



**State of Washington**  
**DEPARTMENT OF FINANCIAL INSTITUTIONS**  
Division of Credit Unions

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June 4, 2002

“A”

**Subject: Response to Your Letter Regarding Whether Washington State Chartered Credit Unions can Sell and Finance Debt Cancellation Contracts**

**DCU Opinion O-02-5 Redacted Version**

Dear “A”:

This letter responds to your inquiry as to whether Washington state-chartered credit unions can sell and finance debt cancellation contracts. We appreciate your patience in allowing us enough time to respond to your request.

You have asked whether state chartered credit unions would be permitted to sell and finance debt cancellation contracts in Washington. You point out in your letter that federally chartered credit unions in Washington are permitted to sell and finance these products under a recently issued rule covering incidental powers of federal credit unions.

I refer you to Division of Credit Unions’ (DCU) Opinion number 01-08, which covers the State Parity Provision of the Revised Code of Washington (RCW 31.12.404(1) and the State Incidental Powers Provision of the RCW (RCW 31.12.402(23)). Opinion number 01-08 states that Washington state-chartered credit unions possess the powers granted to federal credit unions under the National Credit Union Administration’s (NCUA) amended Incidental Powers rule now found at 12 C.F.R. Part 721. The NCUA rule cites debt cancellation agreements as an example of a loan-related product that is incidental to a federal credit union’s lending authority and therefore authorized as a federal credit union activity. See, 12 C.F.R. Sections 721.3 (g). A copy of DCU’s Opinion #01-08 is located at <http://www.dfi.wa.gov/cu/opinions2001.htm#8>. NCUA’s rules are located at [http://ncua.gov/ref/rules\\_and\\_regs/rules\\_and\\_regs.html](http://ncua.gov/ref/rules_and_regs/rules_and_regs.html). Therefore, state-chartered credit unions have similar power and authority to offer debt cancellation products that are incidental to the loan products they are offering.

CUNA Mutual's white paper describes the debt cancellation product concept at <http://www.cunamutual.com/cmgi/media/00001116.pdf>. As described in that white paper, a debt cancellation agreement is offered to the borrower as an addendum to the lending agreement and describes when and how a debt will be cancelled or suspended. The addenda should be designed so that the obligation for any losses for suspended or canceled loans follows the loan and would not become a separate liability for the lender if the underlying loan were sold on the secondary market.

It is the current opinion of the Division that these types of loan addenda canceling or suspending a repayment obligation are not insurance products and therefore fit the definition of a "debt cancellation agreement" as envisioned by the federal incidental powers rule. However, third party agreements offered to a borrower that promise to pay the remaining balance to a lender on occurrence of some event may still be treated as a credit insurance product in some states. The determination of whether a particular product is a credit insurance product in Washington will depend on other law interpreted by the Office of the Insurance Commissioner. See definition of "Insurance" at RCW 48.01.040.

As you are aware, debt cancellation agreements can present a substantial risk to a credit union if that risk is not transferred to the insurer. The Division would expect a credit union that proposed to offer such products to establish and maintain a separately identifiable loss reserve for debt cancellation contracts at a sufficient level to meet expected losses for suspended or canceled debts. Alternatively, the credit union may obtain a third party insurance policy from a suitable insurer to cover these expected losses. The Division would expect the credit union to perform adequate due diligence of any such insurer.

Finally, the Division would encourage state-chartered credit unions that decide to offer debt cancellation products to consider the consumer disclosure practices for such products proposed by the Office of the Comptroller of the Currency (OCC) for national banks. Those proposed rules can be found at 66 Fed. Reg. 19901 (April 18, 2001). While the OCC proposed rules are not presently a requirement for either national banks or credit unions, the Division would consider them to be "best practices."

The Division of Credit Unions does not endorse the selling of debt cancellation coverage, nor does it endorse any insurer or vendor of this product. If you have any questions regarding this letter, please contact me at (360) 902-8778.

Sincerely,

William V. Taylor  
Acting Director