March 12, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Regulation Z; Docket No. R-1217

Dear Ms. Johnson:

On behalf of the Debt Cancellation Coalition (the "Coalition") and the American Bankers Insurance Association ("ABIA"), we respectfully request the Federal Reserve Board (the "Board") to exercise its authority under Section 105 of the Truth in Lending Act ("TILA") to expand the class of voluntary debt cancellation fees that may be excluded from the disclosed finance charge.[1] We also request conforming and clarifying changes to the definition of debt cancellation coverage in the Official Staff Commentary to Regulation Z.[2]

I. National and state banks have been authorized to offer a broad range of debt cancellation contracts that are not addressed in Regulation Z. This regulatory disparity stands as an impediment to the development of new forms of contracts that are intended to meet the changing needs of consumers.

The Board's Regulation Z currently provides that the fees paid in connection with certain types of debt cancellation contracts may be excluded from the disclosed finance charge.[3] The types of debt cancellation contracts covered by this exclusion are those that cancel all or part of a consumer's debt in the event of "loss of life, health, or income, or in the case of an accident."[4] This provision was added to the Regulation a decade ago when most debt cancellation contracts were limited to such events.[5] However, since then, federal and state chartering authorities have permitted national and state banks and other creditors to offer debt cancellation contracts that

[1] The Debt Cancellation Coalition is an informal organization that is active on policy issues related to debt cancellation contracts and debt suspension agreements. The members of the Coalition are AEGON USA, AHL Group (Citigroup Affiliate), Assurant Group, Bank of America, JPMorgan Chase, HSBC Finance Corporation, Securian Financial Group, TCF Financial Corporation, US Bank, and Wells Fargo. The American Bankers Insurance Association is a subsidiary of the American Bankers Association that develops policies and provides advocacy for banks engaged in the business of insurance.

[2] This letter is a supplement to a letter submitted by the Coalition on March 28, 2005.

[3] 12 CFR 226.4(d)(3)(i)(A), (B), and (C).

[4] 12 CFR 226.4(d)(3)(ii).

[5] 61 Federal Register 49237, September 19, 1996.

relate to a much broader range of events, such as the birth or adoption of a child, marriage, divorce, natural disaster, leave of absence, or call to military duty. As a result, there is growing interest within the banking industry to offer products covering a wide range of events. Absent an expansion of the class of debt cancellation fees that may be excluded from the finance charge disclosure, Regulation Z's disclosure requirements will impede the development of products that have been permitted by various chartering authorities.

Accordingly, we respectfully request that the Board replace the list of events in Section 226.4(d)(3)(ii) of the Regulation with a reference to "events that interrupt the normal flow of a debtor's income or expenses, or otherwise impair the debtor's financial situation, and that have been included by the creditor as a specified event in the debt cancellation coverage." This revision would conform Regulation Z with the regulations and policies of other regulatory agencies.[6] It also would be consistent with the Board's authority under Section 105 of TILA to make exceptions that effectuate the purpose of the Act and facilitate compliance with the Act. Attachment A shows our proposed changes to Section 226.4(d)(3)(ii).

The Board has a record of modernizing regulations in response to legal and market developments. Indeed, the existing provisions in Regulation Z that address debt cancellation coverage are an example of such an action. The time has come to make further adjustments in those provisions.

The balance of this letter provides some background information on the development of debt cancellation contracts and the Board's authority to make the proposed change. The letter also proposes some conforming and clarifying revisions to the definition of debt cancellation coverage in the Official Staff Commentary to Regulation Z.

II. As the regulation of debt cancellation contracts has evolved, the nature of these contracts has expanded.

A. 1963-1990

The first formal acknowledgment of debt cancellation contracts by federal banking regulators occurred in 1963 when the Comptroller of the Currency ruled that national banks could issue contracts that cancelled a debt in the event of the death of the debtor.[7] This ruling was based upon the premise that such contracts were incidental to a national bank's power to make loans.

The Comptroller's ruling sparked a debate over the proper regulatory treatment of debt cancellation contracts. To state attorneys general and state insurance commissioners, contracts that cancelled a debtor's obligation to repay a loan upon the death of the debtor were a form of insurance. Thus, in response to the Comptroller's ruling, a number of states issued competing

[6] See, e.g., 12 CFR 37.2(f).

[7] OCC Interpretive Ruling 7.7495, 12 CFR 7.7495 (1963).

rulings that classified debt cancellation contracts as insurance products, subject to state insurance rate and form regulation.

B. 1990-1997

The debate over the proper regulatory treatment of debt cancellation contracts remained unsettled until 1990. In that year, the United States Court of Appeals for the Eighth Circuit held that debt cancellation contracts issued by national banks were part of the business of banking, and not part of the business of insurance.[8] This decision was followed by a series of rulings by federal banking regulators that gradually expanded the authority of federally chartered depository institutions to offer debt cancellation contracts:

> In 1993, the Office of Thrift Supervision ruled that federal savings associations could issue contracts that cancel a consumer's debt upon "their death or upon the occurrence of certain defined events that would affect their ability to repay their loan, such as medical disability or loss of job."[9]
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> In 1994, the Office of the Comptroller of the Currency expanded the type of debt cancellation contracts that national banks could offer to include not only contracts linked to the death of a consumer, but also those related to the disability or unemployment of a consumer. That ruling noted that "While [the pre-existing OCC ruling] addresses only DCAs that cancel debt upon the death of the debtor, the same rationale underlying the ruling, that DCAs are incidental to banks' express loan-making authority, would apply to DCAs involving borrowers' disability or unemployment."[10]
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> In 1997, the National Credit Union Administration ruled that debt cancellation contracts and GAP waiver agreements offered by federal credit unions were not insurance products.[11]

C. Board Action in 1995 - 1996

It was within the context of these other agency actions that the Board first addressed debt cancellation contacts. In December 1995, the Board issued a proposed interpretation of the treatment of debt cancellation fees. That interpretation generally concluded that such fees were finance charges paid as an incident to an extension of credit. The interpretation further noted

[8] First National Bank of Eastern Arkansas v. Taylor, 907 F.2d 775 (8th Cir. 1990).

[9] Letter from Carolyn B. Lieberman, OTS Acting Chief Counsel, dated September 15, 1993.

[10] OCC Interpretive Letter No. 640, January 7, 1994.

[11] OGC Legal Opinion 97-0632, dated September 12, 1997. Guaranteed automobile protection agreements, or GAP agreements, are sold in connection with motor vehicle loans. They provide for the cancellation of the remaining loan obligation when the vehicle securing the loan is stolen or destroyed and the settlement payment made by the consumer's primary automobile insurance carrier is insufficient to pay the loan balance.

that, in those states that regulated debt cancellation contracts as credit insurance products, the fees might be excluded from the finance charge disclosure in accordance with Section 226.4(d) of Regulation Z, which excluded credit insurance premiums from the finance charge disclosure under certain conditions.[12] Thus, the Board proposed that fees charged in connection with debt cancellation contracts regulated as insurance might be excluded from the finance charge, provided the conditions otherwise applicable to the credit insurance exclusion were satisfied. In contrast, the Board proposed that fees charged in connection with debt cancellation contracts not regulated as insurance products would not be covered by the exclusion.

The Board's proposal was not well received.[13] Commenters were particularly concerned about the need to make a state-by-state determination of whether such contracts were considered insurance. They also noted that reliance on state law would not create a uniform rule for measuring the cost of credit, contrary to the purpose of TILA. Additionally, commenters stated that some creditors would decline to make or purchase loans with such coverage due to the legal uncertainty over fee disclosures.[14]

In response to these comments, the Board withdrew the proposed interpretation, and proposed an amendment to Regulation Z that permitted the exclusion of certain debt cancellation fees, without regard to the status of debt cancellation contracts under state insurance law. More specifically, the amendment provided that fees charged in connection with debt cancellation contracts (and GAP agreements) could be excluded from the finance charge disclosure if, like credit insurance premiums, the purchase of the product was voluntary, the fee disclosed, and the consumer elected, in writing, to make the purchase.

When this amendment was published in final form, the preamble to the rule briefly addressed the class of debt cancellation contracts covered by the rule. The preamble stated that, for purposes of Regulation Z, debt cancellation contracts are "contracts between a debtor and creditor providing for satisfaction of all or part of the debt when *a specified event* occurs."[15] (emphasis added). The final rule, however, was not written so broadly. The final rule was limited to fees paid for debt cancellation coverage that provides for the cancellation of all or part of the debtor's liability for (i) amounts exceeding the value of the collateral securing the obligation (i.e., GAP agreements), or (ii) in the event of loss of life, health or income or in case of accident. At the time, this range of contracts was consistent with the actions of other federal regulators and industry practices. That is no longer the case.

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[12] When TILA was enacted in 1968, Congress expressly excluded fees charged in connection with credit insurance from the finance charge disclosure, as long as the consumer was informed that the purchase was voluntary, the premium was disclosed, and the consumer elected, in writing, to purchase the coverage. See Section 106(b) of TILA (15 USC 1605(b)). The Board subsequently incorporated this provision in Section 226.4(d) of Regulation Z.

[13] The Board acknowledged that comments on the proposal were "mostly negative." See 61 Federal Register 49240, September 19, 1996.

[14] Ibid.

[15] 61 Federal Register 49239, September 19, 1996.

D. Recent Developments

Since the Board's regulation was issued, other federal banking regulators and courts have continued to expand the type of debt cancellation contracts that may be offered by federally chartered depository institutions:

> In 1998, the Comptroller of the Currency ruled that national banks could suspend or freeze a borrower's obligation to pay a debt for a specified period of time in the event the borrower becomes "involuntarily unemployed, is unable to work due to disability, goes on an approved family leave, is hospitalized for more than a specified number of days, or becomes temporarily unable to continue to make payments on the account for certain other *specified reasons.*"[16] (emphasis added)
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> In 1999, the Alabama Court of Appeals upheld the authority of national banks to offer debt suspension agreements, holding that the McCarran-Ferguson Act does not permit Alabama to regulate these agreements as insurance.[17]
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> In 2002, the National Credit Union Administration amended its rules to clarify that debt cancellation contacts and debt suspension agreements were incidental to the lending power of federal credit unions. That rule does not limit the types of events related to such contracts or agreements.[18]
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> In 2002, the Office of the Comptroller of the Currency issued a comprehensive rule governing debt cancellation contracts and debt suspension agreements issued by national banks.[19] That rule defined a debt cancellation contract as "a loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a *specified* event."[20] (emphasis added)
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> In 2005, the Office of the Comptroller of the Currency issued an opinion that GAP waivers were a type of debt cancellation contract.[21]

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[16] OCC Interpretive Letter 827, April 3, 1998.

[17] Steele v. First Deposit National Bank, 732 So.2d 301 (1999).

[18] 12 CFR 721.3(g).

[19] 67 Federal Register 58962, September 19, 2002.

[20] 12 CFR 37.2(f). The rule also defined debt suspension agreements with reference to any "specified event."

[21] Interpretive Letter No. 1028, May 2005.

State regulatory treatment of debt cancellation contracts also has undergone significant changes since the mid-1990s. Today, 48 states and the District of Columbia permit state chartered banks to offer debt cancellation contracts and either treat those contracts as a banking product or grant them a special exception from insurance regulation.[22] In most of these states, the change is the result of a state parity or wild-card statute that permits state banks to engage in the same activities as national banks. Thus, most state banks can offer the same range of debt cancellation contracts as national banks. Several states also have adopted comprehensive debt cancellation regulations that are patterned after the regulations issued by the Office of the Comptroller of the Currency.[23]

In sum, during the decade since the Board amended Regulation Z to address debt cancellation fees, other regulatory authorities have expanded significantly the types of debt cancellation contracts that may be offered by insured depository institutions. As a result, insured depository institutions and other lenders have the ability to offer products that are related to any "specified" event that may arise in the life of a borrower, not just the events listed in Regulation Z. We urge the Board to close this regulatory gap by exercising its authority under Section 105 of TILA to expand the class of voluntary debt cancellation fees that may be excluded from the disclosed finance charge.

III. Expanding the class of debt cancellation fees will effectuate the purpose of TILA and will facilitate compliance with TILA.

Section 105 of TILA authorizes the Board to make exceptions for classes of transactions if such exceptions effectuate the purpose of TILA or facilitate compliance with TILA. Expanding the class of voluntary debt cancellation fees that may be excluded from the disclosed finance charge is consistent with these statutory standards. It also will conform Regulation Z to the powers granted insured depository institutions and other lenders by their chartering authorities.

A. *The Expansion of the Exclusion will Effectuate the Purpose of TILA*

The principal purpose of TILA is to ensure a meaningful disclosure of credit terms so that consumers can make informed comparisons of credit products.[24] The existing treatment of debt cancellation fees under Regulation Z does not provide for uniform treatment of debt cancellation contracts, and this misleads and confuses consumers. Presently, fees for debt cancellation contracts that are related to the "loss of life, health or income or in the case of accident" may be excluded from the disclosed finance charge. In contrast, the Regulation does not address fees

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[22] Only three states continue to treat the products as insurance when offered by state chartered banking institutions, and the regulatory treatment of such products in one state, Alaska, is unclear. Thirty-four states and the District of Columbia treat these products as non-insurance products when offered by non-bank lenders, and 16 continue to treat them as insurance products when offered by such lenders. Again, regulatory treatment for nonbanking lenders in Alaska is unclear.

[23] Colorado, New York, Texas, Utah, and Wyoming.

[24] Section 102(a) of TILA, 15 USC 1601(a).

related to other events in the life of a consumer, such as the birth or adoption of a child, marriage, divorce, natural disaster, leave of absence, or call to military duty.

This lack of uniform treatment is not unlike the situation the Board faced in 1996 when there was a major difference in state regulation of debt cancellation contracts, with many states treating the contracts as insurance and some states treating them as non-insurance products. Then, the Board concluded that the establishment of a uniform disclosure regime for such contracts, regardless of how they were regulated by the states, effectuated the purpose of TILA. The same rationale should be applied in this case. Consumers should be able to evaluate all forms of debt cancellation contracts on the basis of the same disclosure requirements.

B. The Expansion of the Exclusion will Facilitate Compliance with TILA

The current treatment of debt cancellation fees complicates compliance with TILA. Under the present rule, lenders cannot be certain how to disclose debt cancellation fees. For example, what disclosure applies to a debt cancellation contract that cancels a borrower's obligation to repay a loan in the event of a natural disaster or a divorce? A creditor could conclude that such an event would have an impact on the borrower's income, and decide to exclude the fee from the finance charge. Yet, the event may not have such an impact. In that case, the creditor would have provided an incorrect disclosure statement. This type of uncertainty creates compliance and litigation risk, and discourages creditors from offering debt cancellation contracts with features that may be attractive to borrowers.

Again, this type of compliance confusion and risk is similar to the situation the Board faced in 1996 when it first created the exclusion for debt cancellation fees. Then, creditors refused to make or purchase loans with debt cancellation or GAP features because of the uncertainty over how fees should be disclosed under TILA. Extending the fee exclusion to debt cancellation fees charged in connection with specified events that interrupt the normal flow of a borrower's income or expenses, or otherwise impair the borrower's financial situation, would resolve this compliance problem.

C. TILA Disclosures Should Not Act as a Limitation on Activities Otherwise Authorized by Chartering Authorities

TILA is a disclosure statute designed to help consumers compare the cost of credit. It is not an authorizing statute. In this case, however, the non-uniform application of Regulation Z to debt cancellation contracts limits the ability of federal and state insured depository institutions and other lenders to engage in activities authorized by their chartering authorities. While lenders have been given the legal authority to develop debt cancellation contracts that meet different customer needs by addressing a variety of specified events, Regulation Z, by remaining static, has essentially neutralized this authority. Today, there is significant risk in offering a product that includes specified events that go beyond those set forth in Regulation Z, as it would necessitate a complex and inherently risky process of allocating part of the debt cancellation fee to the finance charge in the case of certain events, but not in the case of others. The Board can correct this problem by extending the exclusion for certain debt cancellation fees to debt cancellation fees charged in connection with specified events that interrupt the normal flow of a borrower's income or expenses, or otherwise impair the borrower's financial situation.

D. Distinctive Nature of Debt Cancellation Contracts

The current treatment of debt cancellation fees is patterned after the long-standing treatment of credit insurance premiums. This reflects the history of the two products, which were developed to serve a similar purpose. However, the products are increasingly distinct, and we do not believe that the treatment of debt cancellation fees should be linked, automatically, to the treatment of credit insurance premiums.

Because debt cancellation contracts are not treated as insurance products in most states, lenders have been able to design new forms of debt cancellation contracts to meet the changing needs of consumers. For example, while many states limit credit insurance coverage to the death, disability or involuntary unemployment of a borrower, a debt cancellation contract can be written to cover any number of events that have an adverse financial impact on a borrower, such the birth or adoption of a child, marriage, divorce, natural disaster, leave of absence, or call to military duty. Additionally, a debt cancellation contract may be written to apply not only to events in the life of a borrower, but also to events in the life of a spouse or other household member, even if that person is not a party to the loan. For borrowers living on two-incomes, this can be a significant benefit.

Another attraction of debt cancellation contracts is that they can be sold in connection with any type of closed-end or open-end loan. They are commonly offered in connection with open-end credit card loans, home equity lines of credit (HELOC) and closed-end mortgage and installment loans. Currently, they are issued most commonly in connection with credit card loans. Also, some loans include hybrid contracts that have both debt cancellation and debt suspension features. Finally, debt cancellation contracts are attractive to lenders because they can be customized to provide protection for major life events and may be sold throughout the life cycle of a loan or line of credit. They may be sold face-to-face at the inception of a loan, or over the telephone or through the mail after a loan is closed.

IV. Proposed Revisions to Section 226.4(b)(10) of the Official Staff Commentary

In addition to the amendment to Regulation Z discussed above, we also respectfully request that conforming and clarifying revisions be made to the definition of debt cancellation coverage in Section 226.4(b)(10) of the Official Staff Commentary. Specifically, we recommend that the Commentary to Section 226.4(b)(10) be revised to: (i) clarify that debt cancellation coverage includes debt suspension agreements; (ii) include a non-exclusive list of specified events; and (iii) explicitly extend to debt cancellation coverage the same treatment the Commentary currently provides to post-consummation sales of credit insurance. These proposed changes are shown in Attachment A.

A. Debt Suspension Agreements

As described above, debt suspension agreements have been recognized by other regulators and the courts as a type of debt cancellation coverage. Basically, they provide for the suspension of all or part of a borrower's debt when a specified event arises in the life of the borrower. It is our understanding that Board staff has informally interpreted references to debt cancellation coverage in Regulation Z to include debt suspension agreements. Therefore, we believe it would be appropriate to revise the definition of debt cancellation coverage in Section 226.4(b)(10) to clarify that the term includes debt suspension agreements.

B. Specified Events

As a complement to our proposed amendment to Section 226.4(d)(3)(ii), we recommend that Section 226.4(b)(10) of the Official Staff Commentary include a non-exclusive list of specified events that may be associated with debt cancellation coverage. Our proposed amendment to Section 226.4(d)(3)(ii) refers to specified events that "interrupt the normal flow of a debtor's income or expenses, or otherwise impairs the debtor's financial situation." It would be useful to both creditors and debtors if the Commentary provided a non-exclusive list of such events. Our proposed list would be the events that currently are contained in Section 226.4(b)(3)(ii), plus "accident, disability, divorce, marriage, the birth or adoption of a child, natural disaster, leave of absence and call to military duty." An accident or disability is an example of a life event that can disrupt a borrower's income stream. Marriage and the birth or adoption of a child are examples of life events that impact a borrower's expenses. Natural disaster is an example of an event that can impair a borrower's financial situation through the destruction of assets, such as a home.

C. Post-Consummation Sales

The Official Staff Commentary to Section 226.4(b)(7) and (8) provides that "insurance" products sold after consummation of a closed-end or the opening of an open-end credit plan are not "written in connection with" the transaction or plan if the consumer requests the insurance at such time.[25] Some depository institutions and other lenders have relied upon this interpretation to engage in the post-consummation sale of debt cancellation contracts and debt suspension agreements without a redisclosure of the finance charge. We recommend that the Commentary to Section 226.4(b)(10) be revised to include a parallel treatment for post-consummation sales of debt cancellation contracts and debt suspension agreements.

The policy rationale for excluding post-consummation sales of debt cancellation contracts and debt suspension agreements from the finance charge disclosure is the same as the rationale for excluding post-consummation sales of insurance products. The terms and conditions of the underlying credit product would have long been determined and disclosed to the borrower. The subsequent addition of a debt cancellation or debt suspension feature, like the addition of

[25] 12 CFR 226 Supp. I, Section 226.4, paragraphs 4(b)(7) and (8), note 2 (Insurance written in connection with a transaction).

insurance coverage, would be a voluntary transaction completed at the request of the consumer. Furthermore, even if a debt cancellation contract is not "written in connection with" a credit transaction, the debt cancellation regulations of the Office of the Comptroller of the Currency (and those state regulations that afford consumers similar protections) require comprehensive disclosures, including an affirmative election to purchase the debt cancellation contract after receiving numerous disclosures, e.g., the fact that the purchase is optional, the amount of the fee, and that there are eligibility requirements and exclusions.

V. Conclusion

Debt cancellation contracts have evolved in the past decade to become an important means for creditors to help borrowers obtain financial security. However, the current non-uniform treatment of such contracts under Regulation Z is confusing to creditors and consumers, and is impeding the issuance and development of such contacts contrary to the purpose of TILA. We urge the Board to rectify this problem by extending the current exclusion for debt cancellation fees to all forms of debt cancellation contracts, not just the types of contracts that were in existence a decade ago when the Board created the current exclusion. We also urge conforming and clarifying changes to the definition of debt cancellation coverage in the Official Staff Commentary to the Regulation. Your consideration of this request is appreciated.

Sincerely,

J. Kevin McKechnie	James C. Sivon	James T. McIntyre
Co-Executive Director,	Barnett Sivon & Natter, PC	McIntyre Law Firm, PLLC
American Bankers Insurance Association		

Attachment A

Proposed Changes to Regulation Z and the Official Commentary to Regulation Z

1. Revise Section 226.4(d)(3)(ii) to read as follows:

(ii) Paragraph (d)(3)(i) of this section applies to fees paid for a debt-cancellation contract that provides for cancellation of all or part of the debtor's liability for amounts exceeding the value of the collateral securing the obligation, or in response to an event that interrupts the normal flow of a debtor's income or expenses, or otherwise impairs the debtor's financial situation, and that has been included by the creditor as a specified event in the contract.

2. Revise the discussion of Section 226.4(b)(10) of the Official Commentary to Regulation as follows:

1. *Definition.* Debt-cancellation contracts provide for payment or satisfaction of all or part of a debt when a specified event occurs. Included within debt cancellation contracts are guaranteed automobile protection, or GAP, agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted, and debt suspension agreements, which suspend all or part of a debt when a specified event occurs. Examples of specified events may include, but are not limited to, loss of life, health, or income; accident; disability; divorce; marriage; the birth or adoption of a child; natural disaster; leave of absence or call to military duty. Debt cancellation coverage sold after consummation in closed-end credit transactions or after the opening of a plan in open-end credit transactions is not "written in connection with" the credit transaction if the contract is written because the consumer requests the contract after consummation or the opening of a plan.