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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 7 and 37

[Docket No. 02-14]

RIN 1557-AB75

Debt Cancellation Contracts and Debt Suspension Agreements

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is adding a new part 37 to its regulations that addresses debt cancellation contracts (DCCs) and debt suspension agreements (DSAs). The purpose of the final rule is to establish standards governing these products in order to ensure that national banks provide such products consistent with safe and sound banking practices and subject to appropriate consumer protections.

EFFECTIVE DATE: This rule is effective June 16, 2003.

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SUPPLEMENTARY INFORMATION:

I. Background

National banks' authority to offer DCCs and DSAs

A DCC is a loan term or a contractual arrangement modifying loan terms linked to a bank's extension of credit, under which the 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. A DSA is a loan term or a contractual arrangement modifying loan terms linked to a bank's extension of credit, under which the bank agrees to suspend all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event.

Under a DCC or a DSA, the customer typically agrees to pay an additional fee to the bank in exchange for the bank's promise to cancel or temporarily suspend the borrower's obligation to repay the loan. The fee may be a lump sum that is 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 charge. The fee compensates the bank for releasing borrowers from loan obligations under the circumstances specified in the DCC or DSA. These arrangements also provide customers a convenient method of extinguishing debt in times of financial or personal hardship, and enable the bank to avoid the time and expense of collecting the balance of the loan from a borrower's estate in the event of the borrower's death or other specified circumstances.[1]

The authority of national banks to offer DCCs and DSAs is well-established.[2] Nearly 40 years ago, in 1963, the OCC concluded that offering DCCs was a lawful exercise of the powers

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[1] See generally, Joseph L. Moore & James W. Smith, Debt Cancellation Contracts: A Neglected Asset, 112 Banking L. J. 918 (1995).

[2] 12 U.S.C. 24(Seventh). See Memorandum from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, to John D. Hawke, Jr., Comptroller of the Currency, dated June 25, 2002 (discussing national banks' authority to offer DCCs and DSAs).

of a national bank in connection with the business of banking.[3] The following year various OCC issuances affirmed that position.[4] As explained by Comptroller James Saxon:

> The debt cancellation ruling issued by this Office [OCC] is not intended as a means for National Banks to invade the field of insurance. Rather, it is a recognition by this Office of a National Bank's right to protect itself by the establishment and maintenance of appropriate reserves against anticipated losses in connection with its lending activities under 12 U.S.C. § 24. The necessity to maintain such reserves and to adjust its charges in relation to both reserves and the risk involved in a particular transaction has long been recognized as an essential part of the business of banking.[5]

In 1971, the OCC codified the interpretive ruling on DCCs as 12 CFR 7.7495.

The only Federal circuit court of appeals that has considered DCCs or DSAs upheld the OCC's determination that the National Bank Act authorizes national banks to enter into DCCs with their borrowers and that DCCs were banking products, not part of the "business of insurance."[6] In First Nat'l Bank of Eastern Arkansas v. Taylor, the Eighth Circuit Court of Appeals considered whether DCCs provided by a national bank to its loan customers were subject to Arkansas State insurance regulation. The court held that the National Bank Act authorized national banks to offer DCCs. Further, it held that Federal law precluded the State

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[3] See Comptroller of the Currency, The National Banking Review 264 (Dec. 1963).

[4] See Letter from James J. Saxon to the President of a National Bank (Mar. 10, 1964); Letter from James J. Saxon to the President of a National Bank (Mar. 26, 1964); James J. Saxon, Statement of the Comptroller of the Currency on Debt Cancellation Contracts and Their Relation to State Law (May 18, 1964); James J. Saxon, Letter to the Presidents of all National Banks (July 21, 1964).

[5] James J. Saxon, Statement of the Comptroller of the Currency on Debt Cancellation Contracts and Their Relation to State Law (May 18, 1964).

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

insurance commissioner from requiring the national bank to obtain a State insurance license and from taking enforcement action against the national bank for failing to do so.[7]

The Eighth Circuit found that DCCs do not constitute the "business of insurance" under the McCarran-Ferguson Act because the product falls within the powers incidental to banking granted by the National Bank Act.[8] The court emphasized that DCCs offered by banks in connection with their loans differ significantly from traditional insurance contracts. DCCs do not require the bank to take an investment risk or make payment to the borrower's estate. The loan simply is extinguished when the borrower dies. Thus, the court reasoned, "the primary and traditional concern behind state insurance regulation -- the prevention of [the insurer's] insolvency -- is not of concern to a borrower who opts for a debt cancellation contract."[9] The court concluded that further support for its holding that DCCs do not constitute the "business of insurance" derives from the fact that national banks fulfilling their obligations under DCCs do not implicate this central concern of insurance regulation.[10]

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[7] "Because national banks are considered federal instrumentalities, states may neither prohibit nor unduly restrict their activities. Thus, the National Bank Act preempts the Commissioner's authority to prohibit FNB from offering debt cancellation contracts." Id. at 778 (citations omitted).

[8] The court recognized that whether an activity falls within the "business of insurance" for purposes of the McCarran-Ferguson Act is a federal question and not determined by State law defining insurance. Id. at 780, n.8 (citing SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65, 69 (1959)). See also Steele v. First Deposit Nat'l Bank, 732 So.2d 301 (Ala. Civ. App. 1999) (finding a credit protection debt deferral product was not within the meaning of the "business of insurance").

[9] Taylor, 907 F.2d at 780.

[10] See id.

In 1996, the OCC amended the interpretive ruling (renumbered as §7.1013) to expressly include offering DCCs for the disability of the borrower, in addition to death.[11] The OCC also has issued various interpretive letters concerning DCCs and DSAs over the years.[12] In 1998, for example, the OCC confirmed that a national bank may offer DSAs as well as DCCs, as part of its express authority to make loans.[13]

The OCC's rulemaking

On January 26, 2000, the OCC published in the Federal Register an advance notice of proposed rulemaking (ANPR) requesting comment on whether regulations addressing DCCs and DSAs were necessary or appropriate (65 FR 4176).[14] In particular, in the ANPR, we noted the absence of a comprehensive Federal consumer protection scheme governing DCCs and DSAs.

We OCC received 41 comments in response to the ANPR. Commenters were evenly divided on whether additional regulations were necessary. On balance, we agreed with those who favored additional standards in this area.

On April 18, 2001, we published a notice of proposed rulemaking (NPRM) requesting comment on proposed regulations governing DCCs and DSAs (66 FR 19901). The preamble to the proposal said that the proposed rules were designed to facilitate consumers' informed choice about whether to purchase DCCs or DSAs, to discourage unfair or abusive sales practices, and to promote national banks' ability to offer DCCs and DSAs on a safe and sound basis.

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[11] See 61 FR 4849 (Feb. 9, 1996).

[12] See, e.g., Interpretive Letter No. 641 (Jan. 7, 1994); Interpretive Letter No. 827 (Apr. 3, 1998); Interpretive Letter No. 903 (Dec. 28, 2000).

[13] See Interpretive Letter No. 827 (Apr. 3, 1998).

[14] The comments we received on the ANPR are summarized in the notice of proposed rulemaking (66 FR 19901, Apr. 18, 2001).

The OCC received 51 comment letters in response to the NPRM.[15] The commenters included bank trade associations, national banks, credit card companies, and consumer groups. Comments were also filed by insurance trade associations, insurance companies, and State insurance regulators. Finally, we received comments from a number of individuals and companies. The vast majority of commenters favored the proposed regulation, but most of these commenters recommended changes.

The final rule makes a number of changes to the proposal, many in response to suggestions provided by commenters. The next section of this discussion sets out a general overview of the final rule.

II. Overview

The final rule includes the following significant features:

- It codifies the OCC's longstanding position that DCCs and DSAs are permissible banking products.
- It establishes important safeguards to protect against consumer confusion and areas of potential customer abuse. In particular, the final rule prohibits national banks from offering lump sum, single premium DCCs or DSAs in connection with residential mortgage loans.
- The rule provides for standardized disclosures of key information in connection with the offer and sale of DCCs and DSAs. The disclosure requirements are structured to accommodate widely used methods of marketing DCCs and DSAs, including telephone solicitations, mail inserts, and so-called "take one" applications.

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[15] Several commenters filed multiple comments.

- To the extent feasible, the rules apply consumer protections modelled on the framework of consumer protections that Congress directed the OCC (and the other Federal banking agencies) to apply to banks' insurance sales. National banks are familiar with these insurance sales requirements, which are contained in part 14 of the OCC's regulations, and the approach taken in the final rule enables banks to harmonize their policies, procedures, and employee training programs across the two product lines.
- The rule addresses safety and soundness considerations presented by DCCs and DSAs by requiring national banks to manage the risks associated with these products according to safe and sound banking principles, including appropriate recognition and financial reporting of income, expenses, assets, and liabilities associated with DCCs and DSAs, adequate internal controls, and risk mitigation measures.

Section III of this preamble discussion describes the most significant comments we received on the proposed rule and responds to the commenters' principal concerns. Section IV summarizes the final rule.

III. Summary of Comments

Authority, purpose, and scope (section 37.1)

The proposed rule removed 12 CFR 7.1013 and replaced it with 12 CFR 37.1. Section 37.1(a) stated the authority of national banks under 12 U.S.C. 24(Seventh) to enter into both DCCs and DSAs and to charge a fee for these products. Section 37.1(b) set forth the purposes of the new regulations. Section 37.1(c) stated that the regulations applied to the provision of DCCs and DSAs by national banks and Federal branches and agencies. In addition, it clarified that the sale of DCCs and DSAs are governed by new part 37 and not by 12 CFR 14 (Consumer Protections for Depository Institution Sales of Insurance).

Applicability of State law

Many commenters sought clarification about the regulatory framework that governs DCCs and DSAs. They urged the OCC to clarify that DCCs and DSAs offered by national banks are not subject to regulation under State insurance law. One commenter, however, asserted that DCCs and DSAs are "authorized" insurance products under the Gramm-Leach-Bliley Act (GLBA)[16] and that States have express authority to regulate them as insurance, subject only to the preemption standards set forth in section 104 of the GLBA.

As is described in the Background section of this preamble discussion, DCCs and DSAs are banking products authorized under 12 U.S.C. 24(Seventh). This final rule, together with any other applicable requirements of Federal law and regulations, are intended to constitute the entire framework for uniform national standards for DCCs and DSAs offered by national banks. Accordingly, the final rule states that DCCs and DSAs are regulated pursuant to Federal standards, including part 37, and not State law.

Establishment of fees

Many commenters urged that the OCC regulate the amount of fees banks can charge for DCCs and DSAs. The premise of a number of these comments was the assertion that DCCs and DSAs are substitute products for credit insurance. These commenters contended that the market for DCCs is analogous to the market for credit insurance, which is characterized by "reverse competition." "Reverse competition" refers to market conditions that result in increased prices because insurers compete with each other for the business of the agents who control placement

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[16] Pub. L. No. 106-102, 113 Stat. 1338 (Nov. 12, 1999).

of the product. To obtain this business, insurance companies pay high commissions or provide other compensation or services, resulting in higher costs that are then passed on to the consumer. These commenters expressed concern that disclosure requirements are inadequate to address this market failure, and they recommended that the OCC impose the same type of regulation -- including fee, form, and claims regulation -- on the sale of DCCs or DSAs as is commonly required by State insurance regulators with respect to the sale of credit insurance.

For several reasons, we decline to depart from the basic regulatory approach we proposed, although the final rule does contain enhanced consumer protection features beyond those contained in the proposal. First, as the Taylor court explained, DCCs and DSAs are distinct from credit insurance as a matter of law. Moreover, we see no evidence that the market for DCCs and DSAs suffers from the same flaws as the commenters assert prevail in the credit insurance market. Issuers of DCCs and DSAs do not compete to enlist independent, third-party sellers to place their product. Instead, every national bank that issues DCCs or DSAs is its own seller because these products are provided in conjunction with loans that the bank itself makes. Commenters provided no evidence of impairment in the market for DCCs and DSAs, but instead relied on concerns regarding distortions and abuses in the credit insurance market. Thus, we cannot conclude that the strongest reason given by the commenters in support of fee regulation -- dysfunction in the market that disclosures are inadequate to overcome -- is present in the market for DCCs and DSAs. Moreover, as the rule's express prohibition on tying makes clear, the choice of purchasing the product is left exclusively to the customer. We have concluded, therefore, that a regulatory approach that includes price controls as a primary component is not warranted.

The OCC's regulations reflect the fact that national banks may set fees subject to standards of prudent banking practices. Section 7.4002 of our rules authorizes national banks to establish non-interest charges and fees "according to sound banking judgment and safe and sound banking principles."[17] A bank satisfies this standard if it employs a decision making process to set fees that involves consideration of four factors identified in the regulation. The standards of §7.4002 apply to the fees charged by a national bank for a DCC or DSA.

Several commenters stated that, in some cases, either banks do not charge customers a fee for a DCC or DSA or a third party pays the fee. These commenters urged the OCC to clarify that the regulation does not apply if the customer does not pay a fee for the DCC or DSA, or to create an exemption to some of the provisions of the rule. We have not modified the final rule in this way because, in our view, such a modification could create an incentive for banks to evade the requirements of the rule. This could occur if, for example, a bank structures its fees so that it does not explicitly charge the customer for a DCC or DSA but builds that fee into some other component of the transaction.

For these reasons, §§37.1(a), (b), and (c) are substantively the same in the final rule as in the proposal, with certain stylistic changes to improve clarity. For stylistic purposes, the regulation text uses both the terms "extension of credit" and "loan;" we do not intend this usage to create any substantive distinctions. In addition, we have added a phrase in subsections (a) and (c) to clarify that DCCs and DSAs are offered in connection only with extensions of credit made by the same bank.

Definitions (section 37.2)

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[17] 12 CFR 7.4002(b)(2).

The proposed rule defined a DCC as a contract entered into between a bank and its customer providing for cancellation of all or part of the amount a customer owes under an extension of credit from that bank upon the occurrence of a specified event. A DSA was similarly defined as a contract entered into between a bank and its customer providing for suspension of all or part of the customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The rule used the term "bank" to include a national bank as well as a Federal branch or agency. A customer was defined as an individual who obtains a loan or other extension of credit from a bank primarily for personal, family or household purposes.

A number of commenters sought clarification of the terms defined in the proposal, and we have, accordingly, made a number of clarifying changes to the text. For example, many commenters were concerned that the definitions of a DCC and a DSA implied that they are products separate from the underlying extension of credit. The text of the final rule adds language to clarify this point.

The final rule makes stylistic changes in all the definitions and adds five definitions: actuarial method, closed-end credit, contract, open-end credit, and residential mortgage loan. In response to suggestions from commenters, we have added a sentence to the definition of a DSA to clarify that the rule does not cover so-called "skip-a-payment" agreements in which the triggering event for a deferral arrangement is either the borrower's unilateral election to defer payment or the bank's unilateral decision to allow a deferral of repayment. The rule covers "hybrid" arrangements that contain both debt suspension and debt cancellation features. It also covers DSAs where interest continues to accrue during the suspension period, as well as DSAs where the accrual of interest is suspended.

Both the proposal and the final rule require that if a refund feature is part of the DCC or DSA, the bank must compute that refund using a method no less favorable to the consumer than the actuarial method. In response to requests from commenters, the final rule defines that term. The rule adopts the definition of "actuarial" found in the Truth in Lending Act (TILA), because banks are already familiar with the TILA definition and its implementation in the Federal Reserve Board's Regulation Z.[18] For the same reason, the terms "open-end credit" and "closed-end credit" are defined based on Regulation Z.[19]

For purposes of the prohibition on single-payment fees for DCCs and DSAs issued in connection with residential mortgage loans, we have added the term "residential mortgage loan" and defined it to mean a loan secured by one-to-four family, residential property.

Finally, the rule adds the new term "contract" as a less cumbersome, short-form reference to a debt cancellation contract or a debt suspension agreement in the remainder of the regulation text.

Prohibited practices (section 37.3)

Anti-tying provision

The proposed rule contained several types of customer protections that would be standard when a bank provides products associated with a loan, including an anti-tying provision precluding a bank from extending credit or changing the terms or conditions of an extension of credit conditioned upon the purchase of a DCC or DSA from the bank.

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[18] See 15 U.S.C. 1615(d)(1). See also 12 CFR 226, app. J (appendix to the Federal Reserve Board's Regulation Z, implementing the TILA, explaining the use of the actuarial method for purposes of computing the annual percentage rate).

[19] See 12 CFR 226.2(20) and 226.2(10), respectively.

Several commenters supported the anti-tying prohibition. These commenters thought that a bank's authority to deny a consumer's request for credit gives the bank a unique ability to seek to coerce consumers to purchase a DCC or DSA. They asserted that disclosures alone are not effective to dispel the potentially coercive effect that tying has in this context.[20]

A number of commenters opposed this provision, however. These commenters offered different objections, depending on their view of the effect on these products of the anti-tying provision in section 106 of the Bank Holding Company Act Amendments of 1970.[21] Section 106 generally forbids a bank from extending credit, leasing or selling property, furnishing services, or fixing or varying prices of these transactions, on the condition or requirement that the customer obtain additional credit, property, or service from the bank, subject to certain exceptions. One of these exceptions, the statutory "traditional bank product" exemption, permits a bank to extend credit, lease or sell property, furnish services, or fix or vary prices on these transactions, on the condition that a customer obtain a loan, discount, deposit or trust service from the same bank.[22] Some commenters argued that section 106 does not apply because DCCs and DSAs are an integral term of the loan agreement and the tying prohibition only applies to <u>separate</u> products. Others thought that section 106 applies but would operate to permit tying either because the DCC or DSA is part of the loan and section 106 permits the tying of loan

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[20] In support of this view, one commenter cited a study indicating that even when consumers receive disclosures informing them that the lender's decision to grant a loan is not conditioned on the purchase of insurance, some consumers still believe that there is a connection between their ability to obtain the loan or to obtain favorable loan terms and their purchase of insurance. <u>See</u> John M. Barron & Michael E. Staten, Credit Research Center, Purdue University, <u>Credit Insurance: Rhetoric and Reality</u> (1994).

[21] Section 106 is codified at 12 U.S.C. 1972.

[22] <u>See</u> 12 U.S.C. 1972(1)(A).

products, or because the DCC or DSA is a "traditional bank product" and may be tied to a loan on that basis. On the other hand, one commenter argued that the rule's anti-tying provision is unnecessary because section 106 already applies to prohibit tying a loan to a customer's purchase of a DCC or DSA from the bank.

DCCs and DSAs may be offered and purchased either contemporaneously with the other terms of the loan agreement or subsequent to the execution of that agreement. In either case, the effect of the DCC or DSA is to extinguish or suspend the borrower's obligation to repay under the otherwise operative provisions of the loan. Since a bank's ability to adjust the terms of loan repayment is an integral component of its authority to lend, in our view, a DCC or DSA could properly be treated as a component of the loan and, as such, would not be subject to the tying prohibitions in section 106 because a DCC or DSA is a term of the loan rather than a separate product. Thus, the final rule retains a tying prohibition specifically applicable to DCCs and DSAs.

<u>Misleading practices</u>

The proposed rule prohibited a bank from engaging in any practice that could mislead a reasonable person with respect to the information that the proposal required to be disclosed.

Several commenters objected to the "reasonable person" standard on the grounds that it was vague, subjective, or so broad that it would be impossible to enforce.[23] Yet, the proposed standard was very similar to the standard governing misleading practices found in the regulations

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[23] A few commenters also argued that this provision is unnecessary because national banks are already subject to the prohibitions in the Federal Trade Commission Act against fraud and misleading or deceptive advertising. Section 5 of the Federal Trade Commission Act (15 U.S.C. 41 *et seq.*) (FTC Act) generally prohibits "unfair or deceptive acts or practices in or affecting commerce." The prohibition retained in the final rule is consistent with, but not duplicative of, the standards in the FTC Act.

of the OCC (and the other Federal banking agencies) implementing consumer protections in the insurance sales context.[24] National banks' sale of DCCs and DSAs, which may be solicited and marketed using methods similar to insurance solicitation and marketing, can present similar consumer protection issues as the sale of insurance products. Moreover, national banks are already generally familiar with the standard contained in the insurance sales regulations. Thus, the final rule retains the substance of the prohibition as proposed but with changes in wording so that the language conforms more closely with the language of part 14. We have also added an express reference to misleading advertisements, as well as practices, to make clear that the scope of the prohibition is no less than that in part 14.

Unilateral modification of the contract

The proposed rule prohibited a bank from retaining a unilateral right to modify or cancel the contract.

A commenter representing several organizations supported this provision, but the majority of the commenters who addressed it either were opposed or recommended modifications. Many commenters stated that modifying the terms of credit is standard business practice in the credit card industry. They noted that modifications are subject to the protections of the TILA and Regulation Z, which permit changes in certain terms upon notice and agreement by the customer. Other commenters suggested that the OCC create an exemption in the case of customers who pay the fee on a monthly basis and have the right to cancel at any time. Several

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[24] See 12 CFR 14.30(b). This provision is included in part 14 of the OCC's regulations, which implements the insurance sales consumer protections prescribed by section 305 of the GLBA. The statute requires the regulators to prohibit advertising or statements that could mislead any person or cause a reasonable person to reach an erroneous belief with respect to several enumerated facts. See 12 U.S.C. 1831x (codifying section 305 of the GLBA).

commenters urged the OCC to permit banks to make unilateral changes, provided the change benefits the customer.

The OCC remains of the view that retaining a unilateral right to modify or cancel the DCC or DSA, whether the product is associated with open- or closed-end credit, has the potential to be abusive because it could be exercised in such a way as to deny a customer debt relief for which the customer has paid. We agree, however, that some of the circumstances described by the commenters do not present this potential for abuse. Accordingly, the final rule excepts unilateral changes from the prohibition in two circumstances: first, if the modification is favorable to the customer and is made without additional charge to the customer; and, second, if the customer is notified of the proposed change and provided a reasonable opportunity to cancel the contract without penalty before the change goes into effect. For example, the OCC would generally regard a 30-day notice period as reasonable. This time period is consistent with the time requirements imposed by TILA in an analogous situation.[25] The final rule does not require that the contract language specify the circumstances under which the bank may make a unilateral modification, though inclusion of explicit provisions in the contract may be helpful to avoid misunderstandings. Rather, the rule operates to prohibit the bank from requiring its customer to abide by a unilateral modification unless it meets one of the exceptions described in the rule.

Single, lump sum payment

Several commenters urged the OCC to include in the final rule a provision prohibiting banks from requiring a customer to pay the fee for a DCC or DSA in a single payment. These commenters focused on abuses that have occurred in the sale of credit insurance in the subprime

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[25] The types of changes that might occur if a bank made a unilateral modification to a DCC or DSA are analogous to changes for which Regulation Z requires 30 days prior notice. See, e.g., 12 CFR 226.9(e) and (f).

market for residential mortgage loans and argued that the sale of DCCs and DSAs present a similar potential for abuse. They noted that customers who pay the fee in a single payment routinely add the amount of the fee to the amount borrowed, which means that customers will pay interest on the fee for the life of the loan. They contended that lenders marketing credit insurance target borrowers who are unsophisticated about financial products and thus unlikely to realize that financing the fee has the effect of reducing the homeowner's equity in his or her home.

The issues identified with respect to single premium credit insurance in the home mortgage market are particularly problematic because they highlight practices targeting consumers whose economic choices may be circumscribed or who may be especially vulnerable to predatory sales practices. Moreover, we are aware, as commenters pointed out, that some large financial institutions have voluntarily abandoned the practice of financing single payment credit insurance premiums for home mortgage loans. In addition, both Fannie Mae and Freddie Mac have announced that they will no longer purchase mortgages that carry single premium credit insurance.[26] The reaction of these market participants supports the conclusion that the potential for abuse in the marketing and sale of these products outweighs any potential consumer benefits.

In the absence of evidence that the abuses identified by the commenters are occurring in the DCC or DSA market, we have declined to adopt an across-the-board prohibition on lump sum fees. We remain concerned, however, that abuses similar to those occurring in the credit insurance market not develop with respect to DCCs or DSAs provided in connection with home

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[26] See Freddie Mac Unveils Policy on Insurance To Protect Borrowers, Wall St. J., Mar. 27, 2000, at A6; Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices, News Release (Fannie Mae), Apr. 11, 2000.

mortgage loans. To guard against that result, the final rule prohibits a national bank from requiring a customer to pay the fee for a DCC or DSA in a single payment, payable at the outset of the contract, if the debt that is the subject of the contract is a residential mortgage loan. The rule permits single payment contracts in the case of all other consumer loans, but requires banks that offer the option of paying the fee in a single payment to also offer the bona fide option of paying for that contract in periodic payments. In such cases, the bank must also make certain disclosures related to the fee.

Terms not routinely enforced

The proposed rule prohibited a bank from including in a DCC or DSA any term that the bank routinely does not enforce.

Twelve commenters addressed this provision and they unanimously opposed it. They contended, among other things, that it sets a standard that is unclear and difficult to administer. In addition, they argued that the provision could harm customers because it would have a chilling effect on banks' flexibility to work with customers to resolve delinquent debt issues and rehabilitate credit relationships. Several commenters stated that legal means already exist to address instances in which the failure routinely to enforce a term would mislead consumers, such as the OCC's general authority to enforce unfair or deceptive business practices laws applicable to national banks.

We agree with these commenters that this prohibition would be counterproductive if it produced the unintended result of deterring banks from negotiating with their customers to work out or restructure delinquent debt. Accordingly, we have deleted this prohibition from the final rule.

Refunds of fees in the event of termination of the agreement or prepayment of the covered loan (section 37.4)

The proposal required a bank that provides a no-refund DCC or DSA also to offer a product that provides for a refund of the unearned portion of the fee in the event of termination of the agreement or prepayment of the covered loan. In addition, the proposal required banks to calculate the amount of any refund due a customer based on a method at least as favorable to the customer as the actuarial method.

Several commenters opposed this provision. Some argued that fees charged in connection with DCCs and DSAs should be treated the same as any other fee a bank charges in connection with a loan. Others thought that no-refund DCCs and DSAs are inherently unfair to consumers and recommended that the OCC prohibit them. Many commenters stated that the refund provision should not apply to open-end credit where customers pay for DCCs or DSAs on a month-to-month basis.

As we noted in the proposal, some banks that offer DCCs and DSAs may structure those products 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. Banks have suggested that customers benefit from a "no-refund" product because the total fee paid by the customer is substantially less than the fee that would be charged for the same product with a fee refund feature. On the other hand, a no-refund product could be structured in a way that is unfair to customers if, for example, the customer pays most of the fee early in the term of the contract but also prepays the loan well before the end of the term.

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 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 or DSA coverage on a "pay as you go" basis.

Accordingly, the final rule retains this provision (as renumbered) with one substantive change. The text of the final rule requires that a bank that offers a no-refund DCC or DSA must also offer the customer a bona fide option to purchase a comparable contract that provides for a refund. The option to purchase is bona fide if the refund product is not deliberately structured in such a way, including pricing of the product, as to deter a customer from selecting that option.

In response to questions raised by commenters, we clarify that the refund provision does not apply in the case of open-end credit where customers pay for the contract on a month-to-month basis. In that case, there are no "unearned" fees to refund. Nor does it apply if the fee for the contract is paid by the bank or some other third party rather than the customer.

If a customer is entitled to a refund, the amount due the customer may vary greatly depending on the method used to calculate the refund. The two most commonly used formulas for computing refunds are "the Rule of 78's" and the actuarial method. Under the Rule of 78's, a customer will receive a substantially lower refund than if the actuarial method had been used to compute the refund. Because application of the Rule of 78's creates substantial inequities for the customer, the final rule retains the requirement that banks calculate the amount of any refund due a customer based on a method at least as favorable to the customer as the actuarial method. As described earlier in this discussion, we have added to the final rule a definition of the term "actuarial method."

Method of payment of fees (section 37.5)

As we have described, section 37.3(c)(2) prohibits a bank from requiring a customer to pay the fee for a DCC or a DSA in a single lump sum where the associated credit is a residential mortgage loan. Several commenters urged the OCC to prohibit a bank from requiring a customer to pay the fee for any DCC or DSA in a single payment. While we do not believe the available evidence supports that result, we agree that single payment fees have potential to be problematic even outside the home mortgage loan context. Accordingly, for DCCs or DSAs associated with any other type of loan, § 37.5 of the final rule requires a bank that offers a customer the option to pay the fee for a contract in a single payment also to offer that customer a bona fide option to pay the fee for that contract in periodic payments. The option is "bona fide" if it is not deliberately priced in such a way as to deter a customer from selecting that option.

Disclosures (section 37.6)

Content of short and long form of disclosures in general

The proposed rule listed eight disclosures that a bank, where applicable, was required to give.

Many commenters objected to the number of required disclosures. They noted that banks already are required to provide disclosures under the TILA and argued that the new disclosures were too burdensome for banks and too confusing for customers. Several commenters who supported rate, form, and claims regulation similar to the regulation of the insurance industry challenged the usefulness of disclosures and criticized the OCC for relying too heavily on disclosures. For the reasons we have earlier described, in our view, regulation of DCCs and DSAs as if they were insurance products is not appropriate. We agree with the commenters who thought the proposed disclosure requirements could be improved, however.

Therefore, the final rule retains much of the content of the disclosures prescribed by the proposal, but revises the disclosure process so that it more readily accommodates the methods banks use to market and sell DCCs and DSAs. The final rule specifies which disclosures must be given at different stages of the marketing and sales process and provides forms of disclosure that serve as models for satisfying the requirements of the rule.

In the final rule the disclosures have been reorganized into two types: a short form of disclosure suitable for use in telemarketing and various abbreviated written solicitations, and a more detailed long form of disclosure that a customer generally will receive prior to purchasing the contract. A sample short form is provided as Appendix A to the regulation and a sample long form is provided as Appendix B. Use of these forms is not mandatory. A bank may adjust the form and wording of its disclosures so long as the requirements of the regulation are met. Because many of the disclosures will appear in both the short and long form, we discuss the short and long form disclosures together.

<u>Anti-tying disclosure</u>

The proposed rule required a bank to inform the customer that neither its decision whether to approve a loan nor the terms and conditions of the loan are conditioned on the purchase of a DCC or DSA from the bank.

Commenters opposed to the anti-tying prohibition also opposed the anti-tying disclosure. Most of these commenters contended that the anti-tying disclosure is necessary only if the DCC or DSA is being sold while a customer's application for credit is pending. If the OCC retains this disclosure, they recommended creating an exemption for DCCs and DSAs sold subsequent to the extension of credit.

As described earlier in this discussion, the final rule retains the prohibition on tying either the availability or the terms of credit to a customer's purchase of a DCC or DSA. Because the effectiveness of the prohibition is greatly enhanced if the customer knows that the bank may not tie DCCs or DSAs to its loan products, the final rule also retains the requirement that the bank provide an anti-tying disclosure. The disclosure appears in both the short form and long form and, insofar as appropriate,[27] is similar in content to the anti-tying disclosure required by the insurance sales consumer protection rules. The appendices suggest a wording that is simpler than the text of the proposed rule, however, and contain a statement that purchase of the product is optional and will not affect either the bank's credit decision or the terms of credit already extended.

Explanation of effect of debt suspension agreement

Certain commenters asserted that there is a potential for increased customer confusion regarding DSAs when compared with credit disability insurance products and DCCs where disability is the triggering event. They noted that these products are similar to DSAs in that they address the health status of customers in relation to their ability to continue employment. In response to these commenters' suggestions, the final rule requires a bank to explain in the long form the nature of a debt suspension agreement. The bank must disclose that if a customer activates the agreement, the customer's duty to pay the loan principal and interest is only suspended and the customer must fully repay the loan after the period of suspension has expired.

Disclosure of the amount of the fee

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[27] See 12 CFR 14.40(b)(2). The insurance sales rules also require a bank to disclose that it may not condition an extension of credit on its customer's not obtaining insurance from an entity unaffiliated with the bank. A similar disclosure is not appropriate in the case of a DCC or DSA, since the DCC or DSA must be offered by the bank extending the credit.

The proposed rule required a bank to inform customers of the total fee for the DCC or DSA.

Many commenters argued that it is not possible to compute the total fee for a DCC sold in connection with open-end credit because the fee is based on the customer's outstanding balance which fluctuates from month to month. The commenters urged the OCC to eliminate this disclosure in the case of open-end credit or to adopt a more flexible alternative. Most commenters recommended that an appropriate disclosure would be the unit-cost approach under Regulation Z or the formula used to compute the fee.

We agree that it may be impracticable to require disclosure of the amount of the fee at the time the bank first solicits the purchase of a DCC or DSA, particularly in the case of open-end credit. The final rule therefore requires a bank to make disclosures regarding the amount of the fee only in the long form. However, the disclosure must differ depending on whether the credit is open-end or closed-end. In the case of closed-end credit, the bank must disclose the total fee. In the case of open-end credit, the bank must either: (1) disclose that the periodic fee is based on the account balance multiplied by a unit-cost and provide the unit-cost, or (2) disclose the formula used to compute the fee.

Disclosure concerning lump sum payment of fee

The proposed rule required a bank to disclose the method of payment, including whether the payment would be collected in a single payment or periodic payments, and whether the fee was included in the loan amount.

Only two commenters directly addressed this disclosure. One commenter recommended that the OCC eliminate this disclosure, and the second commenter stated that this disclosure would be confusing in the context of open-end credit.

The final rule modifies this disclosure to reflect the requirements in § 37.5. As modified, this disclosure, which is included in both the short and long form, requires a bank to disclose, where appropriate, that a customer has the option to pay the fee in a single payment or in periodic payments. This disclosure is not appropriate in the case of a DCC or DSA provided in connection with a home mortgage loan, since, under the final rule, the option to pay the fee in a single payment is not available in that case. The rule also requires a bank to disclose that adding the fee to the amount borrowed will increase the cost of the contract.

Disclosure concerning lump sum payment of fee with no refund

The proposed rule required a bank to disclose, if applicable, that the customer is not entitled to a refund of the unearned portion of the fee in the event the customer terminates the contract or prepays the loan prior to the scheduled termination date, and that the customer has the option of purchasing a DCC or DSA that provides for a refund in those circumstances.

A few commenters urged the OCC to clarify that this disclosure does not apply to open-end credit accounts where the fee is billed monthly. One commenter recommended that the OCC replace this disclosure with a statement as to whether the customer will be entitled to a refund of the unearned portion of the fee in the event the customer terminates the contract or prepays the loan in full prior to the scheduled termination date.

In response to these comments, the final rule deletes part of this disclosure and adds a new sentence. The revised disclosure appears in both the short and long form. The final rule eliminates the requirement that a bank must state whether or not the customer will be entitled to a refund of the unearned portion of the fee in the event the customer terminates the contract or prepays the loan in full prior to the scheduled termination date. Instead, if a customer may elect to pay the fee in a single payment, the rule requires a bank to disclose that the customer has the option to choose a contract with or without a refund provision. An additional sentence in both the short and long form states that prices of refund and no-refund products are likely to differ.

Disclosure concerning refund of fee paid in lump sum

A bank's cancellation policy may be a material factor in a customer's decision whether to purchase the product, particularly if the customer has elected to pay the fee for a DCC or DSA in a single payment and also has elected to finance the fee. The final rule accordingly requires, at § 37.5, that (for DCCs or DSAs associated with loans other than residential mortgage loans) if a bank permits a customer to pay the fee in a single payment and to add the fee to the amount borrowed, the bank must disclose the bank's cancellation policy. This disclosure is required in both the short and long form. It apprises the customer that the DCC or DSA may be canceled at any time for a refund, within a specified number of days for a full refund, or at any time with no refund. The method the bank uses to calculate any refund due is addressed in § 37.4(b).

Disclosure concerning whether use of credit line is restricted

The proposed rule required a bank to inform a customer if the customer's activation of the contract would prohibit the customer from incurring additional charges or using the credit line.

Only two commenters addressed this disclosure. One commenter contended that the phrase "activation of the debt cancellation contract" might be ambiguous and suggested that the OCC clarify that this phrase refers to the customer's assertion of the right to cancel or suspend payments on the debt. The second commenter recommended that the OCC amend this disclosure to state that it does not apply to closed-end loans.

The final rule retains this disclosure, but only in the long form because the information, while relevant to the customer's final decision to purchase a DCC or DSA, is not necessarily central to the customer's initial evaluation of the product.

<u>Disclosure concerning termination of a DCC or DSA</u>

The proposed rule required a bank to explain the circumstances under which a customer or the bank could terminate the contract if termination is permitted during the life of the loan.

Two commenters urged the OCC to eliminate this disclosure. One of these commenters argued that it was unnecessary and burdensome and recommended that the OCC require this information to be contained in the DCC, provided the customer has 30 days within which to cancel the DCC. The final rule retains this disclosure, but requires it only in the long form.

<u>Additional disclosures to be provided</u>

The final rule adds a disclosure in the short form requiring banks to inform consumers that the bank will provide additional information before the customer is required to pay for the product. The adjustments made in the rule to accommodate marketing practices that do not lend themselves to detailed disclosures mean that some important information will not be conveyed when the bank first solicits the purchase of a DCC or DSA. This disclosure apprises the customer that more information will be available for consideration before the customer is obligated to pay for the product.

<u>Disclosure pertaining to eligibility requirements, conditions, and exclusions</u>

The proposed rule required a bank to describe any material limitations relating to the DCC or DSA.

Many commenters objected to this disclosure, and the majority of them urged the OCC to eliminate it. They contended that the term "material limitations" is ambiguous and creates the potential for litigation over its meaning.

Several commenters noted that the "material limitations" are included in the contract that is mailed to the customer. They said that almost all of the provisions of a DCC impact in some way on the customer's ability to collect benefits and these limitations are therefore so lengthy that they are not suitable for disclosures apart from the contract. Commenters recommended a number of alternatives, including modifying the required timing of the disclosure and permitting a bank to refer the customer to the contract for a description of its limitations.

The final rule retains this disclosure. The DCC and DSA contracts we have reviewed often contain provisions imposing requirements on a customer's eligibility to claim benefits under the contract, or conditions or exclusions that could effectively preclude the customer from obtaining those benefits. Examples include: imposing a waiting period before a customer may activate benefits; limiting the number of payments a customer may defer; limiting the term of coverage to a specific number of months; limiting the maximum amount of indebtedness the bank will cancel; or terminating coverage when the customer reaches a particular age. Knowledge of these limitations may be dispositive to the customer's decision whether to purchase the product. Moreover, disclosing them may enable the bank to avoid sales practices that could subject it to substantial reputation or litigation risk.

We have modified the disclosure significantly, however, to address the concerns expressed by the commenters. In both the short and long form, the final rule replaces the phrase "material limitations" with the phrase "eligibility requirements, conditions and exclusions" and requires a bank to disclose that these features could prevent a customer from receiving benefits under the contract. The content of the short and long form may vary, depending on whether a bank elects to provide a summary of the conditions and exclusions in the long form disclosures or refer the customer to the pertinent paragraphs in the contract. The short form requires a bank to instruct the customer to read carefully both the long form disclosures and the contract for a full explanation of the terms of the contract. In response to commenters' suggestions, the long form gives a bank the option of either separately summarizing the limitations or advising the customer that a complete explanation of the eligibility requirements, conditions, and exclusions is available in the contract and identifying the paragraphs where a customer may find that information.

Disclosure concerning procedures

The proposed rule required a bank to describe the procedures a customer must follow to notify the bank that a triggering event has occurred.

Several commenters contended that disclosing this information would be lengthy and cumbersome, particularly if the DCC was offered in connection with a credit card or other marketing material where available space is limited. Some of these commenters urged the OCC to eliminate this disclosure while others proposed permitting a bank to deliver this information to a customer post-sale.

We agree that, while this information is relevant to a customer who has purchased the contract and wishes to activate the debt suspension or debt cancellation feature, it is unlikely to be a factor in the customer's decision whether to purchase the product. Therefore, the final rule eliminates the requirement for this disclosure.

Disclosure requirements; timing and method of disclosures (section 37.6(c))

The proposal required a bank to provide certain disclosures to a customer before the customer completes the purchase of a DCC or DSA. It also required that the disclosures be made in writing, or electronically, if done in a manner consistent with the requirements of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7001 *et seq.*) (E-Sign).

Most commenters objected to the requirement that the disclosures be made in writing as impracticable where a bank advertises or solicits the purchase of DCCs or DSAs through telemarketing, so-called "take one" applications, statement inserts, and direct mail solicitations. Commenters recommended a variety of alternatives to the proposal, including mailing written disclosures to the customer within a prescribed number of days or permitting the customer to cancel the product without charge. A number of commenters urged the OCC to adopt the approach of Regulation Z, which permits a bank to make limited initial disclosures in the case of open-end credit if the bank provides the full disclosures before the customer is obligated to pay, and permits oral disclosures in certain cases.

The final rule makes significant modifications in the timing and method requirements. It addresses the concerns raised by the commenters by establishing different timing and method requirements for short form and long form disclosures. Creating two separate forms also eliminates the need for banks to provide the most detailed and complicated information – information about eligibility requirements, conditions, and exclusions that limit the customer's ability to obtain benefits – in the short form.

Section 37.6(c)(1) requires a bank to disclose certain information in the short form orally at the time the bank first solicits the purchase of a contract. Section 37.6(c)(2) requires a bank to disclose the applicable information in the long form in writing before the customer completes the purchase of the contract. However, if the bank solicits a customer's purchase of a DCC or DSA in person – for example, at the time the customer applies for credit in person – then the bank must also provide the long form disclosures in writing at that time.

The final rule creates special exceptions for transactions by telephone, solicitations through written materials such as mail inserts or "take one" applications, and electronic transactions. The first exception, in § 37.6(c)(3), addresses the concern that lengthy disclosures are not practical for solicitations via telemarketing. Under the telemarketing exception, banks may give the short form disclosures orally, provided they mail the written disclosures within 3 days after the telephone solicitation. These telemarketing provisions are similar to those in the insurance sales consumer protection rules with which banks are already familiar.[28] The rule requires that the customer have an opportunity to review the more detailed information before being obligated to pay for the contract.

The second exception, in § 37.6(c)(4), is for written solicitations such as mail inserts and "take one" applications. Similar to the telemarketing exception, it permits a bank to give only the short form disclosures in mail inserts or "take one" applications where space is limited, provided the bank mails the written disclosures within 3 days after the customer contacts the bank to respond to the solicitation. The effect of this exception is the same as the effect of the provision in the insurance sales consumer protection rules that covers mail and "take one" solicitations. No oral disclosures are required and the short form disclosures may be made in this written material.

The third exception, in § 37.6(c)(5), permits disclosures to be made electronically in a manner consistent with the requirements of E-Sign.

Form of disclosures (section 37.6(d))

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[28] See 12 CFR 14.40(c)(3).

Proposed §37.6(c) required disclosures to be clear, conspicuous, readily understandable, and designed to call attention to the nature and significance of the information provided.

The only commenter that addressed the form of the disclosures thought that Regulation Z sets forth a standard for disclosures and that a new standard is unnecessary.

In our view, however, the better model for requirements as to form is part 14 of the OCC's rules, which governs products that are often marketed and sold using methods similar to the methods used to market and sell DCCs and DSAs. Accordingly, the final rule modifies this provision so that its text is more similar to part 14.[29] Section 37.7(d)(1) therefore requires that the disclosures must be simple, direct, readily understandable and designed to call attention to the nature and significance of the information provided. Section 37.7(d) requires that the disclosures must be meaningful. The examples of methods, such as spacing and type style, that a bank could use to satisfy the requirements for the form of disclosures have not been changed.

Advertisements and other promotional material for debt cancellation contracts and debt suspension agreements (section 37.6(e))

As described earlier, the final rule conforms more closely with part 14[30] because it covers advertising and promotional material. See § 37.3(b). Accordingly, the final rule adds a new subsection (e) requiring that short form disclosures must be made in advertisements and promotional material for DCCs unless the advertising and promotional material is of a general nature describing or listing the services or products offered by the bank.

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[29] See 12 CFR 14.40(c)(5) and (6).

[30] See 12 CFR 14.40(d).

Affirmative election to purchase and acknowledgment of receipt of disclosures required (section 37.7)

Proposed § 37.4 required that the customer affirmatively elect to purchase a DCC or DSA in writing in a document that was separate from the documents pertaining to the credit transaction. The proposal permitted the acknowledgment to be made electronically if the bank complied with the requirements of E-Sign.

Most of the commenters who addressed this provision opposed it because, they said, the written election would have the effect of curtailing or prohibiting current marketing practices. They urged the OCC to eliminate these requirements or to modify them to permit oral elections with certain safeguards.

Several commenters stressed that requiring separate documents also would create significant compliance difficulties in the case of "take one" credit applications where space is limited to a single sheet of paper, and in the case of auto financing, where procedures are not as readily monitored by the bank. Many commenters contended that this provision was not consistent with the TILA, which permits a customer's affirmative election to be in the same document as the loan contract.

The final rule retains the requirement that the bank obtain the customer's affirmative election to purchase a DCC or DSA before obligating the customer to pay for the product. We have made substantial revisions, however, to address the commenters' concerns about the effects of the proposed requirements on methods widely used to market DCCs and DSAs and to conform the rule with the insurance sales regulations with which banks already are familiar. The final rule also adds a requirement, like that contained in the insurance sales regulations, that the bank obtain a customer's written acknowledgment of receipt of the disclosures required by § 37.6.[31]

In the case of telephone solicitations, the final rule permits the customer's affirmative election to be made orally, provided the bank: (1) maintains sufficient documentation to show that the customer received the short form disclosures and then affirmatively elected to purchase the contract; (2) mails the affirmative written election and written acknowledgment, together with the long form disclosures to the customer within 3 business days after the telephone solicitation, and maintains sufficient documentation to show that it made reasonable efforts to obtain the documents from the customer; and (3) permits the customer to cancel the purchase of the contract without penalty within 30 days after the bank has mailed the long form disclosures to the customer.

In the case of solicitations conducted through written materials such as mail inserts or "take one" applications, the final rule permits the bank to provide only the short form disclosures in the written materials, provided the bank mails the acknowledgment of receipt of disclosures and the long form disclosures to the customer within 3 business days, beginning on the first business day after the customer contacts the bank or otherwise responds to the solicitation. The bank may not obligate the customer to pay for the contract until after the bank receives the customer's written acknowledgment of receipt of disclosures, unless the bank: (1) maintains sufficient documentation to show that the bank provided the acknowledgment of receipt of disclosures to the customer as required by this section; (2) maintains sufficient documentation to show that the bank made reasonable efforts to obtain from the customer a written acknowledgment of receipt of the long form disclosures; and (3) permits the customer to cancel

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[31] See 12 CFR 14.40(c)(7).

the purchase of the contract without penalty within 30 days after the bank has mailed the long form disclosures to the customer.

The final rule also eliminates the requirement that the customer's election to purchase be in a separate document, and thus better harmonizes this provision with the requirements of the TILA.[32] Similarly, the rule imposes no requirement that the customer's written acknowledgment of receipt of disclosures be in a separate document. The final rule clarifies that the standard for the form of the election and acknowledgment information is the same as for the form of disclosures (which is also the same standard contained in part 14 of our rules). The information must be conspicuous, simple, direct, readily understandable, and designed to call attention to their significance. The rule also adds a statement that the election and acknowledgment will satisfy these standards if they conform with the requirements in § 37.6.

Finally, the provision in proposed § 37.4 permitting the customer's affirmative election to be made electronically has been moved to § 37.7(d) and modified to include the customer's acknowledgment of receipt of the disclosures.

Safety and soundness requirement (section 37.8)

The OCC's prior regulation on DCCs (12 CFR 7.1013) permitted, but did not require, banks to establish the reserves necessary to enable them to enter into DCCs. The proposed rule required national banks to establish a separate loss reserve and to maintain the reserve at a level

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[32] Regulation Z permits a creditor to exclude from the finance charge the charge or premium paid for voluntary debt cancellation coverage provided certain conditions are met. One of those conditions requires that the consumer sign or initial an affirmative written request for coverage after receiving the disclosures required by Regulation Z, but there is no requirement that the affirmative written request be contained in a separate document. See 12 CFR 226.4(d)(3)(i)(C).

adequate to conduct this business in a safe and sound manner. As an alternative, the proposed rule also permitted a national bank to obtain third-party insurance to cover "expected losses."

The commenters were divided about whether the OCC should retain the proposed requirement for an "identifiable loss reserve." Some commenters, however, pointed out that the reserve requirement, as drafted, may not accurately reflect current accounting practices and the standards established by generally accepted accounting principles for recording the income and liabilities associated with DCCs and DSAs. One commenter, for example, said that the OCC should distinguish between reserve requirements for DCCs, which are based on future losses in the credit accounts and already included in the loan loss reserves, and DSAs, which need only address foregone interest payments. This commenter also said that losses on the two types of products may vary widely and that banks should be permitted to reserve separately on each.

The OCC's recent supervisory experience indicates that methodologies for recognizing losses may appropriately vary depending on whether the product requires the bank to forgive the debt or only forego interest income for a period of time. These methodologies vary further and are more complex if the product has both debt cancellation and debt suspension features or if the bank securitizes the loans associated with the DCCs or DSAs.

For these reasons, we have concluded that the loss reserve requirement contained in the proposal is not sufficiently flexible to permit appropriate management and recording of anticipated losses in the variety of situations that occur in actual practice. Accordingly, the final rule replaces that requirement with a requirement that banks must establish and maintain effective risk management and control processes over its DCCs and DSAs. Such processes include appropriate recognition and financial reporting of income, expenses, assets, liabilities, and appropriate treatment of all expected and unexpected losses associated with the products.

The final rule also requires a bank to assess the adequacy of its internal control and risk mitigation activities, which would include, if appropriate, the bank's purchase of third-party insurance, in view of the nature and scope of its DCC and DSA programs.

IV. Summary of the Final Rule

New part 37 defines the relevant terms, including "debt cancellation contract" and "debt suspension agreement."

The rule prohibits certain practices for banks that provide DCCs or DSAs. These practices are: tying the approval or terms of an extension of credit to a customer's purchase of a DCC or DSA; engaging in misleading advertisements or practices; retaining a right to modify a DCC or DSA unilaterally, unless the modification benefits the customer or the customer has a reasonable opportunity to cancel without penalty; and charging a single, lump-sum fee for a DCC or DSA issued in connection with a residential mortgage loan.

The rule permits a bank to offer a DCC or DSA that makes no provision for a refund of fees but, if the bank does so, it also must offer the customer a bona fide option to buy the product that includes a refund feature.

For loans other than residential mortgage loans, the bank may offer the customer the option of paying the fee for the associated DCC or DSA in a single, lump sum; but if it does, it also must offer a bona fide option of paying the fee for that contract in monthly or other periodic payments. If the bank offers the option to finance the single payment fee, it must disclose to the customer whether the customer may cancel the product and receive a refund and any time limits that apply to the customer's right to cancel.

The rule also requires that national banks disclose certain information to their customers. The rule accommodates the methods that national banks use to market DCCs and DSAs by permitting the use of abbreviated disclosures in marketing circumstances -- including telephone solicitations and "take one" applications -- where full disclosure of the terms most relevant to the consumer's decision to purchase is not practicable.

The abbreviated or "short form" disclosures that the rule requires include:

- disclosure that the decision to buy a DCC or DSA is optional and whether or not the customer purchases the product will not affect the customer's application for credit or terms of any existing loan;
- disclosure that if a no-refund product is offered, a product with a refund feature also is available;
- disclosure for DCCs or DSAs offered in connection with loans other than residential mortgage loans, that if the customer may elect to finance a single payment, lump sum fee, the customer also has the option to pay the fee in periodic payments, and a statement about the effect of the customer's cancellation of the DCC or DSA before expiration of the term of the loan;
- a statement that the customer will receive additional information before being obligated to pay for the DCC or DSA; and
- a statement that certain eligibility requirements, conditions, and exclusions apply that may affect the customer's ability to claim benefits under the DCC or DSA are described more fully in the "long-form" disclosures that the rule also requires.

The "long-form" disclosures may be given after the bank's initial marketing occurs but generally must be given prior to the completion of the sale of the product. If the solicitation occurs when the customer applies for credit in person, then the long form disclosures must be given at that time. The information required to be disclosed in the long form includes:

- disclosure that the decision to buy a DCC or DSA is optional and whether or not the customer purchases the product will not affect the customer's application for credit or terms of any existing loan;
- disclosure that in the case of a DSA, the DSA only suspends, and does not cancel, the customer's obligation to pay the associated debt;
- disclosure, if applicable, that the customer may not incur additional charges under its loan agreement if the DCC or DSA is activated;
- an explanation of the circumstances in which the customer has the right to cancel the DCC or DSA; and
- a description of any applicable eligibility requirements, conditions, or exclusions, which may be provided either in the disclosure form itself or by reference to particular provisions of the DCC or DSA.

The disclosure requirements are complemented by a requirement that a national bank generally obtain the customer's written acknowledgment of his or her receipt of the required disclosures and an affirmative election to purchase the DCC or DSA before completing the sale. Like the disclosure requirements, these provisions of the rule are also tailored to accommodate the use of sales methods -- such as by telephone -- where immediate receipt of a written acknowledgment is not practicable.

The rule requires that disclosures and acknowledgments and affirmative elections be presented in a form that is simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided. Disclosures must also be meaningful, and the rule gives examples of methods -- such as spacing and type styles -- that may be used to satisfy that standard.

Appendices to the rule contain the two sample forms of disclosure: the "short form" for use in situations where the abbreviated disclosures may be used, and the "long form" for use thereafter to ensure that the customer is adequately informed about the key terms of the DCC or DSA prior to completing the purchase. Banks are required to make only the disclosures that are appropriate to the product offered. The forms of disclosure are illustrative of the wording and format a bank could use to comply with the rule's disclosure requirements. Banks that make disclosures in a form substantially similar to the forms provided in the rule will be deemed to satisfy the disclosure requirements. These particular forms are not mandatory, however, and a bank may elect to use different wording or a different format, as long as the approach chosen satisfies the substance of the applicable requirements.

Finally, the rule contains a safety and soundness requirement that a national bank that offers DCCs or DSAs must manage the risks associated with these products in accordance with safe and sound banking principles. The rule also requires a bank to establish and maintain effective risk management and control processes, including appropriate recognition and financial reporting of income, expenses, assets, and liabilities associated with the products and adequate internal control and risk mitigation measures.

<u>Effective date</u>

Two commenters requested that the OCC delay the effective date of the final rule until one year from the date of its publication. Another commenter requested a delayed effective date of six months to a year. Each of these commenters stressed that the rule will require banks that currently offer DCCs and DSAs to review their programs, create new forms, and train employees to comply with new procedures. One commenter thought that the adjustments to marketing and methods necessary to implement the regulations governing DCCs would be comparable to those required to implement the consumer protections for bank sales of insurance, which also required new disclosures. Part 14 originally had an effective date of 120 days, but that transition period was later extended to a total of nine months.

The final rule has a delayed effective date of nine months. We agree with the commenters that we should be guided by our experience in implementing part 14. The final rule requires two types of disclosures and prohibits a number of practices that currently are not barred. Furthermore, unlike the sale of insurance products, DCCs and DSAs are offered in connection with an extension of credit, which will require banks to coordinate the disclosures in the final rule with disclosures they are required to make under TILA.

V. Regulatory Analysis

A. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995, the OCC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

The OCC submitted the collection of information requirements contained in the notice of proposed rulemaking to the Office of Management and Budget (OMB) for review and received approval under OMB Control Number 1557-0224.

The revision of the collection of information requirements contained in this final rule have been submitted to the OMB for review.

The final rule retains much of the content of the disclosures prescribed by the proposed rule, but revises the disclosure process so that it more readily accommodates the methods banks use to market and sell DCCs and DSAs. The final rule specifies which disclosures must be given at different stages of the marketing and sales process.

The final rule provides two forms of disclosure that serve as models for satisfying the requirements of the rule. Those two disclosure forms are set forth in appendices to the final rule. Appendix A sets out a short form of disclosure suitable for use in telemarketing and various written solicitations, while Appendix B provides a more detailed long form of disclosure that a customer generally will receive prior to purchasing the contract. Use of the forms is not mandatory. A bank may adjust the form and wording of its disclosures so long as the requirements of the regulation are met.

The final rule generally requires a bank to disclose information about a DCC or DSA orally in the short form and in writing in the long form. In the case of solicitations through written materials such as mail inserts or "take one" applications, however, the bank may provide the short form disclosures in writing. The final rule also permits short and long form disclosures to be made electronically.

Comments Received

The OCC received two comments regarding the burden imposed by the proposed rule. Both commenters stated that the amount of time required to develop the required disclosures was greater than the OCC's estimate of 10 hours. The first commenter, a large national bank, stated that developing the required disclosures would involve approximately 25 hours to consider legal, operational, and marketing issues. However, if the disclosures were modified in accordance with the recommendations in its comment letter, the commenter estimated that the amount of time would be approximately 15 hours. We believe that modifications to the timing and manner of the required disclosures address most of the commenter's objections. Notwithstanding these changes, upon further consideration of the paperwork burdens likely to be imposed as a result of the final rule, the OCC has estimated that the burden imposed on the average national bank offering DCCs and DSAs is likely to be 24 hours per bank.

The second commenter mentioned the increased burden associated with the requirements that the disclosures be in writing and separate from the loan application. The commenter contended that, particularly for credit cards banks, the total cost of creating, print, and distributing new forms could outweigh any benefit a national bank might gain from selling DCCs and DSAs. As described in the discussion above, modifications in the proposed rule eliminate the separate document requirement and permit oral disclosure in certain circumstances. In addition, we believe that the 9-month delayed effective date will enable banks to minimize costs. They should have sufficient lead time to deplete their current supply of forms, revise forms to be used once the rule becomes effective, and include the required disclosure in their next print run.

Disclosure Requirements

Section 37.6 requires a bank to provide the following disclosures, as appropriate:

- Anti-tying disclosure – The final rule requires a bank to inform the customer that neither its decision whether to approve a loan nor the terms and conditions of the loan are conditioned on the purchase of a DCC or DSA. This disclosure appears in both the short form and the long form ("This product is optional").
- Explanation of debt suspension agreement – The final rule requires a bank to disclose that if a customer activates the agreement, the customer's duty to pay the loan principal and interest is only suspended and the customer must fully repay the loan

after the period of suspension has expired. This disclosure appears in the long form ("Explanation of debt suspension agreement").

- Disclosure of the amount of the fee – The final rule requires a bank to make disclosures regarding the amount of the fee. The disclosure must differ depending on whether the credit is open-end or closed-end. In the case of closed-end credit, the bank must disclose the total fee. In the case of open-end credit, the bank must either: 1) disclose that the periodic fee is based on the account balance multiplied by a unit cost and provide the unit cost, or 2) disclose the formula used to compute the fee. This disclosure appears in the long form ("Amount of fee").
- Disclosure concerning lump sum payment of fee – The final rule requires a bank to disclose, where appropriate, that a customer has the option to pay the fee in a single payment or in periodic payments. This disclosure is not appropriate in the case of a DCC or DSA provided in connection with a home mortgage loan since, under the final rule, the option to pay the fee in a single payment is not available in that case. The final rule also requires a bank to disclose that adding the fee to the amount borrowed will increase the cost of the contract. This disclosure appears in the both the short form and long form ("Lump sum payment of fee").
- Disclosure concerning lump sum payment of fee with no refund – The final rule requires a bank to disclose that the customer has the option to choose a contract with or without a refund provision. This disclosure appears in both the short form and long form ("Lump sum payment of fee with no refund"). This disclosure also contains a sentence that states that prices of refund and no-refund products are likely to differ.

- Disclosure concerning refund of fee paid in lump sum – The final rule requires that if a bank permits a customer to pay the fee in a single payment and to add the fee to the amount borrowed, the bank must disclose the bank's cancellation policy. The disclosure informs the customer that the DCC or DSA may be canceled at any time for a refund, within a specified number of days for a full refund, or at any time with no refund. This disclosure appears in both the short form and long form ("Refund of fee paid in lump sum").
- Disclosure concerning whether use of credit line is restricted – The final rule requires a bank to inform a customer if the customer's activation of the contract would prohibit the customer from incurring additional charges or using the credit line. This disclosure appears in the long form ("Use of card or credit line restricted").
- Disclosure concerning termination of a DCC or DSA – The final rule requires a bank to explain the circumstances under which a customer or the bank could terminate the contract if termination is permitted during the life of the loan. This disclosure appears in the long form ("Termination of [PRODUCT NAME]").
- Disclosure concerning additional disclosures – The final rule requires a bank to inform consumers that the bank will provide additional information before the customer is required to pay for the product. This disclosure appears in the short form ("Additional disclosures").
- Disclosure pertaining to eligibility requirements, conditions, and exclusions – The final rule requires a bank to describe any material limitations relating to the DCC or DSA. This disclosure appears on both the short form and the long form ("Eligibility requirements, conditions, and exclusions"). The content of the short and long form

may vary, depending on whether a bank elects to provide a summary of the conditions and exclusions in the long form disclosures or refer the customer to the pertinent paragraphs in the contract. The short form requires a bank to instruct the customer to read carefully both the long form disclosures and the contract for a full explanation of the terms of the contract. The long form gives a bank the option of either separately summarizing the limitations or advising the customer that a complete explanation of the eligibility requirements, conditions, and exclusions is available in the contract and identifying the paragraphs where a customer may find that information.

Affirmative Election to Purchase and Acknowledgment of Receipt of Disclosures Required

Section 37.7 requires a bank to obtain a customer's written affirmative election to purchase a contract and written acknowledgment of receipt of the disclosures required by § 37.6.

If the sale of the contract occurs by telephone, the customers affirmative election to purchase and acknowledgment of receipt of the required short form may be made orally, provided the bank maintains certain documentation.

If the contract is solicited through written materials such as mail inserts or "take one" applications and the bank provides only the short form disclosures in the written materials, then the bank shall mail the acknowledgment, together with the long form disclosures, to the customer. The bank may not obligate the customer to pay for the contract until after the bank has received the customer's written acknowledgment of receipt of disclosures unless the bank maintains certain documentation.

The affirmative election and acknowledgment may also be made electronically.

Burden Estimate

The estimated total annual burden with respect to extensions of credit will depend on the number of banks that offer DCCs and DSAs, the number of consumer loan transactions per bank per year where disclosures are provided, and the amount of time per transaction. The OCC cannot at this time accurately estimate the total number of participating banks or the total number of consumer loan transactions in which disclosures are provided to individual customers because the OCC does not currently collect this type of data. Solely for the purpose of complying with the Paperwork Reduction Act, the OCC has estimated the annual paperwork burden assuming that 2,200 national banks will provide DCCs and DSAs, and the average burden associated with developing the disclosures would be approximately 24 hours.

The likely respondents are national banks.

Estimated number of respondents: 2,200 respondents

Estimated number of responses: 2,200 responses

Estimated burden hours per response: 24 hours

Estimated total annual burden hours: 52,800 hours

Comments

The OCC requests comment on appropriate ways to estimate the total number of participating banks, the total number of consumer loan transactions in which these disclosures will be provided to individual customers, and the burden associated with developing the disclosures and providing the disclosures to individual customers.

The OCC will revisit the burden estimates when we have more information on the number of potential respondents and consumer loan transactions. The revised estimates will also reflect all comments received concerning the burden estimates.

The OCC also invites comment on:

Whether the collection of information contained in this final rule is necessary for the proper performance of the OCC's functions, including whether the information has practical utility;

The accuracy of the OCC's estimate of the burden of the information collection;

Ways to enhance the quality, utility, and clarity of the information to be collected;

Ways to minimize the burden of the information collection on the respondents, including the use of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments on the collection of information should be sent by mail to Joseph F. Lackey, Jr., Desk Officer, Office of Information and Regulatory Affairs, Attention: 1557-0224, Office of Management and Budget, Washington, DC 20503, or by e-mail to jlackeyj@omb.eop.gov.

Comments should also be sent to Jessie Dunaway, OCC Clearance Officer, Legislative and Regulatory Activities Division, Attention: 1557-0224, Office of the Comptroller of the Currency, 250 E Street, SW, Mailstop 8-4, Washington, DC 20219. Due to disruptions in the OCC's mail service, commenters are encouraged to send comments by fax to (202) 874-4889, or by e-mail to jessie.dunaway@occ.treas.gov.

B. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and short, explanatory statement in the **Federal Register** along with its rule.

Pursuant to section 605(b) of the RFA, the OCC hereby certifies that this rulemaking will not have a significant economic impact on a substantial number of small entities.

The final rule will apply only to those national banks that choose to offer DCCs or DSAs. However, the OCC has very limited data as to the number of national banks that currently offer these products. For purposes of this analysis, we have conservatively assumed that all national banks will offer these products.

<u>Compliance and Record keeping Requirements of the Final Rule</u>

The final rule imposes the following conditions or requirements:

- A national bank that offers a DCC or DSA with no refund of unearned fees in the event the customer terminates the DCC or DSA must also offer that customer the *bona fide* option to purchase the product with a refund feature;
- A national bank is prohibited from requiring a customer to pay the fee for a DCC or DSA in a single payment, payable at the outset of the contract, if the debt that is the subject of the contract is a residential mortgage loan;
- A national bank must provide customers with the short form disclosures at the time of solicitation;
- A national bank must provide customers with the long form disclosures before the customer completes the purchase of a DCC or DSA;
- A national bank must obtain a customer's written affirmative election to purchase the DCC or DSA; and
- A national bank must obtain a customer's written acknowledgment of receipt of the disclosures.

The rule provides banks significant flexibility in meeting these requirements. For example, in the case of telephone solicitations, the rule permits an oral affirmation, provided the bank makes reasonable efforts to obtain a written affirmative election, and waives the requirement obtain a written acknowledgment, provided the bank makes reasonable efforts to obtain the acknowledgment. A bank that takes advantage of the special exceptions must maintain sufficient documentation to demonstrate that it made reasonable efforts to obtain the written affirmative election and written acknowledgment.

Costs Associated with Compliance and Recordkeeping Requirements of the Final Rule

Based on input from OCC examiners and other staff, we have determined that national banks typically offer refundable products and are moving away from offering customers a lump sum DCC or DSA in conjunction with a mortgage loan. We have therefore concluded that there will be only minimal costs associated with complying with the requirement that a bank offer offers a DCC or DSA with a no refund DCC or DSA must also offer that customer the *bona fide* option to purchase the product with a refund feature and the prohibition on paying the fee in a single, lump sum. Accordingly, our cost estimate focuses on costs associated with the short form disclosure, long form disclosure, affirmative election, and written acknowledgment.

We expect that national banks will incur four types of costs associated with these requirements: (1) development of the short form disclosure, long form disclosure, affirmative election and acknowledgment forms; (2) distribution of the documents; (3) documentation requirements; and (4) employee training.

We estimate these costs per bank to be $4,992. To determine whether this will have a significant impact on small banks, we considered the average annual net income for a small bank, which was $796,000 as of March 31, 2002. In light of the fact that these costs are approximately 0.6 percent of net income, we do not find them to be significant.

C. Executive Order 12866

The OCC has determined that the final rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866. Under the most conservative cost scenarios that the OCC can develop on the basis of available information, the impact of the proposal falls short of the thresholds established by the Executive Order.

D. Executive Order 13132

Executive Order 13132 requires Federal agencies, including the OCC, to certify their compliance with that Order when they transmit to the Office of Management and Budget (OMB) any draft final regulation that has Federalism implications. Under the Order, a regulation has Federalism implications if it has "substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government." In the case of a regulation that has Federalism implications and that preempts State law, the Order imposes certain consultation requirements with State and local officials; requires publication in the preamble of a Federalism summary impact statement; and requires the OCC to make available to the Director of the OMB any written communications submitted to us by State and local officials. By the terms of the Order, these requirements apply to the extent that they are practicable and permitted by law and, to that extent, must be satisfied before the OCC promulgates a final regulation.

Some commenters raised issues concerning whether DCCs and DSAs should be regulated as insurance that could be construed as falling within the scope of Executive Order 13132. In the opinion of the OCC, however, the final regulation on DCCs and DSAs does not have Federalism implications. The GLBA designates the States as the appropriate functional regulators of national bank insurance activities.[33] As we have described earlier in this preamble discussion, as a matter of law DCCs and DSAs are not insurance, but rather, bank products. This conclusion was confirmed, as to DCCs, by the Taylor case decided in 1990. The reasoning and conclusions of the Taylor court are equally applicable to DSAs. Because these products are bank products and not insurance the framework of State insurance regulation would not apply to them, even in the absence of Federal regulations. While this regulation establishes new standards that govern national banks providing DCCs and DSAs, the standards are therefore not in derogation of State insurance law or regulation. For this reason, the regulation does not directly affect the States, substantially or otherwise; it does not alter the relationship between the national government and the States; and it does not alter the distribution of power and responsibilities among the various levels of government.

Since the regulation does not satisfy any of the components of the definition of actions that have Federalism implications under Executive Order 13132, the provisions of the Executive Order do not apply. The OCC nonetheless believes that it has in material respects satisfied the requirements of the Order. First, the OCC has received and considered a number of comments from State insurance authorities, as described earlier in the preamble. In addition, at the end of the public comment period and very early in the development of the final rule, on June 18, 2001, senior representatives of the OCC met with members of the National Association of Insurance Commissioners (NAIC). The concerns of the NAIC were memorialized in its written comment which is a part of the record of this rulemaking. Principally, the NAIC urged the OCC to adopt DCC/DSA regulations that were similar to the rate, form, and claims regulation imposed on

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[33] GLBA sec. 301, *codified at* 15 U.S.C. 6711.

insurance products under many State insurance regulatory regimes. For the reasons described earlier in this preamble, including the reason that DCCs and DSAs are not insurance, the OCC declined to follow that recommendation. Finally, prior to the publication of this final rule, the OCC has transmitted to the Director of OMB the written communications – that is, the comment letters – we have received from State officials.

E. Unfunded Mandates Act of 1995

Section 202 of the Unfunded Mandates Act of 1995 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the annual expenditure of $100 million or more in any one year by State, local, and tribal governments, in the aggregate, or by the private sector. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act requires an agency to identify and consider a reasonable number of alternatives before promulgating a rule.

The OCC has determined that the final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more in any one year. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

Solicitation of Comments on Use of "Plain Language"

Section 722 of the GLBA requires that the Federal banking agencies use "plain language" in all proposed and final rules published after January 1, 2000. We invite your comments on how to make the proposed rules easier to understand.

List of Subjects

12 CFR Part 7

Credit, Insurance, Investments, National banks, Reporting and recordkeeping requirements, Securities, Surety bonds.

12 CFR Part 37

Banks, banking, Consumer protection, Debt cancellation contract, Debt suspension agreement, National banks, Reporting and recordkeeping requirements, Safety and soundness.

Authority and Issuance

For the reasons set forth in the preamble, the OCC amends part 7 of chapter I of Title 12 of the Code of Federal Regulations and adds a new part 37 as follows:

PART 7--BANK ACTIVITIES AND OPERATIONS

1. The authority citation for part 7 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq*., 93a, and 1818.

2. Section 7.1013 is removed.

3. Add part 37 to read as follows:

PART 37--DEBT CANCELLATION CONTRACTS AND DEBT SUSPENSION AGREEMENTS

Sec.

37.1 Authority, purpose, and scope.

37.2 Definitions.

37.3 Prohibited practices.

37.4 Refunds of fees in the event of termination or prepayment of the covered loan.

37.5 Method of payment of fees.

37.6 Disclosures.

37.7 Affirmative election to purchase and acknowledgment of receipt of disclosures required.

37.8 Safety and soundness requirement.

Appendix A to Part 37 – Short Form Disclosures

Appendix B to Part 37 – Long Form Disclosures

Authority: 12 U.S.C. 1 *et seq.,* 24(Seventh), 93a, 1818.

§ 37.1 Authority, purpose, and scope.

(a) Authority. 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 that it makes, pursuant to 12 U.S.C. 24(Seventh).

(b) Purpose. This part sets forth the standards that apply to debt cancellation contracts and debt suspension agreements entered into by national banks. The purpose of these standards is to ensure that national banks offer and implement such contracts and agreements consistent with safe and sound banking practices, and subject to appropriate consumer protections.

(c) Scope. This part applies to debt cancellation contracts and debt suspension agreements entered into by national banks in connection with extensions of credit they make. National banks' debt cancellation contracts and debt suspension agreements are governed by this part and applicable Federal law and regulations, and not by part 14 of this chapter or by State law.

§ 37.2 Definitions.

For purposes of this part:

(a) Actuarial method means the method of allocating payments made on a debt between the amount financed and the finance charge pursuant to which a payment is applied first to the accumulated finance charge and any remainder is subtracted from, or any deficiency is added to, the unpaid balance of the amount financed.

(b) Bank means a national bank and a Federal branch or Federal agency of a foreign bank as those terms are defined in part 28 of this chapter.

(c) Closed-end credit means consumer credit other than open-end credit as defined in this section.

(d) Contract means a debt cancellation contract or a debt suspension agreement.

(e) Customer means an individual who obtains an extension of credit from a bank primarily for personal, family or household purposes.

(f) Debt cancellation contract means 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. The agreement may be separate from or a part of other loan documents.

(g) Debt suspension agreement means a loan term or contractual arrangement modifying loan terms under which a bank agrees to suspend all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The agreement may be separate from or a part of other loan documents. The term debt suspension agreement does not include loan payment deferral arrangements in which the triggering event is the borrower's unilateral election to defer repayment, or the bank's unilateral decision to allow a deferral of repayment.

(h) Open-end credit means consumer credit extended by a bank under a plan in which:

(1) The bank reasonably contemplates repeated transactions;

(2) The bank may impose a finance charge from time to time on an outstanding unpaid balance; and

(3) The amount of credit that may be extended to the customer during the term of the plan (up to any limit set by the bank) is generally made available to the extent that any outstanding balance is repaid.

(i) Residential mortgage loan means a loan secured by 1-4 family, residential real property.

§ 37.3 Prohibited practices.

(a) Anti-tying. 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.

(b) Misrepresentations generally. A national bank may not engage in any practice or use any advertisement that could mislead or otherwise cause a reasonable person to reach an erroneous belief with respect to information that must be disclosed under this part.

(c) Prohibited contract terms. A national bank may not offer debt cancellation contracts or debt suspension agreements that contain terms:

(1) Giving the bank the right unilaterally to modify the contract unless:

(i) The modification is favorable to the customer and is made without additional charge to the customer; or

(ii) The customer is notified of any proposed change and is provided a reasonable opportunity to cancel the contract without penalty before the change goes into effect; or

(2) Requiring a lump sum, single payment for the contract payable at the outset of the contract, where the debt subject to the contract is a residential mortgage loan.

§ 37.4 Refunds of fees in the event of termination or prepayment of the covered loan.

(a) Refunds. If a debt cancellation contract or debt suspension agreement is terminated (including, for example, when the customer prepays the covered loan), the bank shall refund to the customer any unearned fees paid for the contract unless the contract provides otherwise. A bank may offer a customer a contract that does not provide for a refund only if the bank also offers that customer a bona fide option to purchase a comparable contract that provides for a refund.

(b) Method of calculating refund. The bank shall calculate the amount of a refund using a method at least as favorable to the customer as the actuarial method.

§ 37.5 Method of payment of fees.

Except as provided in § 37.3(c)(2), 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. If the bank offers the customer the option to finance the single payment by adding it to the amount the customer is borrowing, the bank must also disclose to the customer, in accordance with § 37.6, whether and, if so, the time period during which, the customer may cancel the agreement and receive a refund.

§ 37.6 Disclosures.

(a) Content of short form of disclosures. The short form of disclosures required by this part must include the information described in Appendix A to this part that is appropriate to the product offered. Short form disclosures made in a form that is substantially similar to the disclosures in Appendix A to this part will satisfy the short form disclosure requirements of this section.

(b) Content of long form of disclosures. The long form of disclosures required by this part must include the information described in Appendix B to this part that is appropriate to the product offered. Long form disclosures made in a form that is substantially similar to the disclosures in Appendix B to this part will satisfy the long form disclosure requirements of this section.

(c) Disclosure requirements; timing and method of disclosures.

(1) Short form disclosures. The bank shall make the short form disclosures orally at the time the bank first solicits the purchase of a contract.

(2) Long form disclosures. The bank shall make the long form disclosures in writing before the customer completes the purchase of the contract. If the initial solicitation occurs in person, then the bank shall provide the long form disclosures in writing at that time.

(3) Special rule for transactions by telephone. If the contract is solicited by telephone, the bank shall provide the short form disclosures orally and shall mail the long form disclosures, and, if appropriate, a copy of the contract to the customer within 3 business days, beginning on the first business day after the telephone solicitation.

(4) Special rule for solicitations using written mail inserts or "take one" applications. If the contract is solicited through written materials such as mail inserts or "take one" applications, the bank may provide only the short form disclosures in the written materials if the bank mails the long form disclosures to the customer within 3 business days, beginning on the first business day after the customer contacts the bank to respond to the solicitation, subject to the requirements of § 37.7(c).

(5) Special rule for electronic transactions. The disclosures described in this section may be provided through electronic media in a manner consistent with the requirements of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 *et seq.*

(d) Form of disclosures.

(1) Disclosures must be readily understandable. The disclosures required by this section must be conspicuous, simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided.

(2) Disclosures must be meaningful. The disclosures required by this section must be in a meaningful form. Examples of methods that could call attention to the nature and significance of the information provided include:

(i) A plain-language heading to call attention to the disclosures;

(ii) A typeface and type size that are easy to read;

(iii) Wide margins and ample line spacing;

(iv) Boldface or italics for key words; and

(v) Distinctive type style, and graphic devices, such as shading or sidebars, when the disclosures are combined with other information.

(e) Advertisements and other promotional material for debt cancellation contracts and debt suspension agreements. The short form disclosures are required in advertisements and promotional material for contracts unless the advertisements and promotional materials are of a general nature describing or listing the services or products offered by the bank.

§ 37.7 Affirmative election to purchase and acknowledgment of receipt of disclosures required.

(a) Affirmative election and acknowledgment of receipt of disclosures. Before entering into a contract the bank must obtain a customer's written affirmative election to purchase a contract and written acknowledgment of receipt of the disclosures required by § 37.6(b). The election and acknowledgment information must be conspicuous, simple, direct, readily understandable, and designed to call attention to their significance. The election and acknowledgment satisfy these standards if they conform with the requirements in § 37.6(b) of this part.

(b) Special rule for telephone solicitations. If the sale of a contract occurs by telephone, the customer's affirmative election to purchase may be made orally, provided the bank:

(1) maintains sufficient documentation to show that the customer received the short form disclosures and then affirmatively elected to purchase the contract;

(2) mails the affirmative written election and written acknowledgment, together with the long form disclosures required by § 37.6 of this part, to the customer within 3 business days after the telephone solicitation, and maintains sufficient documentation to show it made reasonable efforts to obtain the documents from the customer; and

(3) permits the customer to cancel the purchase of the contract without penalty within 30 days after the bank has mailed the long form disclosures to the customer.

(c) Special rule for solicitations using written mail inserts or "take one" applications. If the contract is solicited through written materials such as mail inserts or "take one" applications and the bank provides only the short form disclosures in the written materials, then the bank shall mail the acknowledgment of receipt of disclosures, together with the long form disclosures required by § 37.6 of this part, to the customer within 3 business days, beginning on the first business day after the customer contacts the bank or otherwise responds to the solicitation. The bank may not obligate the customer to pay for the contract until after the bank has received the customer's written acknowledgment of receipt of disclosures unless the bank:

(1) maintains sufficient documentation to show that the bank provided the acknowledgment of receipt of disclosures to the customer as required by this section;

(2) maintains sufficient documentation to show that the bank made reasonable efforts to obtain from the customer a written acknowledgment of receipt of the long form disclosures; and

(3) permits the customer to cancel the purchase of the contract without penalty within 30 days after the bank has mailed the long form disclosures to the customer.

(d) Special rule for electronic election. The affirmative election and acknowledgment may be made electronically in a manner consistent with the requirements of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 *et seq.*

§ 37.8 Safety and soundness requirements.

A national bank must manage the risks associated with debt cancellation contracts and debt suspension agreements in accordance with safe and sound banking principles. Accordingly, a national bank must establish and maintain effective risk management and control processes over its debt cancellation contracts and debt suspension agreements. Such processes include appropriate recognition and financial reporting of income, expenses, assets and liabilities, and appropriate treatment of all expected and unexpected losses associated with the products. A bank also should assess the adequacy of its internal control and risk mitigation activities in view of the nature and scope of its debt cancellation contract and debt suspension agreement programs.

Appendix A to Part 37 - Short Form Disclosures

X **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.

X **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].

X **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.

X **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.

X **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].

X 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].

Appendix B to Part 37 - Long Form Disclosures

X **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.

X **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.

X **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 __________________].

X **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].

X **Lump sum payment of fee with no refund**
[Applicable if a bank offers the option to pay the fee in a single payment for 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.

X **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.

X **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.

X **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: ______________.

X **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.

Dated: August 16, 2002

John D. Hawke, Jr.,
Comptroller of the Currency.