

INTERPRETIVE LETTER 94-011 (JUNE 15, 1994)

State bank may offer debt cancellation agreements to its customers as a power incidental to its authority to loan money and carry on a general banking business as well as under the authority of Section 5(11).

This is in reply to your letter dated *, and addressed to District Supervisor * of this Agency. In your letter, you inquired about the authority for state-chartered banks to offer debt cancellation agreements. For the reasons described below, it is the position of this Agency that state-chartered banks may enter into debt cancellation agreements with their borrowers.

A debt cancellation agreement is a contract between a lender and borrower pursuant to which any remaining debt of the borrower is extinguished upon the occurrence of a specified event (*i.e.*, the borrower's death, disability, or loss of employment). The consideration received by the lender is normally a fee received at the time the loan is made. The lender establishes a reserve account with the fees resulting from debt cancellation agreements or with other funds available for reserve. The reserve account is then used to protect the lender against potential losses in the event that borrowers' debts are extinguished prematurely pursuant to debt cancellation agreements.

The Illinois Banking Act ("Act"), 205 ILCS 5/1 *et seq.* (1992), does not directly address debt cancellation agreements. However, Section 3 of the Act authorizes Illinois banks to conduct a general banking business and to loan money on personal and real estate security. Those and other enumerated powers include the authority to engage in activities that are convenient and useful in connection with the enumerated powers, or that are incidental and germane to the enumerated powers. Corbett v. Devon Bank, 12 Ill. App. 3d 559, 572 (1973) (hereinafter "Corbett").

In First National Bank of Eastern Arkansas v. Eubanks, 740 F. Supp. 1427 (E.D. Ark. 1989), *aff'd*, 907 F.2d 775 (8th Cir. 1990) (hereinafter "First National Bank"), a federal court found that debt cancellation agreements were so closely related to the exercise of recognized banking powers as to be a proper incident thereto. The court stated as follows:

This Court is persuaded that the debt cancellation agreements are designed to protect loans, traditionally a banking activity, and, as such, the activity is an incidental power referred to in the incidental powers clause of the National Bank Act. In other words, the debt cancellation agreements are directly related to what the National Bank Act refers to as "the business of banking."

740 F. Supp. at 1431.

Applying the First National Bank and Corbett decisions to your inquiry, we conclude that debt cancellation agreements are incidental to an Illinois bank's statutory authority to loan money and carry on a general banking business. Therefore, debt cancellation agreements are permissible transactions pursuant to Section 3 of the Act.

Section 5(11) of the Act provides alternative authority for state-chartered banks to enter into debt cancellation agreements. State-chartered banks are generally authorized by Section 5(11) to do any act that is authorized for a national bank. Specifically, Section 5(11) states:

A bank organized under this Act...shall...have all the powers conferred by this Act and the following additional general corporate powers:

(11) Notwithstanding any other provisions of this Act, to do any act and to own, possess, and carry as assets property of the character, including stock, which is at the time authorized or permitted to national banks by an Act of Congress, but subject always to the same limitations and restrictions as are applicable to national banks by the pertinent federal law.

National banks are authorized to enter into debt cancellation agreements providing for the cancellation of the borrower's outstanding debt upon the death of the borrower. 12 C.F.R. 7.7495. The Office of the Comptroller of the Currency ("OCC") recently extended that authority to include debt cancellation agreements pursuant to which debt is cancelled as a result of the borrower's disability or loss of employment. OCC Interpretive Letter No. 640, Fed. Banking L. Rep. (CCH) 1993-94 Transfer Binder, par. 83,527. Because national banks have the authority to offer debt cancellation agreements to their borrowers, state banks have similar authority pursuant to Section 5(11) of the Act.