Threat of service contract regulation looms

Insurance regulators are turning their attention to service contracts and raising concerns about how they are regulated and whether these products should be categorized as insurance.

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Recent changes in the political landscape have landed us in an era of increased scrutiny of the F&I industry.

Early concerns about the Consumer Financial Protection Bureau overstepping its regulatory authority are somewhat curbed at this point, but a new challenge is looming. Insurance regulators are turning their attention to service contracts and, once again, raising concerns about how they are regulated and whether consideration should be given to recategorizing these products as insurance.

The National Council of Insurance Legislators Property and Casualty committee convened this summer and explored the topic of service contracts. Understanding the general differences between warranties, service contracts and insurance was discussed, as was the size of the warranty market. A point was raised about the importance of claims and loss history, followed by a state representative's remark that states should perhaps be collecting this data on service contracts.

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Cause for concern?

Do these points of discussion cause you concern? They should. Though no concrete legislative action has yet resulted from this meeting, there are red flags waving that we shouldn't ignore.

As longtime industry professionals know, the issue of product classification was addressed in a seemingly satisfactory manner with the NAIC Model Act in 1997. However, it now appears ripe to be revisited as concerns such as the rise in robocalls and the proliferation of service contracts offered through big box stores and other retailers have thrust consumer protection back into the spotlight.

As recently noted by the Motor Vehicle Protection Products Association, it is "always a dangerous discussion to be discussing retail cost and claims costs in a legislative environment, as we have all seen over the years."

Change happens slowly, of course, but here are the key points to consider:

- Service contracts are distinct from insurance and have been carved out from insurance products, though they may be governed by the Department of the Interior or another regulatory agency.
- Service contracts are also subject to consumer protection laws.
- If classification is revisited, states that do not currently regulate service contracts as insurance, or at all, may do so.
- In addition, states that already regulate them could do so more stringently.
- There will likely be a high cost and increased red tape for all involved.

Let's review the worst-case scenario: Should vehicle service contracts be recategorized as insurance, all F&I providers and sellers (dealers) would have no choice but to form

licensed insurance companies. This would require a rigorous licensure process as well as licensing requirements in every state.

On the financial side, there would be a greater need for capital and surplus. And dealers may be unable to participate in their products in the same meaningful way without additional burden.

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No reason to change

At DOWC, we take the position that the NAIC excelled at crafting the Model Act and regulators' reliance on it is well placed. Financial security requirements and other criteria for licensure implemented by the states are sufficient to ensure consumers are protected, and we see no need for change now. It is critical for dealers to be aware of this issue and the potential impact of any regulatory change along these lines. Make it a point to remain vigilant, continue to educate yourself as the topic continues to be discussed in the industry and speak with your lobbying group as you see fit.

As always, DOWC's priority is to protect dealers' best interests. As such, we will strongly resist any change to current product categorization, thereby protecting dealers' opportunity to participate fully and build their own wealth.