



MOTOR VEHICLE ADVISORY BULLETIN

Debt Cancellation Agreements Overview & Interim Guidance

Overview

Under Senate Bill 1966, a retail seller, in connection with a retail installment transaction subject to Chapter 348, may now offer a retail buyer a debt cancellation agreement. "Debt cancellation agreement" is defined as:

[A] retail installment contract term or a contractual arrangement modifying a retail installment contract term under which a retail seller or holder agrees to cancel all of part of an obligation of the retail buyer to repay an extension of credit from the retail seller or holder upon the occurrence of the total loss or theft of the motor vehicle that is the subject of the retail installment contract but does not include an offer to pay a specified amount on the total loss or theft of the motor vehicle.

A retail seller cannot require a retail buyer to purchase a debt cancellation agreement as a condition of purchasing a motor vehicle on a retail installment contract.¹ The retail seller, in addition to other disclosures required by state or federal law, must provide to the retail buyer a separate notice in connection with the retail installment contract stating that the retail buyer is not required to accept or provide a debt cancellation agreement in order to purchase the motor vehicle under a retail installment contract.²

A retail installment contract may include an amount for a debt cancellation agreement as a separate charge in a retail installment contract if the agreement is included as a term of a retail installment contract.³ This makes a debt cancellation agreement different from other products whose charges are included in a Chapter 348 retail installment contract. The purchase and sale of a debt cancellation agreement modifies the retail installment contract, thereby obligating any holder. In other words, a debt cancellation agreement sold in connection with a retail installment contract becomes a part of the contract. In contrast, most other products that may be included in a Chapter 348 retail installment contract are considered "add-on" products that do not modify the retail installment contract itself.

Proposed Rules

The amount charged for a debt cancellation agreement made in connection with a retail installment contract must be reasonable.⁴ At its August meeting, the Texas Finance Commission voted to publish for comment rules on reasonableness of charges for debt cancellation agreements subject to Chapter 348 retail installment contracts. These proposed rules will appear in the September 4, 2009 issue of the *Texas Register*, available at: <http://www.sos.state.tx.us/texreg/index.shtml>. The comment period for these rules will expire so close to the October meeting for the Finance Commission that the adoption of the rules will probably not be considered until the December meeting.

¹ Texas Finance Code §348.124(a).

² Texas Finance Code §348.124(d).

³ Texas Finance Code §348.208(b)(6).

⁴ Texas Finance Code §348.124(c).

Interim Guidance*

The amendments to the Texas Finance Code contained in Senate Bill 1966 became effective on September 1, 2009; therefore, retail sellers may begin offering and selling debt cancellation agreements in connection with Chapter 348 retail installment contracts on September 1, 2009. The statutory changes mandate that the retail seller only contract for, charge, and receive an amount that is "reasonable" for the debt cancellation agreement. (Please note that Senate Bill 1966 does not remove a retail seller's ability to sell GAP insurance.)

If a retail buyer challenges the amount charged for the debt cancellation agreement, the analysis will be a totality of the circumstances. All aspects of the retail installment contract and its collateral will be taken into consideration by the fact-finder and may include:

- Downpayment amount;
- Cash price amount in relation to value of the vehicle;
- Remaining term of the retail installment contract;
- Finance charge rate (e.g. "contract rate");
- Existence of insurance or other insurance-type products and relation to debt cancellation agreement;
- Terms, conditions, and limitations of the debt cancellation agreement; and
- Vehicle depreciation rate.

The Office of Consumer Credit Commissioner will, at a minimum, consider a debt cancellation agreement fee that is in conformity with the rules published for comment by the Texas Finance Commission to be reasonable. In order for the fee to be in conformity with the rules, the terms of the debt cancellation agreement must also agree with the terms provided in the rules on debt cancellation that were published for comment. Other amounts charged for debt cancellation agreements may be reasonable, but the reasonableness must be analyzed according to the criteria discussed above.

The rules on debt cancellation agreements have only been published for comment and have not been adopted by the Texas Finance Commission. A person operating in compliance with rules that have not been adopted will not have the protection of adopted rules. Without the adoption by the Texas Finance Commission, any retail seller or holder who sells a debt cancellation agreement in conformity with the published rules will not have the safe harbor that the retail seller would have if the debt cancellation agreement were sold in conformity with adopted rules. A successful challenge and finding that an amount charged for a debt cancellation agreement was not reasonable could possibly result in the assessment of Chapter 349 penalties.

**This guidance will remain in effect until the adoption of permanent rules by the Finance Commission relating to debt cancellation agreements.*