

January 3, 1996

John J. Baker, Marketing Representative
Intercon General Agency, Inc.
14881 Quorum Drive, Suite 100
Dallas, TX 75240

Re: Collection of GAP Insurance Premiums
(Your October 18, 1995, Letter)

Dear Mr. Baker:

You have asked several questions regarding the operation of a proposed GAP deficiency balance insurance program ("GAP insurance"). According to your letter, GAP insurance would protect credit unions from losses when the vehicle securing a borrower's automobile loan is declared a total loss and the borrower's primary insurance settlement does not satisfy the outstanding loan balance. Under the program a credit union would purchase GAP insurance from Intercon General Agency (an insurance company), and then enter into a waiver of liability addendum (the "Waiver") with the borrower who would be responsible for paying the premiums. The Waiver releases the borrower from his obligation to pay the credit union the difference between his primary insurance settlement and his outstanding loan balance. Your questions and our responses are set forth below. Please be advised that our responses only apply to federal credit unions ("FCU"). You should contact the appropriate state supervisor for the guidelines applicable to state-chartered credit unions.

ANALYSIS

1. Should the GAP insurance premium be added to the total amount financed by the borrower or should the borrower pay the premiums and the note separately, or can the interest rate be adjusted to compensate for the premium?

The National Credit Union Administration ("NCUA") does not directly regulate an FCU's repayment procedures beyond the credit practices addressed in Part 706 of NCUA's Rules and Regulations. 12 C.F.R. Part 706. NCUA only requires that any repayment method comply with any applicable laws and regulations, and does not present any safety and soundness concerns. Accordingly, we express no opinion as to whether the borrower should pay the GAP insurance premium and the note separately, or whether the interest rate should be adjusted to reflect the GAP insurance premium and recommend that you obtain the advice of private counsel.

2. May an FCU receive compensation or a reimbursement of expenses for participating in the GAP insurance program?

NCUA's regulations would permit an FCU to earn income by participating in the GAP insurance program as long as the sale of GAP insurance was directly related to the extension of credit by

the FCU. 12 C.F.R. §721.2(b)(1). However, the FCU would be subject to any state laws governing the sale of insurance, including any limits on insurance commissions. If the sale of insurance is not directly related to the extension of credit, then an FCU could only be reimbursed for its costs. 12 C.F.R. §721.2(b)(2).

When the NCUA Board promulgated the current Part 721 of NCUA Regulations, the preamble to the rule listed the types of insurance that may be directly related to an extension of credit. 50 Fed.Reg. 16462, April

26, 1985 (enclosed). While GAP insurance is not included on that list, it operates in the same manner as credit life insurance, which is included in the Board's list. Both GAP insurance and credit life insurance are designed to pay off the member's loan upon the occurrence of a specified event. Accordingly, GAP insurance is directly related to an extension of credit by an FCU, and the only limits on income to an FCU would be applicable state law. Repeating the comments from our enclosed November 16, 1995, letter to Richard W. Hetzel (the "Hetzel Letter"), we defer to the NCUA regions whether GAP programs warrant special monitoring based on safety and soundness objections.

3. What disclosures must be given when the FCU gives the Waiver to the borrower.

The required disclosures for automobile loans are governed by Federal Reserve Board Regulations M and Z, ("Regulations M and Z"), 12 CFR Parts 213 and 226, respectively. NCUA is not authorized to interpret those regulations.

Finally, the Waiver appears to operate in the same manner as a "debt cancellation contract." *See*, the Hetzel Letter. We note that at least one state, Arkansas, considers debt cancellation contracts an insurance product. *See*, Douglas v. Dynamic Enterprises, No. 93-663, 1994 Ark. Lexis 35 (Sup.Ct. Jan. 24, 1994). We suggest that you contact the appropriate state insurance regulator to determine whether the Waiver would be treated as an insurance product, and whether an FCU would be required to obtain an insurance license before it could offer the Waiver to its members.

Sincerely,

Richard S. Schulman
Associate General Counsel

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Enclosure