costs to be paid at the loan settlement, in part so that the borrower can compare the estimate to the actual charges imposed. The law also ensures that certain payments are properly handled from escrow accounts, such as those for homeowner's insurance.

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Minimum Payments, Maximum Costs on Credit Cards

Customers who pay the minimum due each month face years of costly interest charges

One of the great things about using a credit card is that you can buy now and pay later. But some consumers take the pay-later concept to an extreme — they pay only the minimum amount due on their card's outstanding balance each month and end up paying the *maximum* costs. (The minimum payment is set by each card issuer — typically it's about two percent of your outstanding balance — and it is shown on your monthly bill.) While it might appear to be a good deal to pay only $20 a month to buy a $1,000 computer, ***FDIC Consumer News*** wants you to know just how much that computer will *really* cost when you add in the interest charges.

"Many people think if they only make the minimum payment shown on the statement they can keep their account current, keep charging, and have extra cash for other bills," says Janet Kincaid, a Senior Consumer Affairs Officer with the FDIC. "This is generally true, but what people also need to think about is the long-term cost of this alternative." She adds that if you pay only the minimum amount, "it will take you a very long time to pay off the balance, and the interest costs can be shocking."

How shocking? Take a look at the two tables on this page. The top one shows what would happen if you have a $5,000 outstanding balance on your credit card (to keep things simple, we assume you make no additional purchases), an Annual Percentage Rate of 18 percent, and you make only the minimum payment due ($100 initially but gradually declining each month because minimum payments usually are based on a percentage of the balance, which will decrease.) Using this example, it will take 46 years and cost $13,926 in interest charges before you've paid the $5,000, putting the total cost at $18,926. If instead you pay $100 the first month and every month — which would be more than the minimum due — the balance would be paid off in eight years and the interest charges would be cut from $13,926 to $4,311.

The bottom table shows that if you pay only the minimum due (set at two percent of the outstanding balance or $10, whichever is greater), a $500 television will cost $939 and require eight years of payments, a $1,000 computer will cost $2,899 and take 19 years of payments (about 15 years longer than you'll probably own the computer), and furniture purchased for $2,500 will cost $8,781 and take 34 years to pay off.

How can you protect yourself?

Pay as much as you can on your charge card each month — pay the entire balance, if possible — in order to avoid interest charges. The FDIC and other bank regulators have taken steps to ensure that minimum card payments are reasonable, "but because there is no law or regulation requiring that minimum payments be a certain dollar amount or percentage, card issuers have a lot of flexibility in setting low minimum payments,"

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Making Only the Minimum Payment Adds to Costs

Starting Balance	Interest Rate (APR)	Monthly Payment	Years to Pay Off	Total Interest Paid	Total Cost
$5,000	18%	The minimum ($100 the first month, then gradually declines)	46	$13,926	$18,926
$5,000	18%	$100	8	$4,311	$9,311
$5,000	18%	$250	2	$986	$5,986

Note: The minimum payment is assumed to be two percent of the outstanding balance or $10, whichever is greater. Years are rounded to the nearest whole year.

Item	Price	Interest Rate (APR)	Years to Pay Off	Total Interest Paid	Total Cost
TV	$500	18%	8	$439	$939
Computer	$1,000	18%	19	$1,899	$2,899
Furniture	$2,500	18%	34	$6,281	$8,781

Note: All payments are the monthly minimum of two percent of the outstanding balance or $10, whichever is greater. Years are rounded to the nearest whole year.

says FDIC Consumer Affairs Specialist Howard Herman. "As credit card interest rates are often quite high, consumers need to take charge of the situation and pay as much of their card balance as they can afford. The amount you pay toward your credit card bill each month can have greater long-term consequences for your finances than how much money you save or invest each month."

And if you can't pay most or all of your credit card bill, try to pay as much above the minimum as possible. "Depending on your balance," Kincaid says, "even stretching to pay an extra $50 a month can make a big difference in reducing your total interest costs."

If all you can afford is the minimum amount, pay that... and pay it on time. "Many consumers are not aware that if they pay less than the minimum, the bank may still assess a late fee of $35 or more and could report the account to the credit bureaus as delinquent," says FDIC Supervisory Consumer Affairs Specialist Lynne Gottesburen. This kind of negative information in your credit file could result in your card issuer increasing the interest rate or even canceling your card.

If you plan to carry a balance each month, look for a card that has a low interest rate and a grace period. The grace period is the number of days before the card company starts charging interest on new purchases. Remember that grace periods can vary. With most cards, if you don't pay your bill in full you can be charged interest immediately on new purchases. Many cards have no grace period, which means you *always* pay interest on new purchases from the day you make the purchase.

Kincaid and Herman agree that one of the worst financial moves a consumer can make is to pay only the minimum due on credit card balances. They and other FDIC officials say that while it takes discipline to pay most or all of your credit card bill each month, the sooner you pay off your balance, the less you pay in interest and the more you have available to save for a home, college education, retirement, or something else that truly benefits you.

If Your FDIC-Insured Bank Fails: What *Really* Happens

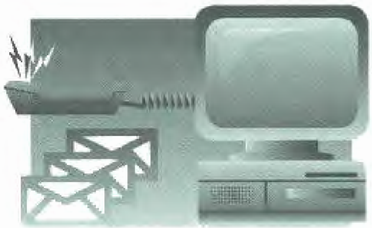
The FDIC continues to receive calls from bank customers who have serious misconceptions about how FDIC insurance works. "For example, some people say they've heard the FDIC takes up to 99 years to pay insured deposits after a bank fails, while others say they've been told the FDIC only pays pennies on the dollar," notes Martin Becker, an FDIC senior specialist for insurance claims. "Both of these statements are completely untrue." It's important to the FDIC that bank customers understand the basics about federal deposit insurance, so they can be confident that their insured deposits are safe.

As a depositor at an FDIC-insured institution, rest assured that in the unlikely event your bank fails, all of your deposits would be fully protected up to the $100,000 federal insurance limit. Also, the FDIC will pay your insured deposits, including principal and interest, as soon as possible after a bank fails, usually the next business day. In most cases, the FDIC will arrange for the failed bank's depositors to become customers of a healthy bank, and depositors will have prompt access to their insured funds through the new bank. Even in the rare cases in which the FDIC cannot find another institution to acquire the failed institution's accounts, payments to insured depositors begin within a few days.

What if your bank fails and you had deposits above the $100,000 federal insurance limit? It still may be possible to recover some or, in rare cases, all of your money over the insurance limit. The exact amount you'd get back would depend on factors such as the cost of the bank failure and how much the FDIC recovers by selling the bank's assets. Remember, though, that the overwhelming majority of depositors at failed institutions are within the $100,000 insurance limit and get quick access to all their money.

For more information about how FDIC insurance works when a bank fails, including how to make sure all of your deposits are fully protected, start at the FDIC's Web site — www.fdic.gov — or call or write the FDIC at the phone numbers or addresses listed on the next page.

For More Information



The **Federal Deposit Insurance Corporation** insures deposits at banks and savings associations and supervises state-chartered banks that are not members of the Federal Reserve System. The FDIC's services include a toll-free consumer assistance line, answers to written questions, and informational material. Toll-free phone: (877) ASK-FDIC or (877) 275-3342. The phone line is staffed Monday through Friday, 8:00 a.m. to 8:00 p.m., Eastern Time. Recorded information is available 24 hours a day. The toll-free TTY number for hearing-impaired consumers is (800) 925-4618. Home Page: www.fdic.gov. Mail: 550 17th Street, NW, Washington, DC 20429.

For questions about deposit insurance coverage: Contact the FDIC Division of Supervision and Consumer Protection at the address and phone numbers above, by fax to (202) 942-3098, or by e-mail using the Customer Assistance Form on the Internet at www2.fdic.gov/starsmail/index.html. The National Credit Union Administration (listed below) insures deposits at federally insured credit unions.

For other questions, including those about consumer protection laws, or complaints involving a specific institution: First attempt to resolve the matter with the institution. If you still need assistance, write to the institution's primary regulator listed on this page. Although the FDIC insures nearly all banks and savings associations in the United States, the FDIC may not be the primary regulator of a particular institution. Other regulators are listed below. To submit a complaint about an FDIC-supervised institution, contact the FDIC Division of Supervision and Consumer Protection as listed above. For inquiries involving problems or complaints related to the FDIC, contact the FDIC Office of the Ombudsman at the mailing address and phone numbers listed above, by fax to (202) 942-3040, or by e-mail to ombudsman@fdic.gov.

The **Federal Reserve System** supervises state-chartered banks that are members of the Federal Reserve System. Phone: (202) 452-3693. Fax: (202) 728-5850. Home Page: www.federalreserve.gov. Mail: Division of Consumer and Community Affairs, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

The **Office of the Comptroller of the Currency** charters and supervises national banks. (The word "National" appears in the name of a national bank, or the initials "N. A." follow its name.) Phone: (800) 613-6743. Fax: (713) 336-4301. Home Page: www.occ.treas.gov. E-mail: consumer.assistance@occ.treas.gov. Mail: Customer Assistance Group, 1301 McKinney Street, Suite 3710, Houston, TX 77010.

The **Office of Thrift Supervision** supervises federally and state-chartered savings associations plus federally chartered savings banks. (The names generally identify them as savings and loan associations, savings associations or savings banks. Federally chartered savings associations have the word "Federal" or the initials "FSB" or "FA" in their names.) Phone: (800) 842-6929 or (202) 906-6237. Home Page: www.ots.treas.gov. E-mail: consumer.complaint@ots.treas.gov. Mail: Consumer Affairs Office, 1700 G Street, NW, Washington, DC 20552.

The **National Credit Union Administration** charters and supervises federal credit unions, and insures deposits at federal credit unions and many state credit unions. Phone: (703) 518-6330. Fax: (703) 518-6409. Home Page: www.ncua.gov. E-mail: pacamail@ncua.gov. Mail: Office of Public and Congressional Affairs, 1775 Duke Street, Alexandria, VA 22314.

Your state government also may offer assistance and publish useful information. Contact your state's Attorney General's office, consumer protection office or financial institution regulatory agency as listed in your phone book or other directories, or visit your state's official Web site.

FDIC *Consumer News*

Published by the Federal Deposit Insurance Corporation

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A Final Exam

Test your knowledge by taking a quiz based on information in this issue

1. In general, credit insurance and similar programs called "debt cancellation" and "debt suspension" will pay off a debt if the borrower dies or suspend monthly payments if the borrower becomes ill or unemployed. ***True or False?***

2. Credit insurance and debt cancellation/suspension programs offered by lenders are the same as traditional insurance (such as term life insurance and disability insurance) not sold with a loan. Coverage and costs are the same. ***True or False?***

3. Most credit insurance, debt cancellation and debt suspension coverage is optional — you do not need to purchase it to get the loan. An exception is property insurance that a creditor may require to cover the costs of repairing or replacing property (such as your home or auto) that serves as loan collateral. ***True or False?***

4. If you fail to maintain sufficient property insurance for a loan or if you forget to give the lender evidence of your coverage, the creditor typically reserves the right to purchase property insurance and charge you for it. ***True or False?***

5. Because your credit card offers the option to pay a minimum amount due each month, it's always smart to send in the minimum and stretch out the card payments as long as possible instead of paying the bill in full. ***True or False?***

6. If an FDIC-insured bank fails, the $100,000 federal insurance coverage includes both principal and interest. ***True or False?***

Correct answers:

1. True (See Page 2)
2. False (See Page 2)
3. True (See Page 2)
4. True (See Page 4)
5. False (See Page 5)
6. True (See Page 6)

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