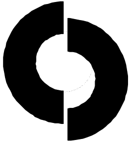

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #827
May 1998
12 U.S.C. 24(7)

April 3, 1998

Re: “Debt Suspension Agreements”

Dear [ ]:

This responds to your request that the Office of the Comptroller of the Currency (“OCC”) confirm that a national bank that issues credit cards (the “Bank”) may offer its cardholders “debt suspension agreements.” For the reasons discussed below, we agree that the proposed activity is permissible for national banks because it is part of banks’ expressly-authorized lending function and also because it is incidental to the business of banking.

Background

Under the proposed debt suspension agreements, the Bank will agree, in exchange for the payment of a monthly fee by each participating cardholder:

(a) To “freeze” the cardholder’s account for up to a specified number of months in the event that the cardholder 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; and

(b) To cancel the balance outstanding under the cardholder’s credit card account (up to the cardholder’s approved credit limit) in the event of the cardholder’s death.

While a credit card account is “frozen,” no monthly payment will be due; no finance, late or other charge will accrue; no monthly suspension fee will be due; and the Bank will not send any negative report to any credit agency due to the freeze. During the “freeze,” the cardholder will not be permitted to use the credit card for additional charges. Once a “freeze” expires, the credit card account will be reactivated and the cardholder will again be required to make monthly payments.

Participation in this program will be completely at the option of the cardholder. The Bank expects that a cardholder will not be eligible for a "freeze" until enrolled in the program for a specified minimum period of time. This waiting period may vary from one type of contingency to another. It may, for example, be longer for disabilities based on pre-existing conditions.

Discussion

A. Business of Banking

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . .

12 U.S.C. § 24(Seventh).

The Supreme Court has held that the powers clause in 12 U.S.C § 24(Seventh) is a broad grant of the power to engage in the business of banking, including, but not limited to, the five specifically recited powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 513 U.S. 251 (1995) ("*VALIC*"). Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank v. State Bank*, 77 U.S. 604 (1871); *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977); *American Insurance Association v. Clarke*, 865 F.2d 278, 282 (2d Cir. 1988).

1. Functionally Equivalent to or a Logical Outgrowth of Recognized Banking Functions

Lending is one of the expressly enumerated powers in 12 U.S.C. § 24(Seventh). Part of any lending transaction is the negotiation of the terms of the obligation, including the interest rate, due dates of payment, etc. Loan agreements often state the consequences of default, whether those consequences are penalties, repossession of collateral, or acceleration of the debt obligation. In the case of a debt suspension agreement, the parties have negotiated an option for the debtor to cease payments for a time, under specified circumstances, without adverse consequences. This type of contractual provision is no less a part of lending than any of the various other terms (covenants, security interests, etc.) that are part of a loan agreement. The authority of a national

bank to offer debt suspension agreements is, therefore, an inherent part of its express authority to make loans.

Additionally, debt suspension agreements adjust an outstanding obligation of a customer in a way resembling, but more limited than, a debt cancellation agreement.[1] Like a debt cancellation contract, a debt suspension contract helps to protect the borrower against the risk of financial hardship in times of adversity. A debt suspension agreement simply interrupts the obligation to pay for a specified time, rather than cancels it. From the bank's perspective, a debt suspension contract provides a mechanism for the bank to manage and obtain compensation for the credit risk that it undertakes in making a loan. Thus, it is a very logical outgrowth of the bank's express lending authority.

2. Respond to Customer Needs or Otherwise Benefit the Bank or its Customers

As you note in your letter, a debt suspension agreement is finely tuned to the potential duration of financial problems posed by temporary situations such as involuntary unemployment and hospitalization. For these types of situations, suspension of the debt serves the customer's need for relief from financial pressure while also protecting the bank's interest in the eventual repayment of the obligation. A customer who otherwise would suffer long-term damage to his or her credit rating can instead survive a period of difficulty with his or her standing as a borrower intact.

For the Bank, debt suspension contracts provide a source of income, from the fees charged for the debt suspension option, to offset credit losses on credit cards. The agreements also help both the Bank and the customer manage temporary situations that might otherwise result in default on the customer's obligations, thereby enhancing the Bank's ability to eventually obtain repayment from the customer. Additionally, by providing a useful option for customers, debt suspension contracts could increase the competitiveness of the Bank's credit card offerings.

3. Risks Similar in Nature to Those Already Assumed by National Banks

In times of financial stress, some borrowers will fail to repay with or without a debt suspension agreement. The risk assumed when a bank provides a debt suspension agreement is similar to the type of risk that the bank assumes when it makes a loan or provides a debt cancellation contract as part of a loan. In any of these situations, the bank accepts the risk that the borrower may be unable to repay some or all of the loan. The Bank's proposal would permit the Bank to obtain compensation for its assumption of this risk and the additional cost of temporarily foregoing the collection of interest.

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[1] The authority of a national bank to offer debt *cancellation* agreements is well established. *First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775 (8th Cir. 1990); 12 C.F.R. § 7.1013. A national bank may offer debt cancellation agreements contingent not only on the death of the borrower, but also on other events such as disability or involuntary unemployment. Letter from William P. Bowden, Chief Counsel (January 7, 1994).

B. Incidental to the Business of Banking

As the Supreme Court established in the *VALIC* decision, national banks are also authorized to engage in an activity if that activity is incidental to the performance of the five specified powers in 12 U.S.C. § 24(Seventh) *or* incidental to the performance of an activity that is part of the business of banking. An activity is incidental to the business of banking if it is "convenient and useful" in the conduct of the banking business. *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972).

The OCC and the courts have long authorized national banks to engage in credit related activities that protect the bank and the borrower against a variety of credit-related risks. The OCC's approvals and court holdings concluded that these activities are incidental to a bank's lending activities because they protect banks' interest in their loans by reducing the risk of loss if borrowers cannot make their loan repayments. *See* Interpretive Letter 283 (March 16, 1984), *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447 (credit life, disability, mortgage life, involuntary unemployment, and vendors single interest insurance); 12 C.F.R. Part 2 (credit life insurance); *IBAA v. Heimann*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) (confirming the OCC's authority to adopt its credit life insurance regulation at 12 C.F.R. Part 2). *See also* Interpretive Letter 671 (July 10, 1995), *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,619, and Interpretive Letter 724 (April 22, 1996), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,039 (vehicle service contracts); 12 C.F.R. § 7.1013 (1996) (debt cancellation contracts); *First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775 (confirming the ability of national banks to enter into debt cancellation contracts).

The rationale behind these OCC precedents and court cases is applicable to the Bank's proposal. A debt suspension contract provides a convenient and useful way for the Bank and its borrowers to manage the risk of nonpayment due to temporary financial hardship. As was discussed above, it protects the bank by providing a source of compensation for the credit risk that is part of the transaction, and it protects the borrower from long term credit damage during an interval of financial difficulty.

Conclusion

Based on the foregoing facts and analysis, we conclude that providing debt suspension agreements in connection with a bank's credit card business is permissible for national banks. This conclusion relates only to the permissibility of debt suspension agreements under the National Bank Act. The Bank should, of course, satisfy itself regarding the treatment of such agreements under any other applicable laws and provide appropriate disclosures to fully inform consumers about the relevant costs and terms, such as may be required under the Truth in Lending Act.

Prior to conducting the described activities, any bank must consult with its examiner-in-charge or with the appropriate supervisory office to ensure that its program will comply with reporting and reserving requirements associated with providing debt suspension agreements. *See* 61 FR 4852 (1996).

Sincerely,

/s/

Julie L. Williams
Chief Counsel

[12 USC 24(7)43B]