

State of North Carolina

OFFICE OF THE COMMISSIONER OF BANKS

MICHAEL F. EASLEY
GOVERNOR

June 2, 2004

JOSEPH A. SMITH, JR.
COMMISSIONER OF BANKS

Paul H. Stock
Executive Vice-President, Counsel
North Carolina Bankers Association
Post Office Box 19999
Raleigh, North Carolina 27619-1999

Re: Declaratory Ruling 2004-01 – Debt Cancellation Contracts/Debt Suspension Agreements

Dear Mr. Stock:

This is in response to your letter dated March 11, 2004 in which you request confirmation that a North Carolina state-chartered commercial bank (hereinafter, a "Bank") may legally offer so-called "debt cancellation contracts" or "debt suspension agreements" to its consumer loan customers. I am treating your inquiry as a request for a declaratory ruling under 4 NCAC 3B .0105.

I conclude that the proposed activity is permissible, for the reasons and under the conditions discussed below. Although your request does not refer to North Carolina state-chartered savings banks and savings and loan associations, I believe those institutions may, for the different reasons discussed below, also offer these contracts.

Definitions

For purposes of this Declaratory Ruling, the following definitions adopted by the Office of the Comptroller of the Currency ("OCC") in its regulation regarding DCCs and DSAs, 12 C.F.R. Part 37 ("Part 37")¹ apply:

"Debt cancellation contract" ("DCC") - 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.

¹ 12 C.F.R. §37.2



“Debt suspension agreement” (“DSA”) - 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.

These terms are not defined in North Carolina law, and neither Chapter 53 (Banks) nor Chapter 54B (Savings and Loan Associations) nor Chapter 54C (Savings Banks) expressly permits nor prohibits the offer by those institutions of DCCs or DSAs. Counsel to the North Carolina Commissioner of Insurance has advised that as long as the arrangement is between a lender and its borrower and does not include an element of indemnification, then the arrangement is not a contract of insurance under N.C. Gen. Stat. §58-1-10 subject to that department's regulation.²

National Bank Act as Precedent

The OCC has for several decades³ permitted national banks to offer DCCs and DSAs, based on the combined authority of national banks under 12 U.S.C. §24 (Seventh) of the National Bank Act (“NBA”) to make loans and to exercise “...all such incidental powers as shall be necessary to carry on the business of banking.”⁴ This position has been upheld by a number of federal court decisions.⁵

While neither the OCC's views nor those of the courts regarding the NBA are binding on this agency insofar as the authority of Banks is concerned, I believe the legal reasoning applied by the OCC is sound and that North Carolina law is sufficiently similar to corresponding sections of the NBA to support a comparable conclusion as to a Bank's authority under the law to offer such contracts.

Authority for State Banks

N.C. General Statutes Chapter 53, Article 6 sets forth the powers of Banks. G.S. §53-43 (1) expressly authorizes Banks to “...loan[ing] money on personal security or real and personal property...”. Unlike the NBA, Chapter 53 does not expressly confer authority to exercise

² Letter from Peter A. Kolbe dated May 27, 2004.

³ The OCC's news release regarding the adoption of 12 C.F.R. Part 37 in 2002 (OCC NR 2002-73) refers to letters from then-Comptroller James J. Saxon dated Mar. 10, 1964, Mar. 26, 1964 and July 21, 1964 and “Statement of the Comptroller of the Currency on **Debt Cancellation** Contracts and Their Relation to State Law (May 18, 1964); James J. Saxon, Letter to the Presidents of all National Banks (July 21, 1964).

⁴ 12 U.S.C. 24 (Seventh)

⁵ See, e.g., First National Bank of Eastern Arkansas v. Taylor, 902 F.2d 775 (8th Cir. 1990)

“incidental powers.” In 1962, the North Carolina Supreme Court held that a Bank’s powers are limited to “...those expressly granted, *or those fairly incidental thereto*, in Article 6 of Chapter 53 (citations omitted),” Sparks v. Union Trust Company of Shelby, 256 N.C. 478, 481, 124 S.E. 2d 365, 367 (emphasis added). No reported case since then has questioned this conclusion.

Based on my review of the facts presented to me and of relevant legal authorities, I conclude that North Carolina law provides to Banks authority commensurate to that enjoyed by national banks under the NBA, as interpreted by the OCC and the courts with regard to DCCs and DSAs.

Authority for State Savings and Loan Associations and Savings Banks

I have also concluded that North Carolina state savings and loan associations and savings banks (together, “State Thrifts”) may legally offer DCCs and DSAs, albeit pursuant to different legal authority than that applicable to Banks.

The Office of Thrift Supervision (OTS) as regulator of federally chartered thrifts has, following the OCC’S “incidental powers” reasoning, concluded that the Home Owners Loan Act (“HOLA”) authorizes federally chartered savings associations to offer DCCs.⁶

Unlike Banks, State Thrifts have the benefit of so-called “parity” or “wild card” statutes. In an effort to promote competitive equality with federally-chartered institutions, these statutes⁷ allow a state-chartered thrift institution to “...engage in any activity...” permissible for federal associations with principal offices in North Carolina. As such, it is clear that State Thrifts may offer DCCs and DSAs.⁸

Consumer Protection and Safety and Soundness Concerns

As noted above, the OCC’s adoption of Part 37 in 2002 was far from its first issuance authorizing national banks to offer DCCs or DSAs. In that rulemaking, the OCC acknowledged that these products carry some risks to both banks and consumers; the regulation therefore imposed a detailed list of conditions on its exercise. These include both prohibitions against specified conduct and contract provisions and also requirements of specific disclosures and substantive provisions. Part 37 also requires national banks to adopt adequate “risk management and control” processes over their offered DCCs and DSAs.

⁶ See OTS General Counsel’s Letters dated 9/15/93 (1993 OTS LEXIS 36) and 12/18/1995 (1995 OTS LEXIS 21).

⁷ G.S. §54B-195 (Savings and Loan Associations) and §54C-145 (Savings Banks). G.S. §54C-145 also provides “parity” with national and North Carolina state-chartered banks.

⁸ The OTS’s letters do not expressly address DSAs, but the reasoning of each suggests that this is purely the result of the omission of DSAs from the inquiries to which the letters responded and not a result of any substantive distinction drawn by the agency.

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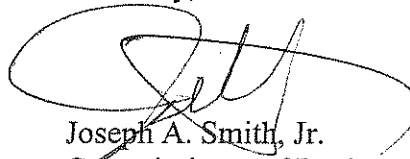
None of the risks addressed by Part 37 are unique to national banks. While we have not experienced a significant number of consumer complaints regarding DCCs or DSAs, this may be a result of the fact that, in the absence of this Declaratory Ruling, few if any Banks or State Thrifts have offered the products. In any case, I agree with the OCC that both prohibitions against unfair or abusive practices and meaningful disclosures are needed to minimize the risks to both the public and the institution.

The Office of the Commissioner of Banks will undertake a review of the consumer and safety and soundness provisions of Part 37 and thereafter consider (1) whether these provisions are adequate to protect North Carolina consumers and institutions; and (2) whether these or similar provisions should be specifically embodied into North Carolina banking law or regulations. Pending completion of that process, this agency will treat a Bank or State Thrift's good faith compliance with Part 37 (and any supplemental OCC guidance) to constitute compliance with North Carolina law.

Compliance With Other Federal and State Laws and Regulations

This Declaratory Ruling is limited to the authority of Banks and State Thrifts to offer DCCs and DSAs. It presumes that any Bank or State Thrift offering these products will take all necessary steps to ensure that it is in compliance with all other applicable laws and regulations, including, but not limited to, the Federal Truth-in-Lending Act and Federal Reserve Regulation "Z". Compliance with other relevant statutes should suffice to bar improper tying arrangements and other abuses.

Sincerely,



Joseph A. Smith, Jr.
Commissioner of Banks