

SUBJECT: Motor vehicle debt-cancellation agreements, warranties, and service contracts

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 9 ayes — Averitt, Solomons, Denny, Ehrhardt, Elkins, Grusendorf, Marchant, Pitts, Juan Solis
0 nays

WITNESSES: For — Gene Fondren, Texas Automobile Dealers Association; Jerry Tweeten, FLS Services Inc.
Against — Rob Schneider, Consumers Union

BACKGROUND: In 1997, the 75th Legislature enacted SB 1290 by Cain, authorizing insurance agents to sell debt-cancellation waiver policies. The Texas Department of Insurance (TDI) has not promulgated rates for these types of policies, and thus Texas insurers have not issued such policies.

In general, warranties and service contracts sold by a retail seller of motor vehicles have not been considered insurance and generally have not been regulated by TDI unless they shift risk from the seller to a third party.

Finance Code, sec. 348.202 allows motor vehicle sellers to require a retail buyer to provide credit life insurance and credit health and accident insurance as additional protection for an installment sale contract. Sellers may include the cost of this insurance as a separate charge in the contract. Current law does not allow sellers to offer involuntary unemployment insurance (IUI).

DIGEST: CSHB 3515 would amend the Finance Code to allow a buyer and seller to agree to include a debt-cancellation provision in retail installment contracts and for motor vehicles, including mopeds, motorcycles, and trailers to transport them. Debt-cancellation provisions would involve the seller's waiving the difference between the actual cash value of the vehicle and the amount owed if the vehicle were rendered a total loss by theft or collision. The seller also could agree to waive the deductible amount, if any, the buyer was required to pay under the buyer's personal insurance policy, in addition to other liability incurred under such a provision.

Debt cancellations contracts or waivers would have to be an itemized charge in the retail installment contract.

The bill explicitly would state that debt-cancellation provisions included in a retail installment contract are not considered insurance and are not subject to regulation by TDI. It also would state that warranties and service contracts sold by retail sellers of motor vehicles are not insurance.

The bill also would also allow a seller to offer involuntary unemployment insurance to a consumer as a separate charge on the contract.

CSHB 3515 would take immediate effect if finally passed by a two-thirds record vote of the membership of each house.

**SUPPORTERS
SAY:**

CSHB 3515 would be good for consumers because it would enable car dealers to offer products that are demanded in the market and are widely available to consumers in other states. These would be voluntary additions to installment contracts, all listed as line items so the customer would know up front the costs and benefits of these products.

Optional debt-cancellation provisions protect consumers who are paying off their car in circumstances when it is totaled or stolen. Many people do not realize that their insurance does not cover the amount of the loan on their vehicle. In cases of total loss, insurance covers only the value of the car, which often is less than the amount owed on the vehicle because of its rapid depreciation. For a 60-month contract, most car buyers are not “right-side-up” until the fifth year, when the car’s value finally exceeds the amount the consumer owes. Until then, the consumer would benefit from a debt-cancellation agreement because it would enable the car dealer to waive the difference between an insurance settlement and the amount owed.

Banks and insurance companies can sell debt-cancellation products, but many Texans cannot acquire standard financing from banks and cannot pay for standard insurance up front. These are the people who would benefit most from a debt-cancellation provision, because their liability usually is about \$2,000 more than the value of the car for most of the loan. With 60-month terms becoming more prevalent, consumers’ need for this product is increasing. Allowing retail dealers to provide this product would ensure its availability to all who would benefit from it.

Because of the highly competitive nature of the retail vehicle sales industry, consumers would not be charged exorbitant amounts for this product. The bill would require the cost of any debt-cancellation provision to be listed as a separate line item, making its cost clear to the consumer. If consumers were not satisfied with the price or potential benefit, they easily could go to another dealer who might have a better offer. Since this would be an optional addition to the contract, any consumer could decline the product.

Consumers also would benefit from being able to obtain IUI at the time they bought a vehicle. Most retail installment sellers can offer IUI policies at the time of purchase. Typically, these policies cover monthly payments when their beneficiaries become separated from work involuntarily. As with debt cancellation, individuals who are less likely to obtain standard financing from banks are more likely to be at financial risk from a layoff.

CSHB 3515 would codify the state's long-held policy that warranties and the sale of service contracts by sellers of property do not constitute the business of insurance. Service contracts for motor vehicles are similar to extended warranties sold for appliances and other products that provide for repair or replacement services for a specified period. Warranties are contracts between a manufacturer and the consumer. Service contracts are agreements between a seller and the consumer that effectively extend a warranty and may provide for additional services, such as routine maintenance. CSHB 3515 would require these optional agreements to be listed as line items in a retail installment agreement so the consumer could see up front the cost of a service contract.

**OPPONENTS
SAY:**

Debt-cancellation provisions function like an insurance policy because their benefits are triggered by specific circumstances and represent a risk to their issuer. CSHB 3515 would, in effect, permit car dealers to sell insurance without a license and with scant regulation, providing them a windfall at consumers' expense.

In other contexts, debt-cancellation provisions clearly are called insurance and regulated as such. For example, such provisions in a revolving credit agreement usually cost a fixed amount per \$100 of outstanding balance per month and pay part or all of the balance in certain circumstances. In the case of credit insurance, the forms and rates are regulated by the state from which it is issued. Without this regulation, it is highly likely that the costs borne by

the consumer would exceed the amount needed to cover the risk exposure of the issuer.

In other states, the average yearly charge for this kind of coverage is around \$250, a hefty sum in light of how infrequently the consumer collects. There would be no connection between the value of the benefit and its cost, as is required and regulated for other kinds of insurance. Oversight of cost as determined by the value of losses likely would reduce the cost of these policies by about 75 percent. At some point, the cost of the policy crosses the line from covering the risk exposure to being profit or additional interest, when it may constitute usury or violate time-price differential requirements of the Finance Code. Declaring this kind of policy “not insurance” effectively would leave the courts as the only arbiter of the nature and fairness of this product.

CSHB 3515 would require only that dealers show the cost of the debt-cancellation provision as a separate line item. It would not require dealers to inform consumers what the detailed provisions of these agreements stipulated, what the consumers’ benefits would be, and what their recourse would be in a dispute. Under this bill, the Office of the Consumer Credit Commissioner would have some regulatory authority over disclosure and could establish some requirements by rule. However, the commissioner would have tenuous authority at best to regulate areas involving costs and benefits. The commissioner’s only likely course of action in terms of costs would be through the courts.

The bill would allow dealers to offer debt-cancellation provisions to people who never would collect the benefit. Consumers who make a considerable down payment, finance their purchase at a lower interest rate, or negotiate for a more favorable price may never be “upside down” and might never benefit from a debt-cancellation policy. The bill would not require dealers to disclose the potential benefits nor whether an individual consumer ever would benefit. Because the dealer possesses this knowledge and the consumer does not, the negotiating position clearly favors the dealer, and consumers might never be aware that they never could qualify for benefits they were paying for. If TDI could regulate these policies, there would be substantial safeguards that consumers would be informed more fully before making their decisions.

If debt-cancellation provisions were deemed to be something other than insurance, the benefits collected under these provisions would be considered income for federal tax purposes. Under federal law, a forgiveness or elimination of debt is a taxable event even if the beneficiary paid for the potential privilege of having the debt extinguished.

As with debt-cancellation provisions, the bill would not require dealers to provide consumers with enough information to make informed decisions about IUI coverage. Such coverage is less a protection for the consumer than for the seller, and its inclusion in retail installment contracts ought to be regulated fully by TDI.

The bill should specify that service contracts are not insurance only if there is no transfer of risk. In other words, the contract must be between the buyer and the seller or manufacturer only. Service contracts that transfer the risk and benefit to a third party are considered insurance and subject to TDI regulations. TDI has brought action against several unlicensed third-party service contract providers.

OTHER
OPPONENTS
SAY:

If debt-cancellation provisions are to be deemed something other than insurance, the bill at least should limit the fees a seller could collect for the product to “reasonable” fees.

Also, the seller should be required to inform the consumer that benefits paid under a debt-cancellation provision are considered income for federal tax purposes and could affect the consumer’s tax liability.

NOTES:

The committee substitute added that debt-cancellation provisions and warranties and service contracts would not be considered insurance and that sellers could offer involuntary unemployment insurance. It also added the requirement that debt-cancellations contracts and waivers be an itemized charge.

In 1995, the 74th Legislature enacted a similar bill, HB 1586 by Marchant, which would have authorized motor vehicle sellers to offer debt-cancellation contracts as a separate charge and specified that they were not insurance or an insurance product. Gov. Bush vetoed that bill, stating that “the conditioning of this cancellation on the loss of the vehicle is in the nature of insurance and should be regulated.”

In 1997, the 75th Legislature enacted SB 1913 by Sibley, which would have specified that a service contract offered by the manufacturer or seller of property was not insurance. Gov. Bush vetoed that bill, stating that “the bill may permit the unregulated sale of insurance, including fire, theft and other casualties normally covered by property and casualty insurance.”