SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 2311 (Maienschein)
Version: June 20, 2022
Hearing Date: June 28, 2022
Fiscal: Yes
Urgency: No

SUBJECT

Motor vehicle conditional sale contracts: guaranteed asset protection waivers

DIGEST

This bill establishes baseline protections in connection with guaranteed asset protection waivers.

EXECUTIVE SUMMARY

A guaranteed asset protection (GAP) waiver is an optional contractual obligation sold to car purchasers. The purpose of these waivers is to protect consumers when there is a total loss of the vehicle or an unrecovered theft. The waiver provides for payment to the consumer of all or some portion of the "gap" between the actual cash value of the vehicle (often determined by insurance companies) and the remaining loan balance exceeding that amount.

However, concerns have arisen that these waivers are largely unregulated, and specifically excluded from laws governing insurance products. This leads to problematic market practices, including where GAP waivers are excessively expensive, of questionable value, are not properly refunded, or not properly explained to consumers.

This bill seeks to address these issues by establishing some baseline consumer protections in connection with the sale of GAP waivers. The bill implements a number of disclosure requirements to institute some transparency in the market. It also provides consumers the right to cancel GAP waivers at any time and details various rights regarding refunds. There are also clear parameters for what can be charged for these waivers to ensure baseline value and prevent excessive pricing.

This bill is sponsored by Attorney General Rob Bonta. It is supported by the Consumer Federation of California. Recent amendments have removed all known opposition.

PROPOSED CHANGES TO THE LAW

Existing law:

1) Establishes the Automobile Sales Finance Act, also known as the Rees-Levering Motor Vehicle Sales Finance Act, to regulate the sales of automobiles pursuant to conditional sales contracts. (Civ. Code § 2981 et seq.)

2) Defines "conditional sale contract" as a contract to purchase a motor vehicle primarily for personal, family, or household purposes, with or without accessories, under which the buyer takes possession of the vehicle, but either a) obtains title only upon payment of the purchase price, or b) provides the seller a lien on the vehicle as security for payment of the purchase price. (Civ. Code § 2981 (a)(1).)

3) Defines "nationally recognized pricing guide" to include, but not be limited to, the Kelley Blue Book, Edmunds, the Black Book, or the National Automobile Dealers' Association Guide. (Veh. Code § 11950 (c)(2).)

4) Defines "guaranteed asset protection" (GAP) insurance, a form of insurance regulated under the Insurance Code. However, exempted from this definition is a debt cancellation agreement contained in a conditional sales contract for the sale of a vehicle. (Ins. Code § 1758.992 (h).)

5) Requires contractual disclosures under the Vehicle Leasing Act regarding GAP liability and coverage in connection with automobile leases. (Civ. Code § 2985.8 (j).)

This bill:

1) Defines "guaranteed asset protection waiver" (GAP waiver) as an optional contractual obligation under which the seller of a motor vehicle agrees, for additional payment, to cancel or waive all or part of amounts due on a conditional sales contract if the vehicle is subject to a total loss or unrecovered theft.

2) Defines "holder" as the seller of a motor vehicle under a conditional sales contract, and any person who can subsequently enforce such a contract against the buyer at the time.

3) Defines "administrator" as any person, other than an insurer, that performs administrative or operational functions in connection with a GAP waiver. Deems an administrator to be an agent of the holder.

4) Requires the offer, sale, or provision of a GAP waiver to comply with the Automobile Sales Finance Act in the Civil Code.

5) Requires itemized disclosure, in the conditional sales contract, of the amount charged for a GAP waiver.

6) Declares that a GAP waiver, which may be titled as an addendum, forms part of the conditional sales contract and remains a part of the conditional sales contract when the contract is assigned, sold, or transferred.

7) Forbids a seller from conditioning the terms of a conditional sales contract or an extension of credit on whether the buyer purchases a GAP waiver.

8) Requires, prior to the execution of a conditional sales contract, that the seller provide and obtain the buyer's signature on a written disclosure that includes both a description and the price of any GAP waiver agreement.

9) Requires the terms and conditions of a GAP waiver to be included on a document separate from the conditional sales contract that is signed by the buyer. The document should include the following:
    a) a statement that the GAP waiver is an optional addition to the contract;
    b) a statement that the holder of the sales contract is the contracting party;
    c) the name and mailing address of the seller;
    d) the name and mailing address of any administrator; and
    e) a statement, in a box outlined in red with a heading in at least 12-point bold type and the text in at least 10-point bold type, circumscribed by a line, immediately above the contract signature line that reads:

> STOP AND READ:
>
> YOU CANNOT BE REQUIRED TO BUY A GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES. IT IS OPTIONAL.
>
> NO ONE CAN MAKE YOU BUY A GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES TO GET FINANCING, TO GET CERTAIN FINANCING TERMS, OR TO GET CERTAIN TERMS FOR THE SALE OF A VEHICLE.
>
> IT IS UNLAWFUL TO REQUIRE OR ATTEMPT TO REQUIRE THE PURCHASE OF THIS GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES.

10) Requires, if the conditional sales contract is assigned, that within 30 days of assignment the buyer be provided written notice of the assignment and the name and mailing address of the assignee.

11) Prohibits the sale of a GAP waiver if the waiver's price exceeds four percent of the amount financed under the conditional sales contract.

12) Prohibits the sale of a GAP waiver if the amount financed through the conditional sales contract is more than the maximum dollar amount covered by the GAP waiver.

13) Prohibits the sale of a GAP waiver if, on the date of sale, the conditional sales contract's loan-to-value (LTV) ratio exceeds the maximum LTV ratio covered by the GAP waiver, unless the terms of the GAP waiver conspicuously disclose the maximum LTV ratio limitation, including the method by which the limitation is applied, and the buyer is informed in a writing, acknowledged by the buyer, that the amount financed in the buyer's conditional sales contract exceeds the waiver's maximum LTV limitation and therefore the waiver will not cover the total amount owed on the conditional sales contract.

14) Defines LTV ratio as the total amount financed as a percentage of the manufacturer suggested retail price (MSRP) for a new vehicle or the average retail value for a used vehicle, as determined by a nationally recognized pricing guide, which includes the Kelley Blue Book, Edmunds, the Black Book, or the National Automobile Dealers' Association Guide.

15) Prohibits the sale of a GAP waiver if the amount financed—not including the cost of the GAP waiver and any credit insurance or service contracts—is less than 70 percent of the MSRP or average retail value.

16) Clarifies that a GAP waiver terminates upon the earliest of the following:
    a) cancellation by the buyer;
    b) payment in full by the buyer of the conditional sales contract;
    c) if the vehicle is repossessed or surrendered, the expiration of any redemption and reinstatement periods under the Automobile Sales Finance Act;
    d) if the vehicle is subject to a total loss or unrecovered theft, after the holder has applied all applicable benefits required under the GAP waiver; or
    e) any other termination event set forth in the GAP waiver.

17) Entitles the buyer, upon termination of a GAP waiver, to a refund as follows:
    a) if the termination occurs within the first 30 days, a full refund of all GAP waiver charges, plus all finance charges attributable to the GAP waiver;

   b) thereafter, a refund of any unearned GAP charges, calculated on a pro rata basis, as provided; or
   c) no refund if there has been a total loss or unrecovered theft of the motor vehicle specified in the conditional sales contract and the buyer has or will receive the benefit of the GAP waiver.

18) Requires any refund to be tendered or initiated within 60 business days of the termination date. A refund may be applied as a reduction of the amount owed under the contract unless already paid in full. These refunds are in addition to any other refunds provided for. The holder must maintain records of such refunds for four years, and make them electronically accessible in response to a subpoena or other administrative or judicial request.

19) Authorizes a buyer to cancel a GAP waiver at any time without penalty. Prohibits a cancellation, termination, or similar fee to be charged in connection with the termination.

20) Requires a holder, when communicating an itemized contract balance to the buyer in writing, to individually identify as a credit or refund available to the buyer the unearned portion of GAP waiver charges paid by the buyer as of the date of the communication on a pro rata basis. The holder may alternatively state that a buyer who purchased a GAP waiver is generally entitled to a refund of the unearned portion of the guaranteed asset protection waiver charges on a pro rata basis upon early termination of their contract or cancellation of the waiver, and that the buyer should contact the administrator identified in the GAP waiver, or any other appropriate person designated by the holder, for identification of the amount of such a refund available to the buyer at that time.

21) Authorizes a buyer to recover three times the amount of GAP charges paid for any violation of the above provisions, unless the violation is the result of an accidental or bona fide error of computation.

COMMENTS

1. A GAP in regulation

GAP waivers are contractual agreements between purchasers of vehicles and creditors. Sold as an add-on product to auto loan contracts, the creditor commits to waive the remainder of the balance on the underlying auto loan that exceeds the market value of the vehicle in the event that the vehicle is a total loss or stolen and unrecovered.

The issue motivating the current bill is that unlike similar products, existing law does not specifically address the rights and responsibilities of the parties to GAP waiver agreements and therefore the market is largely unregulated. The author argues that in the absence of such consumer protections unfair practices in the sale and administration of GAP waivers enable auto dealers and lenders to take advantage of vulnerable consumers and harm competition. Research supports this contention:

> Add-on products sold by car dealers, such as service contracts, Guaranteed Asset Protection (GAP) insurance, and window etching, make up a large share of dealers' profits. They also significantly increase car buyers' costs. While many have questioned the value of these products for consumers, the pricing of these products has received less attention, largely because pricing is not transparent and consumers, and to some extent even regulators, lack information about what car buyers pay for these products. Dealers decide what to charge each consumer and generally only the dealer, the finance company, and the third party provider of the add-on ever know what other consumers are paying.[1]

The data analysis came up with the following findings:

- Add-on products are sold at prices far higher than dealer costs. Dealers mark up add-on products more than other similar products are marked up. They mark up add-on products by a far higher percentage than they mark up cars.
- Dealers are inconsistent in the pricing of add-on products, with even individual dealerships charging some consumers many times more than other consumers for the same product with the same dealer cost.
- This inconstant pricing for the same add-ons leads to pricing discrimination, with Hispanics charged higher markups than non-Hispanics.

Specifically as to GAP waivers, the need for protections is arguably clear:

> Dealers aggressively push GAP products because they are highly profitable. GAP products also reduce risk for the creditor while at the same time adding to the amount financed, thus increasing finance charges. On the other hand, consumers often find that GAP products fail to provide the promised benefits. Most GAP products exclude cars that are uninsured or under-insured and also do not pay for interest and fees accruing from the time the car was totaled or stolen until the insurance payment is made. GAP coverage often excludes that portion of negative equity resulting from a trade-in whose pay-off exceeds its value. It may also exclude the portion of the consumer's obligation that reflects the cost of add-ons, such as service contracts, window etching, and sometimes

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[1] John W. Van Alst et al., *Auto Add-Ons Add Up: How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing* (October 2017) National Consumer Law Center, https://www.nclc.org/images/pdf/car_sales/report-auto-add-on.pdf [as of June 23, 2022].

even the GAP product itself. Some GAP policies also do not cover the deductible on the consumer's collision or theft coverage.

When excessively priced GAP waivers are purchased, it also increases the loan to value (LTV) ratio of the vehicle. This contributes to increases in negative equity, which hurts the consumer and the market at large.

2. Reasonable parameters on GAP waiver sales

According to the author: "Despite their name, GAP waivers hardly provide the bare minimum protections for the car buyer. This bill will ensure that car buyers are covered through stricter consumer protection laws, helping them avoid this costly add-on when unnecessary."

The bill seeks to implement basic protections for consumers in connection with the purchase and value of GAP waivers. The first area that is addressed is the pricing of these waivers. The bill places a limit on what can be charged for a waiver at four percent of the amount financed under the sales contract. Creditors are also prevented from selling GAP waivers where the amount financed through the sale contract exceeds a maximum dollar amount covered by the waiver.

GAP waivers also cannot be sold if the amount financed minus the total cost of the GAP waiver, credit insurance, and service contracts is less than 70 percent of the MSRP for a new vehicle or the average retail value for a used vehicle, based on a recognized pricing guide. The final restriction is on GAP waivers offered where the sales contract's LTV ratio at the contracting date exceeds the maximum LTV ratio covered by the GAP waiver. However, such a waiver can be offered if the terms conspicuously disclose the maximum LTV ratio limitation and the buyer is informed that the amount financed exceeds that limitation and therefore the waiver will not cover the total amount owed.

The bill additionally makes clear that GAP waivers cannot be mandated and sets out specific events that terminate them. This includes upon cancellation by the buyer at any time or full payment of the sales contract. No cancellation, termination, or similar fees may be charged. The bill also lays out clear refund requirements based on when termination occurs and the value provided.

The bill also implements a number of disclosure requirements that ensure consumers are made fully aware of their rights. For instance, the bill requires a separate document with the terms and conditions of the GAP waiver that must be signed by the consumer. This must include a notice in a specified manner that the consumer cannot be required to buy such a waiver. The holder of the contract must also disclose in various written communications to the buyer that the latter generally has the right to a refund of unearned portions of GAP waiver charges.

To ensure proper enforcement, a holder is liable to a buyer for three times the amount of any GAP waiver charges paid if they are in violation, outside of accidental or bona fide computational errors.

3. Stakeholder support

Attorney General Rob Bonta, the sponsor of the bill, writes:

> GAP waivers are usually very costly. The product only benefits consumers who are underwater on their auto loan at the time that a triggering event occurs. In addition, the full cost of a GAP waiver is charged up front and typically financed at a high interest rate.
>
> Because GAP waiver charges are prepaid, the creditor (or its agent) holding the loan still holds the unearned portion of the GAP waiver charges when a consumer terminates a loan early by refinancing, sale, or early payoff. Unlike laws in some other states, California law does not expressly require the holder to promptly refund these unearned charges absent a request from the consumer. Consumers typically do not know to request it, so most never receive the refund to which they are entitled. Unfortunately, California trails other states, like Wisconsin and Oregon, which already have enacted similar laws requiring the creditor to promptly refund these unearned charges to the consumer in such circumstances.
>
> Accordingly, AB 2311 would establish a number of consumer protections for GAP waivers within the Rees-Levering Act (Civil Code § 2981 et seq.) First, the bill requires the prompt refund of the unearned, prepaid GAP waiver charges when the loan or waiver agreement terminates early, as specified. Second, the bill caps the amount that may be charged for a GAP waiver relative to the loan amount, and seeks to restrict partial waivers and valueless waivers from being sold as GAP waivers. Third, AB 2311 requires the seller to make important disclosures to consumers regarding GAP waivers, including that the product is optional and cannot be a condition to the loan or sale terms. Finally, the bill makes violations of these provisions enforceable under the Rees-Levering Act.
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> Attorney General Bonta is proud to sponsor AB 2311, and reaffirms his commitment to protect vulnerable consumers, promote transparency, and guard the public from unfair business practices.

Writing in support, the Consumer Federation of California asserts:

> AB 2311 will help rectify the lack of consumer protections related to GAP waivers. The bill would require that refunds for unearned, prepaid GAP waiver charges be automatically disbursed when a loan terminates early. The bill ensures that disclosures are made to the consumer, like the fact the waiver is optional, while also capping the amount that these waivers can be sold for.
>
> No consumer should be unfairly saddled with additional debt as a result of unclear or nefarious auto sales tactics. AB 2311 takes an important step towards ensuring that consumers are better informed about these waivers and are not being unfairly taken advantage of.

4. Technical amendments

The previous round of author's amendments included a few errors. The following amendments effectuate the intent of the previous amendments, correcting and clarifying where necessary:

Amendments

(e) "Holder" means the ~~seller or any~~ person ~~subsequently~~ entitled to enforce the conditional sale contract against the buyer at the time.

(iii) Contain a notice, ~~within a box outlined in red,~~ with a heading in at least 12-point bold type and the text in at least 10-point bold type, circumscribed by a line, immediately above the contract signature line, that reads as follows:

(III) The amount financed through a conditional sales contract~~, less the cost of a guaranteed asset protection waiver, the cost of credit insurance, and the cost of service contracts~~ is less than 80 70 percent of the manufacturer-suggested retail price for a new motor vehicle or the average retail value for a used motor vehicle, as determined by a nationally recognized pricing guide, as defined in paragraph (2) of subdivision (c) of Section 11950 of the Vehicle Code.

(6) In addition to the requirements of Section 2984.5, the holder shall maintain records identifying any refund made and tendered ~~under clause (ii) of subparagraph (B) of paragraph (5) of subdivision (a) and~~ under paragraphs (2) and (3) of this subdivision, including those refunds the holder instructed the administrator or other appropriate party to make, and provide electronic access to those records, in response to any subpoena or other administratively or judicially enforceable request, until four years after the date the refund was tendered.

SUPPORT

Attorney General Rob Bonta (sponsor)
Consumer Federation of California

OPPOSITION

None known

RELATED LEGISLATION

Pending Legislation: SB 1249 (Archuleta, 2022) increases the document processing fee that vehicle dealers can charge when a buyer or lessee purchases a car from $85 to $175. This bill is currently in the Assembly Transportation Committee.

Prior Legislation: None known.

PRIOR VOTES:

Assembly Floor (Ayes 52, Noes 16)
Assembly Appropriations Committee (Ayes 11, Noes 4)
Assembly Judiciary Committee (Ayes 7, Noes 1)

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