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Auto Ancillary Products

Sales and marketing of ancillary or add-on products have been a top priority for regulators for more than five years—with regulators initially focusing on the offering of such products in connection with credit cards. Most enforcement actions relating to ancillary products have been predicated on allegations of unfair, deceptive, and/or abusive acts and practices (UDAAP or UDAP) — a broadly applied, subjective, and context-specific theory of liability.

BNA INSIGHTS: What's Driving Regulation of Auto Ancillary Products



BY JONICE GRAY TUCKER, KRISTOPHER KNABE AND
ERIC CHANG

Federal and state regulatory scrutiny of the automobile finance industry has accelerated over the last several months. The Consumer Financial Protection Bureau (CFPB or the Bureau) and the Department

Jonice Gray Tucker is a Partner with the Washington, D.C. office of BuckleySandler LLP.

Kristopher Knabe is an Associate with the Chicago office of BuckleySandler LLP.

Eric Chang is a Law Clerk with the Washington, D.C. office of BuckleySandler LLP.

of Justice (DOJ) recently announced the fourth public resolution with an indirect auto finance company in a series of joint efforts to address perceived fair lending risks from discretionary pricing and compensation policies.

Similarly, other federal and state regulators have increased their attention on the auto industry, taking a broad look at various practices. This heightened, industry-wide scrutiny is carrying over to another area that has been targeted by regulators—ancillary products sold in connection with automobiles.

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tive, and/or abusive acts and practices (UDAAP or UDAP) — a broadly applied, subjective, and context-specific theory of liability.

The CFPB has led the charge, often with prudential banking regulators in tow,¹ bringing 11 enforcement actions against credit card companies alone for the sale and servicing of add-on products. These actions have resulted in over a billion dollars in consumer relief and fines.

Regulatory oversight of ancillary products has not been limited to cards; other industries are being scrutinized including mortgage, telecommunications, and now, the automotive industry. Notably, the CFPB entered into a consent order with an auto lender in June 2013 for allegedly deceptive marketing of automobile ancillary products; and more recently, the CFPB kicked off 2016 with a public enforcement action alleging that a “buy here, pay here” dealer’s offering and financing of ancillary products violated UDAAP prohibitions, among other things.

Similarly, the Federal Trade Commission (FTC) and state Attorneys General also have been pursuing coordinated actions related to ancillary products based on allegations of unfairness and/or deception (UDAP).

The expansion of focus on automotive ancillary products also holds the potential to bring a new twist on legal claims that moves beyond traditional UDAAP/UDAP allegations. In an environment where there has been intense focus on alleged discriminatory practices within the auto industry, there is now emerging interest in discrimination in connection with automotive ancillary products as well. This focus could set the stage for future legal claims alleging violations of fair lending statutes such as the Equal Credit Opportunity Act (ECOA) in connection with the sale and servicing of ancillary products that relate to motor vehicles.

As the auto industry evaluates practices and strives to meet evolving and often ambiguous regulatory expectations, auto lenders and service providers would do well to examine their offering and sale of ancillary products. By understanding the regulatory landscape and examining procedures and practices involving ancillary products, industry players will be positioned to take proactive steps to mitigate their risks well-before regulators arrive, and perhaps they will simply drive by.

Complex and Evolving Federal and State Regulatory Oversight

The CFPB has been a primary driver of the scrutiny of ancillary products, using both its supervisory and enforcement authority. Given the Bureau’s extensive efforts related to these products, it is important for the auto industry and service providers to understand the scope of the agency’s jurisdiction and how it can be applied.

The Bureau has authority to supervise certain large depository institutions, larger participants as defined by

rule, service providers to covered persons, and entities engaged in conduct posing “risks to consumers.” In August 2015, the CFPB’s rule authorizing supervision of “larger participant” nonbank auto finance companies became effective, expanding its authority to supervise all aspects of nonbank auto finance companies with at least 10,000 aggregate annual originations.²

The Bureau’s expanded supervisory oversight of nonbank auto lenders undoubtedly means greater scrutiny of automotive ancillary products. The CFPB’s Automobile Finance Examination Procedures (Examination Procedures) explain that it will examine covered entities for compliance with federal consumer protection laws, including UDAAP and ECOA.³ And germane to this discussion, the Examination Procedures instruct examiners to pay close attention to ancillary products, such as GAP insurance and extended service contracts.⁴

The conduct and management of service providers also has been a significant focal point for the CFPB in evaluating the offering of ancillary products. The CFPB has supervisory power over certain service providers to banks and nonbanks.

Service providers must provide a “material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service.”⁵ This definition typically includes persons participating in “designing, operating, or maintaining” or “processing transactions related to” consumer financial products or services.⁶ Therefore, even those outside of the CFPB’s normal supervisory boundaries can find themselves within the Bureau’s jurisdictional ambit based on their conduct.

In light of the Bureau’s focus on ancillary products, falling under the CFPB’s supervisory authority has significant consequences. Supervised entities are expected to have Compliance Management Systems (CMS) that are consistent with the CFPB’s expectations. CMS deficiencies, historically, have been a gateway for enforcement actions as serious failures can cause consumer harm.

Nonbank auto lenders or service providers that now find themselves subject to supervision may be put through the CFPB’s rigorous evaluation process. Preparing for and responding to examination requests can be time consuming and draining on internal resources, particularly for those companies that may not have experienced such regulatory scrutiny in the past. Examiners may obtain and review policies and procedures, advertisements, meeting minutes, consumer-facing documents, and customer complaints. They also may conduct interviews with management and staff.

The supervisory process affords the CFPB opportunities to assess whether a company’s acts and practices are compliant with governing laws, including laws prohibiting unfair, deceptive, or abusive conduct as well as statutes prohibiting discrimination. These matters can

² 80 Fed. Reg. 37496.

³ CFPB, EXAMINATION PROCEDURES - AUTO FINANCE 5, (June 10, 2015), http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.

⁴ CFPB, EXAMINATION PROCEDURES - AUTO FINANCE 4, (June 10, 2015), http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.

⁵ 12 U.S. Code § 5481 (26).

⁶ *Id.*

¹ See e.g., Consent Order, *In the Matter of Discover Bank*, 2012-CFPB-0005, (Sept. 24, 2012), http://files.consumerfinance.gov/f/201209_cfpb_consent_order_0005.pdf (joint CFPB/FDIC enforcement action); Consent Order, *In the Matter of JPMorgan Chase Bank, N.A.*, 2013-CFPB-0007, (Sept. 19, 2013), http://files.consumerfinance.gov/f/201309_cfpb_jpmc_consent-order.pdf (joint CFPB/OCC action).

be resolved with supervision or referred to enforcement for further investigation and potential public enforcement action.

CFPB Enforcement Authority

While supervision can lead to enforcement, the CFPB does not depend upon supervisory authority to initiate investigations and enforce the consumer financial laws. The CFPB has expansive power to investigate potential violations of federal consumer financial laws—including UDAAP, among others. This broad enforcement power extends far beyond the Bureau’s supervisory scope. In carrying out this function, the CFPB may issue subpoenas or civil investigative demands for testimony, documents, or other materials. The CFPB may also obtain information from third parties in furtherance of investigations.⁷

Although the Bureau lacks criminal enforcement authority, it may pursue administrative enforcement and civil actions in Federal District Court. Recently, the Bureau has also taken the controversial position that, in administrative proceedings, statutes of limitations may not apply.⁸

Beyond the CFPB: the FTC, the DOJ, and State AGs

No CFPB jurisdiction? No regulatory problem! The FTC, the DOJ, and state Attorneys General can pursue potential jurisdictional deltas on the Bureau’s authority and often initiate actions on their own. Moreover, the dual UDAAP authority shared by federal and state enforcement authorities presents the possibility of parallel or joint investigations. And indeed, other regulators have taken a growing interest in the automotive industry and ancillary products in particular. For example, in March 2015, the FTC announced results from “Operation Ruse Control”—a sweeping, coordinated effort by the FTC and state partners that resulted in over 250 auto-related actions, including actions addressing the advertising and sale of ancillary products. And, in December 2015, the FTC announced a proposed qualitative survey to study car buyer’s experiences in buying and financing automobiles at dealerships.⁹ The survey proposes a series of questions on the entire purchase experience, including how consumers are offered additional products. The FTC intends to use the survey to gain insights about potential consumer protection issues that could be addressed through FTC action, such as enforcement initiatives, rulemaking, or education.

The DOJ also has jurisdiction to enforce ECOA on its own or upon referral from another agency. While the DOJ and the Bureau have pursued coordinated actions

against auto finance companies, the DOJ may take actions against auto dealers in circumstances where the CFPB’s jurisdiction is lacking. For example, the DOJ, along with the North Carolina Attorney General, settled the federal government’s first-ever discrimination lawsuit involving “buy here, pay here” auto lending in early 2015.¹⁰ In that matter, the DOJ alleged that the used car dealerships violated ECOA by engaging in reverse redlining by intentionally targeting African-Americans for unfair and predatory credit practices in financing used car purchases. The North Carolina AG also alleged that the dealerships’ actions violated the state’s Unfair and Deceptive Trade Practices Act.

Scrutiny of Ancillary Products: Lessons to Be Learned

Regulators have subjected ancillary products to significant scrutiny in the context of both supervision and enforcement. Such actions have resulted in allegations leading to significant customer remediation, substantial penalties, and enhanced compliance processes. Such actions can serve as an important guidepost for companies in evaluating their processes.

The application of UDAAP is highly fact-dependent and varies case-by-case, but several common themes have emerged from past ancillary products enforcement actions. To assess whether a product or service is potentially unfair, deceptive, or abusive, regulators have focused on the entire lifecycle, including marketing, enrollment, servicing, and issues related to third-party management. Some conduct that may give rise to UDAAP claims include:

- Questionable presentation of benefits;
- Material terms and conditions omitted or deferred (e.g., buy now and disclose later);
- Fees or premiums paid in exchange for little or no value to the product or service;
- Rapid sales delivery with downplayed disclosures;
- “Free trials” with negative option billing;
- Deceptive representations relating to product or service price;
- Enrollment processes where customer is billed regardless of taking a required second step necessary to access products or services;
- Servicing practices that may be perceived as making it difficult to cancel the product or service (e.g., excessive rebuttals, downselling); or
- Insufficient refund policies.

A closer look at the enforcement actions involving auto ancillary products provides greater insight into what regulators may consider unfair, deceptive, or abusive in practice.

An early example is the Bureau’s June 2013 consent order with an auto lender and service provider, which

⁷ CFPB § 1052(c)(1), 12 U.S.C. § 5562(c)(1).

⁸ CFPB’s Opposition to Respondents’ Motion to Dismiss, *In re Matter of Integrity Advance, LLC*, Administrative Proceeding File NO. 2015-CFPB-0029, http://files.consumerfinance.gov/f/201601_cfpb_bureaus-opposition-to-respondents-motion-to-dismiss-integrity-advance-llc-james-r-carnes.pdf.

⁹ FTC, Press Release, *FTC Seeks Public Comment on Proposed Survey of Consumers Regarding Their Experiences Buying and Financing Automobiles from Auto Dealers*, <https://www.ftc.gov/news-events/press-releases/2015/12/ftc-seeks-public-comment-proposed-survey-consumers-regarding>.

¹⁰ Consent Order, *United States and State of North Carolina v. Auto Fare, Inc.*, No. 14-cv-00008 (W.D.N.C. Feb. 10, 2015).

led to a total of \$5.5 million in customer remediation.¹¹ In that action, the Bureau alleged that the marketing of various ancillary products to servicemembers was deceptive. In particular, the Bureau asserted that the marketing surrounding a vehicle service contract understated its costs by claiming that purchasing a contract would add “just a few dollars to your monthly payment” when, to the contrary, the average monthly cost was more than \$40. The materials presented to consumers also allegedly failed to accurately disclose the scope of the service contract’s coverage. The companies cooperated during the investigation and proactively provided refunds to customers, avoiding any civil money penalties. The companies agreed to make significant compliance enhancements by improving disclosures and committed to ensuring that dealers participating in this program did not misrepresent material product terms.

Very recently, in January 2016, the CFPB signaled that it continues to focus on auto ancillary products in its settlement with a “buy here, pay here” auto dealer to resolve UDAAP allegations, among other things.¹² The Bureau alleged that the dealer required consumers to purchase an auto repair policy and GPS reminder device (a device that the company placed in each car in its inventory that audibly reminded customers to make payments and disengaged the ignition when a customer went delinquent). The CFPB further alleged that the company required customers to keep the GPS device and purchase the repair warranty in each car that it sold on credit, but did not impose the same requirement on cash-paying customers. The Bureau alleged that the company’s failure to disclose the finance charges — including the cost of the required repair warranty and the cost of the required GPS device — was a deceptive practice in violation of UDAAP.

State Attorneys General and the FTC also have been actively challenging perceived unfair or deceptive tactics in the auto industry. For instance, in May 2015, the FTC announced a \$2.4 million enforcement action claiming a company deceptively sold consumers an auto payment program in violation of the FTC Act. The action focused on the company’s claim that consumers enrolled in the payment program would save money, but fees charged for the service often reduced any savings. The FTC also brought an action against the dealerships that sold the company’s service to consumers.

Ancillary products have come under scrutiny by state regulators as well. Last year, the New Jersey Attorney General settled with a company to resolve allegations of deceptive advertising of vehicle service contracts.¹³ The New Jersey AG alleged that misstatements were made in the marketing and sale of the product, and that the company had improper and inconsistent claims handling. The company reached a settlement for \$800,000 that included remediation, penalty and fees, and an

agreement to terminate its New Jersey business operations and stop selling to New Jersey residents.

In a separate suit, the New Jersey AG brought claims that a provider of vehicle service plans engaged in unfair practices by continuing to charge consumers’ bank or credit card accounts for the plans post-cancellation. The New Jersey AG also alleged that the company deceptively implied that it sold warranties by operating under the name “Stanley Warranty,” when it actually sold residential service contracts and motor vehicle service contracts.

And UDAAP is not the only tool that regulators can wield in cases involving ancillary products, as illustrated by an ongoing auto loan review initiative by the Massachusetts AG.¹⁴ In three recent cases, auto finance companies settled with the state AG to resolve allegations that consumers were charged interest rates on certain auto loans that exceeded the state’s usury laws. The loans allegedly were above the 21 percent state interest rate cap after the fees for GAP insurance coverage were added to consumers’ loans. As part of the settlements, the companies agreed to provide more than \$12 million in remediation and conduct a supervised audit of their portfolios to identify whether other customers have been overcharged as a result of financing the GAP insurance fees.

Regulator’s Next Stop: Fair Lending?

The CFPB and DOJ have been leading the charge on fair lending scrutiny within the auto industry. To date, these regulators principally have focused on the exercise of discretion and the alleged absence of policies in connection with the practice of dealers marking up buy rates. Yet, this fair lending focus could easily shift to how auto companies and service providers offer, finance, and service ancillary products for protected class members.

Indeed, the CFPB has already signaled that it is watching for potential fair lending issues with the respect to ancillary products. In its 2012 bulletin addressing credit card ancillary products, the CFPB cautioned that fair lending concerns may arise based on differential treatment on a prohibited basis in connection with the sale and marketing of add-on products. In particular, the Bureau explained that fair lending concerns may arise by requiring applicants based on their race or age to purchase ancillary products as a condition of obtaining credit.¹⁵

Consumer groups also have started to highlight perceived fair lending concerns related to ancillary products, which may set the stage for future legal claims. These groups have cited surveys allegedly revealing that protected class borrowers are more likely to be sold multiple ancillary products than white borrowers.¹⁶ Consumer advocates further claim that surveys

¹¹ Consent Order, *In re U.S. Bank Nat’l Ass’n*, No. 2013-CFPB-0003, (June 26, 2013), http://files.consumerfinance.gov/f/201306_cfpb_enforcement-order_2013-0589-02.pdf

¹² Consent Order, *In re Y King S Corp.*, No. 2016-CFPB-0001, (Jan. 21, 2016), http://files.consumerfinance.gov/f/201601_cfpb_consult-order_y-kings-corp-also-doing-business-as-herbies-auto-sales.pdf.

¹³ Office of the New Jersey Attorney General, *Seller of Motor Vehicle Service Contracts Will Cease Business in New Jersey* (Jan. 29, 2015), <http://nj.gov/oag/newsreleases15/pr20150129a.html>.

¹⁴ Press Release, Attorney General of Massachusetts, <http://www.mass.gov/ago/news-and-updates/press-releases/2016/massachusetts-drivers-to-receive-7-4-million-in-relief.html>.

¹⁵ CFPB Bulletin 2012-06, “Marketing of Credit Card Add-on Products” (July 18, 2012), http://files.consumerfinance.gov/f/201207_cfpb_bulletin_marketing_of_credit_card_addon_products.pdf.

¹⁶ Center for Responsible Lending (CRL), “Non-Negotiable: Negotiation Doesn’t Help African-Americans and Latinos on Dealer-Financed Car Loans.”

and focus groups have revealed instances in which protected class borrowers are being told that ancillary products were required to receive a particular loan or offers were contingent on the buyer accepting the product. If past is prologue, consumer group attention may trigger further regulatory scrutiny.

Taking Proactive Steps: Ancillary Products Risk Assessment

In light of the scrutiny and regulatory attention on ancillary products, auto finance companies and service providers should be proactive and evaluate their practices to assess whether they align with the law and meet regulatory expectations. The review should address the entire product or service life cycle—from development through servicing to termination—to identify potential gaps or risks. The components of such a review may include:

- Evaluating how products have been developed and asking whether the product is designed to deliver value commensurate with any fees or customer charges;
- Analyzing consumer facing documents and agreements to determine whether terms and conditions do not unfairly limit the ability to receive offered benefits;
- Reviewing marketing materials to verify that products are described accurately and disclosures and exclusions are clear and prominent;
- Evaluating whether the marketing, sales, and servicing of products may differ based on prohibited

factors such as gender, age, or race—or factors that could be a proxy for these prohibited demographics;

- Sampling call recordings and evaluating scripts to assess whether sales practices describe the product accurately and do not unduly pressure a consumer to purchase or retain unwanted products;
- Reviewing servicing communications, including fulfillment materials for accuracy and clarity and requests for cancellation and refunds; and
- Assessing how requests for cancellation and refunds are handled.

Companies also would be well-served to assess the design and effectiveness of their compliance management systems. Policies, procedures, and actual practices should be reviewed for consistency. They also should employ a robust complaint management process that includes steps for receipt, investigation and resolution of complaints as well as tracking complaints and any trend analysis.

There are no signs of regulators' drive regarding ancillary products slowing and the CFPB continues to lead the way. The intense focus on alleged discriminatory practices within the auto industry may carry over to ancillary products offered there as well. Auto finance companies and service providers should not be parked and waiting. By undertaking a comprehensive assessment of their practices related to ancillary products, companies can detect and address any potential issues to mitigate their risks—steering clear of the regulators who may be speeding down the road.