What is Collateral Protection Insurance (CPI)

... and Does Your Credit Union Need It?

On the road of life, we all face obstacles — some we can manage, and others are outside of our control. To minimize catastrophe caused by the unavoidable hazards, it's important to have security measures in place. In your personal life, daily security measures may involve wearing a seat belt while driving or turning on your house alarm each night. Long-term security measures may involve maintaining an emergency fund or purchasing life insurance. Credit unions also need to take both short-term and long-term steps to **minimize unavoidable hazards** in their institutions.

Collateral protection insurance, or CPI, provides a solution by helping mitigate the risk credit unions incur when offering vehicle loans to borrowers. Because CPI can be helpful during all economic circumstances, it serves as both a short-term and long-term security measure.

Understanding how CPI works will help you decide if it is the best way to mitigate risk in your credit union. And if CPI is the best choice, this understanding will help you **choose a provider** that is best able to provide the protection and service you need to make your credit union's CPI program a success.

A Complex Definition Made Simple

Collateral Protection Insurance (CPI) is coverage placed on a borrower's vehicle, on behalf of a lender, when there is a lapse in insurance.

When your members take out an auto loan from your credit union, their loan agreement usually requires that they maintain physical damage insurance to cover the loan collateral, naming your credit union as an additional interest on the policy. Unfortunately, not all borrowers will fulfill this agreement, either never purchasing insurance or letting their coverage lapse.

Credit unions can choose to retain the risk of loss if damage occurs to uninsured vehicles. However, just like wearing a seat belt is a smart choice for preventing harm in an auto accident, most institutions transfer risk through an insurance program, such as CPI.

How Does CPI Work?

CPI shares similar characteristics with all types of insurance: Policies are written, and CPI insurers pay claims when losses occur. However, there are also significant differences between CPI and other types of insurance. Lenders should understand these differences when choosing a CPI program and provider.

Borrowers who do not comply with loan requirements to purchase insurance on their own will have CPI policies issued under CPI program objectives. Once a program is in place, borrowers are not individually underwritten — issuance of a certificate of coverage is guaranteed by the provider.

Because CPI placement is determined by the status of underlying insurance, CPI requires a high level of service, monitoring, and management to avoid accidental lender-placed insurance. A CPI provider's ability to quickly and accurately identify and manage a lapse in coverage directly correlates to saving a lender time and money.

Data on borrowers' private insurance must be constantly collected and kept current to ensure that CPI placements are correctly made and that refunds are accurately issued when previously noncompliant borrowers do purchase the required insurance. This is one of the many reasons the CPI program provider a lender selects is of critical importance. An ideal CPI provider will offer borrowers **hassle-free, turnkey ways to update their insurance** on behalf of the lender.

Are Lenders Required to Use Portfolio Protection?

Although regulators often recommend having a portfolio protection solution in place, such a program is not required. Credit unions can instead choose to retain the risk of loss if damage occurs to uninsured vehicles they repossess by self-insuring. Alternately, they can mitigate risk with portfolio protection options such as a blanket policy or CPI.

How does CPI compare to blanket and self-insurance? Following are some of the pros and cons of each and insights into the six areas you need to consider when determining which type of program is right for your financial institution.

CPI, Blanket, and Self-Insurance: Which Is Better for Your Credit Union?

Every credit union has unique needs. It is important to take a holistic approach when exploring risk mitigation options. *The key questions to ask yourself when deciding on how to manage risk in your loan portfolio are:*

- ***How much risk can you tolerate vs. how much do you want to transfer?***
- ***What are your goals and objectives?***
- ***What do you expect in return?***

Self-Insurance

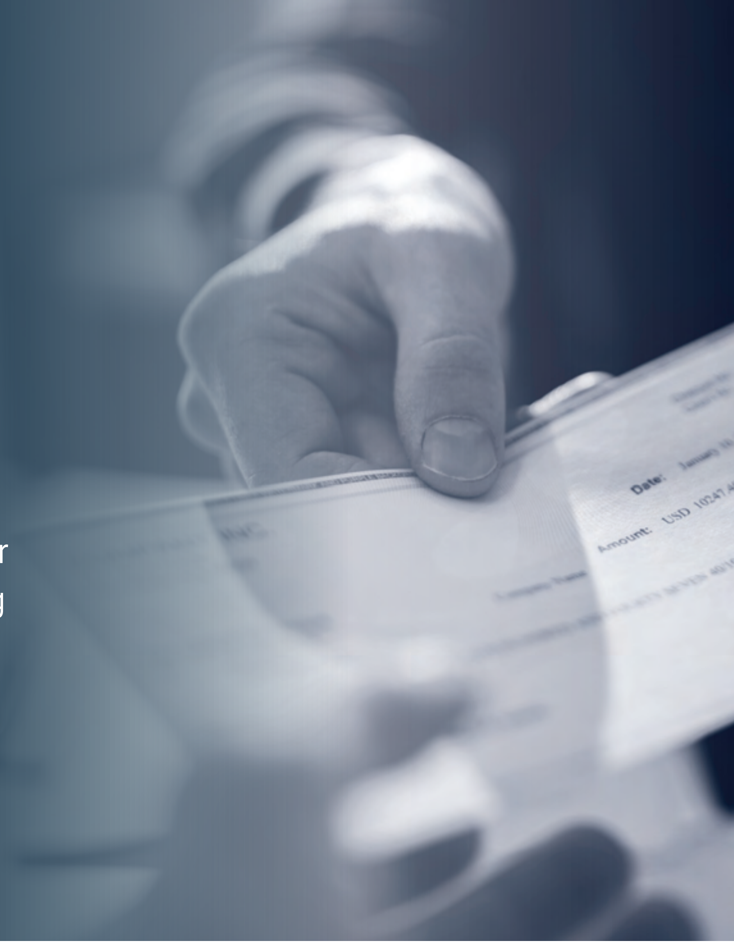
Can a credit union skip the trouble of finding a CPI provider and simply self-insure their auto loans? They can, but similar to not wearing a seat belt while driving, by doing so they are increasing the risk of unfavorable financial outcomes.

Retaining the responsibility of covering financial losses due to uninsured and/or damaged collateral undermines the fundamental purpose of any insurance program, which is risk transference. The risk is even more adverse because your credit union cannot control the status of a borrower's insurance coverage or personal economic shifts any more than you can personally control how another driver may drive on the road around you.

A self-insured lender assumes all risks and absorbs any losses that occur. The greatest disadvantage of self-insurance is the volatility of earnings and that the risk is not transferred. To minimize uninsured losses, some self-insured lenders add follow-up procedures such as:

- Requiring evidence of physical damage insurance at the time of loan closing.
- Writing or calling the borrower when evidence of insurance is not received.
- Writing or calling borrowers who receive cancellation notices from insurance carriers.

These procedures are time-consuming, difficult to execute without advanced technology and highly trained staff, and rarely effective without a mechanism for forced placement.



Blanket Insurance

With a blanket insurance policy, lenders pay a premium based on the total number of loans, typically a fixed dollar amount per vehicle or a percentage of the outstanding balance. Through a blanket policy, your members (either members who are also borrowers, or all members, depending on how costs are distributed) must bear the cost of an uninsured borrower.

Some states do not permit the cost of blanket insurance to be charged to borrowers. In these states, the costs must be borne solely by the lender, which can serve to weaken a credit union’s competitive edge in the market, especially as the best borrowers are able to choose a lender that can offer lower rates and fees because they are not building the cost of a blanket policy premium into the loan cost.

Additionally, a blanket policy is, in essence, a “cost plus” policy, with the lender trading dollars with the insurance company that must cover both the cost of claims plus the insurer’s expenses. Therefore, the direct cost of the blanket policy to the lender will continue to increase as loan business grows. The cost of a blanket policy on a growing book of business most often increases regardless of whether or not a policy’s loss ratio — the ratio of claim payments lenders receive to premiums they pay — worsens.

Collateral Protection Insurance (CPI)

CPI enables lenders to manage and mitigate risk by transferring the risk of uninsured collateral to an insurance provider. The program is administered by the provider only on borrowers who fail to purchase or maintain insurance.

CPI requires no individual underwriting. A borrower who does not comply with the loan requirement to procure private insurance is "written" regardless of age, driving record, or location of residence. Coverage for insurance placed in a CPI program offers your credit union the same protection you would have received had the borrower maintained his or her own private insurance.

In administering the program, the CPI provider receives a file of all new loans and updates on existing loans in the lender's portfolio and then tracks the insurance status of each loan. The provider confirms which borrowers have not provided adequate proof of insurance and sends appropriate notices alerting them to do so.

If the borrower fails to submit proof of insurance in response to these notices, the lender may then choose to place a CPI policy on the noncompliant borrower's loan to protect the credit union's interest from damage or loss. They then pass the cost to the borrower by adding the premium to the loan balance. The charge is removed as soon as private coverage is reinstated. It costs financial institutions little or nothing to obtain this protection.

Which Is Better for Your Business?
Five Considerations When Determining Which Program Is Right for Your Credit Union

1. Determine the level of risk your institution is willing to assume.
2. Consider market drivers, costs, and broader economic conditions.
3. Consider how an insurance product leverages new technology to improve administration and reduce borrower noise.
4. Recognize the overall impact on you and your members.
5. Analyze your losses, their sources, and how they impact your bottom line.

For an in-depth look at all five concepts, read our white paper "Blanket & Self-Insurance vs. CPI: A No-Nonsense Guide to Choosing the Right Program for Your Financial Institution's Portfolio"

Advantages of CPI

In addition to protecting loan collateral, there are several advantages to CPI:

- Only uninsured borrowers pay premiums; as a result, CPI is more equitable to the lender and to those borrowers who do comply with agreed-upon insurance requirements.
- Since CPI transfers the risk of loss to an insurance company, loan portfolio expenses are predictable, charge-off ratios are more stable, and loan business can be more competitive.
- In challenging economic conditions, when auto repossessions (which often have damage) are increasing, blanket policy premiums can skyrocket — so the relative value of a CPI program over blanket coverage increases in direct proportion to the number of charge-offs in a loan portfolio.
- Because borrowers who have let their insurance coverage lapse often have other financial problems, the detailed insurance tracking in a good CPI program can give a lender warning that a borrower's credit rating may be slipping.
- Notification of lapsed coverage presents lenders the opportunity to work with a borrower to keep the loan current and prevent losses that come with problem loans.

What to Look For in a CPI Provider

If your credit union decides CPI is the right choice for protecting your portfolio, choosing the right CPI provider will save you time and benefit your bottom line. Just like shopping for a personal insurance policy, when shopping for a CPI program credit unions should **seek out a partner** who best fits their lifestyle, values, needs, and philosophy.

A quality CPI provider will try to avoid placing insurance by diligently notifying borrowers when they have identified a lapse in insurance. They will also provide borrowers with easy and hassle-free ways to update their insurance information and avoid CPI coverage on their vehicles.

How Is a High-Quality CPI Program Run?

As previously mentioned, when lenders contract with a provider to track the insurance status of each loan in their portfolio, the provider will receive data files on all new loans, verify that acceptable physical damage coverage is in force, and ensure the borrowers' insurance companies have the lender named as the lienholder. The provider will also receive regular updates on existing loans in the lender's portfolio and process proof of insurance information when a private insurance policy is issued, canceled, or materially changed. A high-quality program will have technology and processes in place that enable the provider to complete these verifications in as close to real time as possible, to avoid communication with borrowers who are complying with the requirement to purchase and maintain private insurance.

If a borrower does not obtain insurance coverage for loan collateral, it is the provider's job to urge the borrower to do so. Throughout the life of a loan, proof of insurance is monitored to ensure that policies remain in force; if policies lapse, borrowers are sent notices advising them to reinstate coverage. A high-quality program will communicate with borrowers in multiple ways, including mailed notices, email, and text messaging. It will also offer informational resources, such as videos that address a borrower's specific situation, to help educate them in clear, understandable terms about why they are being notified and what they need to do next.

Should a borrower fail to respond to multiple notifications over a period of time, the provider will notify the lender, who may choose to place CPI on the borrower's loan. If a borrower purchases or reinstates private coverage, the CPI policy is canceled and a premium refund is issued. A high-quality CPI program will include technology to automatically calculate premium changes and refunds quickly and accurately.

Throughout the process, the provider will monitor all processes and respond to inquiries from lenders and borrowers. **The highest-quality programs** will provide lenders with robust online tracking tools, transparent access to program information, real-time borrower call recordings, and detailed management reporting on their CPI program, among other features.

How Much Lender Participation Is Required?

A top-quality provider will offer a program that **requires minimal work to administer.** This frees credit union staff from handling routine administrative tasks associated with insurance tracking and also provides access to real-time updates. Lenders simply need to forward insurance-related documents and provide a loan file on a pre-agreed schedule.

Look for a Seamless Experience for Your Credit Union and Your Borrowers

Because CPI placement is determined by the status of underlying insurance, CPI requires a high level of service, monitoring, and management to avoid erroneously placed insurance. A CPI provider's ability to quickly identify any lapse or impairment in coverage directly correlates to saving a lender time and money.

A combination of effective tracking technology and **personal, customer-focused service** helps ensure that all placements are made accurately, refunds are issued promptly, and requests are handled expediently. This will minimize work for credit union staff and protect your credit union's member relationships.

- Look for a program with a dedicated service team and a contact phone number unique to your credit union; this provides more personal service and the ability for the provider to respond to borrowers' questions and needs promptly and courteously, enhancing the relationship between you and your members.
- To minimize unnecessary notices and placements, seek out a provider that offers an advanced and highly efficient technology platform. Advanced technology that offers quick and accurate processing of incoming insurance information will ensure that communication with borrowers is always based on the most current information. They should also have technology that allows borrowers multiple hassle-free ways to update their insurance, including phone, fax, email, text, and online.

- Look for ease of use and transparency in the provider's tracking and reporting system. Will your staff have to log in to several systems, or just one? Will you be able to view every notice sent, see the complete insurance history of every borrower, and listen to all recordings of borrower phone calls immediately and on demand, right in the system? Does the system have robust reporting capability and easily accessible management reports?
- To avoid chasing down documentation and delays in claims payment, partner with a provider that minimizes paperwork and makes use of sophisticated technology to pay claims either instantly or within a few days after submission instead of the industry average of several weeks.

While it's impossible to avoid all risk (other than by stopping writing loans altogether), a high-quality CPI provider can help you, the lender, find a point of equilibrium at which the protection provided by the program complements the level of risk that your institution is willing to assume — while minimizing borrower noise and protecting your member relationships.