Kardonick v. JP Morgan Chase & Co. et al
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EXHIBIT B

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The Impact of Debt Cancellation Contracts on State Insurance Regulation

A Report to the FIRST

By the Center for Economic Justice

July 2003

1. Introduction

Debt Cancellation Contracts (DCCs) and related products like Debt Suspension Agreements (DSAs) are products sold in connection with a consumer loan and which promise to provide some debt relief to the consumer if certain events occur. The events triggering the benefit under the DCCs/DSAs are typically events that impair the borrower's income or place a financial burden on the borrower. DCCs/DSAs are part of the group of debt protection products that include credit insurance and which promise, among other things, to preserve the borrower's credit rating in adverse circumstances.

Over the past three years, lenders have shifted their debt protection product offerings from credit insurance to DCCs/DSAs, most notably in connection with credit cards. The majority of major credit card issuers, including Citicorp, Discover (Sears), Bank of America, Fleet Bank, Advanta, Bank One, Chase, MBNA, Providian and private label card issuers like Target, have replaced credit card credit insurance with credit card DCCs/DSAs

This report will examine both credit insurance and DCCs/DSAs to help explain how DCCs/DSAs are a substitute for credit insurance and why lenders have moved away from credit insurance to DCCs/DSAs. We will also examine the impact DCCs/DSAs on credit insurance regulation and on consumers who purchase debt protection products. We also review regulatory activity related to DCCS/DSAS and conclude with a set of recommendations for regulatory oversight of DCC.

2. Credit Insurance versus DCCs/DSAs

DCCs/DSAs are part of the group of debt protection products that include credit insurance and which promise, among other things, to preserve the borrower's credit rating in adverse circumstances. A complete understanding of DCCs/DSAs requires an understanding of how DCCs/DSAs compare and relate to credit insurance.

2.1 Credit Insurance

Credit insurance refers to a group of insurance coverages sold in connection with a loan, credit agreement or credit card account. Credit insurance generally makes payments for the consumer *to the lender* for a specific loan or credit agreement in particular circumstances. Credit insurance *protects the lender's loan* in the event something happens to impair the consumer's ability to pay. The common types of credit insurance sold include:

- *Credit Life*, which pays off the consumer's remaining debt on a specific loan or credit card account if the borrower dies during the term of the coverage.
- *Credit Accident and Health, also known as Credit Disability,* which makes monthly payments on a specific loan or credit card account if the borrower becomes disabled during the term of coverage.
- *Credit Involuntary Unemployment*, which makes monthly payments, often limited in number, on a specific loan or credit card account if the borrower becomes involuntarily unemployed during the term of coverage.
- *Credit Leave of Absence*, which makes a limited number of monthly payments on a specific loan or credit card if the borrower takes an unpaid family leave from work for specific reasons, including care for a newborn or care for a seriously ill family member.
- *Credit Property*, which pays to repair or replace personal property purchased with the loan or credit proceeds and/or serving as collateral for the credit if the property is lost or damaged. Unlike the first four credit insurance coverages, credit property insurance is not directly related to an event affecting a consumer's ability to pay his or her debt.

There are three parties to a credit insurance agreement – the borrower, the lender and the credit insurer. The credit insurer sells a group policy to the lender who, in turn, sells credit insurance in connection with individual loans or credit cards to borrowers. The lender typically issues an insurance certificate for the group policy to the borrower. In exchange for specified premium payments, the credit insurer agrees to make the borrower's payments to the lender on behalf of the borrower when a covered event occurs. A covered event is the death, disability, involuntary unemployment or leave of absence specified in the credit insurance policy. Appendix 1 contains an example of a credit insurance certificate.

2.2 Debt Cancellation Contracts and Debt Suspension Agreements

There are two parties to DCC/DSA products – the borrower and the lender. The DCC/DSA is an amendment or addition to the loan agreement between the lender and the borrower. The DCC/DSA loan agreement amendment states that, for a fee, the lender will waive certain payments, charges and/or fees when certain covered events occur. The covered events include death, disability, involuntary unemployment, leave of absence and/or other events specified in the DCCS/DSAS agreement. Unlike credit insurance, no payment is made on behalf of the consumer when a covered event triggers a DCC/DSA benefit. Rather, the lender "cancels" or "suspends" a payment, charge and/or fee. Appendix 2 contains an example of a DCC agreement provided to a consumer.

Although there are technically two parties to a DCC/DSA, lenders offering a DCC/DSA product typically rely on credit insurers for administration of the program. The DCC agreement in Appendix 2 cites American Bankers – the largest credit insurer in the country – as the Plan Administrator. In addition, lenders typically purchase an insurance policy – a contractual liability policy – from a credit insurer to cover the cost of any DCC/DSA program benefits. Therefore, in practice, a DCC/DSA program is administered almost identically to a credit insurance program – the credit insurer administers the program, markets the program to borrowers and pays benefits on behalf of the consumer to the lender while the lender reaps large revenues for providing a list of borrowers to the credit insurer.

2.3 Credit Insurance and DCCs Can Be Functional Equivalents

To a consumer, DCCs and credit insurance are very similar – or even identical – products. For example, a credit card credit insurance program containing credit life, credit disability and credit involuntary unemployment coverages provides the identical benefits for a consumer as a DCC program for death, disability and involuntary unemployment. We will show later in the report how lenders have modified the triggering events (and, consequently, the benefits) from credit insurance when moving to a DCC/DSA program – with very unfavorable results for consumers. But, in this example, the benefits under the two programs are identical from the consumer's perspective – in the event of the death, the entire outstanding debt is eliminated and in the event of qualifying disability or involuntary unemployment, the minimum monthly payment is eliminated.

Table 1
Comparison of Credit Insurance and DCC Benefits

Event	Credit Insurance	DCC
Death	Outstanding Debt Paid Off	Outstanding Debt Canceled
Disability	Minimum Monthly Payment Made	Minimum Monthly Payment and Related Fees Canceled
Involuntary Unemployment	Minimum Monthly Payment Made	Minimum Monthly Payment and Related Fees Canceled

Another important similarity between credit insurance and DCCS/DSAS is the methods of payment. Both products are offered with a monthly payment method in some circumstances and with a single payment method in others. With the single payment method, the premium (credit insurance) or fee (DDC/DSA) is added to the underlying loan and financed. Generally, credit insurance or DCCs/DSAs sold in connection with open-end or revolving loans, such as credit cards, utilize a monthly payment method with the premium or fee based on the average or period-ending outstanding loan balance. Generally, credit insurance or DCCs/DSAs sold in connection with closed-end or installment loans utilize the financed single premium / financed single fee payment method.[1]

[1] There are important exceptions. Credit unions have historically sold monthly payment ("monthly outstanding balance) credit insurance in connection with installment loans because these products are far more favorable to consumers than financed single premium ('single premium) products.

The table below compares the terminology used for credit insurance and DCCs/DSAs:

Table 2
Comparison of Credit Insurance and DCC/DSA Terminology

Credit Insurance	Debt Cancellation/Debt Suspension
benefit	protection, feature
claim	activate protection
contingency	protected event
coverage	protection, feature
credit	debt
Creditor	bank, creditor
insurance	protection
insurer	bank, creditor
Insured	protected cardholder, debtor
life insurance	death protection
paid	canceled, waived
Pay	cancel, waive
policy	agreement, addendum, contract
premium	fee
premium rate	fee rate

2.4 Differences between Credit Insurance and DCCs/DSAs

There are significant differences between credit insurance and DCCs/DSAs, the most important of which is the nature of regulatory oversight of the two products. Credit insurance is an insurance product and, consequently, is regulated primarily by state insurance regulators.[2] The national Comptroller of the Currency, credit union regulator,

[2] The Center for Economic Justice has published two national reports on state credit insurance regulation in collaboration with Consumers Union (1999) and the Consumer Federation of America (2001). In addition, CEJ has published a number of state-specific credit insurance analyses. See www.cej-online.org.
There are a few instances of federal regulation related to credit insurance. For example, regulations implementing the federal Truth in Lending Act provide requirements for calculation of the Annual Percentage Rate (APR). If the offer of credit insurance offered in connection with a loan meets certain requirements, then the cost of credit insurance does not have to be included in the APR calculation. If the credit insurance offer does not meet these requirements, then the cost of credit insurance must be included in the APR. As a result of Regulation Z, virtually all credit insurance sold meets these disclosure requirements.
A second example of federal regulatory action affecting credit insurance relates to financed single premium credit insurance sold in connection with real-estate secured loans. Recent changes to HOEPA regulations require that the costs of single premium credit insurance be included in the APR calculation for these types of loans. These regulatory changes, along with other actions by secondary lenders Fannie Mae and Freddie Mac and advocacy by fair housing and fair lending organizations, led to the virtual elimination of financed single premium credit insurance sold in connection with real estate secured loans and its replacement with monthly pay products.

and thrift regulator have all determined that DCCS/DSAS are a banking product and, consequently, are not subject to the state insurance regulation. The decisions by federal banking regulators about regulatory jurisdiction over DCCS/DSAS have developed over a lengthy period of time and reflect strong disagreements between these federal regulators and state insurance regulators. We discuss the history of DCCS/DSAS regulatory decisions in Section 5.

The differences in regulatory jurisdiction over credit insurance and DCCs/DSAs result in major differences in the scope and nature of regulatory oversight for the products and consumer protections for potential purchasers of the products. We discuss these important differences in Section 6.

Another difference between credit insurance and DCCS/DSAS is the number of parties involved. As stated above, credit insurance involves three parties – borrower, lender and insurer. Since the provision of benefits under the credit insurance policy requires the insurer to pay the lender under certain circumstances, there is a need to ensure that the insurer maintains the ability to pay. Stated differently, there is a regulatory interest in the solvency of the credit insurer. With DCC, there is no payment of benefits to the lender. Rather, the benefits for the consumer under the DCCs/DSAs are a cancellation of certain payments and/or interest charges. Although federal regulators certainly have an interest in the solvency of lenders, there is no need for solvency to provide the DCCs/DSAs benefit. A lender could be insolvent and still be able to cancel or waive a fee[3].

There are important benefit differences between credit insurance and DCCs/DSAs. The DSA benefit is a debt suspension – the consumer can skip a payment and not accrue additional interest charges or late fees. Unlike credit insurance, which makes the monthly payment on behalf of the consumer, and therefore pays down some of the loan principal, a DSA does not reduce the amount owed by the consumer. In addition, some credit insurance products provide a monthly benefit greater than the minimum monthly payment due on a loan. For example, instead of the minimum monthly payment which may be only 1.8% or 2.0% of the outstanding balance, some credit unemployment policies provide a monthly payment of 3% or more of the monthly payment.

[3] DCCs/DSAs are typically amendments to loan agreements. If a DCC/DSA were a separate agreement from the underlying loan agreement, a consumer may not receive the benefits of the DCC/DSA agreement if the lender became insolvent.

3. Market Structure and Regulatory Oversight

Credit insurance is characterized by reverse competition – a market structure in which market forces cannot be relied upon to protect consumers from overcharges by insurers. This market structure leads to, in theory, strict regulatory oversight of credit insurance by state insurance regulators. In this section, we examine the market structure for credit insurance and DCCs/DSAs and the regulatory structures for each set of products.

3.1 Reverse Competition in Credit Insurance Markets

One of the principal responsibilities of state insurance regulators is monitoring the financial condition of insurance companies to ensure that insurers are able to pay the benefits under the insurance contracts for which consumers have paid premiums to the insurers. Consequently, state insurance regulators will monitor the financial condition of credit insurers as they would insurers offering other products. However, state regulatory oversight of credit insurance has typically been, at least in theory[4], far more extensive for credit insurance than for other types of products, such as life, auto or homeowners insurance. The reason for the more extensive regulatory structures for credit insurance arises from the reverse-competitive market structure of credit insurance.

A useful description of credit insurance markets is found in NY State Insurance Department Regulation 27A (11NYCCR 185).

> 185.0(b) In the marketing of credit insurance, the inferior bargaining position of the debtor creates a "captive market" in which, without appropriate regulation of such insurance, the creditor can dictate the choice of coverages, premium rates, insurer and agent, with such undesirable consequences as: excessive coverage (both as to amount and duration); excessive charges (including payment for nonessential items concealed as unidentifiable extra charges under the heading of insurance); failure to inform debtors of the existence and character of their credit insurance and the charges therefore, and consequent avoidance of the protection provided the debtor by such coverage.
>
> (c) In the absence of regulation, premium rates and compensation for credit insurance tend to be set at levels determined by the rate of return desired by the creditor in the form of dividends or retrospective rate refunds, commissions, fee or other allowances, instead of on the basis of reasonable cost. Such "reverse competition," unless properly controlled, results in insurance charges to debtors that are unreasonably high in relation to the benefits provided to them.

[4] See CEJ national reports for state failures in credit insurance regulation

In a normally competitive market, competition for the consumer's business leads to lower prices and reasonable profits. In a reverse competitive market, the credit insurer, who requires a lender to produce credit insurance sales, competes for the lender's business. This competition typically takes the form of offering higher commissioners and compensation and additional services to the lender. Consequently, competition to sell credit insurance policies drives **up** the price of credit insurance. In a reverse competitive market, the consumer is unable to exert market pressure leading to lower prices or reasonable profits.

The National Association of Insurance Commissioners (NAIC) recently adopted a model law regarding the regulation of credit property insurance in an effort to promote more effective and more uniform regulation of the product across the states. One of the purposes of the model is to:

> *Address the problems arising from reverse competition in credit insurance markets.*

The model law defines reverse competition:

> "Reverse competition" means competition among insurers that regularly takes the form of insurers vying with each other for the favor of persons who control, or may control, the placement of the insurance with insurers. Reverse competition tends to increase insurance premiums or prevent the lowering of premiums in order that greater compensation may be paid to persons for such business as a means of obtaining the placement of business. In these situations, the competitive pressure to obtain business by paying higher compensation to these persons overwhelms any downward pressures consumers may exert on the price of insurance, thus causing prices to rise or remain higher than they would otherwise. In a reverse competitive market, powerful market forces work to the disadvantage of the consumer.

3.2 Regulatory Oversight of Credit Insurance

The reverse competitive nature of credit insurance markets requires stringent regulatory oversight of products, sales practices and prices (rates) to ensure that consumers are treated fairly in the sales and claim process and that benefits provided under the credit insurance policy are reasonable in relation to the premiums charged. Towards this end, every state requires prior approval of credit insurance policies to ensure unreasonable restrictions on eligibility and coverage are not included. Many states have also established loss ratio standards as the measure of reasonable benefits in relation to premium. The loss ratio standards for credit life and credit disability range from 40% to 70% with the vast majority of states using loss ratio standards in the 50% to 60% range. The NAIC model regulations for credit insurance specify a 60% loss ratio

standard – meaning that claims paid on behalf of consumers to lenders should be at least 60% of the premiums earned by insurers from the related policies.

There is substantial variation among states in the regulatory requirements for credit insurance, most notably in the states' implementation of the rate standard – that benefits must be reasonable in relation to premium. There is also variation among states in the degree to which policy forms (product filings) are reviewed. Some states routinely approve product filings, while other states challenge the same filings as having unfair or misleading provisions.

The degree of variation among states creates a challenge for national lenders to offer a product across states. For example, if a lender wanted to offer a credit insurance package of life, disability, involuntary unemployment and leave of absence, some of the regulatory hurdles would include:

- Filing and approval of a group insurance policy, insurance certificates and application forms for each coverage for each jurisdiction. A national lender operating in 50 states and the District of Columbia would have to make 204 filings – four filings each in 51 jurisdictions. While the filings will be similar and identical across many states, differing state requirements mean that all of the filings will have some state-specific issues. It is important to point out that an insurer wishing to file and gain approval for this package of coverages will have to use two different types of insurance companies. Insurance companies that write life and health insurance are not permitted to write property and casualty coverages. The filings for credit involuntary unemployment and credit leave of absence must be submitted by a property casualty insurance company.

- Filing and approval of rates for each coverage for each jurisdiction. For credit life and credit disability, most credit insurers will file for the maximum permissible rate – the so-called *prima facie* rate – which an insurer can use without any justification. However, if the lender's particular credit insurance clientele exhibits much higher than average losses, the insurer can and will file for a higher rate – so-called upward deviations. For involuntary unemployment and leave of absence, the rate filings must include an actuarial analysis and justification for the proposed rate. Even after initial approval of rates, the lender and the insurer must monitor the states for changes in the *prima facie* rates, which will necessitate changes in the both the rates charged in those states and changes in the product disclosures.

- Licensing of agents in each jurisdiction. Although many states have simplified the licensing of agents selling only credit insurance, the lender and the insurer must identify and comply with agent licensing requirements in the states.

3.3 Market Structure for DCCs/DSAs

The market structures of credit insurance and DCCS/DSAS products are, to some extent, different. Because the sale of DCCs/DSAs involves two parties, one principal structure of reverse competitive markets – the seller competing for sales to a producer and not directly selling to the ultimate buyer – is missing. Other characteristics of the markets in which credit insurance and DCCs/DSAs are sold are similar, including:

- The credit insurance or DCCs/DSAs is a side issue to the major transaction. The major transaction is the underlying loan or credit for which the consumer is applying.

- An absence of choice for the consumer. The lender selects the coverage or package of coverages to offer and the consumer has only the choice to accept or not accept the package of coverages. Although a few states require credit insurers to offer individual coverages, a consumer who wants to purchase, say, credit disability, must purchase the package of life, disability, involuntary unemployment, etc., even if he or she is ineligible for benefits under the other coverages.

- Limited product information and consumer misperceptions. Typical disclosures for both credit insurance and DCCs/DSAs identify the events that trigger benefits, some eligibility requirements and rates. There is never any information about, for example, the likelihood of a particular event occurring on average. Consumers typically have misperceptions about their likelihood of encountering a triggering event, such as disability or involuntary unemployment.

The absence of the credit insurer from DCC/DSA markets[5] does not eliminate the reverse competition. The inferior bargaining position of the borrower, the fact that the DCC/DSA purchase is tangential to the principal transaction, the ability of the lender to dictate terms and fees and the unique ability of the lender to access the business are all elements of a reverse-competitive market. Although the market structure for DCCs/DSAs is not the classic three-party reverse competition market structure, consumers of DCCs/DSAs products do not have market power sufficient to force lenders to offer DCCs/DSAs products at reasonable rates. As we show below in Section 7, the market results for DCCs/DSAs products – both the relationship of benefits to fees and the nature of coverages and exclusions – vividly document the absence of consumer power in the DCCs/DSAs markets.

[5] In practice, a number of lenders will secure a group insurance policy to insure their DCC and DSA exposure.

3.4 Regulatory Oversight of DCCs/DSAs

DCCs/DSAs are regulated by both federal and state agencies. DCCs/DSAs offered by national banks, savings and loan associations and credit unions are subject to the regulatory oversight of the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the National Credit Union Administration, respectively. DCCs/DSAs offered by state banks, state savings and loan associations and state credit unions are subject to the regulatory oversight of state banking and credit union regulators. We discuss the regulatory oversight of DCCs/DSAs in more detail in Section 6, but the most salient points include:

- The OCC has taken the lead among federal agencies on both establishing DCCs/DSAs as a banking product and establishing the federal regulatory framework for DCCs.
- The OCC's recently-promulgated DCCs/DSAs regulation provides no regulation of the fee amount that can be charged for DCCs/DSAs and few requirements for minimum product standards.
- Most states, even those who continue to believe that DCCs/DSAs are insurance products and should be subject to the same type of regulatory oversight as credit insurance, have adopted the same state requirements for DCCs/DSAs as those created for national banking institutions to avoid putting state-charted institutions at a competitive disadvantage. The development of DCCs/DSAs regulatory structures is a graphic example of regulatory arbitrage – a race to the lowest common denominator of consumer protection.

4. History of DCCs/DSAs and the Fight over Regulatory Jurisdiction

In 2002, the Comptroller of the Currency (OCC) promulgated a regulation governing the sale of DCCs/DSAs by national banks. The 2002 OCC rule culminates a long fight between state insurance regulators and federal banking regulators regarding the regulation of DCCs/DSAs. The fight started in the early 1960's. This section reviews the history and development of regulation of DCCs/DSAs.

4.1 Initial Rulings by the OCC and Opposition by State Insurance Regulators

In a December 1963 issue of The National Banking Review, the OCC discussed DCCs as a legal activity of a national bank. In response to a letter of inquiry on DCCs, the OCC issued a letter on March 10, 1964 stating that that a national bank has the right to issue DCCs on loans issued through the bank. Appendix 3 contains a copy of that letter. Comptroller of the Currency James J. Saxon stated:

> The use of debt cancellation contracts, the imposition of an additional charge and the establishment of reserves as protection against losses arising out of such contracts is a lawful exercise of the posers of a National Bank. The exercise of such powers is necessary to and is part of the business of banking. Such activities may not therefore, properly be considered as engaging in the business of insurance.

On March 26, 1964, the OCC issued another letter to a national bank stating that the March 10, 1964 ruling was also applicable to installment loans as well as to any other obligation owing to a national bank.

Later in 1964, the National Association of Insurance Commissioners (NAIC) issued a resolution in opposition to the OCC's ruling on DCCs stating that DCCs constitute the business of insurance and, therefore, are subject to state insurance regulation. The NAIC resolution stated that, under the OCC's ruling, the public would be "of the protection of such state laws and regulations with respect to credit life insurance." Appendix 4 contains a copy of the NAIC resolution and a legal memorandum prepared by the Life Insurance Association of America examining whether DCCs constitute the business of insurance.

On August 26, 1971, the OCC promulgated 12 C.F.R. 7.7495 permitting national banks to enter debt cancellation agreements, charge a fee for the agreement, and set up reserves to cover liabilities. In 1972, the OCC issued letters permitting national banks to offer debt cancellation agreements for theft, loss, and destruction of collateral. On March 26, 1984, the OCC issued Interpretive Letter No. 283, which provided:

- National banks may sell credit life and disability insurance, as an agent for the insurer.
- The sale of credit life and disability insurance is directly related to a bank's express lending authority because it protects the bank's ability to recover the value of its loan and, therefore, is under the scope of incidental powers.
- The bank is prohibited by statute 12 U.S.C. § 1972(1) from conditioning any extension of credit on the borrower's purchase of credit insurance from the bank or one of its subsidiaries.

4.2 The *First National Bank of Eastern Arkansas* Litigation

Although the OCC had ruled for years that national banks could sell DCCs, the question of the effect of state regulation of credit insurance on those agreements had not been litigated. In 1987, First National Bank of Eastern Arkansas began offering debt cancellation agreements as an alternative to credit insurance. Initially, the Arkansas insurance department stated that it did not object to the practice. However, given the risk of losing their credit insurance business, credit insurers urged the Arkansas Department

of Insurance to change its position. The Department reversed itself and ruled that debt cancellation agreements were an "identical alternative to credit insurance," were subject to regulation, and the sale of any such agreements would result in litigation by the Department against the bank. In response, First National Bank of Eastern Arkansas sued the state insurance department in 1989 seeking a declaration that the Department had no regulatory authority over the bank in its sale of the debt cancellation agreements. The District Court ruled in favor of the bank, concluding that the agreements were not credit insurance and were an incidental power of national banks. The Eighth Circuit Court of Appeals upheld the lower court ruling in 1990.

In response to the *First National Bank of Eastern Arkansas* ruling, the NAIC Credit Insurance Committee discussed the consumer protection problems with unregulated DCCs compared to credit insurance. The chair of the Credit Insurance Committee, Missouri Director of Insurance Lewis Melahn, requested a meeting with the OCC to better understand the OCC's positions on regulation of DCCs. In an August 24, 1992 letter, the OCC declined to meet with insurance regulators. Appendix 5 provides a copy of the OCC letter and the minutes of the Credit Insurance Committee's discussion of DCCs.

4.3 The OCC Expands Its Rulings

Perhaps emboldened by the *First National Bank of Eastern Arkansas* rulings, the OCC moved to expand the powers of federal banks in this area over the following years. On January 1, 1994, OCC Interpretive Letter No. 640 stated that national banks may offer debt cancellation agreements that cancel debt in the event of disability or unemployment, in addition to agreements that cancel debt upon death. In 1996, the OCC expanded its rule to include agreements that cancel debt in the event of disability, in addition to agreements that cancel debt upon death, by deleting 12 C.F.R. 7.7495 and creating 12 C.F.R. 7.1013, which provides that "national banks may enter into a contract to provide for loss arising from cancellation of an outstanding loan upon the death or disability of the borrower."

On April 3, 1998, OCC Interpretive Letter No. 827 stated that a bank could enter a debt suspension agreement. Under such an agreement, the bank could freeze the credit card holder's account for a set period of time for involuntary unemployment, disability, family leave, or hospitalization. The agreement could also provide for the cancellation of the debt upon death.

On June 30, 1998, the OCC issued a letter to a national bank stating that the bank could offer debt cancellation agreements for death, disability or involuntary unemployment on retail loan products and could purchase a liability policy from one of its insurance subsidiaries to cover any losses. On that same date, the OCC issued another letter to a national bank stating that the bank could offer debt deferment agreements that would freeze the credit card holder's account for a set period of time for involuntary unemployment, disability, family leave, or hospitalization.

4.4 Gramm-Leach Bliley Act

In 1999, Congress passed a comprehensive overhaul of national banking, Gramm-Leach-Bliley Act, Public Law 106-102 (GLBA). GLBA has several provisions that arguably affect the regulation of DCCs/DSAs by national banks. By the time of passage of GLBA, most state insurance departments had conceded the fight over whether DCCs/DSAs could be regulated as insurance products. The Texas Department of Insurance (TDI) continued to press the fight. Appendix 6 is copy of a letter issued by the TDI in May 1999 arguing that DCCs were subject to some state insurance regulation. The banking industry quickly responded with an alternative legal brief and rebuttal to TDI, a copy of which is provided in Appendix 7. As discussed below, both opponents and proponents of state regulation of DCCS/DSAS by national banks argue that GLBA supports their cause. However, until the courts rule otherwise, most observers believe that GLBA does not permit state regulation of DCCS/DSAS by national banks.

4.5 OCC DCC/DSA Rulemaking

In 2001, the OCC initiated a rulemaking proceeding to establish regulations for DCCs/DSAs. The rulemaking was welcomed by banks who sought specific guidelines for the sale of DCCs/DSAs. By this time, the NAIC and state insurance regulators had largely given up the fight for jurisdiction over DCCs/DSAs issued by national banks, thrifts or credit unions and submitted comments asking the OCC to create regulatory parity between credit insurance and DCCs/DSAs. The regulators and consumer organizations argued that, since the two products were functional equivalents, less regulatory oversight of DCCs/DSAs would cause a migration from credit insurance to DCCs/DSAs by lenders with troubling results for consumers. Appendix 8 is a copy of the comments submitted by the Center for Economic Justice and the Consumer Federation of America. The OCC issued its rulemaking decision in August 2002.

5. Current Status of States' Authority over Debt Cancellation Contracts and Debt Suspension Agreements

The recent DCC/DSA rule promulgated by the OCC became effective June 16, 2003.[6] The final regulation is found in Appendix 9. The OCC summarized the significant features for the rule as follows:

- It codifies the OCC's longstanding position that DCCs and DSAs are permissible banking products.
- It establishes important safeguards to protect against consumer confusion and areas of potential customer abuse. In particular, the final rule prohibits national banks from offering lump sum, single premium DCCs or DSAs in connection with residential mortgage loans.
- The rule provides for standardized disclosures of key information in connection with the offer and sale of DCCs and DSAs. The disclosure requirements are structured to accommodate widely used methods of marketing DCCs and DSAs, including telephone solicitations, mail inserts, and so-called "take one" applications.
- To the extent feasible, the rules apply consumer protections modelled on the framework of consumer protections that Congress directed the OCC (and the other Federal banking agencies) to apply to banks' insurance sales. National banks are familiar with these insurance sales requirements, which are contained in part 14 of the OCC's regulations, and the approach taken in the final rule enables banks to harmonize their policies, procedures, and employee training programs across the two product lines.
- The rule addresses safety and soundness considerations presented by DCCs and DSAs by requiring national banks to manage the risks associated with these products according to safe and sound banking principles, including appropriate recognition and financial reporting of income, expenses, assets, and liabilities associated with DCCs and DSAs, adequate internal controls, and risk mitigation measures.

In promulgating this rule, the OCC rejected recommendations by state insurance regulators and consumer organizations to establish minimum benefit standards. The OCC explain its decisions as follows:

[6] The Comptroller delayed indefinitely implementation of certain provisions in the DCC regulation. The notice of this action and request for comments on the issue are found in Appendix 10. The comments of CEJ and Consumer Federation of America in response to the action and notice are found in Appendix 11.

> For several reasons, we decline to depart from the basic regulatory approach we proposed, although the final rule does contain enhanced consumer protection features beyond those contained in the proposal. First, as the Taylor court explained, DCCs and DSAs are distinct from credit insurance as a matter of law. Moreover, we see no evidence that the market for DCCs and DSAs suffers from the same flaws as the commenters assert prevail in the credit insurance market. Issuers of DCCs and DSAs do not compete to enlist independent, third-party sellers to place their product. Instead, every national bank that issues DCCs or DSAs is its own seller because these products are provided in conjunction with loans that the bank itself makes. Commenters provided no evidence of impairment in the market for DCCs and DSAs, but instead relied on concerns regarding distortions and abuses in the credit insurance market. Thus, we cannot conclude that the strongest reason given by the commenters in support of fee regulation -- dysfunction in the market that disclosures are inadequate to overcome --is present in the market for DCCs and DSAs. Moreover, as the rule's express prohibition on tying makes clear, the choice of purchasing the product is left exclusively to the customer. We have concluded, therefore, that a regulatory approach that includes price controls as a primary component is not warranted.

The OCC also rejected recommendations by consumer organizations to prohibit single fee products:

> In the absence of evidence that the abuses identified by the commenters are occurring in the DCC or DSA market, we have declined to adopt an across-the-board prohibition on lump sum fees. We remain concerned, however, that abuses similar to those occurring in the credit insurance market not develop with respect to DCCs or DSAs provided in connection with home mortgage loans. To guard against that result, the final rule prohibits a national bank from requiring a customer to pay the fee for a DCC or DSA in a single payment, payable at the outset of the contract, if the debt that is the subject of the contract is a residential mortgage loan. The rule permits single payment contracts in the case of all other consumer loans, but requires banks that offer the option of paying the fee in a single payment to also offer the bona fide option of paying for that contract in periodic payments. In such cases, the bank must also make certain disclosures related to the fee.
>
> We continue to believe that the approach that best balances encouraging banks to provide a viable choice of products for consumers with discouraging unfair practices is to require banks to offer both options so that a customer can choose between a lower total fee or the availability of a refund. In our view, the potential for unfairness in a no-refund product lies principally in the fact that the customer may be induced to pay "up front" for coverage that he or she never receives because the loan is prepaid. This result is substantially mitigated if the consumer has the option of DCC or DSA coverage on a "pay as you go" basis. Accordingly, the final rule retains this provision (as renumbered) with one substantive change.

> The text of the final rule requires that a bank that offers a no-refund DCC or DSA must also offer the customer a bona fide option to purchase a comparable contract that provides for a refund. The option to purchase is bona fide if the refund product is not deliberately structured in such a way, including pricing of the product, as to deter a customer from selecting that option.

Despite this explanation, the OCC announced on June 14, 2003 – two days before the effective date of the rule – an indefinite delay in the implementation of the single fee provisions for certain types of sellers:

> The Office of the Comptroller of the Currency (OCC) has determined to delay the date when compliance is required with certain provisions of the final rule governing debt cancellation contracts (DCCs) and debt suspension agreements (DSAs) in order to allow the OCC to consider issues that have recently been brought to our attention concerning the application of the DCC/DSA rule in the context of closed-end consumer loan transactions where DCCs and DSAs are offered through unaffiliated, non-exclusive agents. The delay of the compliance date applies only to the extent and to the types of transactions described in this document. In all other circumstances, national banks are required to comply with the DCC/DSA rule as of June 16, 2003, which is the date on which the rule takes effect. The OCC also is inviting comment on issues raised by national banks related to the sale of DCCs and DSAs in connection with closed-end consumer loans offered through such non-exclusive agency relationships.
>
> In addition, the rule requires a national bank that offers a customer the option to pay the fee for a DCC or DSA in a single payment also to offer that customer a bona fide option to pay the fee on a periodic basis ("periodic payment option"). The final rule takes effect on June 16, 2003.
>
> The OCC recently has received information that the periodic payment option requirement may present unique issues, of which the OCC was previously unaware, in connection with DCCs and DSAs offered by national banks through unaffiliated, non-exclusive agents, with respect to certain types of consumer purchase transactions, most notably car loans made available through automobile dealers.

> Accordingly, we have determined that it is appropriate to delay the mandatory compliance date for the periodic payment option in the case of transactions where unaffiliated, non-exclusive agents of a national bank offer that bank's DCC or DSA in connection with closed-end consumer credit, until the OCC has an opportunity to further evaluate the feasibility of approaches to providing appropriate customer protections in connection with that type of transaction. Because the availability of the periodic payment option also triggers certain disclosures, we also are delaying the time for compliance with certain other provisions in the DCC/DSA final rule that are linked to the requirement to offer a periodic payment option, including the requirement to provide the long form disclosures.

5.1 Impact of OCC Rule on State Jurisdiction over DCC/DSAs

The regulations by the Office of the Comptroller of the Currency (OCC) deprive the states of authority to regulate the sale by national banks of Debt Cancellation Contracts (DCCs) and Debt Suspension Agreements (DSAs). The regulation provides:

> Scope. This part applies to debt cancellation contracts and debt suspension agreements entered into by national banks in connection with extensions of credit they make. National banks' debt cancellation contracts and debt suspension agreements are governed by this part and applicable Federal law and regulations, ***and not by … State law***.

12 C.F.R. 7.31 (c) (emphasis added). The OCC expressly rejected the Texas Insurance Commissioner's position that states retain the power to regulate DCCs and DSAs by national banks as "insurance." In the Summary of Comments for the final rule making, the OCC stated:

> Many commenters sought clarification about the regulatory framework that governs DCCs and DSAs. They urged the OCC to clarify that DCCs and DSAs offered by national banks are not subject to regulation under State insurance law. One commenter, however, asserted that DCCs and DSAs are "authorized" insurance products under the Gramm-Leach-Bliley Act (GLBA) and that States have express authority to regulate them as insurance, subject only to the preemption standards set forth in section 104 of the GLBA.

> As is described in the Background section of this preamble discussion, DCCs and DSAs are banking products authorized under 12 U.S.C. 24(Seventh). This final rule, together with any other applicable requirements of Federal law and regulations, are intended to constitute the entire framework for uniform national standards for DCCs and DSAs offered by national banks. Accordingly, the final rule states that DCCs and DSAs are regulated pursuant to Federal standards, including part 37, and not State law.

For national banks, therefore, federal law preempts the state's ability to regulate the transaction, barring a lawsuit to overturn the OCC's position. DCCs and DSAs are used by a variety of lenders, however. This section addresses the extent to which states retain regulatory authority over DCCs and DSAs by different types of lenders.

5.1.1 National Banks

The OCC's regulation applies to national banks. 12 C.F.R. § 37.2 (b). Thus, unless the OCC's determination is overruled by a court, the regulation preempts any state regulation of DCCs and DSAs sold by national banks.

The argument against preemption is that the Gramm-Leach-Bliley Act, Public Law 106-102 (GLBA) allows states to regulate DCCs and DSAs. GLBA affirms the right of national banks to sell DCCs and DSAs as "authorized products." "Authorized products" are defined to be products which the OCC as of January 1, 1999, "had determined in writing that national banks may provide as principal." GLBA § 302(b). Since the OCC, prior to the grandfather date, has ruled that national banks have the power under the National Bank Act to underwrite DCCs (12 C.F.R. § 7.1013) and DSAs (OCC Interpretative Letter No. 827) and since these determinations have not been overturned by a court of competent jurisdiction, they qualify as "authorized products", and may be sold by national banks.

The issue, however, is whether the sale of the products by national banks can be regulated by the states. Although GLBA allows national banks to sell DCCs and DSAs, it also expressly reserves the right of states to regulate insurance:

> No person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State in accordance with the relevant State insurance law . . . .

GLBA § 104(b). Thus, the OCC's regulation preempts state laws if DCCs and DCAs are not "insurance," but not if the products constitute "insurance." Historically the decisions by courts and federal agencies were that DCCs and DSAs are not insurance. *See, e.g.*, *First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775, 780 (8th Cir. 1990), *cert. denied*, 498 U.S. 972 (1990) (holding that DCCs are not insurance). The Texas Insurance Commissioner, however, has made a well-reasoned argument that DCCs and DSAs are "insurance" under GLBA. Until a court accepts those arguments, though, the states will not be able to regulate the sale DCCs and DSAs by national banks.

5.1.2 National Credit Unions

The National Credit Union Administration (NCUA) expressly permits national credit unions to sell DCCs and DSAs:

> The categories of activities in this section are preapproved as incidental to carrying on your business under Sec. 721.2. The examples of incidental powers activities within each category are provided in this section as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list. …
>
> (g) Loan-related products. Loan-related products are the products, activities or services you provide to your members in a lending transaction that protect you against credit-related risks or are otherwise incidental to your lending authority. These products or activities may include debt cancellation agreements, debt suspension agreements, letters of credit and leases.

12 C.F.R. 721.3 (g). However, unlike the OCC, the NCUA has not preempted state regulation of those sales. Instead, the NCUA has expressly made those sales subject to state law:

> You must comply with any applicable NCUA regulations, policies, and legal opinions, as well as applicable state and federal law, if an activity authorized under this part is otherwise regulated or conditioned.

12 C.F.R. 721.5. Thus, states are not preempted from regulating the sale of these products by national credit unions.

In a recent Bulletin, NCUA took the position that these products are not insurance:

> 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.

May 2003 Letter No. 03-FCU-06, found at http://www.ncua.gov/ref/letters/2003/03-FCU-06.pdf. However, whether or not the products are insurance, their rule expressly makes national credit unions subject to whatever laws the states pass, whether they are insurance laws or not. And the determination of whether those credit unions are subject to state insurance laws is up to the state. The definition of "insurance" under federal laws, which is an issue under federal preemption issues, is not relevant here because this is not a preemption issue.

5.1.3 National Savings & Loans

The Office of Thrift Supervision (OTS) regulates national savings and savings and loan associations. The OTS has ruled that national savings and loan associations may sell DCCs:

> Institutions may directly provide debt cancellation contracts on originated loans, subject to certain safeguards. Debt cancellation typically provides for the repayment of a loan in the event of the borrower's death or disability, with exceptions for late payments, late charges, loans in default and deaths due to suicide.

Office of Thrift Supervision January 2000 Regulatory Handbook 217.5, found at http://www.ots.treas.gov/docs/74040.pdf. *See also*, OTS Letter dated December 18, 1995, found at http://www.ots.treas.gov/docs/56521.pdf. We found no rule preempting state laws from regulating the sale of DCCs and DSAs by national savings and loan associations. Therefore, states maintain the power to regulate those sales.

5.1.4 State Banks, Credit Unions, and Savings & Loans

Federal regulations regarding DCCs and DSAs do not apply to state-chartered banks, credit unions, and savings and loans. Thus, there is no preemption of the states' right to regulate their sales of DCCs and DSAs.

Many states, however, have "parity" statutes that give the state-chartered institution the same rights as its federally-chartered counterpart. For instance, Texas' constitution provides:

> A state bank created by virtue of the power granted by this section, notwithstanding any other provision of this section, has the same rights and privileges that are or may be granted to national banks of the United States domiciled in this State.

TEX. CONST. ART. § 16 (c). Approximately 40 states have similar parity provisions in their laws. Thus, for instance, a state-chartered bank in one of those states could argue that it has the right to sell DCCs and DSAs free of any state regulation because national banks have that right.

While the resolution of that argument is outside the scope of this report, it is also not relevant to the question of state's power. States can change their parity statutes if they choose to do so. The issue is whether federal law preempts their power to regulate the sale of DCCs and DSAs by state-chartered institutions. Clearly it does not, for the applicable federal rules do not apply to state-chartered institutions. Thus, although a state may need to amend its parity statute, it retains the power to regulate the sale of DCCs and DSAs by state-chartered institutions.

5.1.5 Installment Sales Contracts and Other Lenders

For similar reasons, the OCC ruling does not prohibit states from regulating the sale of DCCs and DSAs by other lenders, including installment sales contracts. The OCC ruling only applies to national banks. Federal preemption of state law is not favored and a party asserting preemption "must overcome the presumption against finding pre-emption of state law in areas traditionally regulated by the States." *California v. ARC Am. Corp.,* 490 U.S. 93, 101 (1989). States have traditionally had regulatory authority over installment sales contracts, small consumer loans, pay day loans and other transactions that could be the subject of a DCC or DSA. Nothing in the OCC regulation even attempts to extend the preemption doctrine to these other lenders and sellers.

The determination of whether the states retain regulatory authority over DCCs and DSAs by lenders other than national banks does *not* depend on whether the product is insurance. Historically, the debate over states' ability to regulate DCCs and DSAs sold by national banks did depend on whether the products were "insurance." *See*, *First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775, 780 (8th Cir. 1990), *cert. denied*, 498 U.S. 972 (1990). That analysis was necessary in the preemption determination because federal law expressly left to the state the regulation of insurance. Even if the products are not insurance, however, states maintain regulatory authority over them in the absence of a federal law preempting the states' regulatory powers. Since no federal statute regulates these products in installment sales contracts and other transactions outside the purview of the OCC, states retain the authority to regulate these transactions.

6. Why Lenders Move from Credit Insurance to DCCs/DSAs

Lenders have moved from credit insurance to DCCs/DSAs because DCCs/DSAs are not subject to state regulation, which leads to the following advantages compared to credit insurance:

- No oversight or limitations on fees charged
- Few limitations on product design and benefit provisions – no restrictions on bundling, flexibility in product design
- Ability to use one product nationally
- No agent licensing requirements
- No form or rate filing requirements
- No premium taxes

The bottom line for lenders is that DCC/DSA programs are far less expensive to develop and deploy, are not subject to any oversight or limitations on pricing and are not subject to any oversight or requirements for benefits. In theory, lenders should be able to offer greater benefits per dollar of fee paid for DCC/DSA than the benefits consumers received per dollar of credit insurance premium because of substantial reduction in administrative costs. These cost reductions arise from developing and using one product and one form countrywide instead of having to file and obtain approval for hundreds of rate and form filings and keeping current on rate changes in any one of 51 jurisdictions. Other cost reductions arise from the absence of any agent licensing requirements and premium tax. If the market for DCCs/DSAs were competitive, the great reduction in administrative costs for DCCs/DSAs would flow to consumers as greater benefits. However, because, DCC/DSA markets are not competitive, the benefits to consumers as a percentage of fees paid has shrunk dramatically for DCCs/DSAs in comparison to credit insurance.

7. DCCS/DSAS Products Today: Lack of Regulatory Protections Causes Poor Value for Consumers

DCCS/DSAS products are defined by the type of benefit, types of events covered, eligibility for coverage and the types of payment methods.

7.1 Types of Benefits

Debt Cancellation: For lump sum benefit programs, such as death, the entire outstanding loan amount is cancelled. The amount of the benefit is equal to the amount of the outstanding loan balance. For monthly benefit programs, the requirement to make the monthly payment is canceled. The amount of the benefit is equal to the monthly payment – the amount of principal reduction in the required monthly payment plus the loan interest for the month. Benefits under a debt cancellation program are generally equivalent to those under a credit insurance program with the same triggering events.

Under a debt cancellation program, the consumer's debt is either eliminated (lump sum benefit) or is reduced (by the principal portion in the monthly payment).

Debt Suspension / Debt Deferment / Debt Freeze: For monthly benefit programs, the requirement to make a monthly payment is canceled and the interest for the month is canceled. Stated differently, a consumer can skip a payment without incurring any new interest charges or any penalty fees. The amount of the benefit is equal to the loan interest for the month. Under a debt suspension program, the amount of the consumer's debt neither decreases nor increases.

Payment Holiday: For monthly benefit programs, the requirement to make a monthly payment is canceled. The consumer's debt continues to accrue interest during the covered month, but no penalty fees are assessed. There is no monetary value to payment holiday benefit. Under a payment holiday program, the consumer's debt increases.

7.2 Types of Events Covered

Death – includes death from any cause with exception of certain pre-existing conditions.

Accidental Death – includes only death from certain accidental events. The incidence of accidental death is a small fraction of the normal death benefit. State insurance regulators have never permitted credit life policies to be limited to accidental death events only.

Dismemberment – includes the loss of specified body parts.

Disability – includes total or partial disability, permanent or temporary disability.

Involuntary Unemployment – includes certain types of involuntary unemployment, such as a layoff or firing or, in some instances, a strike.

Family Leave of Absence – includes an official leave of absence from a job for specified events, such as childbirth or illness of immediate family member.

Divorce – includes the filing of, or completion of, a divorce.

Life Events – includes marriage, divorce, childbirth, adoption, new home purchase, moving to a new home or entering college or graduate school for the first time.

Hospitalization – includes admission and stay in a hospital for at least one night with admission and care directed by a physician.

Military Service – includes being called to active duty in military reserve or guard unit for at least 31 consecutive days.

Disaster Relief – includes direct impact by a declared federal disaster and suffering a loss of at least $500 or missing at least 5 consecutive days of work.

GAP – provides coverage for the difference between the amount owed on a loan and the actual cash value of the collateral pledged in support for the loan. GAP is typically sold by auto dealers to cover the difference between the amount remaining on a loan and the amount an insurance company will pay for a totaled vehicle under the personal auto policy. The gap that GAP covers arises because of the increased term of auto loans over the past decade, which results in vehicles depreciating faster than the principal is paid off on an auto loan.

Appendix 12 provides a table of various DCC/DSA programs. Appendix 13 contains copies of DCC/DSA offers and/initial disclosures.

7.3 Types of Eligibility

Single versus joint – coverage is provided for either the borrower or the borrower and spouse. When joint coverage is provided, benefits occur when either the borrower or spouse encounters a triggering event.

Age restrictions – consumers over a certain age are ineligible for certain benefits in some DCCs/DSAs programs.

Employment Restrictions – full time employment prior to and at the time of program initiation is a typical requirement for disability, involuntary unemployment and leave of absence benefits. Self-employed borrowers are typically ineligible for these three benefits.

Use of Card Restrictions – many monthly benefit DCCs/DSAs programs and most debt suspension programs freeze credit card use if a borrower is receiving any benefits under the DCCs/DSAs program. A borrower who, for example, encounters disability or unemployment and who is enrolled in a DCCs/DSAs program must choose between the benefits under the program and the ability to continue using the credit card.

7.4 Types of Payment Methods

Monthly Pay – typically used for open-end credit, such as credit cards. The monthly fee is typically based on the amount of the outstanding loan or debt balance. A few monthly fee programs are offered in connection with closed-end (installment) loans. Given the great flexibility in designing benefit packages, lenders can structure DCCs/DSAs programs so the likelihood of covered event does not fluctuate dramatically over the period of the installment loan. Stated differently, there is no reason why monthly pay DCCs/DSAs products could not be offered in connection with installment loans.

Single Fee – typically used for installment loans and typically added to the loan amount and financed.

7.5 Current DCCS/DSAS Programs Offered By Lenders

Lenders' use of DCCs/DSAs has grown dramatically in the past three years, particularly in connection with credit cards. Since 1999, most major credit card issuers – Citicorp, Discover (Sears), Bank of America, Fleet Bank, Advanta, Bank One, Chase, MBNA, Providian and private label card issuers like Target, have replaced their credit insurance packages with DCCs/DSAs programs. American Express continues to sell credit insurance. Several lenders have switched to DCCs/DSAs for installment loans, most prominently Bank of America, but penetration in the installment loan market remains small compared to that in the credit card market.

Appendix 12, a summary of the DCC/DSA programs offered by major lenders, shows that DCCs/DSAs programs have evolved into a set of benefits that differ significantly from the coverages provided under the credit insurance program. For example, the death coverage has largely been replaced with an accidental death benefit. The expected claims for accidental death coverage are a very small fraction – perhaps 5% -- of the expected claims for the traditional death coverage. Further, the debt cancellation benefit that is equivalent to the payment benefits provided under credit insurance policies have largely been replaced with debt suspension products. Debt suspension provides a far smaller benefit level than debt cancellation or credit insurance.

7.6 Value to Consumers

Consumers receive far fewer benefits in relation to the fees charged for DCCs than under credit insurance – and consumer organizations have long criticized credit insurance as providing a poor value to consumers!

The expected loss ratio for a credit insurance package is in the range of 40% to 60%. In practice, the actual loss ratios – the ratio of claims paid on behalf of consumers to premiums paid by consumers for the policies in question – are lower. Although the countrywide average loss ratio for credit life and credit disability has generally been in 42% to 46% range, the addition of credit unemployment and credit property brings the

overall average down. Actual loss ratios by state for credit life and credit disability in the 1998-2000 period ranged from 30% to 69%. When credit unemployment and credit property are added, the range of state loss ratios was 25% to 61%. Some improvement in the low credit unemployment and credit property loss ratios has occurred due to higher unemployment and some action by state regulators to improve benefits and/or lower rates.

In contrast, the expected "loss ratio" for the debt suspension agreements offered by credit card issuers is generally in the 3% to 5% range. Actual ratios of benefits in relation to fees paid by consumers are likely even lower because of the restriction on card use if a borrower is receiving a benefit. Many consumers will likely forego the debt suspension benefit once they recognize they will lose the use of the card if the do so. Given that benefits are triggered by events that impair a borrower's income, it is during these times that the borrower is in greater need of borrowing capacity. When faced with the choice of a modest benefit or the loss of use of a credit card, we believe many consumers who paid for benefits and who are eligible for benefits will forego the benefits.

Appendix 9, the comment letter of CEJ and CFA to the OCC on proposed DCC/DSA rules, contains a comparative analysis of benefits to costs of credit insurance and a Citicorp DSA program offered at the time. The credit insurance package included credit life, credit disability and credit involuntary unemployment. The DSA package included disability and unemployment. The table below compares costs and expected benefits under the two programs. The cost of the DSA program is almost 80% higher than the credit insurance program but the expected DSA benefits are only one-seventh of those from the credit insurance program. Even assuming that the lender incurs some administrative costs in the DSA program that the lender does not incur with the credit insurance program, the DSA profit is over 80% of a higher monthly fee.

Table 3
Comparison of 2001 Citicorp DSA program to Texas Credit Insurance Program

	2001 Citicorp DSA	2001 TX Credit Insurance
Cost per $100 Outstanding Balance	$.690	$.386
Monthly Fee, $2,000 Balance	$13.80	$7.72
Expected Monthly Benefits, $2,000 Balance	$0.56	$3.86
Expected Benefits, % of Fee	4.1%	50.0%
Expected Monthly Revenue to Lender, $2,000 Balance	$13.24	$2.32
Expected Revenue to Lender, % of Fee	95.9%	30%

The table below provides estimates of the percentage of expected benefits to fees paid for several of the DCC/DSA programs summarized in Appendix 12. As stated elsewhere, we believe that even these tiny benefit levels are likely overstated because of the common restriction on credit card use if a consumer activates DCC/DSA program benefits. The Fleet Credit Protector program has a significantly higher benefit ratio than the other programs (although "higher" is clearly relative given the low values of all programs) because it is one of the few programs that still offers a death benefit. Most of the other programs have either eliminated the death benefit completely or switched to an accidental death benefit, which provides only a small percentage of the benefits of a "regular" death benefit.

Table 4
Estimated Benefits as a Percentage of Fees for Various DCC/DSA Programs

Program	Ratio of Expected Benefits to Fees Paid
Fleet Card Credit Protector	11%
Citicorp Card Credit Protection	3%
Bank of America Cardholder Security Plan	2%
Discover Card AccountGuard	2%
Bank One First Protect	3%
Chase Card Payment Protection Plan	2%

7.7 Aggregate Dollar Impact on Consumers

From 1995 to 2000, credit card credit insurance premiums grew to about $2 billion annually. Appendix 14 reviews the annual written premiums, paid losses and loss ratios for monthly outstanding balance credit life, credit disability and credit involuntary unemployment sold in connection with open-end loans. The highest loss ratios – highest benefit to premiums paid for consumers – came from credit life where about 60% of the premium was returned as a benefit. The ratios for credit disability were about 45% and the ratios for involuntary unemployment ranged from 6% to 15%, depending upon unemployment rates. Most current DCC/DSA credit card programs have eliminated the coverage providing the greatest value to the consumer – the death benefit. Aggregate loss ratios for all coverages combined were about 40%.

The table below shows our estimates of the aggregate dollar impact of credit card lenders' movement from credit insurance to DCC/DSAs. We estimate, conservatively, that consumers will lose over 80% of the benefits they received under credit insurance – around $700 million annually. We also estimate that overall costs to consumers – just for credit card debt protection – will increase at least 25%. As lenders replace installment loan credit insurance with DCCs/DSAs, the cost to consumers – in increased fees and reduced benefits – will grow.

Table 5
What the Shift from Credit Insurance to DCC/DSA Means
For Credit Card Consumers

	Credit Insurance	DCC/DSA
Premiums / Fees Annually	$2,000,000,000	$2,500,000,000
Benefit Ratios	40%	5%
Benefit Dollars	$800,000,000	$125,000,000
Estimate Increase in Costs		25.0%
Estimate Decrease in Benefits		-84.4%
Decrease in Benefits, Constant Fees		$700,000,000

8. How to Effectively Regulate DCCs/DSAs: Eliminating Abuses While Relying on Market Forces

The current OCC DCC/DSA rule does not adequately protect consumers from market abuses in the sale of the products. We suggest the following changes are necessary to effectively regulate DCCs/DSAs for consumer protection.

8.1 Minimum Ratio of Consumer Benefits to Consumer Costs

Why should there be a required minimum benefit level and a required minimum ratio of benefits to fees paid? Because the DCC/DSS market is not sufficiently competitive to enable consumers to exert market pressure on lenders to ensure reasonable benefits or reasonable benefits in relation to fees paid. We need to examine two markets – revolving loans (credit cards) and installment loans.

Credit card: There is an absence of information to enable a consumer to make an informed decision. Consumers have no idea how likely they are to encounter one of the covered events. For example, very few, if any consumers, will know that there is a huge difference in a benefit for death versus a benefit for accidental death. To illustrate, credit life insurance covers death from any cause, including suicide after a waiting period. Most credit card DCC/DSA programs have limited the coverage to accidental death. The frequency of accidental death is a small fraction of the frequency of the regular death benefit – so much so that one actuary helping lenders design the DCC products calls it a virtual no-cost give away. Consumers will typically make decisions regarding DCCs/DSAs based on incorrect assumptions about the likelihood of an event happening to them.

Many DCC/DSA programs include a provision that prohibits the consumer from using the credit card if he or she is receiving any benefit under the program. So, if a consumer becomes unemployed, the consumer must stop using the card to charge purchases in order to receive the benefit – which in most cases is only a deferral of payment. Most consumers who have lost a job will likely have a greater need to use credit – a need greater than any benefit of deferring the past balance.

Installment Loan: There are the same problems with credit card-based DCCs and DSAs plus the problems associated with unfair and deceptive sales practices of some lenders. There are the same opportunities for unfair and deceptive sales practices with DCC /DSAs sold in connection with installment loans as is the case with credit insurance sold in connection with installment loans.

The bottom line – as demonstrated by current market results for DCCs/DSAs – is that consumers are often purchasing products with very few, if any benefits and the value of the benefits compared to the fees paid is miniscule. These results simply would not occur in a truly competitive market.

We recommend a requirement for a minimum ratio of benefits to fees. The lender will keep track of this ratio and if the ratio of benefits to fees collected drops below 60%, the lender must rebate fees for the period in an amount sufficient to achieve the 60% benefit ratio. Practically, lenders will plan on benefits that exceed 60% by a few percentage points to ensure no rebates are required. The minimum benefit ratio requirement must be accompanied by a date reporting requirement to allow the public to monitor product benefit levels.

Why is 60% reasonable? State insurance regulators have determined that a 60% minimum loss ratio for the major credit insurance coverages – life, disability, unemployment and property. Lenders and retailers offering DCCs/DSAs have much lower costs to design and deliver the product because:

- One national product instead of multiple products in 51 jurisdictions
- No agent licensing requirements as with credit insurance
- No product filing and approval requirements as with credit insurance, which requires a form and rate filing for each coverage (covered event) in each state
- No maintenance of state-specific rates, rules – one product with one description
- No insurance regulatory filings, such as statutory annual statements
- No insurance premium tax

Further, the minimum benefit ratio should start at 60% and increase with the cost of the product:

Cost		Min. Ratio
up to	$0.500	60.0%
$0.501	$0.749	62.5%
$0.750	$0.999	65.0%
$1.000	$1.249	67.5%
$1.250	$1.499	70.0%
$1.500	$1.749	72.5%
$1.750	$1.999	75.0%
$2.000	or greater	77.5%

It should be noted that there is no need to adjust these percentages because of inflation in lender expenses. Any inflation in lender expenses will likely be met by an increase in the average amount of the loan balance. Consequently, over time, lenders will get more expense dollars even with a constant rate and benefit ratio.

Compared to credit insurance, cost of developing and delivering the product is considerably less. If state insurance regulators have determined that a 60% minimum is reasonable for credit insurance, and costs are considerably lower for DCCs/DSAs, then a 60% minimum ratio of benefits to fees is certainly reasonable for DCCs/DSAs.

8.2 Prohibit financed debt cancellation / debt suspension products

There is no longer a need for single fee, financed debt cancellation products. The origins of single premium credit insurance were in an era of short-term loans, low-interest rates and no automated loan systems. Lenders can easily create DCC programs with benefit exposure that does not dramatically change over the duration of the loan and, therefore, are amenable to monthly payments based on outstanding balances. There is an opportunity – and a need – not to recreate the problems with single premium credit insurance. There is simply no need for financed single fee DCCs/DSAs – other than excessive profitability for lenders and auto dealers – because current technology and flexibility in product design allow the development of monthly benefit / monthly fee products for use with installment as well as revolving loans.

8.3 Improved Disclosures to Consumers

Disclosures should include information on the number of times any benefit is provided (benefits for any of the covered events) under the DCC/DSA program per 1,000 loans / accounts and the number of times a benefit a benefit is paid because of each of the specific covered events) per 1,000 loans / accounts. For example, with the Citigroup Credit Protector Program, the disclosure would be:

Outstanding Balance Canceled
A benefits for long term disability per 1,000 accounts in 12 months
B benefits for accidental death per 1,000 accounts in 12 months

Minimum Due Canceled
D benefits for life events per 1,000 accounts in 12 months

Balance Deferred (24 month maximum)
X benefits for job loss per 1,000 accounts in 12 months
Y benefits for short term disability per 1,000 accounts in 12 months

Balance Deferred (3 month maximum)
R benefits for family leave per 1,000 accounts in 12 months
M benefits for natural disaster per 1,000 accounts in 12 months

Balance Deferred (1 month)
H benefits for hospitalization per 1,000 accounts in 12 months

Balance Deferred (No limit)
G benefits for military call to duty per 1,000 accounts in 12 months

Total
Z benefits for any covered event per 1,000 accounts in 12 months

8.4 Data Reporting / Public Access

There is a need for the public to learn the level of fees and benefits for various types of products to enable groups like the Center for Economic Justice, the Consumer Federation of America and Consumers Union, as well as financial advisers, to analyze the DCC/DSA products and identify the best values. There is a need for public disclosure to enable fair lending groups to evaluate the availability and affordability of these products on consumer groups for whom the products would be most useful. There is a need to make this information public to make the markets for the products more competitive by empowering consumers with better information. The information to be reported – number and amount of fees collected broken out by DCC/DSA product package and number and amount of benefits provided broken out by covered event – is not trade secret information. There are literally only a few actuaries and product administrators who are helping lenders and retailers design the products. Any lender or retailer can accurately judge the cost of any set of benefits by consulting with one of these actuaries or product administrators. The only people who don't know how much benefit is provided and how frequently those benefits are provided are the consumers purchasing the product.