



## **Federal Regulation 12 Part C.F.R. 37 Regarding Debt Cancellation Contracts and Debt Suspension Agreements**

### **Current Regulatory Environment and Disclaimer**

The regulatory framework for Debt Cancellation Contracts (DCCs) and Debt Suspension Agreements (DSAs) has been changing and evolving rapidly. The information provided below is for reference purposes only and Lenders are cautioned to seek their own legal council in regards to Federal and State specific rules and regulations.

### **Federally Chartered Institutions**

The OCC final rule 12 Part C.F.R. 37 on Debt Cancellation Contracts (DCCs) and Debt Suspension Agreements (DSAs) was effective June 16, 2003 (see Attachment A for complete copy of the rule and background.) The final rule codifies the OCC's longstanding position that DCCs and DSAs are permissible banking products and states that they are governed by new Part 37 and applicable federal law and regulations, and not by the OCC's insurance sales consumer protection regulations or by state law.

The National Credit Union Administration has also recognized DCCs and DSAs and lists them as a pre-approved product under Incidental Powers Part 721. (See Attachment C) The NCUA rules are not as specific as the OCC, but do encourage Federal Credit Unions to "review the OCC rule on DCS programs, 12 C.F.R. Part 37, for guidance as to best practices in the industry regarding these programs".

### **State Chartered Institutions**

Subsequent to these federal actions, individual states have recognized the authority of state chartered institutions to provide DCCs and DSAs under the "parity" or "wild card" statutes of the individual states. Some states provide automatic parity with no filing required, while others require filing with the state banking authority and prior approval of the product.

### **Indirect Lending**

Shortly before the effective date of OCC Rule 12 C.F.R. Part 37, the OCC issued Bulletin 2003-25 which delayed compliance with certain parts of Rule 37 (See Attachment B). This action specifically removed the requirement to offer a periodic payment option, in the context of closed-end consumer loan transactions where DCCs and DSAs are offered through unaffiliated, non-exclusive agents (auto dealers).

### **Subsequent Publications**

OCC Interpretive Letter 1028 published May 9, 2005 specifically addresses DCCs providing GAP protection. (See Attachment D) In this Interpretive Letter the OCC concluded “for purposes of 12C.F.R. Section 37.3(a), the OCC views a national bank’s extension of credit in connection with an automobile loan with a GAP DCC feature as a single product, and does not contemplate any separate product related to financing for the GAP feature.”

OCC Interpretive Letter 1032 (See Attachment E) published June 16, 2005 again specifically addresses debt cancellation contracts providing GAP protection. In this letter the OCC concluded “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 banks car loans and DCCs available to customers-is also subject to provisions of the OCC’s rule governing DCCs.

### **Potential Tax Issues**

In October 2004 the Internal Revenue Service issued new regulations regarding the “discharges of indebtedness” by “applicable financial entities”. This new regulation is important to Lender and could have an impact on Debt Cancellation/GAP programs.

There have been many questions over the last several years regarding Debt Cancellation products and the potential requirement of Lender’s to provide a Form 1099-C to any individual that receives a debt cancellation benefit of \$600 or more. The new IRS Code Section 6050P covers this topic in great detail, but still leaves many questions regarding its intention for Debt Cancellation products.

Although Frost is not allowed to render any legal advice, we are working closely with industry experts to evaluate recommendations for our mutual clients. Attached for your review is a summary of IRS CODE Section 6050P and a memorandum from our legal firm. Based on our understanding of 6050P, we have encouraged our clients to modify their GAP Waiver addendum to notify borrowers of the potential 1099-C issue.

## Attachment A

OCC 2002-40

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# OCC BULLETIN

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**Comptroller of the Currency**  
Administrator of National Banks

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**Subject: Debt Cancellation Contracts and Debt  
Suspension Agreements**

**Description: Final Rule**

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**TO: Chief Executive Officers of National Banks, Department and Division Heads,  
All Examining Personnel, and Other Interested Parties**

### PURPOSE

This bulletin transmits a final rule on debt cancellation contracts (DCCs) and debt suspension agreements (DSAs) that was published in the *Federal Register* on September 19. The effective date of the rule is June 16, 2003.

### SUMMARY

The Office of the Comptroller of the Currency (OCC) is publishing a final rule that adds a new part 37 to the OCC's rulebook that governs DCCs and 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.

The final rule defines a DCC as a loan term or contractual arrangement under which a bank agrees to cancel all or part of a customer's obligation to repay a loan from that bank upon the occurrence of a specified event. A DSA is defined as a loan term or contractual arrangement under which a bank agrees to suspend all or part of a customer's obligation to repay a loan from that bank upon the occurrence of a specified event.

The final rule codifies the OCC's longstanding position that DCCs and DSAs are permissible banking products and states that they are governed by new part 37 and applicable federal law and regulations, and not by the OCC's insurance sales consumer protection regulations or by state law.

The final rule prohibits the following practices by banks that provide DCCs or DSAs:

- 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 offered in connection with a residential mortgage loan.

The final rule imposes the following limitations on banks that provide DCCs or DSAs:

- A bank may offer a DCC or DSA that makes no provision for a refund of the 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; and
- For loans other than residential mortgage loans, the bank may offer the customer the option of paying the fee 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.

The final rule requires national banks to disclose certain key information to their customers. The disclosure requirements are structured to accommodate the methods that national banks typically use to market DCCs and DSAs by permitting the use of abbreviated disclosures in certain marketing circumstances – including telephone solicitations and “take one” applications – where full disclosure of the terms most relevant to the customer's decision to purchase is not practicable.

Among other requirements, national banks must:

- Tell customers of the prohibition on tying.
- Explain that a DSA, if activated, does not cancel the debt, but only suspends requirements to make payments.
- Disclose the amount of the fees charged.
- Make customers aware of the option to pay in a lump sum or periodic installments.
- Disclose their refund policy if the fee is paid in a single payment and added to the amount borrowed.
- Tell customers whether they would be barred from using the credit line if the DCC or DSA was activated.
- Explain eligibility requirements, conditions, and exclusions that might affect a customer's ability to purchase or obtain benefits under a DCC or DSA.

Sample disclosures are attached to the final rule. The sample forms are not mandatory, but banks that make disclosures in a form substantially similar to those provided will be deemed to satisfy the disclosure requirements.

The final rule also requires 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 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 final rule requires that the disclosures, acknowledgement, and affirmative election 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.

Finally, the rule contains a safety and soundness requirement that a national bank that offers DCCs or DSAs must manage the risk 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.

For further information, contact Jean Campbell, attorney, Legislative and Regulatory Activities Division at (202) 874-5090; Suzette Greco, special counsel, Securities and Corporate Practices Division at (202) 874-5210; or Rick Freer, compliance specialist, Compliance Division at (202) 874-4862, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

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Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel

Attachment – [67 FR 58962](#)

## Attachment B

OCC 2003-25

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# OCC BULLETIN

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**Comptroller of the Currency**  
Administrator of National Banks

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**Subject:** Debt Cancellation Agreements and  
Debt Suspension Agreements

**Description:** Compliance Date Delay

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**TO:** Chief Executive Officers of All National Banks, Federal Branches and Agencies,  
Department and Division Heads, and All Examining Personnel

The Office of the Comptroller of the Currency (OCC) will publish the attached notice and request for comment in the *Federal Register* on June 13, 2003. The notice delays the compliance date for certain provisions of the final rule governing debt cancellation agreements (DCCs) and debt suspension agreements (DSAs) in the context of closed-end consumer loan transactions<sup>1</sup> where DCCs and DSAs are offered by national banks through unaffiliated, non-exclusive agents. The delay in the required time for compliance applies only to the extent and to the types of transactions described in this notice. In all other circumstances, national banks are required to comply with the DCC/DSA rule as of June 16, 2003, the effective date. The OCC also is inviting comment on a number of issues raised by national banks related to the sale of DCCs and DSAs in connection with closed-end consumer loans.

For further information, contact Jean Campbell, attorney, Legislative and Regulatory Activities Division at (202) 874-5090 or Pamela Mount, compliance specialist, Compliance Division at (202) 874-4428.

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Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel

[attachment](#)

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<sup>1</sup> As used in the notice, the term “closed-end consumer credit” and “closed-end consumer loan” refer to consumer credit other than open-end credit, as defined in the final DCC/DSA rule. These terms do not include loans secured by 1-4 residential real property. *See* 12 CFR 37.2(a).



These programs have certain inherent risks and should be evaluated prior to implementation.

While debt cancellation is a form of self-insurance, credit insurance is a three-party contract in which an insurance company takes on the underwriting risk. DCS programs, therefore, can pose a greater potential risk. Due to the increased risk, examiners will be reviewing DCS programs differently than credit insurance products, such as credit life and disability.

Debt cancellation products can vary widely by the types of loans and triggering events covered under the terms of the DCS agreement. They can provide for cancellation of all or part of the member's debt upon the occurrence of certain events, such as death, disability, involuntary unemployment, or the total loss of a vehicle. They can also defer all or a portion of monthly payments. Programs could also be established which share qualities of both cancellation and suspension approaches. The benefits can be provided monthly or in a lump sum, and the duration of benefits can be limited or cover the entire loan term. For example, a Guarantee Auto Protection program pays any remaining balance after application of insurance settlements when the member's collateral is destroyed or stolen. Fees for DCS programs are assessed either as a lump sum or in periodic installments.

Credit unions are expected to adhere to safety and soundness principles when managing the risks associated with DCS programs. Likewise, credit unions should establish and maintain effective risk management and control processes over DCS programs. 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. Credit unions also should assess the adequacy of internal control and risk mitigation activities in view of the nature and scope of DCS programs. Examiners will determine that the credit union's methodologies support participation in DCS programs, as well as policies and procedures for these supporting processes are appropriate.

While stop-loss insurance coverage is not legally required under NCUA Rules and Regulations, credit unions may want to consider such coverage from a third party provider as an appropriate means to effectively manage risk. For credit unions with liability insurance coverage, regardless of the amount, credit union management must have procedures in place to evaluate the third party who provides the coverage. NCUA Letter to Credit Unions 01-CU-20, Due Diligence Over Third Party Service Providers, should be used as guidance for both federal and state-chartered credit unions.

#### **Legal Issues and Compliance Risk**

At least one court has established that a debt cancellation agreement is not an insurance product regulated by state insurance regulators. It is, in fact, a two-

party contract between the lender and its borrower, outside the purview of insurance laws.

NCUA's Office of General Counsel has determined that insurance coverage is not required for the at-risk balance of loans covered by these programs. Credit unions have the option of insuring all or part of the risk. Expanded examination procedures will be considered when examining those credit unions where full contractual liability coverage is not obtained.

Truth in Lending regulations set forth certain requirements if the fees for these programs are not itemized as a finance charge. These requirements include:

1. A written statement that the DCS is not required by the creditor to obtain the loan,
2. Disclosure of the fee or premium and term of coverage in certain situations, and
3. A signed affirmative request for coverage.

Credit unions should also review the Office of the Comptroller of the Currency rule on DCS programs, 12 C.F.R. Part 37, for guidance as to best practices in the industry regarding these programs at [www.occ.treas.gov/ftp/release/2002-73.pdf](http://www.occ.treas.gov/ftp/release/2002-73.pdf).

#### **Accounting**

Credit unions should account for DCS programs in accordance with Generally Accepted Accounting Principles. Accounting procedures for DCS programs can be complex, and credit unions may want to consider consulting with a CPA or other accounting professional in determining the accuracy of their accounting treatment. Examiners will be evaluating credit union management's provisions for accurate accounting treatment, due diligence, and internal controls over these programs.

If you have any questions on DCS programs, please contact your examiner or NCUA regional office.

Sincerely,

/S/

Dennis Dollar  
Chairman

Enclosure

## Attachment D

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**Comptroller of the Currency**  
Administrator of National Banks

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Washington, DC 20219

**Interpretive Letter #1028**  
**May 2005**  
**12 CFR 37**

May 9, 2005

Re: [ ] (“Bank”)

Dear [ ]:

We are writing in response to your inquiry for an interpretation of the Office of the Comptroller of the Currency’s (“OCC’s) Debt Cancellation Regulation at 12 C.F.R. Part 37. You asked for our views concerning application of 12 C.F.R. § 37.3(a) to a national bank’s financing for a debt cancellation feature on an automobile loan. In particular, you inquired about so-called “Guaranteed Automobile Protection” (“GAP”) debt cancellation.<sup>2</sup>

We understand national banks and third party providers often offer GAP in connection with a customer obtaining financing on the purchase of an automobile.<sup>3</sup> Specifically, you inquired whether a national bank would engage in a prohibited arrangement under section 37.3(a) by offering financing for the bank’s own GAP feature in connection with the

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<sup>2</sup> This letter addresses the OCC’s views under 12 C.F.R. § 37.3(a) in connection with a national bank’s automobile loan that includes a GAP feature offered by the bank. We understand the Bank currently is in litigation involving tying allegations related to certain practices concerning GAP. This letter expresses no opinion on the merits of the specific tying allegations against the Bank related to its practices concerning GAP offered in connection with its automobile loans.

<sup>3</sup> GAP provides coverage for the “gap” between what the customer’s primary insurance company will pay on the vehicle (usually the actual present value as determined by the insurance company, less any deductible) and what the customer still owes on the extension of credit. The “gap” exists because vehicle value typically depreciates on a steeper curve than the balance of the extension of credit declines in the first years of the transaction.

automobile loan.<sup>4</sup> If the customer elects the bank's optional GAP feature, the customer pays an additional fee in cash or rolled into the financing of the underlying loan. For the reasons discussed below, we would not find a violation under section 37.3(a) in the described situation because we view the underlying loan and the GAP feature as a single product, and the financing arrangement does not, in our view, create a separate product.

The OCC promulgated Part 37 to establish standards governing debt cancellation contracts ("DCCs") offered by national banks and to ensure the banks provide them consistent with safe and sound banking practices and subject to appropriate consumer protections.<sup>5</sup> Part 37 is very clear that a bank-permissible DCC is a loan term or contractual arrangement modifying loan terms linked to the bank's extension of credit.<sup>6</sup> A DCC does not function as a separate product and the bank does not separately offer it to third parties as a product. By its terms, the DCC only arises in the context of a bank's own loans; the customer typically agrees to pay an additional fee to the bank for the loan's DCC feature.<sup>7</sup> The effect of the DCC is to extinguish the borrower's obligation to repay under the otherwise operative provisions of the underlying loan.<sup>8</sup> The bank's ability to adjust the terms of loan repayment is an integral component to its authority to lend. The payment of a fee related to the DCC is inseparable from the DCC feature itself. The fee is just an increase in the price of the loan package in exchange for the loan incorporating an additional term or provision that benefits the borrower and reflects the bank's assumption of risk related to GAP debt cancellation. Thus, we believe the financing arrangement, which permits the fee to be paid over a period of time, is an integral part of the loan and its DCC feature, and is not a separate product for purposes of Part 37.

Part 37 includes an express provision, 12 C.F.R. § 37.3(a), that prohibits a national bank from making an automobile loan conditioned on the customer's purchase of a DCC, such as a GAP feature, from the bank.<sup>9</sup> The regulation's preamble notes that a DCC may be

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<sup>4</sup> We understand that the bank does not condition the financing for the automobile on the customer's purchase of the bank's GAP coverage.

<sup>5</sup> See 67 Fed. Reg. 58962 (Sept. 19, 2002). The OCC has recognized national banks may provide GAP as a DCC.

<sup>6</sup> As defined in part 37, 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." 12 C.F.R. § 37.2(f). The definition provides the agreement may be separate from or a part of other loan documents.

<sup>7</sup> See 12 C.F.R. § 37.5 (method of payment of fees). The fee may be a lump sum 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 payment.

<sup>8</sup> See 67 Fed. Reg. at 58965.

<sup>9</sup> Section 37.3(a) provides: "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." 12 C.F.R. § 37.3(a).

offered and purchased either contemporaneously with the other terms of the loan agreement or subsequently.<sup>10</sup> The OCC views the loan and the GAP feature as a single product, and the prohibition in 12 C.F.R. § 37.3(a) is not intended to apply separately to the financing arrangement for the DCC.

Accordingly, for purposes of 12 C.F.R. § 37.3(a), the OCC views a national bank's extension of credit in connection with an automobile loan with a GAP DCC feature as a single product, and does not contemplate any separate product related to financing for the GAP feature. We trust this is responsive to your inquiry.

Sincerely,

**signed**

Daniel P. Stipano  
Acting Chief Counsel

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<sup>10</sup> See 67 Fed. Reg. at 58965.

## Attachment E

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219  
Interpretive Letter #1032

June 16, 2005

**June 2005**

12 CFR 37

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)<sup>11</sup> 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.

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<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup>

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.”<sup>14</sup> The agreement may be separate from or part of other loan documents.<sup>15</sup> 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

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<sup>12</sup> 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.

<sup>13</sup> 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.

<sup>14</sup> 12 C.F.R. § 37.2(f).

<sup>15</sup> *Id.*

physical damage. A national bank's direct sale of a GAP Addendum is, therefore, subject to the OCC's rule governing DCCs.<sup>16</sup>

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<sup>17</sup> 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.<sup>18</sup> 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

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<sup>16</sup> 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).

<sup>17</sup> 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).

<sup>18</sup> 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.

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 safety and soundness requirements of the OCC's rule.<sup>19</sup> 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

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<sup>19</sup> 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.*

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December 2, 2004

MEMORANDUM FOR RECORD

From: Chrys D. Lemon

Re: Information Reporting Under New IRS Regulations  
Concerning Discharges of Indebtedness

Internal Revenue Code Section 6050P requires an “applicable financial entity” to file an information return with the IRS, and to furnish information statements to debtors, reporting the discharge of a debt of \$600 or more. The term “applicable financial entity” is defined in part as “any organization a significant trade or business of which is the lending of money.” The IRS has issued final regulations<sup>20</sup> that define when an organization’s lending business is deemed to be “significant.” In general, the regulations provide that the lending of money is a significant trade or business “if money is loaned on a regular and continuing basis.” Clearly, bank lending falls within this definition, so the regulation does not appear to change a bank’s general obligation to report cancellation of a debt under Section 6050P.

There is, however, one notable quote in the preamble to the regulations that is relevant to reporting requirements associated with the cancellation of a debt via a debt cancellation contract:

*Amounts Forgiven Pursuant to the Terms of a Loan*

*Commentators requested clarification as to whether an organization is required to report amounts forgiven pursuant to the terms of a debt obligation, including loan forgiveness under the FFELP [Federal Family Education Loan Program] upon a stated event (such as death, disability, or satisfaction of the service requirements of the Teacher Loan Forgiveness Program). The IRS may issue future guidance under section 6050P addressing amounts forgiven pursuant to the terms of a debt obligation for purposes of section 6050P. Pending issuance of future guidance, applicable entities will not be subject to penalties under section 6721 and section 6722 for failure to report under section 6050P amounts forgiven pursuant to the terms of a debt obligation. (emphasis added)*

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<sup>20</sup> 69 Federal Register 62,181 (Oct. 25, 2004).