



Debt Protection Overview

“It is not the strongest of the species that survives, nor the most intelligent. It is the one that is most adaptable to change.”

Charles Darwin

Start with a Clean Slate

- What are borrowers' perceived needs?
- What do loan officers want?
- What does management want?



Borrowers' Perceived Needs

If a loan officer were to ask the typical borrower,

“What is your primary economic concern when you take out a new loan?”



Borrowers' Perceived Needs

Most would say...

- ❑ How am I going to pay off this loan if I lose my job?



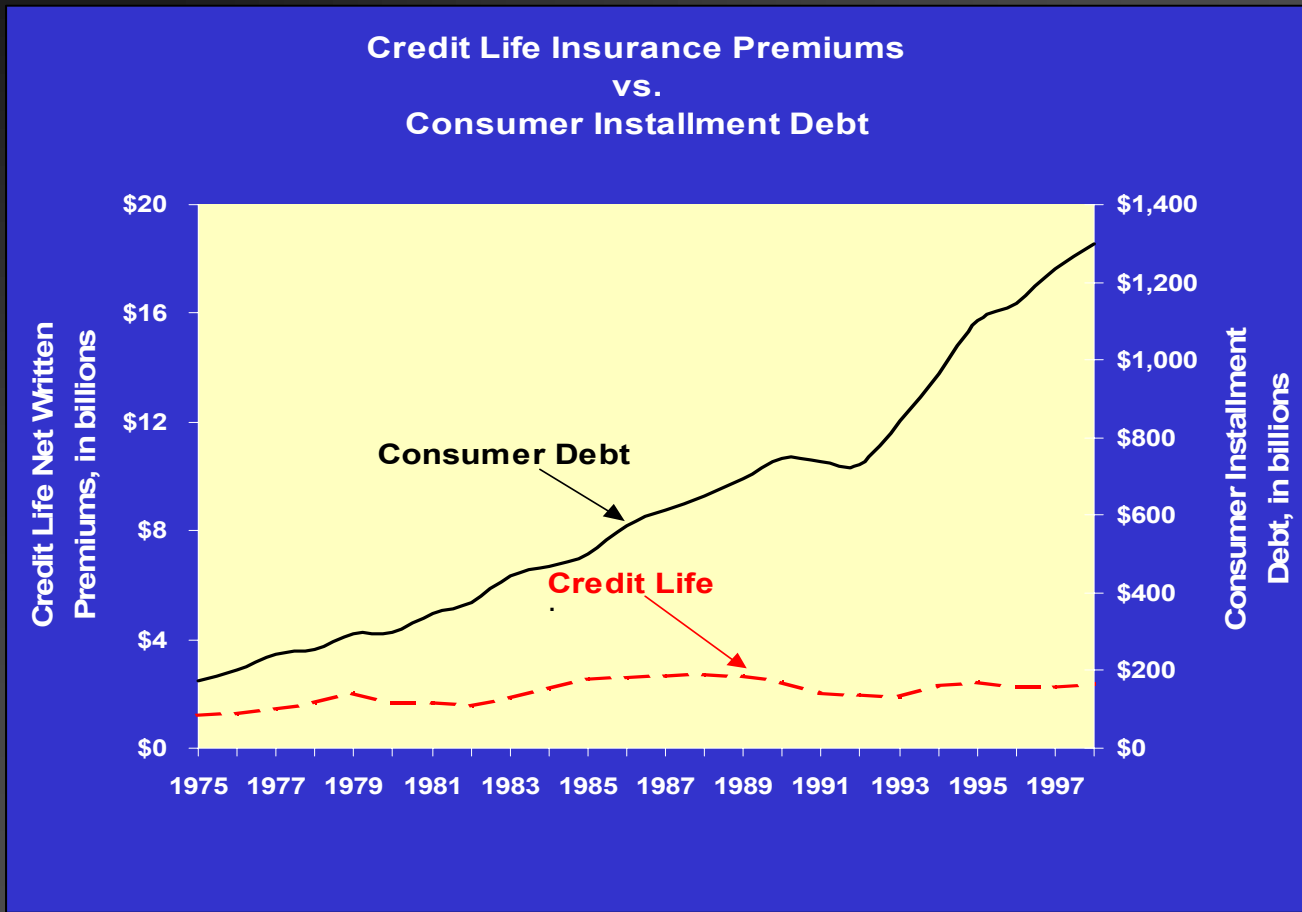
Evidence

Involuntary unemployment and unpaid family leave insurance

- Grown to \$1.2 billion product in 15 years
- 20% of all credit-related insurance

Borrowers want this protection

And Our Old Friend Credit Insurance



Borrowers' Perceived Needs

If the loan officer were to ask the typical borrower,

“You are going to die within four years. How will you die?”

Borrowers' Perceived Needs

Most people feel they will die...

accidentally

Accidental death protection meets perceived needs of borrowers

What Do Loan Officers Want?

They want incentives

- At \$25 per sale—loan officers will move product



What Do Loan Officers Want?

A product with:

- No health questions
- No age limits
- Protection against risks that really concern borrowers?

What Does Management Want?

- Choice of benefits to offer
- Protected borrowers
- Incentives to motivate loan officers
- Substantial fee income
(Buy wholesale and set retail price)

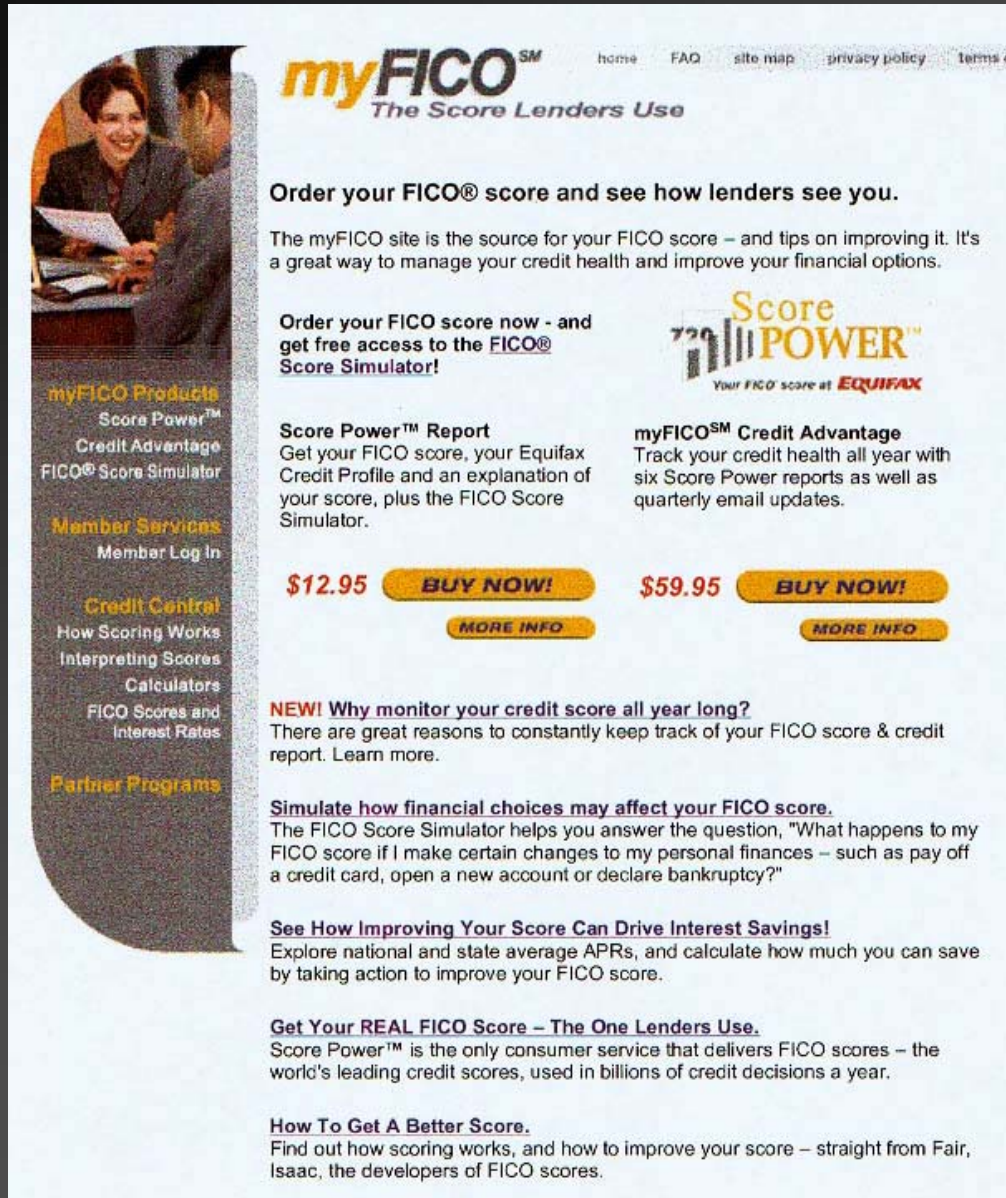
Marketing to the Consumer

What does sell?

“Protect your credit rating”



Awareness of FICO Scores



The image shows a screenshot of the myFICO website. On the left is a vertical navigation menu with categories: myFICO Products (Score Power™, Credit Advantage, FICO® Score Simulator), Member Services (Member Log In), Credit Central (How Scoring Works, Interpreting Scores, Calculators, FICO Scores and Interest Rates), and Partner Programs. The main content area features the myFICO logo and tagline 'The Score Lenders Use'. It includes a navigation bar with links for home, FAQ, site map, privacy policy, and terms of service. The primary message is 'Order your FICO® score and see how lenders see you.' Below this, it explains that the myFICO site is the source for FICO scores and provides tips on improving them. Two main product offerings are highlighted: 'Score Power™ Report' for \$12.95 and 'myFICO™ Credit Advantage' for \$59.95. Each has a 'BUY NOW!' button and a 'MORE INFO' button. A 'NEW!' section titled 'Why monitor your credit score all year long?' explains the benefits of tracking credit scores. Other sections include 'Simulate how financial choices may affect your FICO score', 'See How Improving Your Score Can Drive Interest Savings!', and 'Get Your REAL FICO Score – The One Lenders Use.' The bottom section is 'How To Get A Better Score.' The footer contains the copyright notice '©TFG and CREDITRE'.

myFICOSM home FAQ site map privacy policy terms of service
The Score Lenders Use

Order your FICO® score and see how lenders see you.

The myFICO site is the source for your FICO score – and tips on improving it. It's a great way to manage your credit health and improve your financial options.

Order your FICO score now - and get free access to the FICO® Score Simulator!

Score Power™ Report
Get your FICO score, your Equifax Credit Profile and an explanation of your score, plus the FICO Score Simulator.

myFICOSM Credit Advantage
Track your credit health all year with six Score Power reports as well as quarterly email updates.

\$12.95 BUY NOW! **\$59.95 BUY NOW!**

MORE INFO **MORE INFO**

NEW! Why monitor your credit score all year long?
There are great reasons to constantly keep track of your FICO score & credit report. Learn more.

Simulate how financial choices may affect your FICO score.
The FICO Score Simulator helps you answer the question, "What happens to my FICO score if I make certain changes to my personal finances – such as pay off a credit card, open a new account or declare bankruptcy?"

See How Improving Your Score Can Drive Interest Savings!
Explore national and state average APRs, and calculate how much you can save by taking action to improve your FICO score.

Get Your REAL FICO Score – The One Lenders Use.
Score Power™ is the only consumer service that delivers FICO scores – the world's leading credit scores, used in billions of credit decisions a year.

How To Get A Better Score.
Find out how scoring works, and how to improve your score – straight from Fair, Isaac, the developers of FICO scores.

myFICO Products
Score Power™
Credit Advantage
FICO® Score Simulator

Member Services
Member Log In

Credit Central
How Scoring Works
Interpreting Scores
Calculators
FICO Scores and Interest Rates

Partner Programs

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Awareness of FICO Scores

The TipSheet

Smart Strategies for Your

MUSEUMS FIELD TRIPS

Once Jell-O got a museum, we knew the floodgates were open. A slew of small galleries are opening in the next few months, each with a very small, but very cool, niche.

International Spy Museum

WASHINGTON, D.C.

Sick of summer spy flicks? Check out the tools used in real live espionage—like the “kiss of death” lipstick pistol. 1 (202) EYE SPY U

Charles M. Schulz Museum

SANTA ROSA, CALIF.

Sunday mornings aren't the same without Schulz. Reconnect with Charlie, Snoopy and the little redheaded girl. 1 (707) 579-4452



Museum of Glass

TACOMA, WASH.



MONEY

CREDIT: THE REAL SCORE

BY DANIEL MCGINN

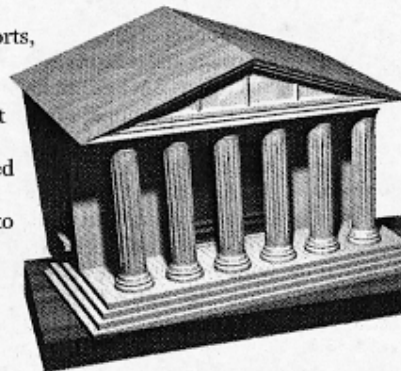
TO MEASURE INTELLECT, Americans use IQ and SAT scores. For health, we use cholesterol tests and the body-mass index. And when it comes to finances, we're judged by our credit scores. For years consumers have been able to request copies of their credit reports, which list their accounts, balances and payment histories. But the actual scores—a single number crunched by the firm Fair, Isaac & Co.—were available only to lenders. Now consumers can access scores themselves at myfico.com. For \$12.95, the site provides your score, some simple analysis—and, for many people, a sudden sense of disappointment.

Believe me, I know. If there

I'm not the only one. When the company launched the Web site in March, managers expected most complaints to come from low scorers. Instead, many angry callers scored well but were still unhappy with their rankings. “The calls we got from higher-scoring people

were along the lines of, ‘I'm perfect, I have an SAT score of 1400, and I'm outraged my credit score is only 812 and not 850,’” says Tom Quinn, the executive who helped devise the scoring system.

To help me come to terms with my shortcomings, I sent my file to Quinn and one of his colleagues. Their analysis was illuminating. The biggest surprise: how some savvy financial moves have hurt my credit score. For instance, a few years



GAMING THE CREDIT SYSTEM

Credit scorers use computer

What Is this Product Set?

- Involuntary unemployment
- Accidental death protection
- Family leave
- Disability or hospitalization

Or, Credit Insurance Protection in a Bank Product

- All cause death protection, with age limits and health questions
- All cause disability protection
- Maybe family leave or hospitalization

Debt Protection Products



Overview

Debt Cancellation Contracts

Office of the Comptroller of the Currency (OCC) has ruled that a national bank may:

- Charge a fee
- Amend its lending agreement
- Cancel the debt upon death, disability, involuntary unemployment, damage to property, and other events

Overview

Debt Suspension Agreements

Office of the Comptroller of the Currency (OCC) has ruled that a national bank may:

- Charge a fee
- Amend its lending agreement
- Suspend the debt upon death, disability, involuntary unemployment, and other contingencies

Overview

Advantages of the Concepts

- A banking product; not “insurance”
- Countrywide; no state variations
- Freedom to choose protected events
- Freedom to select contractual language
- Freedom to select rate

Overview

Advantages of the Concepts

- Freedom from state insurance regulation
 - No agent licensing requirements or fees
 - No policy form approvals
 - No premium taxes
 - No market conduct examinations
 - No claim audits
 - No insurer commission caps; triennial exams

Overview

Limitations and Disadvantages

Can only cancel or suspend the debt

- No gross coverage on death

Overview

Limitations and Disadvantages

Part of the lending agreement

Are age limits permitted?

- Marketplace has decided yes

Is risk classification permitted?

- Marketplace has decided yes

Overview

Limitations and Disadvantages

Are the benefits taxable to debtor?

- Cancellation may be “forgiveness” of debt
- Death, disability, IU cancellations may be taxable
- Bank may have an obligation to issue a 1099 for benefits of \$600 or more per calendar year (No, per PLR 200131027)

Freedom from Ins. Regulation Banks and Thrifts

- Debt protection product of a national bank is not subject to state insurance department regulation
- State bank in a parity state is automatically granted same power
- Office of Thrift Supervision has granted the same power to national thrifts

Freedom from Ins. Regulations

Other Lenders

Credit Unions

- NCUA has found debt protection products to be an incidental power of federal credit unions; state parity often extends the power to state credit unions

All Creditors

- Some states—attorney general and/or insurance commissioner opined that debt protection products are not insurance

Marketplace Evolution

Credit Card Programs

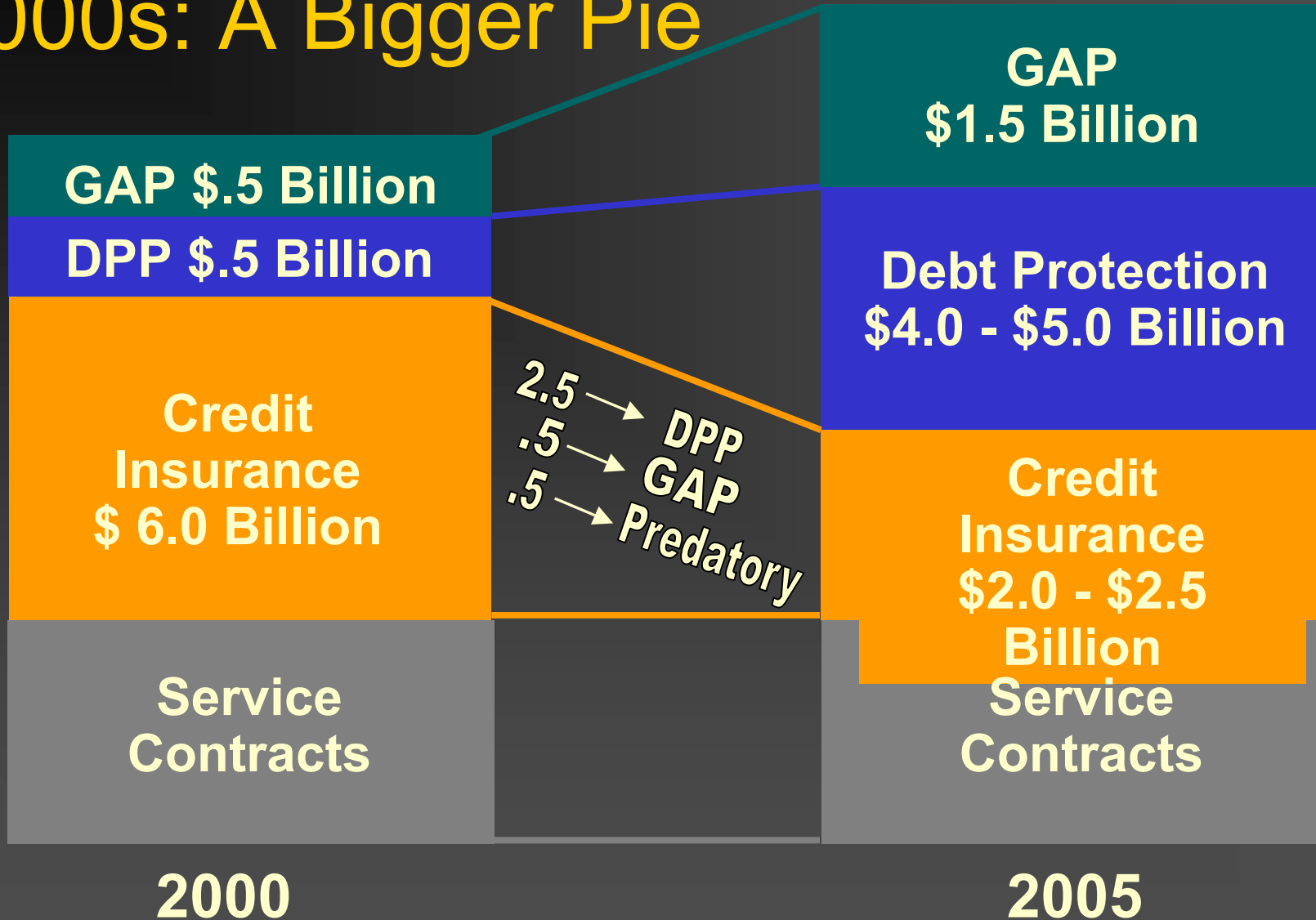
- Nearly complete conversion by major credit card issuers
- New solicitations in 2002 are DPP
- Advanta, Bank of America, Capital One, Chase, Citibank, Discover, First National Bank of Omaha, First USA, Fleet, MBNA

Marketplace Evolution

Installment Lending

- Slow evolution, few programs on the street
- Bank of America, FNB of Eastern Arkansas National Commerce, TCF, and a few others
- Predatory lending emerges and changes the nature on real estate secured lending
- About 50 banks converted by January 1, 2003

2000s: A Bigger Pie



Debt Protection Products

Definitions

Product Overview



Debt Protection Products (DPP)

- Debt Cancellation Contract (DCC)
- Debt Suspension Agreement (DSA)
- Payment Holiday (PH)



Debt Cancellation Contracts

Lump Sum Benefits

When a protected event occurs:

- Cancels the outstanding balance
- Based on date of event

Debt Cancellation Contracts

Monthly Benefits

1. Cancels the requirement to make a payment
2. Cancels the interest for the month
3. Cancels some principal

Debt Suspension Agreements

Monthly Benefits

1. Waives the requirement to make a payment
2. Waives the interest for the month
3. No principal reduction

Amount of debt is suspended at the balance on date the protected event occurs

Payment Holiday

Monthly Benefits

1. Waives the requirement to make a payment
2. Interest accrues
3. No principal reduction

Classified as debt suspension with interest accruing in OCC regulations

Terminology

Insurance Words	Debt Cancellation Words	Debt Suspension Words
Benefit	Protection	Protection
Claim	Benefit activation, activate protection, claim	Benefit activation
Contingency	Protected event	Protected event
Coverage	Protection	Protection
Credit	Debt	Debt
Creditor	Bank, creditor	Bank, creditor
Insurance	Protection	Protection
Insurer	Bank, creditor	Bank, creditor

Terminology

Insurance Words	Debt Cancellation Words	Debt Suspension Words
Insured	Protected cardholder, debtor	Protected cardholder, debtor
Life insurance	Death protection	Death protection
Paid	Canceled	Waived
Pay	Cancel	Waive
Policy	Addendum, contract	Agreement, addendum
Premium	Fee	Fee
Premium rate	Fee rate	Fee rate

Debt Cancellation Protections

Lump Sum Cancellations

- Death
- Accidental Death (AD)
- Dismemberment

Debt Cancellation Protections

Monthly Cancellations

- Disability
- Accidental Disability
- Hospitalization
- Involuntary Unemployment (IU)
- Family Leave
- Marriage
- Divorce
- Stay-at-a-Skilled-Nursing-Facility

Fixed period benefit on lump sum types

Debt Suspension or Payment Holiday Monthly Benefit

- Disability
- Accidental Disability
- Hospitalization
- Involuntary unemployment
- Family Leave
- Marriage
- Divorce
- Stay-at-a-Skilled-Nursing-Facility

Fixed period benefit on lump sum types



Office of the Comptroller of the Currency

Final Regulations
12 CFR Parts 7 and 37
September 13, 2002

OCC Final Regulations

The Long Road

3/64	Initial letter
1990s	Series of letters
1/00	Notice of proposed rules
4/01	Proposed Rules
9/02	Final Rules
6/03	Final Rules effective

OCC Final Regulations

General Regulatory Philosophy

- Regulations address major issues
- Regulations focus on:
 - Consumer protection through disclosure
 - Safety and soundness
- Commentary expands on rationale
- Examinations focus on banks' application of regulations in practice

Fee Standards of 7.4002 (b)

Non-Interest Bank Fees

- Fees are business decision of each bank
 - Must follow sound banking judgment
 - Must follow safe and sound banking principles
- Fees reasonable if bank considers four factors (on next slide)
- No supervisory impediment if factors are considered

Fee Standards of 7.4002 (b)

Four Factors/Considerations

- (1) Cost of providing service plus profit margin
- (2) Deterrence of misuse by customers
- (3) Enhancement of bank's competitive position in accordance with the bank's marketing strategy
- (4) Maintenance of bank's safety and soundness

§37.3 Prohibited Practices

(a) Anti-Tying Provision

Cannot condition credit extension on purchase of DCC/DSA.

Comments:

Anti-tying provisions in Bank Holding Company Act Amendments (1970) do not apply to DCC/DSA since they are part of a lending agreement

§37.3 Prohibited Practices

(b) Misrepresentation Generally

Cannot mislead a reasonable person by actions or advertisements

Comments:

“Reasonable person” test mirrors consumer protections for bank insurance sales

§37.3 Prohibited Practices

(c) Prohibited Contract Terms

- (1) Cannot unilaterally modify contract, unless:
- Prior notification is made and
 - Cancellation without penalty is allowed

Comments:

A 30-day-notice period is reasonable

§37.3 Prohibited Practices

(c) Prohibited Terms

(2) Cannot charge a single fee for protection on residential mortgage loans

Comments:

Potential for abuse in the marketing and sale of these products outweighs any potential consumer benefits.

§37.8 Safety and Soundness Requirements

Bank must establish and maintain effective risk management and control processes.

Comments:

Proposed rules were not sufficiently flexible, so language was changed



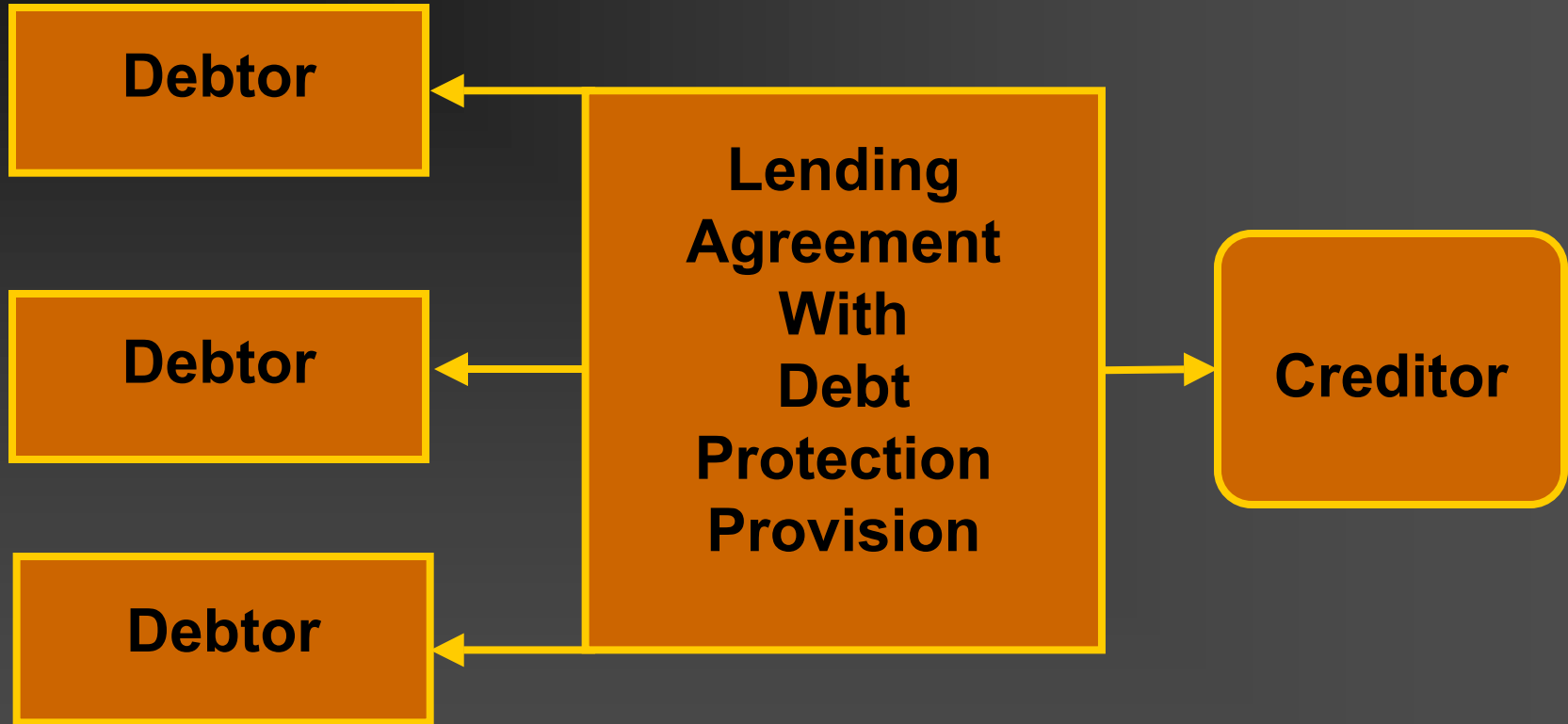
Risk Analysis and Risk Transfer

Financial Risk under Debt Protection Products

Two-party agreement between the Creditor and the Debtor

By definition, financial risk of a debt protection product initially resides at the bank

Use of Debt Protection Products, Creditor Retains Risk



A debt protection product is a two-party contract between the Creditor and the Debtor.

Financial Risk Transfer

Creditor can transfer risk to an insurance company through a contractual liability policy (CLP)

Two-party agreement between the creditor and the insurance company

Contractual Liability Policy (CLP)



A CLP is a two-party insurance policy between the Creditor and the Insurance Company

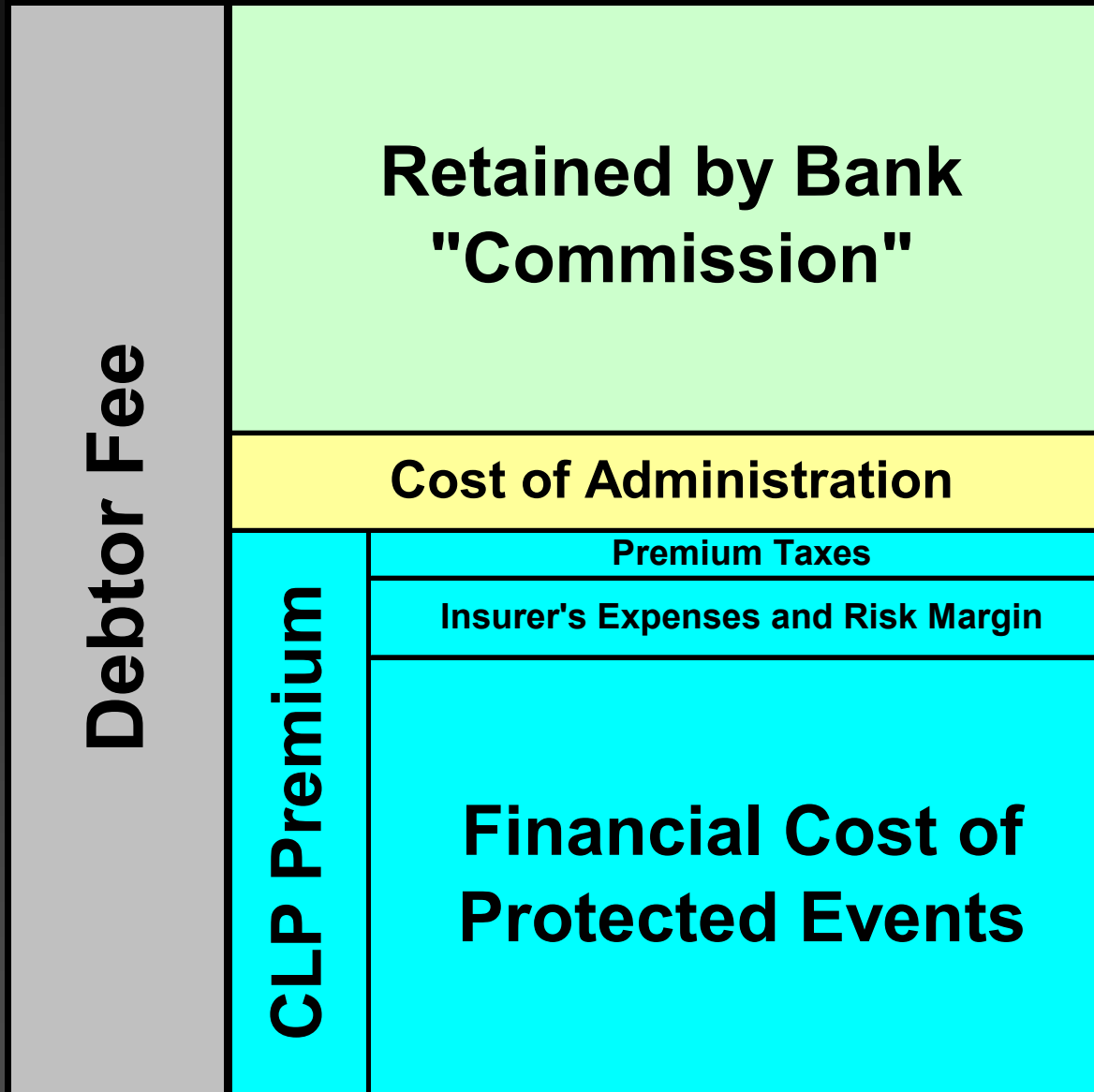
The Contractual Liability Policy

- Contractual arrangement between the creditor and the insurer
- No protection extended to borrower
- Simple policies
- U.S. CLP issued to a creditor in the creditor's state of incorporation; filed in that state only

The Contractual Liability Policy

- Insurer reimburses creditor for all cancellations made pursuant to the DPP provisions
- DPP is attached to, and made a part of, the policy
- Trust may be the beneficiary or may have a loss payable endorsement to CLP

Debtor Fee Structure and Allocation



The Contractual Liability Policy

- Creditor pays a portion of each DPP fee to the insurer as an insurance premium
- Premium must be sufficient to fund:
 - Expected cancellations
 - Insurer's expenses
 - Insurer's profit and risk margin
- Premiums subject to state premium tax

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