Thinking of Force-Placing CPI on All Buyers? Think Again.

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I frequently hear creditors complain about issues they face when trying to confirm that one of their customers has and will maintain the property insurance required by the retail installment contract. For instance, some customers may have coverage when they buy and finance a vehicle, but it gets canceled the very next day.

Other customers may have insurance, but it lapses, the creditor gets notice of the lapse but isn't able to act quickly enough to get the vehicle covered by its insurance, and the customer totals the car. The creditor then has to eat the loss. Other creditors complain about the administrative burden of tracking the insurance coverage (or lack thereof), including hiring full-time staff to manage the process.

One creditor got so frustrated with the headaches and process that it questioned whether it could charge collateral protection insurance to every customer, regardless of whether the customer has the required property insurance or may be able obtain his or her own coverage. For the reasons discussed below, we think that's an idea that really requires some stump-sitting (thinking).

CPI coverage provides either single-interest physical damage insurance coverage to creditors for motor vehicle collateral that has not been insured by the car owner or dual-interest coverage if it protects the interests of both the creditor and the car owner. CPI coverage may be placed at the time of sale of the vehicle or after the creditor receives notice that the car owner's existing insurance coverage has lapsed.

For CPI placement at the time of origination, the dealer typically confirms at closing that the buyer does not have property insurance for the vehicle (or has chosen not to provide evidence of insurance before taking possession of the vehicle). The dealer will provide the buyer with a disclosure explaining that CPI coverage will be used as an alternative to customer-purchased insurance. If the buyer does not provide evidence of insurance within a certain number of days, CPI coverage is placed and is retroactive to the date of the RIC. If the buyer provides evidence that he or she has obtained the required insurance before his or her first payment under the RIC, then he or she will not be charged. The cost for CPI coverage is charged to the buyer.

A creditor requiring CPI coverage on every transaction must treat the charge as a finance charge for purposes of the Truth in Lending Act and Regulation Z, unless TILA and Reg. Z say otherwise. And they do. Reg. Z provides that in order for the premiums for insurance against loss of or damage to property (or against liability arising out of the ownership or use of property, including single-interest insurance if the insurer waives all right of subrogation against the consumer) to be excluded from the finance charge, the following conditions must be met:

> (1) the insurance coverage may be obtained from a person of the consumer's choice, and this fact is disclosed (although a creditor may reserve the right to refuse to accept, for reasonable cause, the consumer's insurer); and
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> (2) if the coverage is obtained from or through the creditor, the premium for the initial term of coverage must be disclosed. If the insurance term is less than the term of the transaction, the insurance term must also be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone, and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

To exclude property insurance premiums from the finance charge, the creditor must permit the consumer to choose the insurer and disclose that fact. This disclosure must be made whether or not the property insurance is available from or through the creditor. This simple proposal of *requiring* CPI coverage on every transaction and not giving the customer the option to obtain it from a person of his or her choice means that the creditor would not be able to exclude the premium from the finance charge under TILA/Reg. Z. The cost of the CPI coverage in such a situation must be included in the creditor's finance charge calculation.

In addition, a creditor requiring CPI on every transaction, regardless of whether the customer already has the required insurance or may be able to obtain the required insurance, may face a claim under federal law that the practice is abusive and/or under state law that the practice is unconscionable. While a seller may not be prohibited from requiring CPI, that requirement may, in some cases (particularly if CPI duplicates other insurance coverage), be unconscionable.

This practice would be particularly problematic in Uniform Consumer Credit Code states with unconscionability provisions applicable to a separate charge for insurance. When applying the UCCC unconscionability provisions to an insurance charge, the following factors are generally among those considered: (1) potential benefits to the consumer, including the satisfaction of the consumer's obligations; (2) the creditor's need for the protection provided by the insurance; and (3) the relation between the amount and terms of credit granted and the insurance benefits provided.

If the CPI coverage duplicates the consumer's existing insurance coverage, arguably he or she would not receive any benefit from the CPI coverage. In those cases, a state regulator or plaintiff's attorney could argue that the practice of charging CPI to all customers, particularly those who may have existing insurance coverage, is unconscionable and could press for statutory damages, attorneys' fees, and costs.

As an alternative to the proposed practice, could a creditor buy vendor's single-interest insurance coverage that attaches at the sale? VSI covers the creditor's interest only and insures the risk that the consumer will, at some time during the contract term, fail to obtain/maintain insurance as required.

Under TILA, mandatory VSI is permitted provided the insurer disclaims the right of subrogation against the consumer and provided the creditor discloses to the consumer that he or she is entitled to buy comparable insurance elsewhere (even though the consumer might not be able to do so).

Many of the installment sale contracts I've reviewed have a section for VSI coverage, so the creditor would not need to revise the contract. State laws have to be checked, of course, to confirm that this is a viable option. If you're considering a similar plan, sounds like you need to have a conversation with your lawyer.

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