

1CCC Inf. Adv. #83
GAP Coverage / Finance
Charge



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Department of Justice

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BY FAX: 314/349-3169

RE: GAP PROGRAM

Dear

Mr. Kingery has referred your letter of March 7 to me.

As we discussed when we spoke on the phone some time ago, the recent change in TIL rules permit the price of a gap insurance policy to be excluded from the TIL finance charge and APR when its sale conforms to specified conditions.

However, that Truth in Lending change does not affect the status of gap premium charges as finance charges for purposes of Iowa's substantive law concerning maximum permissible charges.

Thus, if a creditor wishes to exclude the premium from the TIL price tag disclosures, then it must do different calculations to determine the TIL APR, and the interest rate for purposes of determining the maximum rate under Iowa law. Further, Iowa law requires that the GAP premium be rebated in the event of prepayment, whether by early pay-off of the account, acceleration, or refinancing.

You asked for an illustration of the calculations for TIL and Iowa usury purposes, using a \$395 gap premium charge.

Hypothetical Transaction:

Cash price -- 1997 Yugo	\$10,000
GAP Insurance Premium Charge --	\$ 395

Installment contract payment schedule:

47 payments @ \$313.56
+ 1 final @ \$313.66

Total of Payments Due Under Contract: \$15,050.98

TRUTH IN LENDING DISCLOSURE

Assuming that all the preconditions were met which, under Truth in Lending Regulation Z, § 226.4(d)(3), are necessary to exclude the GAP charge from the price tag disclosures (the APR and finance charge), this transaction could be disclosed as follows on the disclosure statement under TIL rules:

Amount Financed: \$10,395.00
Finance Charge: \$ 4,655.98
APR 19.5%

Itemization of Amount Financed: \$10,000 Cash Price
395 GAP premium

See Chart # 1.

IOWA LAW REGARDING MAXIMUM PERMISSIBLE RATES

Since this is a new car, the maximum interest rate is 21%. Iowa Code § 322.19.¹ Iowa law provides that the amount financed, for purposes of determining the rate being charged, is that defined by Iowa Code § 537.1301(4). What constitutes a finance charge is defined in Iowa Code § 537.1301(19). Some charges which might otherwise fall within the definition of a finance charge may be excluded if they are authorized "additional charges" listed in Iowa Code § 537.2501.

GAP premiums are not authorized additional charges, and they fall within the Iowa definition of a finance charge. Iowa Code § 537.1301(19).

Consequently, to measure the effective interest rate being charged on this transaction against the Iowa maximum rate of 21%, it is necessary to recalculate this transaction.

Moving the \$395 premium from the "amount financed" part of the

¹ A copy of Iowa Code § 322.19, which has the maximum interest charges for motor vehicle retail installment sales is enclosed. Under the Iowa Consumer Credit Code, the maximum rates for consumer-purpose auto sales are those specified in § 322.19. See Iowa Code § 537.2201(1).

equation to the "finance charge" part of the equation, we find that, for purposes of Iowa usury law, the total obligation is allocated this way:

Amount Financed: \$10,000.00
 Finance Charge: \$ 5,050.98
 Effective APR: 21.723%

Itemization of Finance Charge: \$4,655.98 Interest
 395.00 GAP Premium

See Chart # 2.

Since the maximum permissible rate for this Class I vehicle is 21%, this contract exceeds the maximum permissible charge under Iowa law, and would subject the creditor to penalties for excess charges under the ICC. Iowa Code §§ 537.2201(1), 537.5201.

The following table summarizes the difference:

	Truth in Lending	Iowa Law on Max. Rates
Amount Financed	\$10,395	\$10,000
[Consists of]	\$10,000 Cash price + 395 GAP	\$10,000 Cash price
Finance Charge	\$ 4,655.98	\$ 5,050.98
[Consists of]	\$ 4,655.98 Int.	\$ 4,655.98 Int. + 395.00 GAP
Total of Payments	\$15,050.98	\$15,050.98
APR	19.5%	21.723%

As you can see, the amount the consumer owes is the same. Within that total \$15,051, though, the allocation between the items attributable to the "credit price tag" differ.

REBATE ON EARLY TERMINATION

Under Iowa law, the GAP premium will be subject to the rebate requirements of Iowa Code § 537.2510. Our Consumer Credit Code does not authorize the use of a Rule of 78 formula to rebate unearned finance charges. Iowa Code § 537.2510(2). Please note, too, that rebates are required in the event of acceleration, as well as prepayment by other means. Iowa Code § 537.2510(6).

Our office will in the near future be meeting with the Banking Department and the Insurance Department to discuss in further detail rebate issues concerning this product.

PREPARING THE CONSUMERS' CREDIT DOCUMENTS

State law cannot, of course, preempt TIL's disclosure rules. 15 U.S.C. §1610(a)(1), Reg. Z § 226.28. There is, however, some uncertainty concerning the interplay between Iowa law and TIL as to disclosure about which the Banking Division and our office will be contacting the Federal Reserve Board shortly. Should there be any modifications from the Regulation Z disclosure provisions as a result of our communication, we will issue a follow-up letter.

I hope that this is responsive to your question. If you have any further questions, please feel free to call.

Sincerely,

K/

Kathleen E. Keest
Assistant Attorney General
Deputy Administrator, Iowa
Attorney General