Debt Protection Products
CASE Atlanta Meeting

Joey Janzen, FCAS, MAAA
Senior Risk Actuary

September 9, 2008

Bank of America
Bank of Opportunity™

Topics Covered

- Product Overview
- OCC Regulation
- Reserving

Product Overview

- Debt Protection products are two party agreements between the lender and the borrower
- Lender agrees to cancel a specified amount of debt or suspend repayment of debt (waive finance charges) should a specified event occur
- Debt Protection products are banking products

Product Overview

- Debt Protection products today are sometimes offered to:
  - Consumer and Small Business Credit Cards (Cards)
  - Closed-End Loans
  - Home Equity Lines of Credit (HELOCs)
  - Business Lines of Credit (Bus LOCs)

Product Overview

- Fees are charged for debt protection (generally on a monthly basis)

- Specified protected events typically include:
  - Accidental Death
  - All Cause Life
  - Critical Period Life
  - Permanent Total Disability
  - Temporary Total Disability
  - Involuntary Unemployment
  - Hospitalization
  - Family Leave
  - Life Events

Product Overview

- Benefit Structure
  - Balance cancellation, subject to a cap
  - Monthly benefits
    - Cancellation
    - Suspension
  - Sunset provision
  - Product fee waiver

- One product can have many different features

OCC Regulation

- OCC CFR 12, Chapter 1, Part 37
  - Standards for National Banks selling Debt Protection
    - Focus on how product is marketed and sold
    - Focus on customer experience
    - Safety and Soundness requirements
    - Largely silent regarding pricing and reserving

Reserving

- Accounting for reserves
  - No cash going out the door, so why reserve?
  - Cancellation vs. suspension
  - No requirement of a statement of actuarial opinion

Reserving

- Considerations
  - Segmentation (loan type/product/protection)
  - Lags
    - Reporting and approval lags similar to Auto Physical Damage
    - Benefit payout period a mix of Auto Physical Damage and shortened Workers Comp
    - Tail

Reserving

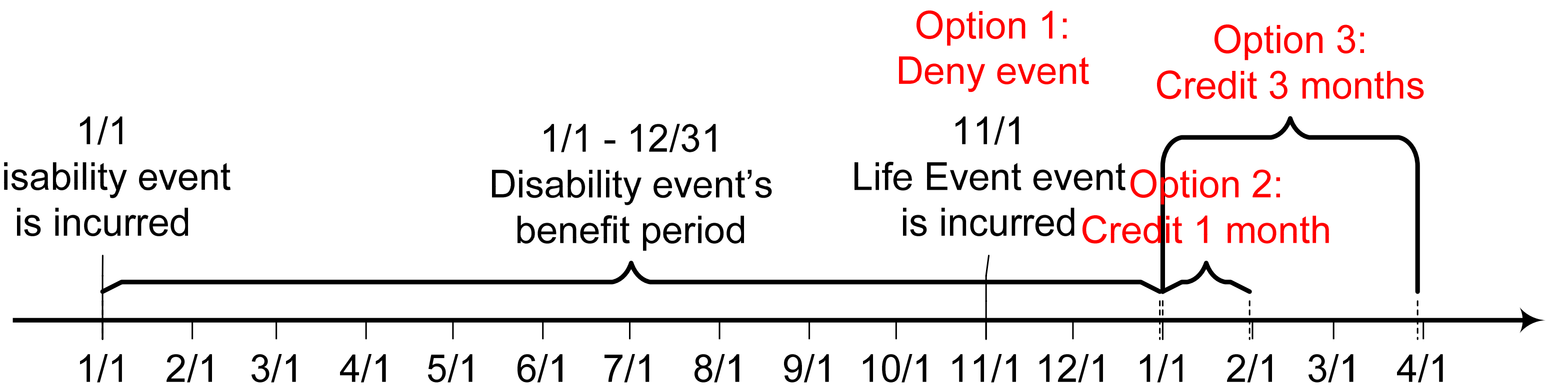
- Methodology
  - Mortality/morbidity tables
    - Based on overall industry experience
    - Must apply factors to calibrate to specific product terms/loan type/consumer demographics
  - Traditional P&C reserving methods
    - Paid dollar development (no case reserves)
    - Percent of exposure method
    - Frequency/severity/duration method
    - Responsiveness is key!

Reserving

- Challenges
  - Free periods
  - Inter-related protections (Hosp to Dis, Dis to PTD)
  - Overlapping benefit periods
  - Phone approval
  - Low event volume = low credibility
  - Data challenges
    - Lack of uniform data standards (no ISO, statutory reporting)
    - Event adjudication processes (TPA vs. in-house)

Reserving

- Overlapping benefit period example



- Since customer is already in benefit status on 11/1, we could:
  - Deny the 2nd event
  - Only credit the non-overlapping portion of the 2nd event's benefit period (1/1 - 1/31)
  - Provide credits for the entire benefit period but only after the 1st event has terminated (1/1 - 3/31)

Reserving

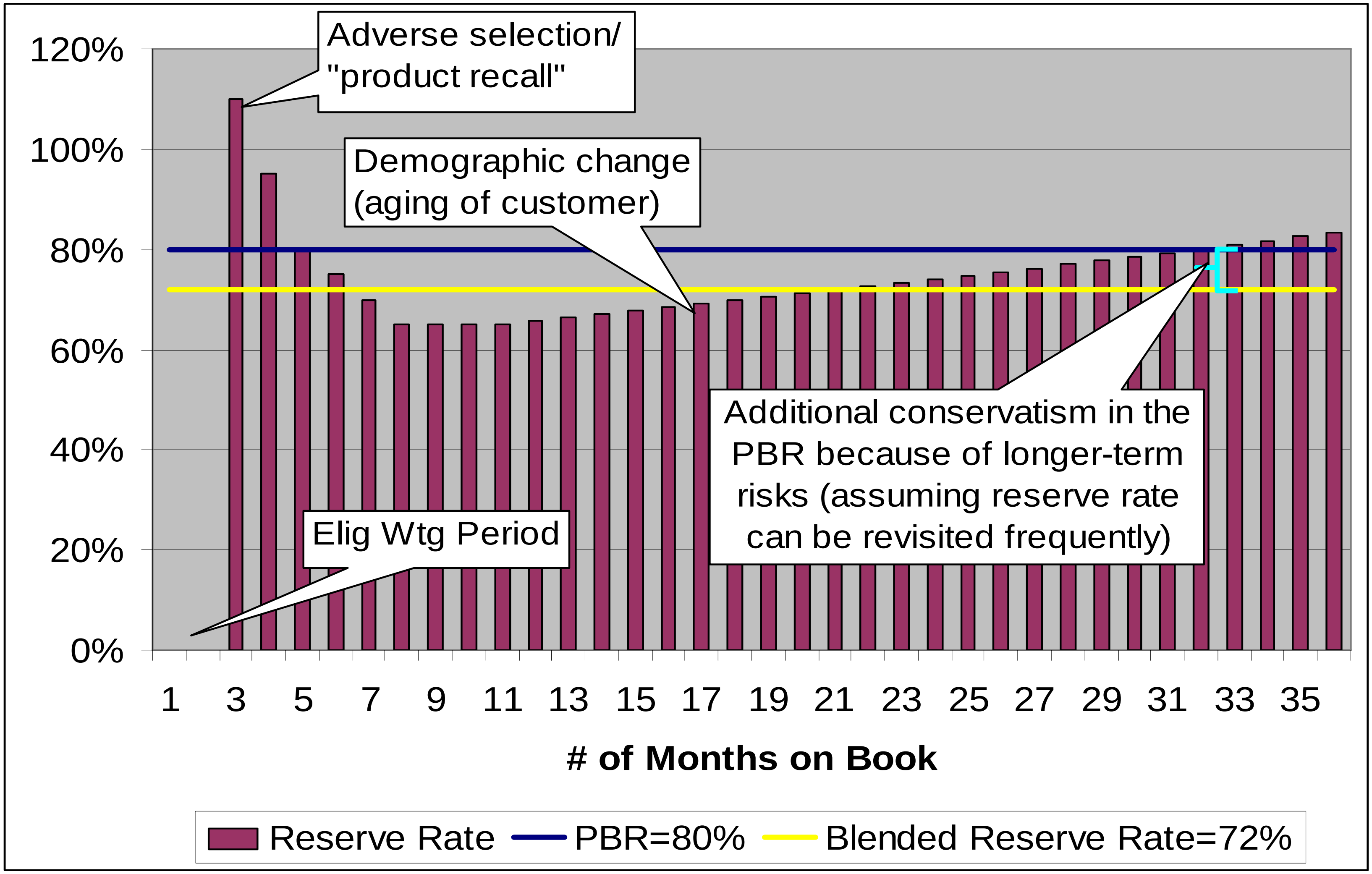
- Considerations for setting reserve rates
  - Start with estimated ultimate benefit ratios for more recent months
  - Impacts to frequency
    - % of in-force book that is new (adverse selection/"product recall")
    - Debt protection fee level (attrition)
    - Economy (e.g., unemployment rate)
  - Impacts to severity (fees vs. exposures)
    - Loan terms (e.g., min pay formula, payment holiday)
    - Economy (e.g., min pays are driven up)
  - Impacts to duration
    - Product terms
    - Economy (e.g., continuing unemployment)

Reserving

- Estimating a new product's reserve rate
  - Leverage pricing work
    - Pricing benefit ratio (PBR) contemplates a long-term vintage view
    - Reserve rate contemplates current in-force view
    - Must account for differences
      - % of in-force book that is new
      - Eligibility waiting period
      - Initial customer demographics (including customer age)
      - Initial loan demographics (including balance)
      - Initial marketing channels
      - Initial economic climate (i.e., National Unemployment Rate)
  - Dependence upon granularity of data and projections

Reserving

- Hypothetical Product



Reserving

- Actuarial Standards
  - ASOP 36: "This standard applies to actuaries who provide written statements of actuarial opinion with respect to loss and loss adjustment expense reserves for <u>any property/casualty insurance coverage</u>. This standard applies to actuaries providing professional services with respect to loss and loss adjustment expense reserves of insurance or reinsurance companies and <u>other property/casualty risk financing systems</u>, such as self-insurance, <u>that provide similar coverages.</u>“
    - Debt protection is not P&C insurance.
  - ASOP 43: "This standard applies to the actuary when <u>estimating unpaid claims</u> for all classes of entities, including self-insureds, insurance companies, reinsurers, and governmental entities."
    - Debt protection claims are called ‘events’, not ‘claims’.

Bank of America

Bank of Opportunity™