

“Phantom” Charges On Contracts Forbidden by Finance Code

By Michael W. Dunagan

Dealer Questions: Can I include in a motor vehicle installment contract a charge for agreeing to waive any deficiency against the debtor that might result from a total loss (also known as a GAP waiver)? How about a charge for agreeing to make repairs to the vehicle?

Answer: The only way a charge for these items can be legally included in an installment contract is if a premium is paid to a licensed insurer for a GAP insurance policy, or a service contract is purchased from a legitimate, registered service contract provider.

Discussion: Some dealers have made it a practice to place charges on installment contracts to cover (1) the dealer’s agreement not to seek a deficiency in the event that the debtor’s collision policy doesn’t cover the balance owed after the vehicle is rendered a total loss; and/or (2) an agreement by the dealer to make certain repairs in the event the vehicle breaks down.

Under the terms of the Texas Finance Code, a car creditor can include an itemized charge in a retail installment contract for “insurance to reimburse the retail buyer for the amount computed by subtracting the proceeds of the buyer’s basic collision policy on the

motor vehicle from the amount owed on the vehicle if the vehicle has been rendered a total loss...”

So-called GAP insurance became popular a few years ago when car creditors began liberalizing the terms of financing by extending credit for longer terms and for lowering down payment amounts. The result was that more and more car buyers were “upside down” in their vehicles; that is, they owed more than their vehicles were worth. Many debtors found to their horror that they still owed substantial balances to the creditors, even after insurance proceeds had been applied.

Another requirement is that any insurance premium included on the contract must be for a policy written (1) at lawful rates; (2) in accordance with the Insurance code; and (3) by a company authorized to do business in this state. A GAP waiver agreement from the dealer, as opposed to a GAP insurance policy issued by a properly licensed insurer, obviously doesn’t meet these requirements, and is considered by the Office of Consumer Credit Commissioner to be an improper charge.

Just as liberal financing policies led to the demand for, and consumer interest in, GAP insurance, so did the realities of the sub-prime car market drive the desire of BHPH dealers to be able to place an additional charge on contracts to cover costs of repairs. It is a fact of life in the BHPH business that buyers who are prevented by breakdowns from using their vehicles are rarely going to pay for their vehicles. It is also true that most BHPH customers have a hard time coming up with the money for repairs. Thus, dealers often perform or pay for repairs they are not obligated under contract to perform or pay for. The next logical step in the equation would be to simply add a charge on the contract to bring in additional revenue to underwrite the cost of such repairs.

The problem is that Texas law requires providers of service contracts to be registered with the Department of Licensing and Regulation (TDLR). To be registered, a service contract provider must demonstrate financial responsibility by either having adequate underlying insurance coverage, or by being bonded or depositing funds with TDLR (the TDLR website, <http://www.license.state.tx.us>, lists registered service contract providers). It is improper to issue or sell a service contract in conjunction with a motor vehicle retail installment contract unless the issue of the service contract is properly registered. A dealer can thus only legally place a charge for a service contract on an installment contract only if an actual service contract is purchased, and the issuer of the service contract is registered.

In conclusion, it is not appropriate for a dealer to add a charge to a retail installment contract for a self-issued GAP waiver (or any other type of type of insurance that doesn't actually exist) or for a service contract that doesn't exist or is not issued by a registered provider.