Why policy loans should not be reported to the CIC

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Written by Dennis B. Funa

Republic Act No. 9510, October 31, 2008, otherwise known as the Credit Information System Act of 2008 (CISA) established a centralized credit information system. Its declared policy is to “address the need for reliable credit information concerning the credit standing and track record of borrowers” and to “enable financial institutions to reduce their over-all credit risk.” To implement this policy, the law established the Credit Information Corporation (CIC) “to receive and consolidate basic credit data”.

Pursuant to this law, the CIC issued CIC Circular No. 2015-01, which classified life insurance companies, mutual benefit associations and other similar entities supervised by the Insurance Commission as “submitting entities.” Under Section 4.6 of the circular, “the submitting entity shall regularly submit the Basic Credit Data of all its Borrowers contained in its database, file or system, to the CIC not later than on the 5th day of the month and in the form/ format and manner prescribed by the CIC.”

The Insurance Commission has, however, maintained that a policy loan is not a reportable transaction.

Policy loans are defined by the U.S. National Association of Insurance Commissioners’ (NAIC’s) Statement of Statutory Accounting Principles (SAP) 49 as follows: “*A policy (or contract) loan shall be defined as a loan to a policyholder, under the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract.*” In other words, it is a loan against the cash surrender value, at an interest rate determined by the Insurance Commission. While the main benefit in a life insurance is the death benefit, there a number of benefits and one of them is the availment of the policy loan.

Characterization

“Policy loans are not consumer loans made in the traditional sense - they are more appropriately understood as advances that are features of the whole life insurance contract. The parameters of the loan are based upon the cash surrender value of the life insurance contract. Without an insurance policy in place, no loan could occur. Without cash surrender value associated with the insurance policy, no loan could occur. In either case, the key to the loan is the existence of the insurance policy with

cash surrender value. The policy loan is an explicit mechanism to allow the policyholders to access their cash surrender value while still maintaining the policy in force - the primary purpose of insurance is the benefit, and that is a longer-term provision than any immediate need for cash. Additionally, policy loans have historically not been considered debt because the policy owner is not obligated to repay the loan."

Characterizing a life insurance policy and the policy loan

A life insurance policy that has a cash value embedded that would increase in value over time. And just like any other assets, it can provide liquid savings and may be used as a security against a line of credit by the owner. This cash value may be accessed in different ways, with each method having its own advantages and disadvantages (*i.e.*, different tax consequences). Thus, accessing the cash value may be through a partial surrender of cash value (policy withdrawal), a policy assignment as collateral (borrowing from a financial institution), and through a policy loan.

The "policy loan" or sometimes referred to as "cash loan" is mandated under Section 233 (g) of the Amended Insurance Code. It is not a "credit facility". Section 3 (f) of the CISA defines a credit facility as a form of "financial accommodation". However, in the case of policy loans, it is a right of a policy owner who has accumulated enough cash surrender value to avail of such policy loans. It is a "right" that is spelled out in no less than a law, the Amended Insurance Code (Sec. 233 [g]).

In a policy loan, the insurer advances a loan secured against the cash value of the life insurance policy. While it is referred to as a loan, it is essentially an advance against the death benefit paid under the terms of the insurance policy. This may be resorted to in lieu of permanently removing the cash from the policy. The loans can be repaid to restore the value of the cash value. If there is not sufficient value in the policy to cover interest, the policy lapses. Consequently, taking loans on life insurance affects the long-term viability of the policy. There are disadvantages in resorting to policy loans. Unpaid loans shorten the life of the policy. Eventually, outstanding loans are deducted from the death benefit at the death of the insured. In the United States, loans are not reported to any credit agency, and payment or non-payment against them does not affect the policyholder's credit rating. The same regulation is true with the Monetary Authority of Singapore (MAS).

There is no "credit-risk" involved, which could affect a stable financial system, which is the issue sought to be addressed by R.A. No. 9510. Failure on the part of the policyowners to repay would have no impact on the financial stability of the insurer. The non-payment of policy loans poses no risk to the insurance companies as these are viewed more as a "return of premium". Non-payment can only inflict injury on the policy owner himself, the supposed borrower.

Policy loans are unilateral agreements. There is no obligation on the part of the policyowner to repay. It is an incident of ownership. You are borrowing from yourself. The reason is that you have the option, in the first place, to stop paying the premiums, and the policy will just lapse. It therefore should not impact one's creditworthiness. For many, it is a good option to running up a credit card balance. The non-payment of policy loans should therefore not translate to "negative credit information", which "refers to information/data concerning the poor credit performance of borrowers such

as, but not limited to, defaults on loans, adverse court judgments relating to debts and reports on bankruptcy, insolvency, petitions or orders on suspension of payments and corporate rehabilitation.” Availing of the policy loan does not mean that one is in dire need of cash. It simply means that there are some expenses to be paid and it is similar to withdrawing cash from one’s ATM or bank account.

A policy loan taken out is based simply on the amount of the cash value in the life insurance policy. Unlike taking out a bank loan, you will not be asked by the insurance company what the money is for nor is there any collateral required. You also do not have to have a good credit standing. There is no loan approval process. Moreover, you are not confined by a fixed repayment schedule. There is no default to speak of. And you can use the policy loan for whatever use you may desire. And any repayment you make goes back to your life insurance policy. It is not a credit facility.

If one decides not a repay his policy loan, because it is his right to discontinue his life insurance policy, why should it negatively impact his credit rating?

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Dennis B. Funa (dennisfuna@yahoo.com) is the current Insurance Commissioner. Atty. Funa was appointed by President Rodrigo R. Duterte as the new Insurance Commissioner in December 2016.