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Department of Justice

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RE: Vendor's Blanket Single Interest Insurance
ICCC Informal Advisory # 86 (December 22, 1998), [as applied]

Dear Mr.

Upon reviewing the two sample policies you supplied, and after consultation with the Director of the Finance Bureau at the Division of Banking, we continue to believe that the policies of the sort you provided to us are of the type described in ICCC Informal Advisory # 86 which constitute a finance charge, as they appear to be primarily of the type described in that Advisory as *default/credit loss blanket* VSI policies, rather than the type of VSI which primarily insures the lender's interest in the collateral. (The basic distinction between the two different types of VSI was described in Informal Advisory # 86, and will not be repeated here.) Consequently, the cost of this product cannot be included in the amount financed. The ICCC rules for treating the charge for such policies are described at C-2, page 3, in informal advisory # 86.

There are a number of factors which are relevant to this conclusion.

<u>The ICCC language</u>

As stated in Ralph J. Rohner & Fred & Miller, *Truth in Lending*, ¶ 3.04[3][a], note 337, page 159 (American Bar Association 2000), VSI "is another instance where the TIL rule for disclosure may not be the same as that for state rate regulation purposes." It cites specifically the 1974 version of the UCCC, which is the basis for the Iowa Consumer Credit Code.

The 1974 version of the UCCC sets special conditions for VSI charges to be excluded from the finance charge, one of which is that it may be excluded "only...to the extent that the insurance does not duplicate the coverage of other insurance under which loss is payable to the creditor as his interest may appear, against loss of or damage to property for which a separate charge is made to the consumer pursuant to paragraph (a)." UCCC § 2.501(2)(c) [1974]. The Commentary notes that this approach adopts a "more sophisticated test and allows the premium to be treated as an additional charge in limited situations in which the vendor's single interest insurance does not duplicate the coverage of other insurance under which loss is payable to the creditor as his interest may appear....In this case, the charge is sufficiently beneficial to the consumer to justify classifying the premium as an additional charge." Uniform Consumer Credit Code, 1974 Act (Uniform Laws Annotated (1985), pp. 84-85 (1985).] As is discussed below, the sample policies you sent, as well as others reviewed independently, all contain requirements that the borrower purchase dual interest insurance on the collateral. Hence, even if Iowa had adopted this Uniform subsection (c), these policies would not have met this precondition necessary to exclude the charge from the finance charge.

However, the Iowa Consumer Credit Code goes further than either TIL or the UCCC. It contains no provisions whatsoever which authorize VSI to be excluded from the finance charge under any circumstances. The VSI is a charge which, even if it were explicitly just insurance on the collateral and not duplicative, would meet the general definition of a finance charge, as it is "payable directly or indirectly by the consumer and imposed directly or indirectly by the credit as an incident to or a condition of the extension of credit." ICCC § 537.1301(19)(a). "Additional charges <u>as defined</u> in section 537.2501" are excluded form the finance charge. ICCC § 537.1301(19)(b)(2); VSI is not among the allowable charges defined in section 537.2501. But beyond that, as the policies are drafted, to be superimposed over a standard dual interest property insurance, the true functional purpose of the VSI coverage is for "insurance protecting the creditor against the consumer's default or other credit loss," a specific example of a finance charge. ICCC § 537.1301(19)(a)(3).

Since both Reg. Z and the 1974 Model UCCC had made specific reference to VSI charges at the time the ICCC was enacted, and prescribed specific preconditions necessary for them to be excluded from the finance charge, it is an unlikely presumption that the Iowa legislature intended, by omitting UCCC 2.501(c), to permit VSI to be excluded <u>absent</u> any special preconditions. (Under both Reg. Z and the model 1974 UCCC, if the specifically required preconditions are not met, the charge is a finance charge.)

The closest to a legislative history that exists for the ICCC is a commentary by the academic and NCUSL drafters aiding the Iowa legislature in crafting the ICCC. It states that "the conservative approach is obvious – if VSI is purchased by a creditor, it should not be passed along to the consumer as an additional charge." Nathaniel E. Butler and George J. Wallace, "A Compliance Guide to the Iowa Consumer Credit Code," p. 4.2 (Iowa Bankers Association, 1974).

VSI as surcharge in addition to mandatory dual interest property insurance/default coverage:

Both of the policies you forwarded, as well as other policies we have seen, the blanket VSI coverage is in addition to a requirement of mandatory property insurance on the collateral which protects the creditors' interest.

The company policy contains this provision:

> **Underlying Insurance** – all **Loans** must contain a provision requirement the **Borrower** to procure and maintain insurance covering the **Insured's** [i.e. creditor's] interest in the **Collateral.** (Section VIII-1)

Under the policy, the "All Risk Physical Damage Installment Loan Insurance" ("Coverage A") is one of four types of coverage. The other three are credit-risk coverages of some type. This policy includes a precondition for Coverage A similar to the Ohio Indemnity policy:

> PRIMARY INSURANCE – COVERAGE A – It is understood and agreed that the Named Insured [creditor] will require all borrowers to agree to carry physical damage insurance with loss payable clause in favor of the Named Insured, for such insurance and in such amounts as normally would be required had not this insurance been effected. Failure on the part of the borrower to provide such insurance shall not be deemed a violation of this Policy provided the Named Insurance [sic] has obtained agreement from the borrower to carry insurance. (Paragraph 15)

Typically, RISCs with a contractual requirement for mandatory property insurance on the collateral also permit the lender/secured party to purchase force-placed insurance to supply that mandatory coverage in the event the borrower fails to keep the policy in force. (See ICCC § 537.2506.)

Both policies clearly state that loss or damage to the collateral is not sufficient to trigger coverage; both only provide coverage in the event of the borrower's default. The policy provides:

> "**Loss** means tangible physical damage, destruction or theft of **collateral,** which would describe a "property" insurance. Section II-9 [Supplemental endorsements add confiscation, skip, and non-filing coverage.[1]] However, the conditions precedent require that all of the following have occurred:

[1] The first two appear to take their cue from Reg. Z, OSC §226.4(d)-10, but see below regarding the non-filing coverage.

1. *There has been a default by the borrower in payment*;

2. There has been an impairment of interest, i.e. the value of the collateral is less than the loan balance;

3 The lender has repossessed "<u>all</u> collateral" securing the loan; (deemed date of notice of loss if repossession impossible, after reasonable effort, due to unrecovered theft or total destruction of collateral.)

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5. The insured has exhausted all collection efforts against any insurance company or other party that may be obligated to compensate for the loss. (Section III, Emphasis added.)

The policy provides

> IMPAIRMENT OF INTEREST – Under no circumstances will any payment be made for a loss under this Policy unless the interest of the Named Insured is impaired *by reason of the borrower having defaulted in his obligation to the Named Insured.* (Emphasis added.) (Paragraph 16)
>
> LOCATION OF VEHICLE - COVERAGE A – As respects damage, it shall e [*sic*] necessary for the named Insured to locate and to take title to the vehicle or be in a position to convey good title to the Company upon demand, before any loss shall be paid under this coverage." (Paragraph 17)

In Informal Advisory # 86, we quote the text describing the type of VSI which requires that "the loan must be in default and the property repossessed" for benefits to be payable, and "the lender must require the borrower to carry insurance." The policies you provided clearly are of this sort. Looking at substance, not form, we believe that this is primarily a credit loss / default coverage, not primarily insurance against damage or loss to the collateral.

<u>Assignee-required VSI</u>: Your question does not indicate whether the banks which have contacted you are direct lenders or indirect lenders. We have been informed in the past by some dealers that indirect lenders impose the requirement for the VSI surcharge, in addition to the usual requirement for the standard property coverage with a loss-payable clause in favor of the secured party. When, as is the case with these policies, there is already property insurance on the collateral which covers the lender's/secured party's interest in the collateral, it raises a serious question as to whether the piggy-backed VSI surcharge required by an indirect lender is more properly analyzed under Reg. Z, 226.4(b)(6), rather than 226.4(d)(2), when passed on separately

to the borrower.[2]

Repossession Coverage

The fourth of the policy's coverage is for "Repossessed Vehicles Insurance." (Coverage D). We would note that even under the Reg. Z Official Staff Commentary, repossession insurance does not "constitute single-interest insurance for purposes of the regulation, and premiums for them do not qualify for exclusion from the finance charge under section 226.4(d)." OSC 226.4(d)-10.

Non-filing Coverage

TIL: Finally, both policies you forwarded include non-filing coverage as part of the policies. Under TIL, the rules for excluding the cost of non-filing coverage (Reg. Z, 226.4(e)(2)) are different than the rules for excluding the cost of VSI insurance (Reg. Z, 226.4(d)(2).) As you may recall, the actual claims practices relating to non-filing coverage must be examined to determined if it is true non-filing insurance, or such in name only. *Edwards v. Your Credit*, 148 F.3d 427 (5th Cir. 1998); *Adams v. Plaza Finance Co.*, 168 F.3d 932 (7th Cir. 1999). Given the history of problems with this coverage, it would seem imprudent for a regulator to make a blanket statement about how the inclusion of this coverage may affect characterization of the premium. The Official Staff Commentary requires that a policy which includes both excludable and non-excludable charges be separated, and the non-excludable charges included in the finance charge, unless the total premium attributable to that portion of the coverage is $1.00 or less, (or $5.00 or less in the case of a multi-year policy.)

ICCC: The ICCC does not have a corollary to Reg. Z, §226.4(e)(2), to exclude non-filing fees.

Thank you for your inquiry. If you have further questions, please do not hesitate to contact me.

Sincerely,

Kathleen E. Keest

Assistant Attorney General
Deputy Administrator, Iowa Consumer
Credit Code

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[2] "Charges imposed on a creditor [the person to whom the obligation is payable on its face] by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation."