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Recent Massachusetts Attorney General Enforcement Actions Involving GAP

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In recent months, the Massachusetts Attorney General has entered into Assurances of Discontinuance with three sales finance companies over practices involving the sale and financing of GAP. Under the settlements (discussed on the Attorney General's site here and here), the companies have agreed to refund nearly $13 million in finance charges (including the GAP fees), delinquency, collection, and refinancing charges paid to date on the affected retail installment sale contracts. The companies also agreed to waive such fees going forward on the contracts, and to pay $375,000 to the Commonwealth for the violations.

The settlements allege that assessment of GAP fees pushed some transactions beyond the maximum 21% APR permitted for indirect auto transactions under § 14 of Chapter 255B of the Massachusetts General Laws. Section 14, in addition to establishing a maximum rate, also limits the fees and charges permissible on an indirect auto transaction. The Division of Banks has interpreted this language to mean that only those fees that are expressly permitted by the statute may be charged. *See, e.g.*, Division Opinion 99-114 (charge for default or repossession fee by retail seller not authorized under G.L. c. 255B). GAP fees are not among the authorized charges set forth in Section 14.

So how is GAP permissible? The answer lies in a relatively old - and somewhat confusing - Opinion Letter issued by the Massachusetts Division of Banks in April of 2004. In Opinion Letter 03-133, the Division of Banks overturned a prior opinion (Opinion Letter 03-029), in which it found GAP fees impermissible. It did so by concluding that GAP fees are a "finance charge" and permissible as part of the overall maximum finance charge rate of 21% APR permissible under § 14 of Chapter 255B. It reached that conclusion in full acknowledgement of the fact that GAP fees may be excluded from the "finance charge" for purposes of Truth in Lending disclosure purposes. Adding to the confusion, we note that while Opinion Letter 03-133 generally speaks to GAP in the context of a two-party debt cancellation product, it also uses the terms "charges" and "premiums" when discussing fees for the product - perhaps suggesting that both two-party GAP waiver and three-party GAP insurance products are permissible.

The practical implication of this Opinion Letter is that if you properly exclude GAP amounts from the finance charge for TILA purposes, you need to do a *second* usury calculation that includes GAP (effectively as a form of prepaid finance charge) to determine if you are above the 21% APR cap. This second calculation would not result in a revised APR disclosure, as Opinion Letter 03-133 requires sales finance companies to disclose GAP charges in compliance with TILA. Rather, it is effectively a quality control step that should be done to ensure compliance with the rate limitation under Chapter 255B, §

14. For recordkeeping purposes, this second calculation should be kept in the file for the transaction in question.

Given the success of her efforts to date, it is likely the Attorney General will continue down this path. If anything, the motor vehicle sales finance space may be enjoying more Attorney General scrutiny as the office also recently unveiled a new Consumer Advocacy & Response Division that will include specialized teams focusing (among other things) on auto purchase and finance issues. These tea leaves suggest that it would be prudent for motor vehicle sales finance companies doing business in Massachusetts to exercise increased vigilance on the compliance front.

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