The Consumer Finance Podcast: Navigating Ancillary Products in Auto Finance
Host: Brooke Conkle and Chris Capurso
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Brooke Conkle:

Hello and welcome to a special edition of the Troutman Pepper *Consumer Finance Podcast*, where we discuss all things driving litigation and enforcement actions in the world of auto finance. I'm Brooke Conkle. I specialize in litigation. I'm joined by Chris Capurso, who specializes in all things compliance. Today, we're going to discuss recent developments in ancillary products which have been a hot topic for regulators for close to a decade. So, Chris, let's start at the very beginning. What are ancillary products?

Chris Capurso:

Yes, Brooke. I feel like it changes. But the big ones that you think of are guaranteed asset protection, which is one we're going to cover a lot, as I'm sure anybody listening to this podcast knows, or GAP; vehicle service contracts; extended warranties; credit insurance in the case of a finance deal. Or it could be products for the car like mud flaps or the cargo net or you know the things that are added to the balance when you purchase a car. Sometimes, those are financed. Sometimes, those are pay in cash, more often financed.

There are additional products that sometimes they're called ancillary products. Sometimes, they're called add-on products. Sometimes, they're called vehicle protection products. There's all sorts of names for them. The buzzword at the moment is ancillary products.

Brooke Conkle:

Yea, Chris. As you mentioned, GAP really has been kind of the focus of scrutiny from federal regulators, state regulators. Everybody is after GAP. And, when we talk about GAP internally, we tend to think it's a good product, don't we?

Chris Capurso:

Certainly. To kind of explain what GAP is, it's an acronym that works very well because it does somewhat explain what it does. Say you have a finance deal, so you have a retail installment contract or a separate loan, or something, to pay for the vehicle. Say it gets totaled. Then your insurance company comes in and says, “Oh, well. It's worth this much.” The problem is “this much” is worth less than what you have on your balance for your finance contract. GAP will waive or cancel that remaining GAP. Lack of a better word, it's a perfect acronym, the GAP between those two numbers.

When we're talking about GAPs, there are really two different types. There’s GAP waivers and GAP insurance. And, GAP insurance is a separate animal. One, it's insurance. Two, it's going to be provided by a third party that is licensed to do insurance in the state, whereas a waiver is really – we call it a two-party deal. Usually, there's going to be some kind of administrator on the GAP, but the GAP waiver is sold at the time the car is sold, and it's financed in the transaction.

One key thing with the GAP waivers, and this is something everybody is overjoyed to hear, is that state GAP laws say that GAP waivers are not insurance regulated by the insurance code, which is something all us consumer finance lawyers love because the insurance code is that shadowy area that we stay away from, outside of credit insurance, of course. It's also good because, obviously, insurance has a load of requirements, a load of licensing problems and a dealer selling a GAP waiver certainly doesn't want to be getting into that. They're already regulated enough as it is. That's one of the big differences between a GAP waiver and GAP insurance.

These GAP laws I mentioned, there is a uniform GAP law that's out there that many states have adopted. Much like any other uniform law, the one that's coming to mind is the Uniform Consumer Credit Code. It's all great until somebody makes one change. Then all of a sudden, you've got 15 little variants running around where some of it's the same. Some of it's different. But these laws will typically have a free look period, which is after the deal is done, the consumer gets a certain amount of time, like 30 days, to basically use the GAP. They can cancel it in that period and not incur any cost. Most of the laws are going to have that. It's what happens after that can be a little bit different from state to state.

I know, for example, Virginia, our home state, they permit GAP waivers to be cancelable or non-cancelable after that free look period. Other states, Maine, as an example, it has to be cancelable so the consumer must be able to cancel the agreement. Here in Virginia, you can say it's non-cancelable. One interesting part of that, and this is where the regulatory focus comes in, is, okay, we're talking about these waivers that are specifically for a finance transaction to remove that GAP amount. What happens if the person pays off the contract early or their car is repossessed? Unlike, say, an extended warranty, you're not going to be able to use that anymore. The financed aspect of the transaction is gone. The car might be gone, too, if you had a repo. But the financed part of it is gone, so what's the benefit?

That's what a lot of regulators are looking at, and that's also different on a state-by-state basis. Most of the state GAP acts do say you have to provide a pro-rata refund, depending on how long the contract was actually in place. But some states, our home Commonwealth, of Virginia, says that you can have a waiver provision that says, "No, we're not going to refund," but it has to be in there. And that's kind of another interesting compliance point is these waivers are their own documents. They have their own requirements under these GAP laws. That's another document the legal council should be looking at and making sure that when it complies into it, it says all the things you wanted to say. These refunds are really the big focus of regulators recently.

Brooke Conkle:

So we've talked a lot about GAP, but ancillary products encompasses more than just GAP. What else is included?

Chris Capurso:

Yes. We've discussed vehicle service contracts, extended warranties, which as any compliance attorney will love to say, an extended warranty isn't really a warranty because it's not a basis of the bargain, and it's something you buy separately, always a fun distinction. But those types of products which as I mentioned aren't tied to financing specifically, they're tied to the vehicle purchase. The benefit can extend beyond the finance contract. If I got a six-year retail installment contract and paid it off in three years, it does nothing for my extended warranty. It's still useful. But my GAP, if I have a GAP waiver, that's where the refund problem comes in.

Then there's also credit insurance products. If you get sick, if you lose your job, dealers will sell credit insurance products that can help pay the balance if one of those events occurs. That's another thing that you finance with the contract, and it's another ancillary product that is regulated at the state level. I had mentioned Uniform Consumer Credit Codes recently. Those have specific provisions in them for credit insurance. State retail installment sales acts will also have provisions regarding credit insurance, and that’s a state grind. Usually, the insurance provider in that case would have done that kind of diligence. But all these products could be regulated in different ways, can be subject to different cancellation and refund requirements. It’s a big universe of compliance risks and different products.

Brooke Conkle:

Yes. As you mentioned, really what a lot of regulators are tending to focus on is really the value of that add-on or ancillary product. We've talked a lot about the FTC’s recent submission of the CARS Rule, and there's a lot of uncertainty about the CARS Rule. It’s being challenged in the Fifth Circuit. Whether or not it survives is still an open question.

But Chris, as you mentioned, one of the major focuses for the FTC is ancillary products and add-ons. And what the FTC has targeted in the CARS Rule is this idea of valueless add-ons. Some of the commentary specifically in the CARS Rule suggests consumers get home after they bought their new car, used car. They've made that purchase, they get home, and they look at the contract and say, “Wait, what did I buy? What is this line for an extended warranty that I didn't know I was buying?”

And, what's really interesting and frankly probably going to be really burdensome on dealers, is this idea that dealers are going to be responsible for ensuring that consumers do not by a valueless add-on. One of the items that is specifically called out in the CARS Rule is a GAP contract that exceeds sort of the loan-to-value ratio of the deal. So, for example, if a consumer buys a GAP waiver but really it is never going to be underwater in the contract, then the FTC would consider that a valueless add-on, and the CARS Rule would prohibit the sale of that GAP waiver.

One of the other examples that the FTC gave of a valueless add-on is a separate vehicle warranty add-on that a consumer can purchase an extended warranty that covers the exact same issues or exact same vehicle parts that the car's standard warranty covers. At the dealer level, there's going to be if the CARS Rule survives, if the challenge is defeated, then there are going to be a lot of decisions really at the dealer level on how to market ancillary products, how to sell them to consumers, and how to make sure that consumers are fully informed about both the benefits and the limitations of ancillary products.

So Chris, with this sort of background, have there been any recent regulatory enforcement actions that target the sale or marketing of ancillary products?

Chris Capurso:

Sure, there have. The CFPB this past year said that not refunding GAP waiver costs upon repossession or early payoffs could be considered an unfair act or practice, which is sort of always, you know… we warn clients. There's the law and the statutory law and t may say whether something is or is not permissible. But there's always that boogeyman of UDAP. Even if the law doesn't say it, you can say it's unfair. You can say it's deceptive. You can say it's abusive. It's always – it's not quite the enforcement by blog post that it used to be – but it's still kind of the specter, the cloud that UDAP action is hanging over. This is just one of those cases.

You know the CFPB just said, "Not refunding it." Not pointing to a specific state law, they point to the Consumer Financial Protection Act and say, "No, this is unfair." And, obviously, state AGs have that same UDAP authority. Actually, Colorado is a good example of a state that has also gone after not refunding GAP waivers. This is – with the CFPB looking at it as an unfair practice, this is something that opens it up beyond any specific state statute but also to state AGs to potentially enforce if their state's GAP laws are a little bit more lenient, shall we say, regarding refunds.

Some other regulators, you just know it's on their radar. Like New York Department of Financial Services released a letter, now almost a year ago, last July, reminding folks that if somebody has a GAP waiver and you know the contract gets cut short, pro-rata refund should be considered. The CFPB has also sent a similar reminder, this one, a couple years ago now saying you should refund in the context of deficiency balances like trying to figure out, okay, somebody's been repossessed what's the deficiency balance? The CFPB says you shouldn't be considering unearned GAP waiver cost. It's definitely on regulator radars right now, especially GAP.

Brooke Conkle:

Yeah, Chris, what's really interesting is that in the recent sort of supervisory highlights, one of the areas that the CFPB mentioned really was kind of going back and looking at what dealers kind of have a higher percentage of sale of ancillary products. Is that kind of a warning sign for auto finance companies? If you have one dealer who has kind of a disproportionate number of sale of ancillary products, maybe that's a red flag for an auto finance company that something could potentially be going on at the dealer level that maybe both the regulators and the auto finance company would not be comfortable with.

I know we both kind of sound like we're beating a dead horse with compliance, but really it's that complaint management specter, making sure when complaints come in that they're addressed and really kind of evaluated. Is one dealer getting a lot of complaints about one particular add-on in particular? Is one dealer getting a line share of the complaints about processes that are at the point of sale? Is there one product in particular that consumers, frankly, it doesn't seem like they feel comfortable with post sale? That sort of management, that compliance, that post-sale review that auto finance companies can engage in really can mitigate your risk and keep you out of the eye of the federal regulators.

Chris Capurso:

That's a great point. And your first point about does the dealer have disproportionate number of consumers getting add-on products, at their base, all of these are supposed to be optional products. The consumer is supposed to have the option of purchasing them. If you have a disproportionate, if a dealer has a disproportionate number of consumers buying the products, it could lead into a theory that maybe they aren't so optional. Maybe there's been some sales pressure. Maybe there's been some potential deceptive acts fitting perfectly into the D in UDAP. Where there's smoke, there could be fire.

Like Brooke said, if the CFPB is out there and the regulators are out there looking for kind of this disproportionate number, above all else, they want consumers to have choice. I mean, why does the CARS Rule have express consent on these things, choice? Why does – if you look at a California retail installment sales contract, it looks like a billboard with all of the different disclosures that you have to have for every single type of ancillary product and every type of disclosure out there because they want consumers to have choice.

That's one of the biggest red flags I can think of is if there's any kind of smell or sense that maybe these products are being portrayed in a way where they're not optional, where they need to get them to get the deal across the line or to get financing or any of those types of things, those are big red flags.

Brooke Conkle:

That's exactly right. As you mentioned, the regulators are looking for outliers. They're looking for things that are sort of different than the average. So, for auto finance companies, if the federal regulators are looking for that, you should be, too. That should be your best sort of indication that there could be a problem.

Chris Capurso:

Absolutely. And with that, that concludes another episode of this special series on auto finance, the spin-off of *The Consumer Finance Podcast*. I was joking earlier that we are the *Frasier* to the CFS podcast *Cheers*, which is great because we're both just wonderful. What you'll want to do is you'll want to go to whatever podcast service you subscribe to, whether it's Spotify, Apple. Subscribe to *The Consumer Finance Podcast* but also to any of the other wonderful podcasts that Troutman Pepper offers. Until next time, this is us signing off.