



Motor Vehicle Sales Finance Act: Guaranteed Automobile Protection (GAP) Contracts

Prepared by the Michigan Financial Institutions Bureau
Policy and Legislation Division

Position Statement

- Because the guaranteed automobile protection (“GAP”) contract is insurance, its costs can be financed through a motor vehicle installment sale contract as insurance.
- The premium for such insurance may be financed through a motor vehicle installment sale contract in the same manner that credit insurance premiums are currently financed.
- Installment sellers under the Motor Vehicle Sales Finance Act (“MVSFA”) may offer the GAP contract to installment buyers, whether or not a fee is charged, if (1) the contract is an Insurance Bureau approved contract of insurance and (2) the installment seller is in full compliance with all applicable insurance law.
- Persons who are not “installment sellers” or “sellers” under Section 2(4) of the MVSFA, and who are not otherwise prohibited under Section 31(c) of the MVSFA, may share in the premiums or profits derived from the sale of GAP contracts to installment buyers.

What is a “GAP” Contract?

In many situations the insurance proceeds derived from a total loss claim made against the borrower’s or lessee’s collision/comprehensive insurance policy are insufficient to pay off the loan balance or lease payment(s) owed upon a motor vehicle. This deficiency creates a “gap” between the balance owed on the installment sale or lease contract and the

amount of insurance proceeds payable under the claim. In such situations, it is the obligation of the borrower or lessee to pay this deficiency.

Generally, the GAP contract¹ provides that in the event a borrower or lessee suffers a total loss of a motor vehicle that is the subject of a GAP contract, the lender or lessor will cancel the underlying debt to the extent reduced by the amount of insurance proceeds received by the borrower and paid over to the lender because of the loss or that could have been received if the borrower had insured the motor vehicle.

“GAP” Contracts Are Contracts of Insurance

Whether referred to as “GAP,” “debt cancellation,” or a similar name, the Michigan Insurance Bureau considers these contracts of insurance which fall under the Insurance Bureau’s regulatory jurisdiction.

If you are considering the purchase of a GAP contract or the marketing of these insurance products, please confirm that the Michigan Insurance Bureau has approved the contract. You may contact the Insurance Bureau at (517) 373-9273 if you have a question regarding a product presented to you. If you sell or enroll individuals in a program that has not been approved, you may be in violation of the Michigan Insurance Code and subject to penalties under that code.

Who Can Offer GAP Contracts?

Installment sellers under the Motor Vehicle Sales Finance Act (“MVSFA”) may offer the GAP contract to installment buyers, whether or not a fee is charged, if (1) the contract is an Insurance Bureau approved contract of insurance and (2) the installment seller is in full compliance with all applicable insurance law.

¹ GAP contracts are often referred to as “debt cancellation contracts” or some similar phrase.

Because the MVSFA does not regulate motor vehicle lease contracts, installment sellers may offer their lease customers² GAP contracts for a fee, provided they have fully complied with applicable insurance law.

Additionally, consumers may purchase GAP contracts directly from insurance companies without going through an installment seller or dealer-related agency.

Can GAP Contracts be Financed?

The costs or fees that may be charged to an installment buyer are set forth with specificity in Section 17 of the MVSFA. However, none of the costs or fees recited in Section 17, other than the phrase “cost of insurance premiums,” references or describes the costs charged for GAP contracts.

Because the MVSFA does not contain any provision for or reference to any cost or fee equivalent to the cost charged for a GAP contract, it is clear that the MVSFA only allows for the payment of GAP contract charges through an installment sale contract if such charges are the “cost of insurance premiums.”

Section 16(a) of the MVSFA permits the installment seller and installment buyer to enter into a GAP contract because it is a contract of insurance.³ Section 17(a) and (c) of the MVSFA permit the installment seller to include the cost of the premium charged for a GAP contract in the principal amount financed under the installment sale contract.

It should be noted that, installment sellers cannot circumvent the provisions of the MVSFA by requiring installment buyers to pay GAP contract charges independently of installment sale contracts by

² However, lease transactions in which “. . . the lessee contracts to pay as compensation a sum substantially equivalent to or in excess of the value of the motor vehicle, and any other form of contract that has a similar purpose or effect” may be determined by the Bureau to be an “installment sale contract” and subject to provisions of the MVSFA.

³ All forms of GAP are contracts of insurance. Any insurer, agent, and installment seller offering GAP contracts or other debt cancellation agreements must comply with all applicable provisions of the Michigan Insurance Code and rules promulgated by the Commissioner of Insurance.

accepting cash and omitting such payments from the “amount financed.” Sections 12(a) and (b) of the MVSFA require that installment sale contracts be in writing and contain all essential terms. Section 13(2)(4) of the MVSFA requires that all installment sale contracts made under the MVSFA must separately state in the contract any insurance premiums charged to the borrower.

Can Installment Sellers Licensed Under the MVSFA Make a Profit On the Sale of GAP Contracts?

Installment sellers may not benefit directly or indirectly from enrollment of borrowers in any GAP contract or charge a higher premium to the borrower than was charged to the installment seller by the insurance agency. Section 31(c) of the MVSFA provides in pertinent part that:

“An insurance company, agent, or broker shall not pay or cause to be paid, directly or indirectly, to any installment seller, *nor shall any installment seller receive from any insurance company, agent, or broker, any portion of an insurance premium involved in the retail installment sale of a motor vehicle other than for the benefit of the installment buyer . . .*”

The Section 31(c) prohibition on insurance premium sharing not only prohibits an insurance company from using such premiums to pay sales commissions to installment sellers, but also prohibits the insurer from reimbursing the installment seller's actual costs incurred in connection with the sale of such insurance to the installment buyer. All payments made by an installment buyer to an installment seller for the cost of GAP contract premiums must be paid over in total to the insurer. The installment seller may not share in any portion of these payments.

What Penalties Accrue for Violations of the MVSFA?

The provision in an installment sale contract for the payment of any unauthorized costs, fees or charges to the installment seller by the buyer is prohibited.

Section 32 of the MVSFA provides that:

“No act, agreement or statement of any buyer in any installment sale contract shall constitute a valid waiver of any provision of this act intended by the legislature for the benefit or protection of retail installment buyers of motor vehicles.”

Further, Section 31(d) of the MVSFA provides:

“Whenever in any installment sale contract under this act the seller or any subsequent holder has charged, contracted for, collected or received from the buyer any prohibited costs, fees or charges in connection with such contract, all the costs, fees and charges in connection with such contract, other than for insurance, shall be void and unenforceable and any amounts paid by the buyer for any such costs, fees and charges other than insurance, shall be applied on the principal of such contract.”

Thus, Section 31(d) of the MVSFA provides not only that all prohibited costs, fees or charges are void and unenforceable, but also any prohibited costs, fees or charges paid by the buyer shall be applied on the principal of such contract. Moreover, even when such “other costs” are authorized under Section 17(d) of the MVSFA, such costs cannot exceed the actual amount the seller expends or intends to expend and any amounts not disbursed by the seller “shall be immediately refunded or credited to the buyer.”

The Legislature has made the willful or intentional violation of any provision of the MVSFA a crime by providing in Section 37(b) of the Act that:

“Any licensee conducting business under this act as an installment seller, sales finance company or any owner, partner, member, officer, director, trustee, employee, agent, broker or representative thereof *who shall willfully or intentionally violate any provision of this act*, or shall direct or consent to such violation, *shall be guilty of a misdemeanor*, and upon conviction thereof shall be sentenced to pay a fine of not more than \$500.00 for the first offense; and for each subsequent offense a like fine and/or suffer imprisonment not to exceed 1 year in the discretion of the court.”

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Questions regarding this pamphlet may be directed in writing to the **Michigan Financial Institutions Bureau**, Office of Policy and Legislation, 333 South Capital Avenue, Suite A, P. O. Box 30224, Lansing, Michigan 48909 or by telephone to DJ Culkar, Office of Policy and Legislation, at **(517) 373-8674**.

Questions regarding GAP insurance, underwriters, or agents may be directed to the **Michigan Insurance Bureau** by telephone at **(517) 373-9273**.