

# STATE OF COLORADO

## Department of Regulatory Agencies

Richard F. O'Donnell  
Executive Director



Bill Owens  
Governor

## DIVISION OF BANKING

Richard Fulkerson  
State Bank Commissioner

### OPERATING MEMORANDUM

**TO:** State Chartered Commercial and Industrial Banks

**FROM:** Richard Fulkerson  
State Bank Commissioner

**DATE:** May 3, 2004

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

A **debt cancellation contract** is a loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The agreement may be separate from or a part of other loan documents.

A **debt suspension agreement** is a loan term or contractual arrangement modifying loan terms under which a bank agrees to suspend all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The agreement may be separate from or a part of other loan documents. The term debt suspension agreement does not include loan payment deferral arrangements in which the triggering event is the borrower's unilateral election to defer repayment, or the bank's unilateral decision to allow a deferral of repayment.

Debt Cancellation Contracts (DCA) and Debt Suspension Agreements (DSA) have become more commonplace as lenders seek to expand product lines. The Division of Banking (Division) has responded to inquiries from state chartered banks and industrial banks concerning the permissibility of these products on a case-by-case basis. The Division has consistently opined that state chartered banks and industrial banks have the authority to offer DCA and DSA under the general lending and contract authority of the Colorado Banking Code of 2003, subject to prudent management practices and general disclosures requirements.

The purpose of this memorandum is to affirm the Division's position that state chartered banks and industrial banks are authorized to offer DCA and DSA under Sections 11-103-101 and 11-108-201, C.R.S. In order to ensure that such products are not misleading and are offered in a safe and sound manner, the Division has adopted the following definitions and policy provisions that mirror regulations promulgated by the Office of the Comptroller of the Currency in 2003.

### **Definitions**

- a. "Actuarial method" means the method of allocating payments made on a debt between the amount financed and the finance charge pursuant to which a payment is applied first to the accumulated finance charge and any remainder is subtracted from, or any deficiency is added to, the unpaid balance of the amount financed.
- b. "Bank" means Colorado state chartered commercial banks and industrial banks.
- c. "Contract" means a debt cancellation contract or a debt suspension agreement.
- d. "Customer" means an individual who obtains an extension of credit from a bank primarily for personal, family or household purposes.
- e. "Residential mortgage loan" means a loan secured by 1-4 family, residential real property.

### **Safety and Soundness**

Bank managers are expected to carefully analyze the risks associated with DCA and DSA products and establish adequate internal controls. In addition, monitoring and reporting systems are to be implemented that provide for adequate recording keeping and GAAP accounting treatment of the income, expense, assets and liabilities associated with the products. Division examiners will review the bank's oversight of the program and risk management systems during the course of regular safety and soundness examinations.

### **Prohibited Practices**

- a. Anti-tying. A bank may not extend credit nor alter the terms or conditions of an extension of credit conditioned upon the customer entering into a debt cancellation contract or debt suspension agreement with the bank or affiliated party.
- b. Misrepresentations. A bank may not engage in any practice or use any advertisement that could mislead or otherwise cause a reasonable person to reach an erroneous belief with respect to information that must be disclosed under this part.
- c. Prohibited contract terms. A bank may not offer debt cancellation contracts or debt suspension agreements that contain terms:
  - 1. Giving the bank the right unilaterally to modify the contract unless:
    - (i) The modification is favorable to the customer and is made without additional charge to the customer; or
    - (ii) The customer is notified of any proposed change and is provided a reasonable opportunity to cancel the contract without penalty before the change goes into effect; or
  - 2. Requiring a lump sum, single payment for the contract payable at the outset of the contract, where the debt subject to the contract is a residential mortgage loan.

### **Refunds Of Fees In The Event Of Termination Or Prepayment Of The Covered Loan**

- a. Refunds - If a contract is terminated (including, for example, when the customer prepays the covered loan), the bank shall refund to the customer any unearned fees paid for the contract unless the contract provides otherwise. A bank may offer a customer a contract that does not provide for a refund only if the bank also offers that customer a bona fide option to purchase a comparable contract that provides for a refund.

- b. Method of calculating refund - The bank shall calculate the amount of a refund using a method at least as favorable to the customer as the actuarial method.

### **Payment Of Fees**

Except as prohibited herein, a bank may offer a customer the option of paying the fee for a contract in a single payment, provided the bank also offers the customer a bona fide option of paying the fee for that contract in monthly or other periodic payments. If the bank offers the customer the option to finance the single payment by adding it to the amount the customer is borrowing, the bank must also disclose to the customer, in accordance with the disclosure provisions hereof, whether and, if so, the time period during which, the customer may cancel the agreement and receive a refund.

### **Disclosures**

- a. Content of short form of disclosures. The short form of disclosures required by these guidelines must include information relating to: the fact that a contract is optional; the lump sum payment features; available refunds of lump sum payments; the fact that additional disclosures will be forthcoming; and that there are restrictions on eligibility. The form of disclosures should be consistent with the best practices of the financial services industry in this area.
- b. Content of long form of disclosures. The long form of disclosures required by these guidelines must include the information relating to: the fact that a contract is optional; an explanation of any debt suspension feature in the product; the cost of the product; the lump sum payment features and any refunds of such fees; any restrictions on the customer's credit availability triggered by the product; termination of the product by the customer and the institution; and requirements, conditions and exclusions relating to eligibility. The form of disclosures should be consistent with the best practices of the financial services industry in this area.
- c. Disclosure requirements; timing and method of disclosures.
  - 1. Short form disclosures. The bank shall make the short form disclosures orally at the time it first solicits the purchase of a contract.
  - 2. Long form disclosures. The bank shall make the long form disclosures in writing before the customer completes the purchase. If the initial solicitation occurs in person, then the bank shall provide the long form disclosures in writing at that time.
  - 3. Special rule for transactions by telephone. If a contract is solicited by telephone, the bank shall provide the short form disclosures orally and shall mail the long form disclosures, and, if appropriate, a copy of the contract to the customer within three (3) business days of the first business day after the telephone solicitation.
  - 4. Special rule for solicitations using written mail inserts or "take one" solicitations. If the contract is solicited through written materials such as mail inserts or "take one" promotions, the bank may provide only the short form disclosures in the written materials if the bank mails the long form disclosures to the customer within three (3) business days of the first business day after the customer contacts the bank to respond to the solicitation, subject to the acknowledgment requirements of these guidelines.
  - 5. Special rule for electronic transactions. The disclosures described in this section may be provided through electronic media in a manner consistent with the requirements of applicable federal and state laws.
- d. Form of disclosures.
  - 1. Disclosures must be readily understandable. The disclosures required by these guidelines must be conspicuous, simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided.

2. Disclosures must be meaningful. The disclosures required by these guidelines must be in a meaningful form, including:
  - (i) A plain-language heading to call attention to the disclosures;
  - (ii) A typeface and type size that are easy to read;
  - (iii) Wide margins and ample line spacing;
  - (iv) Boldface or italics for key words; and
  - (v) Distinctive type style, and graphic devices, such as shading or sidebars, when the disclosures are combined with other information.
- e. Advertisements and other promotional material for contracts. The short form disclosures are required in advertisements and promotional material for these products unless the advertisements and promotional materials are of a general nature describing or listing the services or products offered by the bank.

### **Acknowledgments**

- a. Affirmative election and acknowledgment of receipt of disclosures. Before entering into a contract, the bank must obtain a customer's written affirmative election to purchase a contract and written acknowledgment of receipt of the disclosures required by these guidelines. The election and acknowledgment information must be conspicuous, simple, direct, readily understandable, and designed to call attention to their significance. The election and acknowledgment will satisfy these standards if they conform to the disclosure requirements in these guidelines.
- b. Special rule for telephone solicitations. If the sale of a contract occurs by telephone, the customer's affirmative election to purchase may be made orally, provided the bank:
  1. Maintains sufficient documentation to show that the customer received the short form disclosures and then affirmatively elected to purchase the contract;
  2. Mails the affirmative written election and written acknowledgment, together with the long form disclosures required by these guidelines, to the customer within three (3) business days after the telephone solicitation, and maintains sufficient documentation to show it made reasonable efforts to obtain the documents from the customer; and
  3. Permits the customer to cancel the purchase of the contract without penalty within thirty (30) days after the bank has mailed the long form disclosures to the customer.
- c. Special rule for solicitations using written mail inserts or "take one" solicitations. If the contract is solicited through written materials such as mail inserts or "take one" promotions and the bank provides only the short form disclosures in the written materials, then the bank shall mail the acknowledgment of receipt of disclosures, together with the long form disclosures required by these guidelines, to the customer within three (3) business days of the first business day after the customer contacts the bank or otherwise responds to the solicitation. The bank may not obligate the customer to pay for the contract until after the bank has received the customer's written acknowledgment of receipt of disclosures unless the bank:
  1. Maintains sufficient documentation to show that the bank provided the acknowledgment of receipt of disclosures to the customer as required by this section;
  2. Maintains sufficient documentation to show that the bank made reasonable efforts to obtain from the customer a written acknowledgment of receipt of the long form disclosures; and
  3. Permits the customer to cancel the purchase of the contract without penalty within thirty (30) days after the bank has mailed the long form disclosures to the customer.
- d. Special rule for electronic election. The affirmative election and acknowledgment may be made electronically in a manner consistent with the requirements of applicable federal and state law.