



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

February 27, 2008

Interpretive Letter #1095
March 2008
12 CFR 37

Mr. Paul D. Egidie
Director
State of Wisconsin
Department of Financial Institutions
PO Box 8041
Madison, Wisconsin 53708-8041

Dear Mr. Egidie:

I am writing in response to two questions you posed concerning the OCC's regulation governing debt cancellation contracts, 12 C.F.R. part 37. I apologize for the delay in this reply. In brief, your questions and our answers are as follows:

1. If a bank offers a debt cancellation contract (DCC) on a closed-end loan that is repayable in 5 years, and the DCC provides protection for the full 5-year loan term, can the bank collect the full cost of the DCC in monthly periodic payments over the first year of the loan?

No. For the reasons discussed below, where a national bank's DCC provides protection on a closed-end loan repayable in 5 years, the bank cannot collect the full cost of the DCC in monthly periodic payments over the first year of the loan. To comply with the periodic payment option under section 37.5, the bank must collect DCC fees in periodic payments (i) over the full 5-year term of the loan, or (ii) until such time as the loan is repaid.

2. Can an automobile dealer sell a national bank's DCC, as the bank's agent, in connection with the dealer's automobile retail installment sales contract that the dealer will assign to the bank, and does the OCC's DCC regulation apply to this transaction?

Yes. For the reasons discussed below, a national bank is authorized to offer DCCs to consumers through automobile dealers by 12 U.S.C. 24(Seventh) and 12 C.F.R. part 37, and the DCCs are subject to the standards of part 37 as well.

1. Payment of the DCC Fee

Section 37.5 of the DCC rule (Method of payment of fees) provides, in relevant part:

A bank may offer a customer the option of paying the fee for a contract in a single payment, provided the bank also offers the customer a *bona fide* option of paying the fee for that contract in monthly or other periodic payments.¹

Section 37.5 permits the bank to offer a customer the option of paying a monthly or other periodic payment for a DCC. The language of the regulation and its preamble establish that the periodic payment must continue over the loan term or until the loan is paid. Section 37.5 requires a *bona fide* alternative to paying for the DCC in a single payment. The preamble explains that the periodic payment is intended to operate on a “pay as you go” basis so that customers would not be induced to pay “up front” for coverage they never receive because the loan is prepaid.² The reference to “pay as you go” means the bank must permit the customer to pay for the DCC in periodic payments over the term of the customer’s loan. Otherwise, if the bank could collect the full DCC fee over a period that is shorter than the loan term, the bank could collect payment “up front” for coverage that the customer may never receive if the loan is prepaid. The OCC expressly intended to mitigate this possibility, as explained in the preamble to the regulation.

Accordingly, where a national bank’s DCC provides protection on a closed-end loan repayable in 5 years, the bank cannot collect the full cost of the DCC in monthly periodic payments over the first year of the loan. To comply with the periodic payment option under section 37.5, the bank must collect DCC fees in periodic payments (i) over the full 5-year term of the loan, or (ii) until such time as the loan is repaid.

¹ The OCC states in the preamble to the final rule adopting section 37.5 that, “The option [of paying the fee in periodic payments] is ‘*bona fide*’ if it is not deliberately priced in such a way as to deter a customer from selecting that option.” See 67 FR 58962, 58967 (September 19, 2002).

² The OCC states as follows in the preamble to the regulation:

We continue to believe that the approach that best balances encouraging banks to provide a viable choice of products for consumers with discouraging unfair practices is to require banks to offer both options [(i.e., a no-refund DCC or a refundable DCC)] so that a customer can choose between a lower total fee or the availability of a refund. In our view, the potential for unfairness in a no-refund product lies principally in the fact that the customer may be induced to pay “up front” for coverage that he or she never receives because the loan is prepaid. This result is substantially mitigated if the consumer has the option of DCC...coverage on a “pay as you go” basis.

67 FR 58962, 58967 (September 19, 2002).

2. Sale of DCCs Through Automobile Dealers

In your letter, you also inquire about the applicability of 12 C.F.R. part 37 to DCCs offered on retail installments sales contracts (RICs) originated by automobile dealers and assigned to national banks.

We recently addressed this issue in an OCC interpretive letter.³ As we explained in that letter, part 37 provides that a “national bank is authorized to enter into debt cancellation contracts and debt suspension agreements and charge a fee therefor, in connection with extensions of credit it makes, pursuant to 12 U.S.C. 24(Seventh).”⁴ Section 24(Seventh) authorizes a national bank to engage in activities that are part of, or incidental to, the business of banking as well as to engage in certain specified activities listed in the statute. “Negotiating promissory notes” and “loaning money on personal security” are activities specified in section 24(Seventh).

Pursuant to part 37, national banks are authorized to enter into DCCs with respect to loans they purchase as well as loans they originate directly. The OCC has previously indicated that a national bank-owned RIC is the equivalent of a national bank loan.⁵ Once purchased, a RIC is treated for regulatory and reporting purposes the same as a loan originated by the bank.⁶ Therefore, the purchase of a RIC is a permissible exercise of a national bank’s lending powers under section 24(Seventh) and thus constitutes an extension of credit on which a national bank may offer a DCC under part 37.

In addition, a national bank may offer and sell DCCs through an agent. Section 24(Seventh) states expressly that a national bank may use “duly authorized officers or agents” to exercise its incidental powers.⁷ Thus, national banks are authorized by federal law to offer, through agents, DCCs on RICs that the bank purchases. Whether a particular third party – such as an auto dealer – is acting as agent for a national bank with respect to the sale of a DCC depends on the terms of the arrangement between the third party and the bank and the circumstances under which the DCC is offered. For example, an auto dealer that offers a DCC provided by a national bank to a customer whose RIC the bank has determined to purchase could, depending on the circumstances,

³ See OCC Interpretive Letter No. 1093 (Oct. 29, 2007).

⁴ 12 C.F.R. 37.1(a).

⁵ See OCC Interpretive Letter No. 416 (Feb. 16, 1988) (referring to motor vehicle retail installment sales contracts as “loan assets”); see also OCC Interpretive Letter No. 585 (June 8, 1992) (stating that the securitization of installment sales paper is a permissible method for a national bank to sell its “loans”).

⁶ The Federal Financial Institutions Examination Council’s call report instructions treat the purchase of retail installment sales paper as a loan. FFEIC Form No. 031 and 041, item number 6.c. In addition, the discount of installment consumer paper is a loan for purposes of the OCC’s lending limit rules. 12 C.F.R. §§ 32.2(k) and 32.3(b)(2).

⁷ 12 U.S.C. 24(Seventh); see also 12 C.F.R. § 7.1004; and *SPGGC v. Ayotte*, 488 F.3d 525, 532 (May 30, 2007) (“Accordingly, we agree . . . that the National Bank Act authorizes national banks to engage agents to carry out some of their activities.”)

be acting as agent for that bank with respect to the offer and sale of the DCC. In such a case, the fact that the dealer originated the RIC in the dealer's own name would not necessarily mean that the dealer could not act as the bank's agent with respect to the DCC.

I trust this has been responsive to your inquiry.

Sincerely,

- signed -

Julie L. Williams
First Senior Deputy Comptroller
and Chief Counsel