Truth in Lending Act

How to Keep Insurance and Other Charges Out of the Finance Charge

By Thomas B. Hudson

Long ago and far away, in a very odd place called Washington, D.C., some pointy-headed bureaucrats at the Federal Reserve Board were sitting around a conference table concocting yet another federal regulation. This one was to be Regulation Z, and it was supposed to implement the federal Truth in Lending Act.

As usual, arguments broke out among the participants regarding what the regulation should say. One of the arguments dealt with what fees and charges in a credit transaction the Feds should require creditors to include in the finance charge.

One group insisted that premiums for credit insurance be part of the finance charge. Others argued that unless the creditor required the credit insurance, it wasn't appropriate to include the premiums in the finance charge. If a consumer could get credit without incurring the premium charge, they reasoned, it wasn't logical to call the premium a cost of credit, which is what the finance charge is supposed to represent.

As usual, since this meeting took place in Washington, the participants reached a compromise of sorts. Creditors could exclude premiums for credit life, health and loss-of-income insurance from the finance charge, but only if certain conditions were met.

First, the coverage could not be required by the creditor, and that fact had to be disclosed in writing. The premium for the initial term of the insurance had to be disclosed. If the term of the insurance was to be shorter than the term of the credit transaction, the insurance term had to be disclosed. Finally, the consumer had to sign an affirmative written request for the insurance after receiving the required disclosures. There were somewhat similar requirements for keeping the charge for debt cancellation coverage (sometimes called "GAP") out of the finance charge.

Another part of Regulation Z says that any charge a creditor imposes in a "comparable cash transaction" is not a finance charge. That permits dealers to charge for doc fees, service contracts and services like "etch," and not include the charges for these items in the finance charge, as long as they impose them in comparable cash transactions. **Now dealers make money on credit insurance, doc fees, GAP, service contracts and etch, so there is always a temptation to tell the customer, suggest to the customer, or hint to the customer that some or more of these fees and charges are required in order for the customer to obtain financing. Usually, the dealer places the blame on the finance company – "We cannot get you financed, Mr. Customer, unless you sign up for [fill in the blank]."**

Oops. A dealer who utters these words has probably just stuffed the charge for whatever product appears in the blank back into the finance charge. That means that the charge must be added to the "regular" finance charge and included in the calculation of the APR. Since the dealer almost certainly isn't going to take those steps, we have a TILA/Reg. Z violation. And if the dealer fabricated the bit about the bank or finance company "requiring" the customer to buy the product or service, the dealer has also committed a state law unfair or deceptive trade practice. If the dealer regularly does these things, he is exposed to class action liability, as well.

It is for these and other reasons that many compliance folks urge dealers to use a true, transparent "menu" sales approach, in which every customer is offered the opportunity to buy or decline everything the dealer sells in connection with the car sale, and that fact is documented in writing.

Such a process (assuming that the dealership representatives aren't using winks and nods to get around it) will go a long way toward keeping the dealership out of the courthouse. ❑

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