



Debt cancellation products can vary widely by the types of loans and triggering events covered under the terms of the DCS agreement. They can provide for cancellation of all or part of the member's debt upon the occurrence of certain events, such as death, disability, involuntary unemployment, or the total loss of a vehicle. They can also defer all or a portion of monthly payments. Programs could also be established which share qualities of both cancellation and suspension approaches. The benefits can be provided monthly or in a lump sum, and the duration of benefits can be limited or cover the entire loan term. For example, a Guarantee Auto Protection program pays any remaining balance after application of insurance settlements when the member's collateral is destroyed or stolen. Fees for DCS programs are assessed either as a lump sum or in periodic installments.

Credit unions are expected to adhere to safety and soundness principles when managing the risks associated with DCS programs. Likewise, credit unions should establish and maintain effective risk management and control processes over DCS programs. Such processes include appropriate recognition and financial reporting of income, expenses, assets and liabilities, and appropriate treatment of all expected and unexpected losses associated with the products. Credit unions also should assess the adequacy of internal control and risk mitigation activities in view of the nature and scope of DCS programs. Examiners will determine that the credit union's methodologies support participation in DCS programs, as well as policies and procedures for these supporting processes are appropriate.

While stop-loss insurance coverage is not legally required under NCUA Rules and Regulations, credit unions may want to consider such coverage from a third party provider as an appropriate means to effectively manage risk. For credit unions with liability insurance coverage, regardless of the amount, credit union management must have procedures in place to evaluate the third party who provides the coverage. NCUA Letter to Credit Unions 01-CU-20, Due Diligence Over Third Party Service Providers, should be used as guidance for both federal and state-chartered credit unions.

### **Legal Issues and Compliance Risk**

At least one court has established that a debt cancellation agreement is not an insurance product regulated by state insurance regulators. It is, in fact, a two-party contract between the lender and its borrower, outside the purview of insurance laws.

NCUA's Office of General Counsel has determined that insurance coverage is not required for the at-risk balance of loans covered by these programs. Credit unions have the option of insuring all or part of the risk. Expanded examination procedures will be considered when examining those credit unions where full contractual liability coverage is not obtained.

Truth in Lending regulations set forth certain requirements if the fees for these programs are not itemized as a finance charge. These requirements include:

1. A written statement that the DCS is not required by the creditor to obtain the loan,
2. Disclosure of the fee or premium and term of coverage in certain situations, and
3. A signed affirmative request for coverage.

Credit unions should also review the Office of the Comptroller of the Currency rule on DCS programs, 12 C.F.R. Part 37, for guidance as to best practices in the industry regarding these programs at [www.occ.treas.gov/ftp/release/2002-73.pdf](http://www.occ.treas.gov/ftp/release/2002-73.pdf).

### **Accounting**

Credit unions should account for DCS programs in accordance with Generally Accepted Accounting Principles. Accounting procedures for DCS programs can be complex, and credit unions may want to consider consulting with a CPA or other accounting professional in determining the accuracy of their accounting treatment. Examiners will be evaluating credit union management's provisions for accurate accounting treatment, due diligence, and internal controls over these programs.

If you have any questions on DCS programs, please contact your examiner or NCUA regional office.

Sincerely,

/S/

Dennis Dollar  
Chairman

Enclosure