November 20, 2007

Dear :

Recently you inquired of this office requesting guidance on the authority of Missouri banks to offer a single fee "GAP debt cancellation product." The Division of Finance issued a wild card letter authorizing debt cancellation contracts (DCCs) and debt suspension agreements (DSAs) on February 5, 2003. Interpretive Letter 1-2003, see:

http://www.missouri-finance.org/upload/debt_cancellation.pdf.

Interpretive Letter 1-2003 authorized these banking products to the same extent and under the same standards as national banks under 12 CFR parts 7 and 37. Our letter also included conditions when a bank should inform consumers equivalent insurance products could be available and conditions limiting the administration of bonuses or incentives related to marketing the banking product.

Subsequent to our wild card letter the Office of the Comptroller of the Currency issued Interpretive Letter #1032 (June 16, 2005) through its acting Chief Counsel and indefinitely deferred compliance with certain provisions of the OCC's rule where the bank's GAP addendum is offered through unaffiliated, non-exclusive agents. See, Appendix A to the letter. A copy of OCC Interpretive Letter #1032, including Appendix A is attached.

In as much as our wild card letter has authorized DCCs "under the same standards" as national banks the Division of Finance has no objection to Missouri banks implementing a "GAP debt cancellation product" under 12 CFR parts 7 and 37 including as applied under OCC Interpretive Letter #1032. Please be aware that any bank offering DCC products should periodically check its program against current regulatory requirements to assure their program is up-to-date.

Sincerely,

D. Eric McClure
Commissioner of Finance

DEM:pn
Enclosure

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1032
June 2005
12 CFR 37

June 16, 2005

Subject: **(the Company)**, GAP Program

Dear **( )**:

This letter responds to your letters dated November 17, 2004, and January 20, 2005. In your letters you inquire whether the OCC's rule governing debt cancellation contracts (DCCs)[1] applies when a national bank sells a "GAP Addendum" to borrowers in connection with the bank's motor vehicle loans, in connection with a program administered by **(the Company)** (proposed GAP program).

For the reasons discussed below, and based on the specific facts, we conclude that GAP Addendums that a national bank sells in connection with the proposed GAP program are DCCs, and are subject to the OCC's rule governing DCCs.

I. Background

The proposed GAP program consists of three elements. First, the lender enters into a GAP Addendum with borrowers who secure loans with qualifying vehicles. The GAP Addendum is a contractual agreement between the lender and its customer that a lender provides, for a fee, as an addendum to the loan. The GAP Addendum protects a borrower from financial hardship that may result if the borrower's motor vehicle is involved in an accident and declared a total loss or if it is stolen and not recovered, and the borrower is unable to pay the difference between what his or her automobile insurance pays for the vehicle and the remaining loan balance. Through the sale of the GAP Addendum, which modifies the terms of the underlying loan, the lender agrees to cancel any deficiency balance that may exist on the loan as the result of a "total loss" or unrecovered theft of the motor vehicle collateral.

[1] 12 C.F.R. Part 37.

The second element involves the lender entering into a "GAP Administrative Agreement" (Administrative Agreement) with **( )** (the Company). Pursuant to the Administrative Agreement, the lender agrees to market and sell a "GAP Addendum" to borrowers who finance their motor vehicle purchases with the lender.[2] In addition, the Administrative Agreement provides that the Company will issue an insurance policy to the lender that will cover the lender's risk associated with and the amounts canceled by the lender under the GAP Addendum sold by the lender to the borrower.[3]

The third element of the program consists of the lender obtaining insurance from the Company for each vehicle that is the subject of a GAP Addendum. There is no direct relationship between the borrower and the Company, and the borrower does not pay any fee to the Company.

Your letters urge that a GAP Addendum as described above should not be characterized as a DCC subject to the OCC's rule governing DCCs. For the reasons discussed below, we disagree.

II. Discussion

A. The GAP Addendum is a DCC Subject to the OCC's Rule Governing DCCs.

A GAP Addendum sold by a national bank under the proposed GAP program is a DCC subject to the OCC's rule. A DCC is "a loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event."[4] The agreement may be separate from or part of other loan documents.[5] The GAP Addendum is a DCC because it is "a 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," *i.e.*, in this case, the borrower's vehicle securing the bank's loan becomes a total loss as a result of theft or physical damage. A national bank's direct sale of a GAP Addendum is, therefore, subject to the OCC's rule governing DCCs.[6]

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[2] Under the terms of the Administrative Agreement, the lender also agrees to provide the Company a premium remittance report containing information regarding all of the lender's new GAP Addendum sales by the fifteenth (15) day of the month, accompanied by the appropriate premium remittance amounts the lender must pay the Company.

[3] Under the terms of the Administrative Agreement, the Company agrees that upon its receipt of a premium remittance report and the correct premium remittances from the lender, the Company will provide coverage under the GAP insurance policy for the collateral the lender specifies in the premium remittance report. In addition, the GAP Addendum provides that a borrower's claim under the GAP Addendum must be submitted to the Company.

[4] 12 C.F.R. § 37.2(f).

[5] *Id.*

[6] A national bank participating in the proposed GAP program must comply with all applicable provisions of the OCC's regulation governing DCCs, including the anti-tying requirement at 12 C.F.R. § 37.3(a).

A national bank's sale of a GAP Addendum under the proposed GAP program through unaffiliated, non-exclusive agents – most notably automobile dealers that make the bank's car loans and DCCs available to customers – is also subject to provisions of the OCC's rule governing DCCs. However, in the context of closed-end consumer loan[7] transactions where DCCs are offered by a national bank through unaffiliated, non-exclusive agents, the OCC has delayed the compliance date for certain provisions that are linked to the rule's requirement that a national bank that offers a customer the option to pay the fee for a DCC in a single payment also offers that customer a *bona fide* option to pay the fee on a periodic basis.[8] Accordingly, until further notice, unaffiliated, non-exclusive agents of a national bank that sell the bank's GAP Addendum under the proposed GAP program are not required to comply with certain provisions under the OCC's rule that are linked to the rule's requirement to offer borrowers a periodic payment option in connection with their purchase of a national bank's DCC.

B. A National Bank May Purchase Insurance to Cover Its Exposure from Its Sales of DCCs.

The OCC's rule does not apply to the insurance that the Company provides to a national bank under the proposed GAP program. The rule does not prohibit a national bank from purchasing an insurance policy to cover the bank's risk associated with and the amounts canceled by the bank under a DCC, such as the GAP Addendum, sold by the bank to a borrower. The OCC's rule requires a national bank to manage the risks associated with DCCs in accordance with safe and sound banking principles. The rule provides as follows:

> 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.

12 C.F.R. § 37.8.

If appropriately structured, a national bank's purchase of insurance to cover the bank's risk associated with, and the amounts canceled by, the bank under a DCC can be consistent with the

[7] The term "closed-end consumer loan" refers to consumer credit other than open-end credit, as defined in 12 C.F.R. § 37.2(h).

[8] Attachment A describes the provisions in the OCC's rule governing DCCs for which, until further notice, compliance is not required when a national bank offers DCCs through non-affiliated, non-exclusive agents. Attachment A also describes the requirements in the OCC's rule with which national banks offering DCCs through non-affiliated, non-exclusive agents must continue to comply.

safety and soundness requirements of the OCC's rule.[9] If you have any questions concerning this letter, please contact Asa L. Chamberlayne, Counsel, Securities and Corporate Practices Division, at (202) 874-5210.

Sincerely,

/s/

Daniel P. Stipano
Acting Chief Counsel

[9] *See* 67 Fed. Reg. 58,962, 58971 (September 19, 2002) (preamble to final rule adopting 12 C.F.R. § 37.8) (stating that the OCC's rule requires a bank to assess the adequacy of its internal control and risk mitigation activities, which would include the bank's purchase of third-party insurance, in view of the nature and scope of its DCC program).

Appendix A

The provisions in the OCC's rule governing DCCs for which, until further notice, compliance is not required when a national bank offers DCCs through non-affiliated, non-exclusive agents, are as follows:

- The requirement to offer a periodic payment option set forth in 12 C.F.R. § 37.5.
- The requirement set forth in 12 C.F.R. § 37.4(a) that a bank that offers a customer a DCC without a refund provision also must offer that customer a *bona fide* option to purchase a comparable DCC that provides for a refund.
- The long-form disclosure requirement set forth in 12 C.F.R. § 37.6.
- The second disclosure set forth in Appendix A to Part 37 (Short Form Disclosures), entitled "Lump sum payment of fee," informing the customer that he or she has the option to pay the fee in a single lump sum or in periodic payments.
- The third disclosure set forth in Appendix A to Part 37 (Short Form Disclosures), entitled "Lump sum payment of fee with no refund," informing the customer that he or she has the option to purchase a DCC with a refund provision.
- The fifth disclosure set forth in Appendix A to Part 37 (Short Form Disclosures), entitled "Additional disclosures," indicating that the customer will receive additional information before being required to pay for the DCC.
- The requirement to obtain a customer's written acknowledgment of receipt of disclosures set forth at 12 C.F.R. § 37.7(a).

68 Fed. Reg. 35284 (June 13, 2003).

Banks offering DCCs through non-affiliated, non-exclusive agents remain subject to the following requirements:

- The bank may not extend credit or alter the terms or conditions of an extension of credit conditioned upon the customer's purchase of a DCC.
- The 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 Part 37.
- The bank may not offer DCCs that contain terms giving the bank the right unilaterally to modify the contract unless the modification is favorable to the customer and is made without additional charge to the customer; or 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.
- If a DCC is terminated, the bank must refund to the customer any unearned fees paid for the contract unless the contract provides otherwise.
- The bank shall calculate the amount of a refund using a method at least as favorable to the customer as the actuarial method.
- If a bank offers the customer the option to finance the fee for a DCC, the bank must disclose to the customer whether and, if so, the time period during which, the customer may cancel the agreement and receive a refund.

- A national bank must provide to the customer at the time of the initial solicitation of the DCC, the short form disclosures described in Appendix A to Part 37, as modified to reflect delay of the compliance date for providing the periodic payment option and related changes. The form of the short form disclosures must be readily understandable and meaningful. The short form disclosures also must be included in advertisements and other promotional material for DCCs, unless they are of a general nature.
- Before entering into a contract, the bank must obtain a customer's written affirmative election to purchase the DCC. The written election must be conspicuous, simple, direct, readily understandable, and designed to call attention to its significance.
- A national bank must manage the risks associated with DCCs in accordance with safe and sound banking principles.

Id.