Office of the Comptroller of the Currency

Interpretations - Letter 724

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- *12 U.S.C. 24(7)46*

April 22, 1996

[ ]

Dear [ ]:

This is in response to your letter of April 3, 1996, concerning the sale by national banks in Ohio of vehicle service contracts to their loan customers.

Interpretive Letter No. 671, July 10, 1995, reprinted in [Transfer Binder 1994-95] Fed. Banking L. Rep. (CCH) 83,619, opined that a national bank's sale of such contracts to its vehicle loan and lease customers would be incidental to its secured lending activity and therefore permissible under 12 U.S.C. 24(Seventh). That letter responded to a specific proposed program which was described in the bank's inquiry as having the following features: (1) the term of the vehicle service contract would not exceed the term of the automobile loan or lease; (2) the contract would cover preexisting mechanical defects in the vehicle, but it would not pay for expenses related to scheduled maintenance or routine repairs; (3) the bank would not underwrite the vehicle service contracts or provide repair services; and (4) the bank would be a master contract holder for all vehicle service contracts sold to its vehicle loan and lease customers.

You are familiar with this letter, and ask if two variations are possible for your Ohio national bank clients engaged in selling such vehicle service contracts to their loan customers. First, may a bank sell such a contract to its customer who purchases his or her vehicle with proceeds derived from a home equity line of credit offered by the bank, rather than from a standard vehicle loan? Second, may the term of the vehicle service contract be different from the term of the loan used to purchase the vehicle?

In my opinion, these two differences in detail should not be deemed to prevent the bank lender from selling a vehicle service contract to its borrower who is using the loan proceeds to buy the vehicle. Such a sale is still incidental to the bank's secured lending activity under 12 U.S.C. 24(Seventh). As to the first variation, Interpretive Letter No. 671, supra, reasons that when a bank enters into a vehicle loan or lease arrangement with its customer, the sale of a service contract protecting the vehicle in the event of a mechanical breakdown is related to the underlying credit transaction in two ways -- such a service contract protects the bank's collateral, and makes it more likely that the borrower will continue to be able to make timely repayments on the credit. You indicated to me by telephone that your bank clients sometimes, but not always, take a security interest in the vehicle when their borrowers utilize proceeds from a home equity line of credit to purchase the vehicle. When the bank does take such a security interest in the vehicle, then both points from Interpretive Letter No. 671, supra, remain relevant, i.e., the bank is protecting its interest in the collateral, and its interest in the borrower being able to repay on time. Even when the bank takes no security interest in the vehicle, though, the second point about the bank having an interest in the borrower's repayment capability not being negatively impacted by damage to the vehicle still applies. Therefore, the sale of the service contract is an incident of the bank's lending activity.

I also do not think that the term of the vehcile service contract must always be matched to the term of the loan, regardless of the situation. You indicate that sometimes the home equity lines of credit being offered by your bank clients have no specific repayment term. Even when they do, the service contract term and the loan term which are most appropriate for the customer may not always be identical. If the borrower wants to purchase a vehicle service contract of a particular term, say four or five years, there seems to be no good reason why this should not be possible to do, even if the loan might be of a different term or no term at all. This answer assumes that the bank's customer is making the decision, based upon his or her own circumstances and preference.

I trust this reply is responsive to your inquiry.

Very truly yours,
/s/
William B. Glidden
Assistant Director
Bank Activities and Structure Division