Debt Cancellation Contracts and Debt Suspension Agreements[1]

Debt cancellation contracts (DCCs) and debt suspension agreements (DSAs) are terms in consumer credit agreements that are designed to protect a borrower from defaulting on a loan or paying late fees. They provide for the cancellation or suspension of loan payments when it becomes difficult or impossible for the borrower to make payments. They are based upon a creditor's inherent right to cancel or suspend a debt.

This paper addresses DCCs and DSAs offered in connection with credit cards. The paper explains the typical terms and conditions of the products, how they are marketed, and the benefits they provide to borrowers, including how they strengthen the lending relationship. The paper also discusses how DCCs and DSAs differ from credit insurance and how they are regulated by federal and state authorities.

Executive Summary

DCCs and DSAs are terms in consumer credit agreements. They provide for the cancellation or suspension of all or part of a borrower's obligation to make loan or lease payments upon a specified event in the borrower's life. They are offered in connection with various types of consumer loans, including installment loans, auto loans, credit cards, mortgages, home equity lines of credit, and leases. Federal banking regulators, federal courts, and almost all states have recognized DCCs and DSAs as banking products because they do not have the attributes of insurance. The transfer of risk that occurs with credit insurance – which therefore necessitates regulation of that product as insurance to protect the insured in the case of insolvency – is not present with a DCC or a DSA. In the case of a DCC or DSA, a creditor retains all of the risk of payment cancellation or suspension.

Additionally, DCCs and DSAs differ from credit insurance because they are not offered through agents, brokers, or any other middleman; they are merely a feature of an extension of credit offered by a lender that the customer may cancel at any time.

DCCs and DSAs are subject to comprehensive regulation by federal and state banking regulators. The Office of the Comptroller of the Currency (OCC) issued extensive rules governing DCCs and DSAs in 2002. While these rules apply only to national banks, they have been adopted by many states and are viewed as "best practices" by other regulators and non-depository creditors. Subsequently, during a revision of Regulation Z, the Federal Reserve Board largely adopted the principles contained in the OCC rule. Regulation Z contains several disclosure requirements related to DCCs and DSAs that apply to all debt protection offerings for

---

1 This paper was prepared by Barnett, Sivon & Natter, P.C. and McIntyre & Lemon, PLLC on behalf of the Debt Cancellation Coalition, an informal group of creditors and insurers that offer and administer debt cancellation contracts and debt suspension agreements. Companies that participate in the coalition are: Aegon USA, Assurant Solutions, Bank of America, Capital One, Citigroup, HSBC, JPMorgan Chase, TPC Financial, US Bank, and Wells Fargo Insurance. The American Bankers Insurance Association is an *ex officio* participant in the coalition.

personal, family, or household purposes, regardless of creditor. Finally, the Federal Trade Commission's unfair and deceptive acts and practices standard applies to creditors that offer DCCs and DSAs.

I. **<u>What are DCCs and DSAs?</u>**

As a general rule, DCCs and DSAs are *optional* terms in a credit agreement between a creditor and a borrower.[2] Under the existing OCC regulation, DCCs and DSAs cannot be included in a loan unless a borrower voluntarily and affirmatively agrees to their purchase. If a borrower does agree to purchase this form of credit protection, a DCC or DSA provides the borrower relief from making debt payments when a specified event occurs, such as disability, unemployment, death, or some other event.

The OCC regulation defines a *debt cancellation contract* as, "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."[3] A *debt suspension agreement* suspends all or part of a debt.[4]

Under a DCC or DSA, a creditor agrees to either cancel the debt (debt cancellation), to suspend payments on the debt (debt suspension), or to provide a combination of both benefits (a hybrid product). In the case of a DCC, part or all of the outstanding balance is canceled. A DSA merely suspends loan payments; no principal is canceled, and interest may or may not continue to accrue during the period of debt suspension, depending on the terms of the agreement.

A DCC or DSA can be structured to provide debt relief to a borrower upon the occurrence of a variety of life events that can affect the borrower's ability to repay a loan. These events may include not only accident or loss of life, health, or loss of income, but also military leave, marriage, and divorce. As discussed further below, the ability of creditors to structure DCCs and DSAs to meet a variety of events in the life of a borrower is just one of the ways in which these products differ from credit insurance and term life insurance. Indeed, the ability of creditors to structure DCCs and DSAs enables these products to meet the evolving needs of borrowers. DCCs and DSAs can be offered in connection with any type of consumer loan, including credit cards. They also are offered in connection with installment loans, mortgages, auto loans, home equity lines of credit, and leases.

DCCs and DSAs can be offered by federal- and state-chartered depository institutions as well as by non-depository creditors. DCCs and DSAs may be offered either contemporaneously with the underlying credit transaction or after a loan has closed or a line of credit has been established. A borrower must agree to pay a fee to a creditor to receive the protection provided

---

[2] The OCC's regulation requires that DCCs and DSAs be optional. However, non-depository institution creditors that do not follow the OCC's regulation may require a borrower to purchase a DCC or DSA in connection with a loan.

[3] 12 C.F.R. § 37.2(f)

[4] 12 C.F.R. § 37.2(g).

by a DCC or DSA. In open-end credit plans, such as credit cards, these fees are usually paid monthly and are typically based upon the outstanding balance on the account.

DCCs and DSAs are Banking Products.

DCCs and DSAs have long been recognized as banking products. In 1963, the OCC stated that the offering of properly-reserved DCCs is incidental to the express authority of a national bank to make loans.[5]

After the OCC issued its ruling, several state insurance regulators issued contrary opinions, arguing that DCCs were insurance contracts – not part of the business of banking – and, thus, subject to state insurance regulation. However, the OCC's position that DCCs were banking products – and not subject to state insurance regulation – was upheld in a 1990 ruling by the United States Court of Appeals for the Eighth Circuit. That case, the *Taylor* case, remains the leading federal case on the regulation of debt cancellation contracts offered by national banks.[6]

In *Taylor*, the Court of Appeals agreed with the OCC that DCCs are incidental to banks' authority to extend credit, and that they differ significantly from insurance contracts. According to the court, debt cancellation contracts benefit both borrowers and creditors, because they:

> provide borrowers with a convenient method of extinguishing debt in case of death, and enable [the bank] to avoid the time, expense and risk associated with attempting to collect the balance of the loan from a borrower's estate.... Although [DCCs] may… transfer some risk from the borrower to the bank, the contracts do not require the bank to take an investment risk or make payment to a borrower's estate. The debt is simply extinguished when the borrower dies. Thus, the primary and traditional concern behind state insurance regulation – the prevention of insolvency – is not of concern to a borrower who opts for a [DCC].[7]

After this decision, a number of states withdrew opinions characterizing DCCs as insurance or changed their laws or regulations to that effect. In the 1990s, the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA) authorized federal savings associations[8] and federal credit unions,[9] respectively, to issue DCCs. Thus, by the end of the 1990s, all federally-chartered depository institutions were authorized to issue DCCs.

In a 1998 ruling related to DSAs, the OCC explained how debt protection products enhance the lending relationship: "The agreements also help both the Bank and the customer manage temporary situations that might otherwise result in default on the customer's obligations, thereby enhancing the Bank's ability to eventually obtain repayment from the customer."[10]

---

5 OCC Interpretive Ruling 7.7495, 12 C.F.R. § 7.7495 (1963).

6 *First Nat'l Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775 (8th Cir.), *cert. denied*, 498 U.S. 972 (1990).

7 *Id*. at 780. The history of the regulation of DCCs when offered by a national bank is set forth more fully in the preamble to the OCC's final rule governing the products, 67 Fed. Reg. 58962 (Sept. 19, 2002).

8 OTS Letter from Carolyn B. Lieberman, OTS Acting Chief Counsel (Sept. 15, 1993) (sanitized); Letter from Sheila A. Albin (Sept. 12, 1997).

9 12 C.F.R. § 721.3(g).

10 OCC Interpretive Letter No. 827 (April 3, 1998).

In 2002, the OCC issued a comprehensive regulation on DCCs and DSAs when offered by a national bank.[11] The substance of that regulation is discussed further below.

Today, all but three states[12] permit state-chartered depository institutions to offer DCCs and DSAs and do not regulate the products as insurance when offered by such institutions. Two-thirds of the states do not treat DCCs or DSAs as insurance when offered by non-depository creditors.

II. <u>Benefits of DCCs and DSAs to Consumers</u>

DCCs and DSAs provide consumers with several unique benefits. They provide a flexible way for borrows to protect themselves from a variety of events that can affect their ability to make debt payments. They also permit borrowers to buy only the amount of protection they need based on their financial situation and the amount of credit card debt they have outstanding in a given month. Consequently, DCCs and DSAs are often a more suitable form of debt protection for borrowers than credit insurance or term life insurance.

a. Flexibility in Product Design Gives Borrowers Protection for a Wide Range of Life Events

DCCs and DSAs provided in connection with credit cards can be structured to meet the changing needs of borrowers. In addition to providing relief upon the occurrence of the types of life events traditionally protected by credit insurance,[13] DCCs and DSAs can provide debt relief for a broad array of other life events, including a call-up to active duty military service,[14] marriage, the birth of a child, divorce, natural disaster, business interruption, and family leave. The flexible design of DCCs and DSAs allows for a creditor to match benefits provided with the profile of the particular portfolio (for example, borrowers in a "younger" portfolio might have more interest in "birth of a child" protection than an older one), and makes these products a more appropriate form of debt protection than credit insurance for many borrowers. As a result, DCCs and DSA give borrowers security and financial protection that is not available with other products. DCCs and DSAs also can be modified more easily than credit insurance since they are not subject to regulation by fifty separate state insurance regulators.

Moreover, DCCs and DSAs can be written to cover not only events in the life of a borrower, but also events in the life of the borrower's spouse, or other members in the borrower's household. This product feature recognizes that in many households various family members contribute to total household income.

---

[11] 12 C.F.R. Part 37.

[12] Alaska, Massachusetts and Montana.

[13] Generally, credit insurance only covers loss of life, disability or loss of income.

[14] While servicemembers are entitled to interest relief under the Servicemembers Civil Relief Act (SCRA), 50 U.S.C. App. § 527, DCC/DSA programs go beyond SCRA and provide additional benefits such as indefinite suspension of a debt during active duty.

b. Most Borrowers Can Easily Qualify to Purchase Debt Protection

It is easier for borrowers to purchase protection under a DCC or DSA than to obtain insurance. As a general rule, the only eligibility requirement for the purchase of a DCC or DSA in connection with a credit card is that the borrower's account is current. Most insurance products, in contrast, are subject to various underwriting standards. These standards prevent many borrowers that need debt protection the most from obtaining it. For example, borrowers with a pre-existing medical condition may be unable to obtain an insurance product. In contrast, such a condition generally would not disqualify the purchase of a DCC or DSA.

c. DCCs and DSAs Provide Benefits on a Timely Basis

When an insurance company pays a claim, it may or may not reach the customer's account on time. With a DCC or DSA, a borrower can be assured that a creditor will meet its obligation to cancel or suspend a debt on a timely basis. Unlike insurance, there is no potential delay in the payment of a claim. The creditor simply cancels or suspends the debt. As a result, a borrower does not need to worry about whether a late payment could affect the borrower's credit standing. Moreover, whenever a creditor finds that a borrower who has purchased a DCC or DSA is late in making loan payments, the creditor can pro-actively notify the borrower and encourage and assist the borrower in filing for debt relief under the terms of the DCC or DSA. Most credit card issuers will work with borrowers to establish payment plans when a borrower is delinquent in making payments due. However, under most payment plans interest is not forgiven, nor is any balance canceled, and such plans may harm a customer's credit rating. That is not the case with a DCC or DSA. A borrower's credit rating is not affected when the borrower receives a DCC/DSA benefit.

d. DCCs and DSAs are Priced in Relation to a Borrower's Need

Generally, DCCs and DSAs offered in connection with credit cards are priced in direct relationship to a borrower's use of the card. This ensures that the cost of the product is commensurate with the benefits received. That is not always the case with insurance products. For example, term life policies typically are sold in large dollar amounts (e.g., $10,000). Most consumers, however, maintain credit card balances well below that amount and do not need to pay for that level of coverage. When a DCC or DSA is part of a credit card program, the borrower pays a fee only on the actual balance maintained on the card, and, if the borrower does not use the card during a particular month (i.e., has a zero balance), no fee is charged. In other words, if the balance on a credit card is zero, there is *no charge* for debt protection until a new balance exists. Furthermore, DCA/DSA fees typically are not charged while a borrower is receiving benefits. In sum, credit cardholders who purchase a DCC or DSA pay only for the coverage they need that covers the types of life events that are relevant to their personal situations.

III. How DCCs and DSAs Differ from Credit Insurance

DCCs and DSAs differ from credit insurance in two material respects: They do not involve the transfer of risk to a third party, and they do not expose a borrower to any insolvency risk.

a. DCCs and DSAs do not transfer risk to a third party

The transference of risk is a hallmark of insurance. In a credit insurance transaction, for example, there are three parties involved: a creditor, who makes a loan; a borrower, who assumes an obligation to repay the loan and agrees to pay premiums for the credit insurance; and an insurance company, which agrees to assume the obligation to repay the loan if a specified event occurs. In other words, in a credit insurance transaction, there is transference of risk from the borrower and the creditor to the insurer.

There is no similar transference of risk in a DCC or DSA transaction. A DCC/DSA involves only two parties: (1) a creditor, which makes a loan and, in exchange for a fee paid by the borrower, agrees to suspend or cancel all or part of the loan upon the occurrence of a specified event; and (2) a borrower, who pays a fee for that protection. In other words, in a DCC or DSA transaction the creditor retains all the risk. If a specified event occurs, the creditor cancels or suspends the debt. The fact that there is no transference of risk also shields borrowers in a DCC or DSA transaction from any insolvency risk; the transaction does not involved an insurance company that might become insolvent and be unable to pay on a credit insurance obligation.

b. DCCs and DSAs do not expose borrowers to insolvency risk

In a credit insurance transaction, the transfer of potential liability to the insurance company raises solvency concerns. When a claim is made under a credit insurance policy, the insurer must be solvent to provide the benefit. One of the primary reasons the business of insurance is regulated is to protect insureds from the risk of insurer insolvency. Once a borrower obtains a credit insurance policy, there is a significant state regulatory interest in that transaction, because an insolvent insurer may leave an insured borrower unprotected.

Such consumer risks do not exist with DCCs. Because a creditor is merely agreeing to cancel a debt, an inherent power it has, the borrower does not have to worry about the solvency of the creditor – whether the creditor is solvent or insolvent, the borrower is protected by the creditor's unqualified commitment that the debt will be canceled in whole or in part (or suspended). The Eighth Circuit emphasized this issue when it held that DCCs offered by national banks were "significantly different from traditional insurance contracts."[15] The Court of Appeals discussed the importance of the lack of insolvency risk, noting that the need to prevent insolvency in order to protect borrowers was not present with DCCs. Quoting Justice Brennan's concurrence in *SEC v. Variable Annuity Life Ins. Co. of America*, the court stated:

[15] *Taylor*, 907 F.2d at 781.

> "[t]he prevention of insolvency and the maintenance of 'sound' financial condition in terms of fixed-dollar obligations is precisely what traditional state regulation [of insurance] is aimed at." The fact that debt cancellation contracts issued by national banks in connection with loans do not implicate this central concern of insurance regulation, at least as it relates to the ability of the banks to fulfill their obligations under the contracts, adds further support to our holding that debt cancellation contracts should not be considered the "business of insurance."[16]

The *Taylor* Court drew on this Supreme Court precedent to conclude that state insurance regulators cannot have authority over banking products offered by national banks because those operations are not part of "the business of insurance," as that term has been understood.

IV. The Regulation of DCCs and DSAs

DCCs and DSAs are subject to extensive regulation. In 2002, the OCC issued a comprehensive regulation governing DCCs and DSAs offered by national banks. This regulation has since been adopted by several states, and endorsed by other federal regulators.[17] The Federal Reserve Board also has adopted notice and disclosure requirements applicable to DCCs and DSAs,[18] and Section 5 of the Federal Trade Commission Act,[19] which prohibits unfair and deceptive acts and practices, applies to DCCs and DSAs. The following is a summary of those regulatory requirements.

a. OCC Regulation

The following are the key features of the OCC's DCC/DSA regulation:

- *A DCC/DSA must be optional.* A DCC/DSA may only be offered as an *optional* feature of a loan or line of credit. A national bank may not extend credit or alter the terms of credit conditioned on a customer entering into a DCC/DSA with the bank.[20]

- *A DCC/DSA must not mislead.* A national bank may not engage in any practice or use any advertisement that would mislead or cause a reasonable person to reach an erroneous belief about certain information pertaining to a DCC/DSA.[21] This includes misleading consumers about the terms or eligibility requirements of a DCC or DSA.

- *DCCs and DSAs cannot be contracts of adhesion.* A national bank may not unilaterally modify the terms of a DCC/DSA, unless (1) the modification is favorable to

---

16 *Id*., quoting *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65, 90-91 (1959).

17 *E.g.*, Arkansas Order of the State Bank Commissioner # 210.00, July 14, 2003; 7 Tex. Admin. Code § 12.33 (Texas); U.A.C. § R331-25 (Utah); Wis. Adm. Code DFI-Bkg § 3.08 (Wisconsin).

18 12 C.F.R. Part 226.

19 15 U.S.C. § 45.

20 12 C.F.R. § 37.3(a).

21 12 C.F.R. § 37.3(b).

the customer and is made without any charge to the customer; or (2) when the customer is notified of the change in advance and is given a reasonable opportunity (30 days) to cancel the contract without charge.

- *A periodic fee option is required*: A national bank may offer borrowers a single-fee contract in connection with non-mortgage loans, as long as a customer is also given a periodic fee option for payment. The periodic fee option may not be deliberately priced to deter a customer from selecting it.

- *Single fee structures are not permissible in real estate loans.* A national bank may not require a lump sum, single payment for a DCC or a DSA payable up front, where the related debt is a residential mortgage loan.[22]

- *DCCs/DSAs offered in connection with closed-end credit must include a refund option.* On closed-end credit, a national bank is permitted to structure a DCC/DSA so that the customer does not receive a refund of any unearned portion of the fee paid for the product if the DCC or DSA is terminated or the customer prepays the loan covered by the contract. However, a national bank also must give the borrower a *bona fide* option to buy a DCC/DSA with a refund feature. The regulation provides that an option is *bona fide* if the product having the refund feature is not deliberately structured in such a way, including pricing of the product, as to deter a customer from selecting that option. If a customer is entitled to a refund, the bank must calculate it based on a method at least as favorable to the customer as the "actuarial method," a term that is defined in the OCC's regulation. This requirement does not apply to open-end credit where a customer pays for the contract on a month-to-month basis, because there are no "unearned" fees to refund.[23]

- *Safety and Soundness is required*. A national bank must follow safe and sound banking practices when establishing the price of a debt protection agreement. A national bank must have effective risk management and control processes over its DCC/DSA program, and it must have either adequate reserves to handle any expected or unexpected DCC/DSA losses, or a contingent liability insurance policy (CLIP), or both.[24] The OCC mandates that the following factors be used as the basis for any banking product price: (1) the cost incurred by the national bank in providing the service; (2) the deterrence of misuse by customers of banking services; (3) the enhancement of the competitive position of the national bank in accordance with the national bank's business plan and marketing strategy; and (4) the maintenance of the safety and soundness of the national bank.[25]

- *All material terms and conditions must be disclosed*. The OCC's regulation requires extensive disclosures throughout the process of marketing DCCs and DSAs, and a consumer must receive certain disclosures, in "short" and "long" form, before agreeing to purchase a DCC or DSA. The disclosures must be in an easily readable format,

---

22 12 C.F.R. § 37.3(c).

23 12 C.F.R. §§ 37.4; 37.2(a) (definition of "actuarial method).

24 12 C.F.R. § 37.8.

25 12 C.F.R. § 7.4002.

include plain language, and be simple, direct and readily understandable.[26] The exact form and content of the disclosures depends on the manner in which the bank solicits a customer.

- *Advertisements must adhere to disclosure requirements*. If a national bank advertises a DCC specifically and the advertisement is not general in nature, such that it only describes or lists the bank's products or services, the bank must include *short-form disclosures*, which advise the consumer of the following: (1) that the DCC is optional; (2) for non-mortgage loans, that a customer may pay the fee in a single payment or in periodic payments; (3) that the customer may purchase a contract that includes a refund; (4) the bank's refund policy for single-fee contracts where the customer decides to finance the fee; (5) that additional information, including the long-form disclosures, will be provided before the contract is final; and (6) that there are eligibility requirements, conditions and exclusions that could prevent the borrower from receiving benefits.[27] The OCCs sample short-form disclosures are at Attachment 1.

- *Branch sales are regulated.* If a bank is selling a DCC to a customer in person at a branch or other facility, there are three steps that must be taken. At solicitation, the bank must provide the *short-form disclosures* orally. It also must provide the following *long-form disclosures* in writing: (1) all of the short-form disclosures; (2) an explanation of the effect of debt suspension agreements, specifically that the obligation to pay principal and interest is only suspended, and whether the interest will continue to accrue during the period of suspension; (3) the total fee, or the formula used to compute the fee; (4) the impact on the customer's use of a credit card or credit line during an activation period; (5) how the customer may terminate the contract; and (6) a summary of the conditions of the contract, or a reference to the contract for those provisions.[28] A copy of the OCC's model long-form disclosures is at Attachment 2.

- *An affirmative, written acknowledgment of receipt of disclosures and election to purchase is required.* A national bank must obtain a customer's written acknowledgment of receipt of the disclosures as well as the customer's written election to purchase the product.[29]

- *Telephone sales are regulated.* If the solicitation is being made via telephone, a national bank may provide the short-form disclosures orally, provided it mails the long-form disclosures within three business days of the solicitation. If the sale occurs over the telephone, the bank must:

  1) Document that the customer received the short-form disclosures;
  2) Document that the customer provided oral consent to purchase the contract;

[26] 12 C.F.R. § 37.7(d).
[27] 12 C.F.R. § 37.6(a).
[28] 12 C.F.R. § 37.6(b).
[29] 12 C.F.R. §§ 37.7(a), 37.6(c)(1-2).

3) Mail the written affirmative election, the written acknowledgment, and the long-form disclosures, to the customer within three business days of the solicitation;

4) Document that the bank made "reasonable efforts" to obtain the written election and acknowledgment from the customer; and

5) Give the customer the right to cancel the contract without penalty within 30 days after the mailing.[30]

- *Take-ones and mail inserts are regulated*: If using take-ones and mail inserts to solicit customers, a national bank may provide the short-form disclosures in the materials. The bank must mail the long-form disclosures and the written acknowledgement within three business days after the customer contacts the bank in response to the solicitation. The customer is not obligated under the contract until he has given the bank his written acknowledgment, or until the bank has (1) documented that it has provided the written acknowledgment form; (2) documented that it has made "reasonable efforts" to obtain the written acknowledgment; and (3) given the customer the right to cancel the contract without penalty within 30 days of mailing the long-form disclosures.[31]

In sum, the OCC's regulation strengthens both the customer relationship and customer protection through restrictions and prohibitions, disclosures, and the requirement that the customer affirmatively elect to purchase the product.

b. Regulation Z

Beyond the OCC's disclosure rules, the Federal Reserve Board (Board) has issued regulations under the Truth in Lending Act, which creditors must follow when offering DCCs and DSAs. The Board's Regulation Z, which largely adopts the disclosure requirements incorporated in the OCC's DCC/DSA regulation, requires specific disclosures to be provided when a debt protection product is offered in connection with a credit card.

The Board's rules require that a creditor inform a borrower of all charges paid for DCC/DSA coverage. As a general rule, a fee for a DCC/DSA "written in connection" with a credit transaction must be disclosed to a consumer as part of the finance charge.[32] However, such fees do not have to be included in the finance charge if the creditor discloses to the borrower in writing that the product is voluntary; the fee for the initial term of coverage is disclosed; and the consumer signs an affirmative request for coverage after receiving the required disclosures.[33] If the term of coverage is less than the term of the credit transaction, the term of coverage also must be disclosed. Regulation Z permits the fee to be disclosed on a unit-

---

[30] 12 C.F.R. §§ 37.6(c)(3), 37.7(b).

[31] 12 C.F.R. §§ 37.6(c)(4), 37.7(c).

[32] 12 C.F.R. § 226.4(b)(10).

[33] *Telephone sales rule.* On credit cards, if a DCC/DSA is offered over the telephone, a creditor is permitted to make the disclosures orally, and consumers to consent orally, if the following conditions are satisfied: (1) the creditor maintains reasonable procedures to provide a consumer with the oral disclosures and maintains evidence that demonstrates that the consumer affirmatively elected to purchase the coverage; and (2) the creditor mails the disclosures within three business days after the telephone purchase**.**

cost basis in open-end credit transactions.[34] In the case of a DSA, Regulation Z also requires the use of two model forms for the written election, one for open-end credit and one for closed-end credit. These forms appear in Attachment 3.

As part of a comprehensive review of Regulation Z involving all types of credit, the Board has been in the process of making several changes to provisions affecting credit card offerings of DCCs and DSAs.[35] Some of these changes have been implemented, and others are schedule to be implemented on July 1. The changes to Regulation Z provide consumers with additional protections, including certain disclosures that must be made on statements after a DCC/DSA is purchased. They also clarify certain issues in favor of consumers. The changes include:

- *Regulation Z disclosures apply to DCCs/DSAs offered after credit card issuance*. The scope of the phrase "written in connection with a credit transaction" has been expanded to include a DCC/DSA purchased after a credit card account has been opened (previously, fees for such DCCs/DSAs did not have to be disclosed as part of the finance charge).[36]
- *Places limits on creditor-favorable exceptions to disclosure requirements connected to certain triggering events.* Previously, to exclude fees for debt protection from the finance charge, the triggering events were limited to those associated with accident or loss of life, health, or loss of income (the traditional triggering events). The amendments provide that other triggering events are permissible, but only as long as the DCC or DSA includes at least one of the traditional triggering events.[37]
- *New credit card fee disclosure.* If DCC/DSA coverage is required to obtain a credit card (to the extent permitted by state or other applicable law), the issuer must highlight the fee for such coverage in the table that contains the credit card disclosures.[38]
- *Additional disclosure specific to DSAs*. For DSAs, the disclosures must advise the consumer that the obligation to pay loan principal and interest is only suspended, and that the interest will continue to accrue during the period of suspension. The rules also require that each periodic statement disclose the total interest that has accrued for the billing cycle as well as total year-to-date interest, including that accruing during a time of debt suspension.[39]

---

[34] 12 C.F.R. § 226.4(d)(3).

[35] The final rule on open-end credit is available at 74 Fed. Reg. 5244(Jan. 29, 2009).
The proposed rule on closed-end credit is available at 74 Fed. Reg. 43232 (Aug. 26, 2009) (http://www.federalreserve.gov/boarddocs/meetings/2009/20090723/FR%20Notice--CE.pdf).
The proposed rule on HELOCs is available at 74 Fed. Reg. 43428 (Aug. 26, 2009) (http://www.federalreserve.gov/boarddocs/meetings/2009/20090723/FR%20Notice%20HELOC.pdf).

[36] 12 C.F.R. Part 226, Supp. I, Official Staff Commentary 4(b)(10)2.

[37] 12 C.F.R. § 226.4(d)(3).

[38] 12 C.F.R. § 226.5a(b)(13).

[39] 74 Fed. Reg. 5244, 5267 (Jan. 29, 2009) ("A consumer group suggested that in debt suspension programs where interest continues to accrue during the suspension period, periodic statements should be required to include a disclosure of the amount of the accrued interest. The Board believes that the requirement under § 226.7, as adopted in the final rule, for each periodic statement to disclose total interest for the billing cycle as well as total year-to-date interest on the account adequately addresses this concern.").

c. *Unfair and Deceptive Acts and Practices*

DCCs and DSAs are subject to the Federal Trade Commission Act's prohibition on Unfair and Deceptive Acts and Practices (UDAP).[40] The OCC has used its UDAP authority to regulate debt protection products offered by Providian National Bank. In the Providian case, which was resolved in 2000 – well before the OCC issued its DCC/DSA regulation – the OCC alleged that the bank failed to adequately disclose to consumers the significant limitations in a credit protection program it offered. According to the OCC, consumers who purchased the protection were told they would not have to make credit card payments for up to 18 months in the event of involuntary unemployment, hospitalization, accident, sickness or disability. Moreover, consumers were told that interest would not accrue, late fees would not be charged, and the account would not be reported to credit bureaus for late payment.

There were other allegations made by the OCC, including failures to adequately disclose costs or requirements associated with credit protection products. In total, the OCC required Providian to pay out $300 million in restitution to its customers as part of a settlement.

Conclusion

DCCs and DSAs are loan terms that respond to a borrower's need for protection in the lending relationship. DCCs and DSAs permit borrowers to plan for, and adequately address, a variety of life events that may alter their ability to repay an extension of credit. In addition to this flexibility to meet the needs of the borrower, DCCs and DSAs differ significantly from credit insurance in other ways. Unlike credit insurance, DCCs and DSAs involve two parties, not three. There is no risk transfer to a third party, so the solvency of a third party, such as a credit insurer, is irrelevant to the benefits provided.

Federal regulations provide extensive protections when DCCs and DSAs are offered, including two sets of disclosures, restrictions on what terms can be included in the loan agreement, and a requirement that a borrower affirmatively elect to purchase the protection after confirming receipt of the require disclosures.

In sum, DCCs and DSAs strengthen the relationship between a borrower and a creditor and are designed to provide relief to the borrower to avoid default on a loan or line of credit.

---

[40] 15 U.S.C. §§ 41 *et seq.*

Attachment 1
OCC Requirement – Short-form Disclosures

This product is optional

Your purchase of [PRODUCT NAME] is optional. Whether or not you purchase [PRODUCT NAME] will not affect your application for credit or the terms of any existing credit agreement you have with the bank.

Lump sum payment of fee

[Applicable if a bank offers the option to pay the fee in a single payment]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

You may choose to pay the fee in a single lump sum or in [monthly/quarterly] payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of [PRODUCT NAME].

Lump sum payment of fee with no refund

[Applicable if a bank offers the option to pay the fee in a single payment for a no-refund DCC]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

You may choose [PRODUCT NAME] with a refund provision or without a refund provision. Prices of refund and no-refund products are likely to differ.

Refund of fee paid in lump sum

[Applicable where the customer pays the fee in a single payment and the fee is added to the amount borrowed]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

[Either:] (1) You may cancel [PRODUCT NAME] at any time and receive a refund; or (2) You may cancel [PRODUCT NAME] within --- days and receive a full refund; or (3) If you cancel [PRODUCT NAME] you will not receive a refund.

Additional disclosures

We will give you additional information before you are required to pay for [PRODUCT NAME]. [If applicable]: This information will include a copy of the contract containing the terms of [PRODUCT NAME].

Eligibility requirements, conditions, and exclusions

There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under [PRODUCT NAME].

[Either:] You should carefully read our additional information for a full explanation of the terms of [PRODUCT NAME] or You should carefully read the contract for a full explanation of the terms of [PRODUCT NAME].

Attachment 2
OCC Requirement – Long-form Disclosures

This product is optional

Your purchase of [PRODUCT NAME] is optional. Whether or not you purchase [PRODUCT NAME] will not affect your application for credit or the terms of any existing credit agreement you have with the bank.

Explanation of debt suspension agreement

[Applicable if the contract has a debt suspension feature]

If [PRODUCT NAME] is activated, your duty to pay the loan principal and interest to the bank is only suspended. You must fully repay the loan after the period of suspension has expired. [If applicable]: This includes interest accumulated during the period of suspension.

Amount of fee

[For closed-end credit]: The total fee for [PRODUCT NAME] is ---.

[For open-end credit, either:] (1) The monthly fee for [PRODUCT NAME] is based on your account balance each month multiplied by the unit-cost, which is ----; or (2) The formula used to compute the fee is ----].

Lump sum payment of fee

[Applicable if a bank offers the option to pay the fee in a single payment]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

You may choose to pay the fee in a single lump sum or in [monthly/quarterly] payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of [PRODUCT NAME].

Lump sum payment of fee with no refund

[Applicable if a bank offers the option to pay the fee in a single payment for a no-refund DCC]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

You have the option to purchase [PRODUCT NAME] that includes a refund of the unearned portion of the fee if you terminate the contract or prepay the loan in full prior to the scheduled termination date. Prices of refund and no-refund products may differ.

Refund of fee paid in lump sum

[Applicable where the customer pays the fee in a single payment and the fee is added to the amount borrowed]

[Prohibited where the debt subject to the contract is a residential mortgage loan]

[Either:] (1) You may cancel [PRODUCT NAME] at any time and receive a refund; or (2) You may cancel [PRODUCT NAME] within --- days and receive a full refund; or (3) If you cancel [PRODUCT NAME] you will not receive a refund.

Use of card or credit line restricted

[Applicable if the contract restricts use of card or credit line when customer activates protection]

If [PRODUCT NAME] is activated, you will be unable to incur additional charges on the credit card or use the credit line.

Termination of [PRODUCT NAME]

[Either]: (1) You have no right to cancel [PRODUCT NAME]; or (2) You have the right to cancel [PRODUCT NAME] in the following circumstances:-----.

[And either]: (1) The bank has no right to cancel [PRODUCT NAME]; or (2) The bank has the right to cancel [PRODUCT NAME] in the following circumstances:-----.

Eligibility requirements, conditions, and exclusions

There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under [PRODUCT NAME].

[Either]: (1) The following is a summary of the eligibility requirements, conditions, and exclusions. [The bank provides a summary of any eligibility requirements, conditions, and exclusions]; or (2) You may find a complete explanation of the eligibility requirements, conditions, and exclusions in paragraphs --- of the [PRODUCT NAME] agreement.

Attachment 3
Federal Reserve Board Requirement – Debt Suspension Disclosures

Debt Suspension Model Clause (open-end credit): Please enroll me in the optional [insert name of program], and bill my account the fee of [how cost is determined]. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate. [To Enroll, Sign Here]/[To Enroll, Initial Here]. X----[41]

Debt Suspension Model Clause (closed-end credit): Please enroll me in the optional [insert name of program], and bill my account the fee of [insert charge for the initial term of coverage]. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate. [To Enroll, Sign Here]/[To Enroll, Initial Here]. X----[42]

41 12 C.F.R. Part 226, Appendix G.
42 12 C.F.R. Part 226, Appendix H.