

Voluntary Protection Product Refunds: The Buck Stops Where?

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Here's a common situation: A consumer has financed a GAP policy and pays off the financing ahead of schedule. Is the consumer entitled to a refund? If so, how much? Who must make the refund? Is it the consumer's responsibility to ask for a refund, or must the refund be made automatically?

As consumer financial services compliance attorneys, we regularly receive questions from our dealer and automobile finance company clients regarding their obligations to provide refunds of unearned fees for GAP, vehicle service contracts, and other voluntary protection products. Think the answer is simple? Guess again.

The answer depends on the state and the type of voluntary protection product. In many states, particularly states that have recently enacted GAP legislation, state law clearly dictates which party (e.g., the holder, dealer, or product provider/administrator) must provide a refund and the events that trigger the refund obligation. But what about other states where state law is silent or unclear regarding voluntary protection product refund requirements?

Let's start with how much of a refund the consumer can claim. Some states require a full refund if the protection product is cancelled soon after it is purchased. After that, the refund is typically *pro rata*, based on how long the coverage has been in effect. Some states allow a small deduction from the refund as a cancellation fee, but others do not. Some states require no refund if the amount due is very small, but usually the unearned amount must be VERY small, sometimes only a dollar or less.

Issue number two: When a consumer has paid for coverage that is no longer needed, who is responsible for refunding unearned charges? Often the fee the consumer pays for the voluntary protection product is shared by the dealer, who earns a fee for selling it, and the administrator, who handles claims and may be responsible for providing the protection or indemnifying the dealer. As a result, many states require the dealer to make the refund. In these instances, the dealer usually can make the administrator pay for the administrator's share of the refund.

In other states, the law requires the creditor (holder) of the contract to make the refund. What? The creditor did not get the fee; it simply financed the charge for the product. Why should the creditor have to refund a fee it never received? If you think this outcome seems unfair, many auto finance creditors will agree with you.

But that leads us to the next question: How does a refund get set in motion? Must the consumer ask, or is it automatic? The answer usually depends on who must make the refund. In states where that obligation lies with the dealer, usually the consumer must ask. That makes sense. After all, once the

dealer makes the car sale and assigns the financing contract, the dealer is done with the transaction. The dealer won't typically know if the consumer pays off the financing early or defaults.

But the assignee or holder of the contract *does* know about prepayments and defaults. Consumer advocates (and their friends in state legislatures) reason that the assignee/holder should make the refund. Only the assignee and the consumer know about the prepayment, and consumers often forget to ask for refunds. Thus, many states place this obligation on the assignee and make the refund obligation automatic.

This scheme guarantees that the consumer will get a deserved refund. And, the states reason, the assignees have the leverage to get the money back from dealers. Under this logic, placing the burden on the one entity that did not receive the fee for a voluntary protection product is, ironically, fair to all, especially the consumer. A consumer in these scenarios may not even realize the voluntary protection product coverage is still active, much less that he or she could be entitled to a refund of unearned charges.

What if state law is silent? Be aware that state laws often address GAP and credit insurance but are silent regarding other voluntary protection products. Because consumers are often unaware they may be entitled to a refund, and because the holder may be in the best position to know whether unearned charges exist, there is some risk that a regulator could take the position that the failure of a holder to refund unearned charges or premiums violates federal or state standards governing unfair, deceptive, or abusive acts or practices.

And the UDAAP risk isn't limited to holders. At least one state AG recently expressed the view that a dealership was required to refund unearned voluntary protection product fees when consumers traded in their vehicles while coverage was still active, even though state law was silent on the issue and the contract placed the responsibility to request a refund on the consumer. This AG apparently thinks the dealership should recognize that it sold the trade-in, that it sold a protection product, and that the protection product was still in effect but that the consumer should not need to recall these facts and ask for a refund.

To reduce any potential UDAAP-type risk, the most conservative approach would be for the holder to provide a refund in all instances where the holder has collected unearned ancillary product charges (and seek reimbursement from the dealer). However, this approach does not always make sense, particularly because the dealer typically collects the charge and pays a large portion of it to a third-party administrator. If the state believed this approach was required, it arguably would have mandated it, as many states have done. Instead, the state adopted a different scheme or left the responsibilities up to the parties to the contract.

A more balanced approach may be for the holder to make refunds only in states where required. In all other states, the holder could send a letter to customers upon prepayment or other early contract termination, notifying the consumer that he or she might be entitled to a refund of any voluntary protection product fees, such as GAP, credit insurance, or vehicle service plans, and directing the consumer to the product administrator and/or dealer who sold the car. Providing such notice may serve to reduce potential UDAAP risk by alerting the consumer to the existence of the refund possibility and directing the consumer to the proper party.

Whatever approach you choose, it is important for you to know your refund obligations under state law

and be ready to answer to a regulator who could be looking for someone to take responsibility for ensuring that consumers are not paying for coverages they no longer need.

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