Comptroller of the Currency
Administrator of National Banks

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Interpretive Letter #903
January 2001
12 USC 24(7)

December 28, 2000

Re: Debt Suspension Products

Dear **[ ]**:

This responds to your request that the Office of the Comptroller of the Currency ("OCC") confirm that **[ ]** (the "Bank") may offer its credit card members ("Cardholders") debt suspension agreements. For the reasons discussed below, we agree that the proposed activity is permissible for the Bank under Section 24(Seventh) of the National Bank Act because the activity is part of the expressly-authorized lending function of national banks 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, to "freeze" the Cardholder's account for up to 24 months (up to 3 months for a leave of absence) in the event that the Cardholder becomes involuntarily unemployed, hospitalized, disabled, or takes a voluntary leave of absence from work. While a credit card account is "frozen," no principal payment, finance charges or other fees will be due; no finance, late or other charges will accrue; 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 and will be asked to discontinue preauthorized charges to the account, e.g., subscription payments.[1] Once a "freeze" expires, the

[1] The initial debt suspension agreements will require the Cardholder to discontinue preauthorized transactions, however, the Bank will monitor the level of such transactions after implementation of the program in order to evaluate other approaches. If the Bank concludes, after assessing the risk, that there are more "customer friendly" options to discontinuing preauthorized charges, the Bank may decide to allow some or all of these charges subject to

credit card account will be reactivated and the Cardholder will be required to resume its minimum monthly payments. Normal rates and fees will then apply to the account.

Participation will be offered to Cardholders on an optional basis. In order to enroll or activate a benefit, the Cardholder's account must be open and not delinquent. The Bank may also establish a waiting period for new enrollees before they may claim a debt suspension benefit. After initial qualification for a deferment benefit, the Cardholder must demonstrate continuing eligibility in order to continue receiving the benefit. The Cardholder may cancel the agreement at any time and may do so within 30 days of initial enrollment and receive full credit for any fees charged.

Discussion

A. Business of Banking Relations

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

> [to] 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 this "powers clause" is a broad grant of the power to engage in the business of banking, including 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.[2]

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

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continued monitoring.

[2] *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).

obligation. In the case of a debt suspension product, 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 products is, therefore, an inherent part of its express authority to make loans.[3]

Additionally, debt suspension products adjust an outstanding obligation of a customer in a way resembling, but more limited than, a debt cancellation agreement.[4] Like a debt cancellation contract, a debt suspension product helps to protect the borrower against the risk of financial hardship in times of adversity. A debt suspension product simply interrupts the obligation to pay for a specified time, rather than cancels it. From the bank's perspective, a debt suspension product 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 product 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 products 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 products could increase the competitiveness of the Bank's credit card offerings.

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[3] *See* Interpretive Letter No. 827, *reprinted in* [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,276 (April 3, 1998) (confirming the ability of national banks to enter into debt suspension agreements).

[4] 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.), *cert. denied*, 498 U.S. 972 (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. *See* Interpretive Letter No. 640, *reprinted in* [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,527 (January 7, 1994).

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 product. The risk assumed when a bank provides a debt suspension product 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.

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 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.[5]

The rationale behind these OCC precedents and court cases also is applicable to the Bank's proposal. A debt suspension product 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.

[5] *See* Interpretive Letter No. 283, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447 (March 16, 1984) (involving sales of credit life, disability, mortgage life, involuntary unemployment, and vendors single interest insurance); 12 C.F.R. Part 2 (regulating sales of 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 No. 671, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,619 (July 10, 1995), and Interpretive Letter No. 724, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,039 (April 22, 1996) (involving sales of vehicle service contracts); 12 C.F.R. § 7.1013 (1996) (confirming the ability of national banks to enter into debt cancellation contracts); *First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775 (1990) (same).

Conclusion

Based on the foregoing facts and analysis, we conclude that providing debt suspension products in connection with a bank's credit card business is permissible for the Bank pursuant to section 24(Seventh) of the National Bank Act. 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 regulations or other applicable regulation or supervisory guidance. In this regard, I note that the OCC has issued an advance notice of proposed rulemaking addressing debt cancellation and suspension products. The Bank's product would be subject to any final regulation adopted as a result of that rulemaking. [6]

Prior to conducting the described activities, the Bank should consult with its examiner-in-charge or with the appropriate supervisory office to ensure that its program will comply with reporting and reserving requirements as associated with providing debt cancellation products. *See* 61 Fed. Reg. 4852 (1996).

Sincerely,

-signed-

Jonathan Rushdoony
District Counsel

[6] *See* Debt Cancellation Contracts, 65 Fed. Reg. 4176 (Jan. 26, 2000).