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October 16, 1996

UCCC MATERIAL
FOR YOUR INFORMATION

RE: Purchase of Credit Insurance Resulting in Favorable Rates

Dear Mr. :

This letter responds to your inquiry asking whether a financial institution may offer a "better" interest rate to customers who purchase credit insurance.

A creditor in a consumer credit transaction may either require the purchase of credit insurance in order to make the loan or require the purchase in order to obtain a more favorable interest rate on a loan. However, in either instance the purchase of the credit insurance must be included in the finance charge and the annual percentage rate and cannot be included in the amount financed. This is because in these instances, the purchase of credit insurance is either a "condition of" the extension of credit in the first example, or "incident to" the extension of credit in the second example.

The definition of "finance charge" in Colorado's Uniform Consumer Credit Code ("UCCC") and the federal Truth in Lending Act is very broad. It includes any amount paid directly or indirectly by the consumer whether imposed directly or indirectly by the creditor as an incident to, or as a condition of, the extension of credit. Section 5-3-1109 & Regulation Z, § 226.4(a). Although somewhat subtle, if the purchase of credit insurance by the consumer results in the lender offering a more favorable rate, the cost of the credit insurance is incident to the extension of credit.

Credit insurance may be excluded from the finance charge and annual percentage rate only if it is <u>truly</u> voluntary and not required in any way by the creditor. Regulation Z, § 226.4(d). In fact, the UCCC states that the cost of credit insurance may be excluded from the finance charge as an "additional charge" only if the "insurance coverage is not a factor in the approval by the lender of the extension of credit." Section 5-3-202(2)(b), C.R.S. While this is a factual determination, it has been our consistent enforcement position that if the creditor offers a more favorable rate to those consumers who purchase credit insurance and this is communicated to the consumer when making the decision whether to purchase otherwise voluntary credit insurance, the cost of the credit insurance may not be included in the loan principal amount to be financed. (See Unofficial Opinion letter dated July 6, 1993 "Reduced Loan Interest Rate").

The result of including the credit insurance in the finance charge is significant for two reasons. First, the credit insurance must then be correctly disclosed in the finance charge and APR, not the amount financed. Second, since the UCCC has limitations on rates, the cost of the credit insurance when added and disclosed in the finance charge must not exceed the state's maximum rates (generally 21% per year). If the APR exceeds the rate caps due to the addition of credit insurance which results in a more favorable rate, that amount becomes an excess charge which must be refunded.

Please feel free to contact me if you have any other questions about this matter.

Sincerely,

Laura E. Udis

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Administrator
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