Ancillary Products … Where are We and What's Ahead?

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Patricia E.M. Covington

There's been a flurry of recent news on ancillary products, and unfortunately, most of it is negative. For years the industry has heard shouts that ancillary products were not "liked"; that the products are of little value; and that transactions including them be closely scrutinized for unfair, deceptive and/or abusive practices. We're seeing those shouts turn to enforcement and regulatory actions.

In October 2017, the National Consumer Law Center, a consumer advocacy group, published a report "analyzing 'add-on products'" sold by dealers. The focus of the report was add-on product pricing.

The report attacks the lack of transparency in pricing, and the amount of dealer profit made on the sale of the products. Below are a few of their findings:

- Dealers "mark up" add-on products by a far higher percentage as compared with the price of vehicles.
- Dealers are inconsistent in the pricing of add-on products, which may lead to or result in discrimination against protected classes.
- Finance companies that purchase financing contracts from dealers "play an important role in allowing excessive and discriminatory markups."

The report calls for: (i) dealers to post the available add-on products and their prices on every vehicle; (ii) amending the Equal Credit Opportunity Act to require creditors to collect data about race, national origin and similar information so that it can be reported like HMDA data in mortgage credit transactions; and (iii) state and federal enforcement authorities to investigate discrimination in the pricing of add-on products and to bring enforcement actions.

Lots there, and a definite call to action. While we may see the federal government pull back under the Trump administration, don't expect the same from the states, especially blue state attorneys general. As we've seen in other issues on political fronts, the states feel a duty to step in when they see the federal government pulling out.

And, this call to action has already begun. We've already seen an increase in state enforcements. And this quest includes attacking ancillary products.

The most recent action, a December 2017 lawsuit, was initiated by the New York Attorney General

Schneiderman against two dealerships. These dealers are alleged to have sold an etch product at prices from $129 to $3,998, often without the consumer's even knowing about the product.

For customers who knew about the product, the AG alleges that they did not understand the limits that applied to the payout, and that the benefits of the product were illusory. The AG also alleged that despite selling the etch product, the dealers did not always perform the service of etching the VIN onto the windows. In addition to monetary damages, the AG prohibits the dealers from offering, selling or marketing credit repair and identity theft services.

This action is part of a larger initiative the AG is currently pursuing against dealers for "unlawfully charging consumers for products and services without their knowledge or consent." There have been 14 other settlements with dealerships to date, amounting to $19 million in restitution and penalties since 2015. The AG continues to investigate a "number" of other New York motor vehicle dealers for selling ancillary products and services without consumers' knowledge or consent. Note that in at least one other settlement, Schneiderman prescribed how ancillary products must be disclosed, including in sale or lease documents.

Dealers are clearly on notice. How about finance companies? We've seen state regulators, particularly attorneys general, pursue finance companies for the acts of dealers. The most recent was by the New York City Department of Consumer Affairs ("DCA"). Three auto finance companies were challenged to pay restitution for the deceptive and unlawful trade practices of multiple dealerships, which included misleading consumers about vehicle prices, concealing and misrepresenting sale and financing terms, and failing to inspect the vehicles. In at least one case, the consumer was charged for a service contract that she had expressly declined.

The DCA asserts that it is acting "[i]n response to the growing auto lending crisis," and that it will "for the first time be seeking consumer restitution from the financing companies … that were involved in the subprime lending that saddled the dealerships' consumers with interest rates as high as 24 percent." The DCA declares that it is putting the "entire industry on notice," and that it will seek restitution from financing companies because they have deeper pockets and can assure a remedy to consumers who suffer from a dealership's deceptive practice.

While the facts of the DCA action do not involve ancillary products, the targeting of finance companies for dealer conduct is concerning and could easily be applied in the ancillary product arena-especially when the New York AG has already taken action on this front.

The tide of challenging dealer conduct by actions against finance companies began in Delaware and Massachusetts, when the Attorney General for these states held Santander liable for dealer deceptive conduct-misrepresenting consumer income. In the Delaware and Massachusetts actions, the Attorneys General alleged that Santander was complicit in dealers' deceptive conduct because they knew or should have known about it.

Dealers were falsifying applicant income, and the Attorneys General found that Santander had insufficient monitoring systems to identify this dealer fraud. Delaware's action was based on a theory that Santander facilitated the origination of Delaware retail installment sale contracts that Santander knew or should have known were unfair under Delaware's law prohibiting unfair and deceptive practices; and these contracts were then sold to third parties in a securitization. The Massachusetts action was based on a theory that Santander purchased the contracts without having a reasonable basis to believe that the contracts would be repaid by the consumers, which facilitated

the contracts violating Massachusetts law.

Then, there is the well-established federal "Holder Rule." The Holder Rule, formally called "Preservation of Consumers' Claims and Defenses" and issued by the FTC in 1976, gives consumers the right to assert claims they have against the original dealer, against the assignee or holder of the contract.

Many states also have a Holder Rule. From time to time, regulators use this rule to enforce against finance companies, the bad acts of dealers. We saw this in 2014, when the Maine Attorney General held many finance companies liable for paying restitution to consumers who were harmed when a dealer deceptively representing that vehicles came with an extended warranty *(when they didn't),* and sold vehicles without the required state inspection stickers.

The Maine Attorney General strong-armed the finance companies into settlements threatening to sue based on Maine's Unfair Trade Practices Act and a separate Maine provision that applies to the assignees of consumer contracts and loans. The Attorney General asserted that "assignees … are subject to all claims and defenses of the consumers against [the dealer] as the seller and are therefore responsible parties in such disputes."

In addition to enforcement actions, ancillary product issues are coming up in less public settings, like state and federal exams. Many finance companies have undergone exams where the regulator asked lots of questions about GAP products and whether refunds were issued to consumers when the product was cancelled. With respect to GAP and other ancillary products, regulators are also curious about penetration rates and pricing.

On the topic of pricing, in October 2017, in response to an audience question at an industry conference, the CFPB's Deputy Assistant Director for Originations in the Office of Supervision Policy, Calvin Hagins, stated that the CFPB isn't assessing what's appropriate pricing, but they will ask lots of questions. They will ask the business to explain the business process they went through to decide to finance the product, and as part of that, pricing. They also want to understand what compliance parameters are in place to monitor and prevent "problems."

Finally, there will be a strong focus on whether the product was voluntary-which goes to penetration rates. Penetration rates came up at a January 2018 industry conference, where the Illinois Department of Financial and Professional Regulation Secretary, Bryan Schneider, made a comment that "nobody is that good" in response to a question about high penetration rates.

So, stay alert! I expect the focus on ancillary products to continue, with challenges coming from state and federal regulators. Some public, some behind the scenes in the exam setting. Dealers and finance companies are well-served by examining the products they sell and finance, with a particular focus on exactly how those transactions are being conducted. Folks are being held accountable … will it be you?

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