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January 30, 2004

Jennifer J. Johnson

Secretary

Board of Governors of the Federal Reserve System

20th Street and Constitution Avenue, NW

Washington, DC 20551

By Electronic Mail: *regs.comments@federalreserve.gov*

Re: Docket No. R-1167: Request for Information Regarding
Debt Cancellation and Debt Suspension Agreements

Dear Ms. Johnson:

The Center for Economic Justice,¹ files these comments on behalf of itself and the National Consumer Law Center,² the Consumer Federation of America,³ and Consumers Union⁴. We appreciate the Board's interest in debt cancellation contracts (DCC) and debt suspension agreements (DSA) and submit these comments in response to the Board's request for information.

Attached to these comments, please find a report on debt cancellation and debt suspension agreements written by the Center for Economic Justice. The report provides detailed information responsive to the Board's request and is cited in our comment letter.

¹ The **Center for Economic Justice** (CEJ) is a non-profit organization that advocates on behalf of low-income and minority consumers on insurance, credit and utility issues before administrative agencies to promote greater availability and affordability of the basic services necessary for individual and community economic development.

² The **National Consumer Law Center, Inc.** (NCLC) is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country.

³ The **Consumer Federation of America** is a non-profit association of nearly 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

⁴ **Consumer Union** is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

1. What are the similarities and differences among credit insurance, debt cancellation coverage, and debt suspension coverage, in the case of both closed-end and open-end credit?

Debt cancellation contracts (DCCs) and, in particular, debt suspension agreements (DSAs) provide fewer benefits to consumers than credit insurance and typically cost more for a lower-value product.⁵ This difference generally can be traced to weak regulation. Credit insurance is regulated by state insurance regulators while DCCs and DSAs have been declared banking products by federal banking regulators and, at least for DCCs and DSAs offered by institutions subject to federal banking regulation, are regulated at the federal level. Insurance regulators in every state require credit insurance to provide certain minimum benefit levels and benefits that are reasonable in relation to premium charged.⁶ Federal regulation of DCCs and DSAs has no similar requirements. Consequently, DCCs/DSAs provide very poor value to consumers. For example, credit card DSAs typically return, at most, two to three cents in benefits for every dollar of fee charged.

DCC and DSA benefits also offer less than credit insurance benefits because of differences in covered or triggering events and the type of benefits provided. For example, DSAs typically provide a death benefit only for accidental death. This limitation is not permitted for credit insurance. Moreover, the claims for accidental death are a fraction – 10% or less – of the death claims in credit life insurance policies. The ability of lenders to modify covered events is part of the major asymmetry of information and market power between lenders and consumers in the DCC/DSA market – an asymmetry of information that greatly favors lenders.

DSAs provide significantly different and fewer benefits than either credit insurance or DCCs. DSA benefit levels are lower because the basic benefit is a waiver of the monthly finance charge rather than a cancellation of the monthly loan payment, which includes interest and principal on the loan.

From the consumer's perspective, the three products appear to be identical or nearly identical. All three provide a type of credit protection when a covered event occurs. Credit insurance and DCCs can provide identical protection; the loan is paid off (credit insurance) or cancelled (DCC) in the event of death and the monthly loan payments are paid (credit insurance) or cancelled (DCC) in the event of disability, involuntary unemployment or other covered event. Credit insurance coverages are typically limited

⁵ Pages 26-27 of the CEJ report show that DCCs/DSAs cost more and provide fewer benefits than the credit insurance programs replaced by the DCCs/DSAs.

⁶ Many types of credit insurance, as well as weak state regulation of credit insurance, have been criticized by consumer groups because of the poor value to consumers and the deceptive practices associated with some credit insurance sales. See the national reports on credit insurance at www.cej-online.org/report.pdf and www.cej-online.org/2001credit.pdf, respectively.

to life, disability, involuntary unemployment and personal property. Credit GAP insurance is also available to consumers as a separate product. DCCs typically cover the same events available under credit insurance coverage plus some additional events.

From the lender's perspective, DCCs and DSAs also are substitutes for credit insurance and they can be marketed to the same types of consumers. As noted above, however, vital consumer protections that exist in state credit insurance regulation do not exist for DCCs and DSAs. As a result, DCCs and, in particular, DSAs sold to consumers have very little –or no – value relative to the fees paid for these products. The poor value to consumers from DCCs and DSAs results from the unfavorable market structure that puts consumers in a very weak position versus lenders.⁷

The market structure for credit insurance and DCCs/DSAs is identical. In these markets, consumers have a much weaker market position than the lender selling the product, particularly for credit insurance and DCCs/DSAs sold in connection with closed end loans. However, lenders selling DCC/DSA products have far more knowledge than the consumer about the frequency of triggering events, the likelihood of a benefit occurring and the impact of eligibility requirements. There is a large asymmetry of information favoring the lender. Additionally, where DCCs/DSAs are sold in connection with closed-end loans, there is great potential for the lender to mislead or coerce the consumer into believing that the credit protection product is a requirement for the consumer obtaining the underlying loan or that it enhances the consumer's chances of obtaining the loan. Credit insurance regulation, to some extent, recognizes and attempts to address these market failures with consumer protection requirements, such as minimum benefit levels. DCC/DSA regulation fails to recognize, and provide consumer protections for, the stronger market power of the lender in the transaction.⁸

2. With what types of closed-end and open-end credit are debt cancellation and debt suspension products sold? Do creditors typically package multiple types of coverage (e.g., disability and divorce), or sell them separately? Do creditors typically sell the products at, or after, consummation (for closed-end credit) or account opening (for open-end credit plans)?

DCCs and DSAs are typically sold as a package of coverages. The notable exception is GAP waiver sold by auto dealers. GAP coverage – whether as credit insurance or DCC – pays the difference between the amount owed on a vehicle loan and the actual cash value paid by an insurance company pursuant to an auto insurance policy in the event the vehicle is totaled in an accident or stolen.

⁷ See pages 29-32 of the CEJ report for recommendations to improve consumer disclosures and for limitations on sales of certain types of DCC/DSA products to address the disparity in market power between lenders and consumers.

⁸ Please see pages 2 through 11 and 23 through 29 of the CEJ report for more information responsive to this question.

The vast majority of credit card credit insurance has been replaced by DSA programs. Both the credit insurance and DSA programs are monthly fee products. With credit card DCCs and DSAs, the products are sold upon application and after account opening through notices on the application at time of application and through bill stuffers and telemarketing after the account is opened.

There also has been increased use of DCCs and DSAs with installment (closed-end) loans. Single fee DCCs and DSAs are sold at loan consummation, just as with single premium credit insurance. Monthly fee products sold in connection with installment loans are sold at and after loan consummation.⁹

3. What disclosures are made with the sale of a product or upon conversion from one product to another, whether required by TILA or other laws? How are monthly or other periodic fees disclosed to consumers?

Initial disclosures for DCCs and DSAs are typically quite limited.¹⁰ For some lenders, a consumer must purchase the product before obtaining a full description of the product and eligibility. Monthly fees are typically disclosed as an amount per \$100 of some form of account balance. There is a need for consistency in the base against which the monthly fee is applied.

For single fee DCCs and DSAs, the same disclosure problems exist as with single premium credit insurance. The consumer relies upon the lender to explain not just the rate (cost per unit of coverage), but also the total amount of the up-front fee and the impact on the consumer's loan. Given the flexibility available to lenders in designing DCC and DSA programs (which allows the design of a benefit package with stable exposure as opposed to the declining exposure typically available with credit life insurance) and the tendency for abuse of financed single fee products, the Board should prohibit financed single fee DCCs and DSAs and require that all DCCs and DSAs be monthly fee products.¹¹

⁹ Please see pages 23 through 29 of the CEJ report and Appendices 12 and 13 for a detailed description of current DCC and DSA programs.

¹⁰ Appendix 13 of the CEJ report shows a variety of DCC and DSA solicitations and initial disclosures.

¹¹ The need for such a measure is discussed further in our response to item 4.

4. Under Regulation Z, fees for credit protection programs written in connection with a credit transaction are finance charges but some fees may be excluded from the disclosed finance charge if required disclosures are made and the consumer affirmatively elects the optional coverage in writing. See § 226.4(b)(7) and (10), 4(d)(1) and (3). Is there a need for guidance concerning the applicability of those provisions to certain types of coverage now available? Are the required disclosures adequate for all types of products subject to § 4(d)(1) or 4(d)(3)?

DCCs/DSAs warrant different and additional disclosures than those required for credit insurance. While state insurance regulators provide some measure of consumer protection against deceptive or valueless product offerings, no such framework exists for DCCs and DSAs. For example, no credit life policy has been approved that provides a benefit only in the event of accidental death as opposed to all causes of death (with some suicide exclusions). Similarly, state insurance regulators generally protect consumers from benefit requirements that render the product defective. Because these consumer protections do not exist for DCCs and DSAs, death benefits typically are replaced with accidental death benefits and/or a requirement that a consumer must stop using his or her credit card if receiving the DSA benefit. Since a consumer is most in need of his or her credit card if he or she becomes unemployed or disabled, the consumer is unlikely to “take advantage” of the DSA benefit, which simply allows the consumer to skip a payment without incurring additional finance charges.

The disclosures required by Regulation Z that enable a lender to exclude the cost of single premium credit insurance from finance charge calculations have proven to be ineffective in protecting consumers from widespread abuses in the sale of single premium credit insurance. The activity in the past few years to stop the sale of financed single premium credit insurance with real-estate secured loans reflects the failure of the Regulation Z disclosures. Disclosure has simply proven to be an insufficient and ineffective method of consumer protection for financed single premium or financed single fee credit protection products.¹² Consequently, financed single fee DCCs or DSAs should be prohibited.

For monthly-fee DCCs and DSAs, improved disclosures are needed to address the weaknesses in current disclosure requirements and to alert consumers to the different and often disadvantageous terms and benefits. These 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 is paid because of each of the specific covered events per 1,000 loans / accounts. This type of information is essential for a consumer to have some realistic understanding

¹² Reports by the Center for Economic Justice, Consumers Union and the Consumer Federation of America on credit insurance in 1999 and 2001 identify other sales abuses with credit insurance, despite the Regulation Z disclosures. The reports are available at www.cej-online.org/report.pdf and www.cej-online.org/2001credit.pdf, respectively.

of how likely he or she is to get a benefit from the DCC/DSA product. For example, with a DCC/DSA package that provided debt cancellation for accidental death and long term disability and debt suspension for involuntary unemployment, short term disability and family leave, the disclosure format would include the following type of information:

Outstanding Balance Canceled

of accounts receiving benefits for long term disability per 1,000 accounts in stated 12 month period

of accounts receiving benefits for accidental death per 1,000 accounts in stated 12 months

Balance Deferred (24 month maximum)

of accounts receiving benefits for job loss per 1,000 accounts in stated 12 month period

of accounts receiving benefits for short term disability per 1,000 accounts in stated 12 month period

Balance Deferred (3 month maximum)

of accounts receiving benefits for family leave per 1,000 accounts in stated 12 month period

Total

of accounts receiving benefits for any reason per 1,000 accounts in stated 12 month period

It is only through this type of disclosure that a consumer begins to have the information necessary to make an informed decision about the value of the DCC/DSA product. This type of disclosure should be required to exempt the fees charged from DCCs/DSAs from being included in the calculation of the finance charge.

- 5. Under TILA, a credit card issuer must notify a consumer before changing the consumer's credit insurance provider. See 15 U.S.C. 1637(g); 12 CFR 226.9(f). Card issuers that intend to change credit insurance providers need only notify consumers that they may opt out of the new coverage. Should the Board interpret or amend § 226.9(f) to address conversions from credit insurance to debt cancellation or debt suspension agreements? If so, is there a need to address conversions other than for credit card accounts?**

See response under item 6.

6. OCC regulations for national bank sales of debt cancellation and suspension agreements require a customer's affirmative election of the product. If the Board interprets or amends § 226.9(f) to address conversions from credit insurance to debt cancellation or debt suspension agreements, what additional guidance would card issuers need, if any, to comply with both rules?

As with initial disclosures, described in item 4, disclosure requirements for conversions from credit insurance to DCCs/DSAs need to be more substantial than those for conversions within credit insurance products. We urge an opt-in requirement for any conversion to, or modification of, a DCC/DSA that changes the product in any way other than by increasing the benefits to the consumer. With credit insurance, consumers can rely, to some extent, on state insurance regulators not to approve credit insurance products that are misleading, deceptive or of little value. No such protection exists for consumers with DCCs and DSAs. Consequently, any conversion to or modification within a DCC/DSA should require the same disclosures as described in our response to item 4 and an affirmative acceptance – opt-in – of the new/revised products. The requirements we suggest for conversion to or modification of a DCC/DSA should apply to all such products, whether sold in connection with credit cards, other open-end loans or closed-end loans.

Please contact us if you would like any additional information about any of these issues.

Sincerely,



Birny Birnbaum
Executive Director