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VIEWPOINTS

OCC Provides Clarity on Debt Insurance, And Banks Will Jump at the Opportunity

■ BY JAMES C. SIVON and JAMES T. MCINTYRE

Now that the Office of the Comptroller of the Currency has finalized its regulation governing debt cancellation contracts and debt suspension agreements, we expect that a growing number of banks will begin offering these products, because the OCC has clarified the regulation of them in a manner that strikes an appropriate balance between consumer protection and product design.

From the perspective of a loan customer, debt cancellation contracts and debt suspension agreements, like credit insurance, provide a borrower with financial security and peace of mind. They do so by either anceling or suspending a borrower's obligation to repay all or part of a loan upon the occurrence of certain events, such as the death or disability of the borrower. From a banker's perspective, however, debt cancellation contracts and debt suspension agreements are quite distinct from credit insurance.

First of all, insurance companies do not issue debt cancellation contracts or debt suspension agreements. These products involve just two parties: a bank that makes the loan and a borrower who assumes the obligation to repay. Credit insurance involves three parties: a bank that makes a loan, a borrower who assumes the obligation for repaying the loan, and an insurance company that makes loan payments if certain events arise in the life of a borrower.

Additionally, the two debt provisions do not have the attributes of insurance. Unlike insurance, there is no separate policy governing these products; they are simply part of a loan agreement. Nor is there any transfer of risk between the parties, or any payment to a borrower. Under a debt cancellation contract or debt suspension agreement, a bank retains the risk of nonpayment, and if a certain event occurs the bank makes no payment to the borrower; it just cancels or suspends the borrower's payment obligations.

It has made clear that when offered by a national bank, these aren't insurance products.

Most important is that unlike credit insurance, these products are now subject to a comprehensive scheme of federal regulation — not state regulation — when they are offered by a national bank.

Until now, some state insurance departments claimed regulatory authority over these products, even when offered by a national bank. The new regulation resolves that issue: It clarifies that when offered by a national bank, these products are banking products, not insurance products, and that they are subject to regulation by the Comptroller's Office, not the states. Thus, a national bank can introduce these products without the prospect of state-by-state licensing and review.

We believe bankers and consumers will find this regulation achieves a better balance between consumer protection and product design than does state regulation of credit insurance. It contains extensive disclosure and acknowledgement provisions, and this ensures that a bank fully informs loan customers about these products' costs, benefits, and limitations.

The regulation also prevents banks from engaging in inappropriate practices. For example, it bans tie-in sales and the sale of a single-fee product on a residential real estate loan.

On the other hand, it does not govern the fees charged for these products or require any prior filing or review of these products. Thus, a national bank is free to design and price these products to meet its loan customers' changing needs.

In sum, we expect the OCC's regulation will encourage more banks to offer debt cancellation contracts and debt suspension agreements by bringing regulatory certainty to a well-balanced product.

Mr. Sivon is a principal at the Washington law firm Barnett & Sivon. Mr. McIntyre is the principal at the McIntyre Law Firm of Washington. Together, they represent a coalition of banks and administrators that offer or service debt cancellation contracts and debt suspension agreements.