STATE OF MICHIGAN
DEPARTMENT OF LABOR AND ECONOMIC GROWTH
OFFICE OF FINANCIAL AND INSURANCE SERVICES

Before the Commissioner of Financial and Insurance Services

In the matter of the sale of debt cancellation contracts and debt suspension agreements by depository institutions

Order No. 04-053-M

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Issued and entered
this 18th day of June 2004
by Linda A. Watters
Commissioner

DECLARATORY RULING

I
BACKGROUND

When a depository institution enters into a debt cancellation contract ("DCC") in connection with an extension of credit, it agrees to cancel the outstanding debt upon the occurrence of a specified event, such as the death of the borrower. Under a debt suspension agreement ("DSA") in connection with an extension of credit, a depository institution agrees to suspend loan payments upon the occurrence of a specified event, such as the disability of the borrower.

The Office of the Comptroller of the Currency ("OCC") has over the years issued opinions that national banks were authorized by federal laws to sell DCCs and DSAs. This was confirmed by the passage of the Gramm-Leach-Bliley Act of 1999.

In that Act, Congress expressly allowed national banks to provide insurance as principal with respect to authorized products. Section 302(b) of the Act, 15 USCS 6712(b), provides:

> **Authorized products.** For the purposes of this section, a product is authorized if--
>
> (1) as of January 1, 1999, the Comptroller of the Currency had determined in writing that national banks may provide such product as principal, or national banks were in fact lawfully providing such product as principal;...

The OCC had made such a determination before January 1, 1999, as to DCCs and DSAs.

As mandated by the Act, the OCC promulgated rules that took effect June 2003. [12 CFR part 37] These rules established that states have no role in regulating the price, content, or marketing of DCCs and DSAs when sold by national banks.

Agencies regulating federally chartered thrifts and credit unions have separately concluded that those depository institutions may sell DCCs and DSAs. Moreover, most states stopped regulating these contracts as insurance products years ago. Experts predict that within a few years these contracts will supplant similar credit insurance products that have been widely sold for over 50 years.

In examining the sale of DCCs and DSAs, all depository institutions should be taken into account. For purposes of this Declaratory Ruling, "depository institution" has the meaning given in Section 1201(s) of the Michigan Banking Code of 1999, as amended, MCL 489.11201(s), which provides:

> "Depository institution" means a bank, out-of-state bank, national bank, foreign bank branch, association, savings bank, or credit union organized under the laws of this state, another state, the District of Columbia, the United States, or a territory or protectorate of the United States.

Michigan chartered depository institutions compete with federally chartered depository institutions. The Michigan Legislature has made it abundantly clear that in interpreting and expanding upon powers of Michigan chartered depository institutions,

the Commissioner shall take competition with federally chartered depository institutions into account.

The importance of competition in banking is underscored by Section 2102 of the Banking Code of 1999, as amended ("Banking Code"), MCL 487.12102, which states as follows:

> This act shall be implemented by the commissioner to maximize the capacity of banks to offer convenient and efficient financial services, to promote economic development, and to ensure that banks remain competitive with other types of financial service providers.

While no expansion of powers would be needed as to the sale of DCCs and DSAs, it is instructive that the Legislature authorizes the Commissioner to take into account federal regulations in assessing competition. Section 2204 of the Banking Code, MCL 487.12204, provides:

> (1) The commissioner may issue declaratory rulings in accordance with the administrative procedures act of 1969, or issue orders on applications by 1 or more banks to exercise powers not specifically authorized by this act that will authorize banks to exercise powers appropriate and necessary to compete with other providers of financial services.
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> (2) In the exercise of the discretion permitted by this section, the commissioner shall consider the ability of banks to exercise any additional power in a safe and sound manner, the authority of depository institutions operating under state or federal law or regulation, the powers of other competing entities providing financial services, and any specific limitations on bank powers contained in this act or in any other law of this state. The commissioner shall give notice, at least quarterly, to all banks of declaratory rulings, orders, or determinations issued during the preceding quarter under this section. [Emphasis added.]

Similarly, the Legislature has directed the Commissioner to, "...ensure that savings banks remain competitive with other types of financial institutions and providers of financial services," in Section 201(2) of the Savings Bank Act, MCL487.3201(2).

Finally, by Section 208(2) of the Credit Union Act, MCL 490.208(2), in evaluating a request for additional powers by a domestic credit union, the Commissioner "...shall consider...the powers of other competing entities providing financial services..."

The Michigan Legislature has called for a level playing field. However, as seen above, federally chartered depository institutions currently enjoy an advantage in their ability to offer DCCs and DSAs. Compared to credit insurance products, DCCs and DSAs are flexible with respect to price, terms, and marketing.

II
ANALYSIS

It is appropriate at this time for the Commissioner to apply an analysis that focuses upon the principal object and purpose of the loan agreement. Even though DCCs and DSAs have an element of risk transfer, their inclusion in a loan agreement directly or by addendum does not change the essential character of the loan agreement.

This line of analysis was adopted regarding warranties in Declaratory Ruling 95-254-M. At issue was an automobile warranty that covered collision damage.

This agency has long recognized that warranties are distinct from insurance. In determining that the insurance element of the warranty did not make the warranty into an insurance contract, the agency focused upon the primary object and purpose of the warranty contract.

The declaratory ruling contains an ample discussion of authority on this issue. At the core of its reasoning is a quote from *Transportation Guarantee Co v Jellins*, 29 Cal 2d 242, 249 (1946), where the Court quoted from a federal decision as follows:

> "That an incidental element of risk distribution or assumption may be present should not outweigh all other factors. If the attention is focused only on that feature, the line between insurance or indemnity and other types of legal arrangement and economic function becomes faint, if not extinct. This is especially true when the contract is for the sale of goods or services on contingency. But obviously it was not the purpose of the insurance statutes to regulate all arrangements for assumption or distribution of risk. That view would cause them to engulf practically all contracts, particularly conditional sales and contingent service agreements. The fallacy is in looking only at the risk element, to the exclusion of all others present or their subordination to it.
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> The question turns, not on whether risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose."

The principal object and purpose of a loan agreement is the loan itself, not an incidental provision concerning certain events that may arise during the course of the loan. The conditional cancellation or suspension is only one term of the overall loan agreement. Thus, a loan agreement does not constitute an insurance contract due to the related sale of DCCs and DSAs. A depository institution should not be regulated as an insurer in its offering of these products.

Declaratory Ruling 98-105-M concerned banks selling DCCs. Under Section 402 of the Michigan Insurance Code of 1956, as amended ("Code"), MCL 500.402, a person must be licensed as an insurer in order to transact insurance. Since banks cannot be licensed as insurers, the agency concluded that they could not sell DCCs.

This declaratory ruling reaches a different result because, unlike the previous declaratory ruling, it applies the "principal object and purpose" test in deciding whether the sale of DCCs and DSAs constitute the transaction of insurance. Thus, Declaratory Ruling 98-105-M is changed prospectively and superseded by this declaratory ruling.

This declaratory ruling is limited to the sale of DCCs and DSAs by depository institutions and is limited to MCL 500.402.

III
RULING

Therefore, based upon the application of the principal object and purpose test, it is the Commissioner's ruling with regard to depository institutions that:

1. Loan agreements do not become subject to the Code due to the sale of related DCCs and DSAs. The principal object and purpose of a loan agreement is the loan itself.
2. The sale of DCCs and DSAs does not subject depository institutions to licensure requirements under MCL 500.402.
3. The Code does not regulate DCCs and DSAs because their inclusion in a loan does not change the essential character of the loan agreement.
4. The Code does not regulate depository institutions in their sale of DCCs and DSAs in connection with an extension of credit.
5. This declaratory ruling prospectively changes and supersedes Declaratory Ruling No. 98-105-M.

Linda A. Watters
Commissioner