



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1028
May 2005
12 CFR 37

May 9, 2005

Re: [] (“Bank”)

Dear []:

We are writing in response to your inquiry for an interpretation of the Office of the Comptroller of the Currency’s (“OCC’s) Debt Cancellation Regulation at 12 C.F.R. Part 37. You asked for our views concerning application of 12 C.F.R. § 37.3(a) to a national bank’s financing for a debt cancellation feature on an automobile loan. In particular, you inquired about so-called “Guaranteed Automobile Protection” (“GAP”) debt cancellation.¹

We understand national banks and third party providers often offer GAP in connection with a customer obtaining financing on the purchase of an automobile.² Specifically, you inquired whether a national bank would engage in a prohibited arrangement under section 37.3(a) by offering financing for the bank’s own GAP feature in connection with the automobile loan.³ If the customer elects the bank’s optional GAP feature, the customer pays an additional fee in cash or rolled into the financing of the underlying loan. For the reasons discussed below, we would not find a violation under section 37.3(a) in the described situation because we view the underlying loan and the GAP feature as a single product, and the financing arrangement does not, in our view, create a separate product.

¹ This letter addresses the OCC’s views under 12 C.F.R. § 37.3(a) in connection with a national bank’s automobile loan that includes a GAP feature offered by the bank. We understand the Bank currently is in litigation involving tying allegations related to certain practices concerning GAP. This letter expresses no opinion on the merits of the specific tying allegations against the Bank related to its practices concerning GAP offered in connection with its automobile loans.

² GAP provides coverage for the “gap” between what the customer’s primary insurance company will pay on the vehicle (usually the actual present value as determined by the insurance company, less any deductible) and what the customer still owes on the extension of credit. The “gap” exists because vehicle value typically depreciates on a steeper curve than the balance of the extension of credit declines in the first years of the transaction.

³ We understand that the bank does not condition the financing for the automobile on the customer’s purchase of the bank’s GAP coverage.

The OCC promulgated Part 37 to establish standards governing debt cancellation contracts (“DCCs”) offered by national banks and to ensure the banks provide them consistent with safe and sound banking practices and subject to appropriate consumer protections.⁴ Part 37 is very clear that a bank-permissible DCC is a loan term or contractual arrangement modifying loan terms linked to the bank’s extension of credit.⁵ A DCC does not function as a separate product and the bank does not separately offer it to third parties as a product. By its terms, the DCC only arises in the context of a bank’s own loans; the customer typically agrees to pay an additional fee to the bank for the loan’s DCC feature.⁶ The effect of the DCC is to extinguish the borrower’s obligation to repay under the otherwise operative provisions of the underlying loan.⁷ The bank’s ability to adjust the terms of loan repayment is an integral component to its authority to lend. The payment of a fee related to the DCC is inseparable from the DCC feature itself. The fee is just an increase in the price of the loan package in exchange for the loan incorporating an additional term or provision that benefits the borrower and reflects the bank’s assumption of risk related to GAP debt cancellation. Thus, we believe the financing arrangement, which permits the fee to be paid over a period of time, is an integral part of the loan and its DCC feature, and is not a separate product for purposes of Part 37.

Part 37 includes an express provision, 12 C.F.R. § 37.3(a), that prohibits a national bank from making an automobile loan conditioned on the customer’s purchase of a DCC, such as a GAP feature, from the bank.⁸ The regulation’s preamble notes that a DCC may be offered and purchased either contemporaneously with the other terms of the loan agreement or subsequently.⁹ The OCC views the loan and the GAP feature as a single product, and the prohibition in 12 C.F.R. § 37.3(a) is not intended to apply separately to the financing arrangement for the DCC.

Accordingly, for purposes of 12 C.F.R. § 37.3(a), the OCC views a national bank’s extension of credit in connection with an automobile loan with a GAP DCC feature as a single product, and

⁴ See 67 Fed. Reg. 58962 (Sept. 19, 2002). The OCC has recognized national banks may provide GAP as a DCC.

⁵ As defined in part 37, a DCC is “a loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer’s obligation to repay an extension of credit from that bank upon the occurrence of a specified event.” 12 C.F.R. § 37.2(f). The definition provides the agreement may be separate from or a part of other loan documents.

⁶ See 12 C.F.R. § 37.5 (method of payment of fees). The fee may be a lump sum payable at the outset of a loan (that may be financed over the term of the loan), or the fee may take the form of a monthly or other periodic payment.

⁷ See 67 Fed. Reg. at 58965.

⁸ Section 37.3(a) provides: “A national bank may not extend credit nor alter the terms or conditions of an extension of credit conditioned upon the customer entering into a debt cancellation contract or debt suspension agreement with the bank.” 12 C.F.R. § 37.3(a).

⁹ See 67 Fed. Reg. at 58965.

does not contemplate any separate product related to financing for the GAP feature. We trust this is responsive to your inquiry.

Sincerely,

signed

Daniel P. Stipano
Acting Chief Counsel