ARKANSAS INSURANCE DEPARTMENT

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BULLETIN NO. 07-2003

TO: ALL LICENSED INSURANCE COMPANIES, HOSPITAL AND MEDICAL SERVICE CORPORATIONS, HEALTH MAINTENANCE ORGANIZATIONS, RATE SERVICE OR ADVISORY ORGANIZATIONS, ARKANSAS STATE BANK DEPARTMENT, AND OTHER INTERESTED PARTIES

FROM: ARKANSAS INSURANCE DEPARTMENT

SUBJECT: Lender's Solicitation & Sale to Arkansas Debtors of Debt Cancellation or Debt Suspensions Agreements (DCAs)

The Insurance Department ("Department" or "DOI") is issuing this Bulletin on debt cancellation and debt suspension provisions as a corollary to the "GAP" Bulletin issued some years earlier by the Department as DOI Bulletin 6-98, dated April 9, 1998.

The Department has completed a review of pending inquiries on how the Arkansas Insurance Department will view or regulate two-party debt cancellation and debt suspension contracts issued by creditors, including Federal and State chartered banks or financial institutions, thrifts, credit unions, and lenders other than banks or financial institutions, as well as credit card companies which extend credit. We have been advised by industry sources that at least 39 state insurance departments have opined that debt cancellation agreements are not insurance products when sold by certain or all financial institutions.

The Arkansas position is stated here. Debt cancellation or suspension is not an agreement to indemnify or pay the customer or debtor. It is appropriately described as a waiver or suspension (time extension) of the creditor's right to collect a portion of an obligation or the forgiveness of a debt, i.e., a passive declination to enforce a right, as New York courts have stated in similar cases on collision damage waivers in <u>Hertz Corp. v. Corcoran</u>, 530 N.Y.S. 2d (N.Y. Sup Ct., 1987). An essential element of an insurance contract is the shifting of risk from the insured to the insurer. Another essential element is that the agreement must be one by which the insurer “indemnifies” the insured. Debt Cancellation Agreements do represent a shifting of something, but not of risk. A risk is a chance of something happening (a “fortuitous event” per Ark Code Ann. §23-60-102), such as fire, a flood, or lightening strike. What appears to be the subject of the shifting in the DCA scenario is an obligation, specifically an obligation to repay a loan. Thus, there does not appear to be the requisite risk shifting or indemnification necessary to establish a contract of insurance as defined by Ark Code Ann. §23-60-102.

So long as the debt cancellation or debt suspension agreement is issued by a national or state bank, federal savings bank, federal or state thrift or savings and loan association, federal or state credit union, credit card company, or <u>other</u> non-financial institution lenders or creditors, as appropriate under the Federal Truth in Lending Act, 12 U.S.C. §226, et seq. (part of The Federal Reserve Act), and is issued in the context of a two-party mortgage or loan agreement for an installment purchase or rental, wherein the debt will be cancelled/waived or suspended on a condition stated [death, disability (illness or accidental injury) or hospitalization, loss of employment, destruction or damage to the financed property or goods, etc.], and the creditor is <u>not</u> indemnifying, assuming risk or “spreading” any risk (traditional functions of insurance), the Department will <u>not</u> regulate these contracts or loan addendums as insurance.

In adopting this position, the Department recognizes the impact of amendments to the Truth in Lending Act, which of legal necessity <u>broadened</u> our position on debt cancellations and debt suspensions, following the Arkansas cases of <u>Douglas v. Dynamic Enterprises, Inc.</u>, 869 S.W.2d 14 (1994), commonly called the “Carmart” case; and the important precedent set in <u>First National Bank of Eastern Arkansas v. Ron Taylor, Commissioner of the Insurance Department for the State of Arkansas</u>, 907 F.2d 775 (8th Cir., 1990), on two-party debt cancellation contracts of national banks.

We also recognize the validity and application of the Arkansas Banking Code “wild card” provision, Ark. Code Ann. §23-47-101(c), allowing state-chartered banks the same privileges in this State which are afforded nationally chartered banks, doing business in this State under OCC rules and regulations which interpret the Federal Reserve Act, and which issue debt cancellation provisions in the regular course of business. We understand other financial institutions and lenders have similar laws placing them on equal footing on this issue with national banks.

CAVEAT: The foregoing position of the Department is speaking to two-party DCAs between a lender and a borrower. If the subject DCA is offered by a third-party outside the context of a debt instrument, such as an insurer or third party administrator, wherein the insurer or TPA is the obligee on the debt cancellation contract or loan/lease addendum (<u>not</u> acting as a first party lender or as an investor), then the Department will review those contracts to consider if they should be fully regulated as insurance contracts under the Arkansas Insurance Code, Ark. Code Ann. §§23-60-101, et seq. or as financial instruments under other applicable laws. Likewise, when the lender separately contracts with an insurance company and secures a policy to insure itself against all or a portion of the potential loss it assumes under its DCAs issued to its customers, such an insurance policy and insurance company would have to be authorized by this Department and would be clearly subject to our regulation and oversight.

On line, submit your questions to the Legal Division, by mail or email at

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Direct your questions to General Counsel, Mr. Jay Morgan, in the Legal Division at 501-371-2820 or at jay.morgan@mail.state.ar.us.

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MIKE PICKENS
INSURANCE COMMISSIONER

AUGUST 21, 2003
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DATE