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You have asked Nisen & Elliott, LLC to research the legal reasons why auto finance companies, banks and credit unions should “care about timely and accurate product cancellation filings.”

The purpose of this Memorandum is to assess the current laws, regulations and regulatory guidance that pertain to the process of early cancellation of ancillary products and refund of premiums or charges that have not been earned by the product seller in the context of motor vehicle retail installment sale and lease transactions and direct loans secured by purchase money security interests in motor vehicles (“Motor Vehicle Finance Contracts”).

**1. Types of Ancillary Products.**

There are two basic types of ancillary products for purposes of cancellation requirements: (A) contracts with a term or value that is not tied to the Motor Vehicle Finance Contract and (B) contracts with an obligation that relates to the Motor Vehicle Finance Contract.

*A. Service Contracts and Vehicle Protection Products.*

The first category consists of products with a value that applies during the term of the Motor Vehicle Finance Contract and may continue beyond the end of the term of the Motor Vehicle Finance Contract depending on the respective lengths of the original Motor Vehicle Finance Contract term and the original ancillary product term. This category includes the following:

- Service contracts, extended warranties, roadside assistance agreements, maintenance agreements; and

- A wide range of vehicle protection products, which include a range of vehicle repair and vehicle replacement contracts where a physical product is sold or service is performed to prevent loss or damage to a vehicle from a specific cause with a warranty providing for recovery in the event of loss. Examples of vehicle protection products include (a) etching service or GPS locator device with a warranty that states that if the vehicle is stolen and not recovered, or is a total loss after recovery, the purchaser will be paid some amount; and (b) Interior and Exterior Protection Products with warranties, such as seat repair and tire and wheel products with a repair or replacement warranty, paint applications with a corrosion related warranty, windshield repair and dent & ding coverage.

With respect to the first category, the relevant cancellation is an affirmative decision to cancel by the purchasing consumer, either during a free-look period or thereafter if the ancillary product or relevant applicable law provides such a right. In addition, the ancillary product may be cancelled by the virtue of the termination of the Motor Vehicle Finance Contract through an action of the finance source, such as repossession of the vehicle.

*B. GAP Waivers and Insurance Products.*

The second category consists of products pertaining to the finance obligation, which have no value beyond the end of the finance term. This category includes the following:

- Guaranteed Asset Protection (“GAP”) waivers and debt cancellation agreements-contractual agreements wherein a creditor agrees for a separate charge to cancel or waive all or part of amounts due that creditor on a borrower's finance agreement with that creditor in the event of a total physical damage loss or unrecovered theft of the motor vehicle, which agreement must be part of, or a separate addendum to, the finance agreement; and
- Credit life and credit disability insurance – insurance contracts under which the obligor agrees to make monthly payments when due upon the occurrence of the identified loss event.

With respect to the second category, the relevant cancellation is either an affirmative decision to cancel during a free-look period or thereafter, or an automatic cancellation at the time the Motor Vehicle Finance Contract is terminated due to a total loss event or termination of the Motor Vehicle Finance Contract.

## 2. Regulation of Ancillary Product Cancellations.

### A. Federal Law.

All purchasers of Motor Vehicle Finance Contracts should anticipate that their actions regarding ancillary product cancellation will need to conform to the expectations of the Consumer Financial Protection Bureau (“CFPB”). The CFPB has broad powers to regulate “consumer financial products and services” offered by “covered persons” under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). The definition of “covered persons” includes banks, savings associations, credit unions, captive finance companies and independent finance companies, but excludes motor vehicle dealers. The definition of “consumer financial products and services” includes ancillary products under the CFPB’s interpretation based on the CFPB’s Automotive Finance Examination Procedures. Automotive Finance Examination Procedures, Page 42. Available at [http://files.consumerfinance.gov/f/201506\\_cfpb\\_automobile-finance-examination-procedures.pdf](http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf). The CFPB’s ability and intent to regulate ancillary products that are insurance products is uncertain due in part to the McCarran–Ferguson Act, 15 U.S.C. §§ 1011-1015, which has been interpreted as leaving the regulation of insurance to the states and not the federal government.

The Dodd-Frank prohibits any “covered person” from engaging in “any unfair, deceptive, or abusive act or practice.” 12 U.S.C. § 5536(a)(1)(B). The CFPB’s examination authority is limited to “larger market participants” (originators of 10,000 or more loan, lease and retail accounts per year), and banks with \$10 billion or more in assets. However, because of the broad definition of “covered persons,” the CFPB’s Automotive Finance Examination Procedures should be the starting point for all automotive finance funding sources in understanding the CFPB’s expectations regarding ancillary products and developing the ancillary product portion of their compliance management system.

The Automotive Finance Examination Procedures specifically instruct the Examiner to take the following action:

“Determine how the servicer monitors optional products attached to loans or leases, including cancelling the products in a timely manner, where applicable.”

Finance sources subject to CFPB examination should therefore expect to be asked *how they monitor* the timely cancellation, and not just whether there is a general policy to cancel as required by law. Accordingly, finance sources will need to demonstrate that they have established the appropriate monitoring of all ancillary product cancellations, whether this is accomplished by internal controls or through the use of effective tracking software, or a combination of both.

Other motor vehicle direct purchase money lenders, and indirect motor vehicle retail installment sale and lease finance sources should expect that failure to cancel in a “timely manner” may be considered an abusive practice. The CFPB does not define “timely manner.” Where the CFPB has imposed specific timing rules, their expectations have been for rapid response. For example, when a complaint is filed with the CFPB public complaint database, the CFPB expects that when a company is notified of a complaint that the company will, within 15 days, either respond to the complaint or indicate that the response is “in progress” because it could not be closed within 15 days. Where the complaint was indicated as “in progress,” the status will automatically change to “no response” unless the company responds within 60 days from the date the complaint was sent to the company.

Note also that if the CFPB issues ancillary product regulations, state attorneys general will be able to enforce those federal regulations against state chartered entities. Dodd-Frank provides the following:

“[T]he attorney general (or the equivalent thereof) of any State may bring a civil action in the name of such State in any district court of the United States in that State or in State court that is located in that State and that has jurisdiction over the defendant, to enforce provisions of this title or regulations issued under this title, and to secure remedies under provisions of this title or remedies otherwise provided under other law. A State regulator may bring a civil action or other appropriate proceeding to enforce the provisions of this title or regulations issued under this title with respect to any entity that is State-chartered, incorporated, licensed, or otherwise authorized to do business under State law (except as provided in paragraph (2)), and to secure remedies under provisions of this title or remedies otherwise provided under other provisions of law with respect to such an entity.” 12 U.S.C. § 5552(a)(1).

The Federal Trade Commission regulates the practices of motor vehicle dealers related to ancillary products, primarily with respect to point-of-sale issues. However, the CFPB is expected to lead the regulation and enforcement of ancillary product practices of auto finance companies and banks.

*B. State Law.*

Failure to refund (or apply to the unpaid balance) amounts owed to the consumer may be considered a violation of state unfair and deceptive trade practices laws and, particularly for products with a “free look” period, a failure to refund in a timely manner may be considered a violation of a specific statutory provision.

State laws governing ancillary products include specific statutes governing GAP waivers, service contracts, vehicle protection products and credit insurance. GAP waiver statutes commonly state that there is a 30 or 90 day “free-look” period during which the product may be cancelled for a full refund. Those statutes commonly provide that GAP waivers may be cancellable after the free look period if such cancellation is allowable under the contract, with the consumer entitled to a refund of the unearned portion of the purchase price (similar to an insurance premium refund). Where there is no statute stating that GAP waivers can be non-cancellable after the free-look period, state regulators may apply insurance premium refund concepts and requirements to the product.

Similarly, service contracts statutes provide a “free look period” for cancellation with a mandatory full refund and for refund of the unearned portion after that initial period where the consumer makes a written demand for cancellation of the service contract pursuant to the terms of the service contract. In addition, statutes may stipulate that where the provider cancels a service contract for reasons other than non-payment, the unearned fee must be refunded, less any claims paid and permissible charges for administration.

In the context of vehicle protection products, specific statutes provide that the warrantor, who may cancel only for a permissible reason, must provide specific notice prior to cancellation. For example, if the consumer breaches duties under the warranty, the warrantor is commonly required to send a cancellation notice at least thirty (30) days prior to cancellation. This type of cancellation is likely to be the responsibility of the warrantor rather than the finance source.

Credit life and credit disability insurance are less commonly financed, but are governed by general insurance premium refund rules and, in certain states, specific provisions providing that premium refunds may be credited against the unpaid balance of the finance account.

**3. Summary.**

The CFPB has specifically identified the timeliness of cancellation of ancillary products as an examination item. Creditors should therefore make their explanation of how they monitor the timeliness of cancellation as a specific part of their compliance management system.

State statutes specifically addressing ancillary products do not identify a specific number of days by which cancellation must be effected. However, state regulators are likely to follow the lead of the CFPB, both in its interpretation of the “abusive practices” prohibition under Dodd-Frank and by interpreting general state unfair and deceptive practices laws to require timely cancellation and refund where the consumer has a right to cancel. Specific cancellation and refund rights are common for service contracts, GAP waivers and credit insurance. Motor vehicle finance sources should therefore also anticipate that sales finance license examiners will inquire regarding cancellation practices and timing for service contracts, GAP waivers and credit insurance.

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