

Does the Consumer Financial Protection Bureau Have Jurisdiction Over Extended Warranties and Service Contracts?

Author: Brian T. Casey // T: 404-870-4638 // bcasey@lockelord.com

Once it became operational after its creation under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),¹ the Bureau of Consumer Financial Protection (more commonly known as the CFPB) has demonstrated an aggressive nature in protecting consumers that purchase and policing businesses that sell consumer financial products and services. Although up until July 16, 2013, when the U.S. Senate confirmed his appointment, the CFPB's first appointed Director's status had been in a state of limbo based on the recently decided *Noel Canning v. National Labor Relations Board*² federal case's holding that three of the National Labor Relations Board's Commissioners were not properly appointed by the President during a Congressional Recess, the same method by which CFPB Director Richard Cordray become appointed, the CFPB has been charging ahead in pursuit of its mission. To date, the CFPB has promulgated approximately 38 new or amended final regulations with about 11 more proposed new or amended regulations pending within their notice and comment periods, levied significant fines against certain credit card companies³ and forced-placed insurance companies and recently announced its first criminal case.⁴

In addition to its recent fines against four forced-placed insurance companies, imposed by the CFPB through the exercise of its authority to enforce federal consumer financial laws such as here the Real Estate Settlement Practices Act,⁵ the CFPB on the same basis has waded into the insurance area with its newly promulgated regulation governing residential mortgage loan servicers' obligations when effecting forced-placed insurance policies.⁶ While this type of loan is clearly within the regulatory purview of the CFPB⁷ and thus provides a nexus for it to assert jurisdiction over that type of insurance product given its inextricably tied nature to a residential mortgage loan, there may be other types of insurance or insurance-like products which the CFPB could attempt to regulate as it continues to plow the field of the limits of its territory, notwithstanding that the "business of insurance" is generally outside the CFPB's regulatory jurisdiction. This article examines whether extended warranties, which are usually termed "service contracts" under state statutes generally found within state insurance codes, may be susceptible to intrusion by the CFPB. Extended warranties and service contracts cover a wide variety of underlying consumer products from automobiles, home appliances, computers, jewelry, televisions, stereo equipment to cellphones. To the extent an extended warranty or service contract is sold (and oftentimes financed) in connection with a loan within the CFPB's purview (e.g., residential mortgage loan or auto purchase loan), the ability of the CFPB to assert its jurisdiction over them is heightened.

The CFPB's jurisdiction applies to a consumer financial product or service.⁹ Subject to certain exemptions, a consumer financial product or service means certain financial products or services that are offered for use by consumers primarily for personal, family, or household purposes. The Dodd-Frank Act enumerates 10 types of consumer financial products or services, which are:

1. Extending credit and servicing loans;
2. Extending and brokering personal or real property leases having the functional equivalency of purchase finance arrangements;
3. Providing real estate settlement services;

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4. Taking deposits, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a customer;
 5. Selling or providing stored value or payment instruments, with certain exceptions;
 6. Providing check cashing, collection or guaranty services;
 7. Providing payments or other financial data processing products or services, with certain exceptions;
 8. Providing financial advisory services (except to the extent regulated by the Securities and Exchange Commission or a state securities commission);
 9. Providing consumer reports, with certain exceptions; and
 10. Collecting consumer debt.¹⁰

Service contracts and extended warranties do not fall within any of the above-referenced products or services.

In addition, the CFPB has the power to include by regulation additional financial products or services if it determines that they either (a) have the purpose of evading any federal consumer financial law, or (b) are permissible for a bank or financial holding company to provide under federal law or a regulation and have, or are likely to have, a material impact on consumers.¹¹

Assuming the CFPB can successfully build the case for proceeding to define service contracts and extended warranties as consumer financial products or services (which is a significant assumption and would likely have to be based on the argument that it is permissible for a bank to provide service contracts and extended warranties), there remains another steep hurdle that the CFPB must clear: a financial product or service does not include the business of insurance.¹² For purposes of the Dodd Frank Act's CFPB provisions, the "business of insurance" means writing insurance or reinsuring insurance risk, including all acts necessary thereto.¹³ Moreover, the Dodd-Frank Act expressly reinforces the proscription of the CFPB's jurisdiction in the insurance industry, stating that "[t]he Bureau may not define as a financial product or service, by regulation or otherwise, engaging in the business of insurance..."¹⁴ and disavows federal preemption of state insurance regulators' authority, by providing that "[n]o provision of [the Consumer Financial Protection Act of 2010] shall be construed as altering, limiting or affecting the authority of a State insurance commission or State insurance regulator under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or regulator."¹⁵ A "person regulated by a state insurance regulator means a person that is engaged in the business of insurance and subject to regulation by any State insurance regulator, but only to the extent that such person acts in such capacity."¹⁶

Note that Magnuson-Moss Act warranties are subject to regulation by the Federal Trade Commission (the "FTC"),¹⁷ and while the Dodd-Frank Act transferred certain powers of the FTC to the CFPB, the FTC's powers under the Magnuson-Moss Act were not so transferred. In addition, while historically the FTC has refrained from regulating extended warranties and service contracts, as recently as 2011 when it published a request for comments for updating the FTC's interpretations of its Rules 701-703, the FTC asked whether those rules should be amended to include extended warranties and service contracts.¹⁸ Thus, even the FTC has considered whether it may have the power, and ought, to regulate extended warranties and service contracts, which is a reference point on which CFPB could latch.

Accordingly, whether the CFPB has jurisdiction to add to its oversight scope extended warranties or service contracts as another consumer financial product or service turns on whether extended warranties or service contracts constitute the business of insurance, which should invoke the McCarran-Ferguson Act¹⁹ and its body of case law. The McCarran-Ferguson Act reverse preempts any federal statute that invalidates, impairs or supersedes any state law enacted for the purpose of regulating the business of insurance, unless such federal statute specifically relates to the business of insurance. In contrast to the McCarran-Ferguson Act, the Dodd-Frank Act has codified the definition of the "business of insurance," but there are no references in the Dodd-Frank Act to the McCarran-Ferguson Act. Under the McCarran-Ferguson Act's judicial precedents, there is a tripartite test for determining what is the "business of insurance": (1) whether the business at issue has the effect of transferring or spreading the putative policyholder's risk, (2) whether the business at issue is an integral part of the

relationship between the putative insurer and insured and (3) whether the business at issue is limited to entities within the insurance industry.²⁰ Extended warranties or service contracts have been the subject of McCarran-Ferguson Act cases as well as cases and governmental agency rulings based on state or other federal laws testing whether these products are insurance in a variety of areas, such as whether they are insurance for (a) Magnuson-Moss Warranty Act purposes,²¹ (b) state sales tax purposes,²² (c) federal bankruptcy law purposes,²³ and (d) federal income tax purposes.²⁴ These cases represent a mixed bag as to the classification of extended warranties and service contracts as insurance or non-insurance products.

Under state insurance statutes, extended warranties or service contracts are essentially contracts which, but for their treatment under state service contract laws, would be insurance contracts where the obligor under the extended warranty or service contract is a third party – meaning not the manufacturer or a seller (wholesaler or retailer) of the underlying product in its supply and distribution chain. Therefore, state service contract laws deregulate extended warranties or service contracts from being classified as insurance contracts, but they are still regulated in most states within their state insurance codes by insurance departments. Importantly, the vast majority of the state service contract acts wholesale exempt extended warranties or service contracts as being insurance,²⁵ while a few of the other state service contract acts provide that extended warranties or service contracts are not subject to the insurance code except for certain retained provisions of applicability, such as the unfair claims settlements or unfair trade practices acts within state insurance codes,²⁶ thereby making these products insurance contracts at least in part for purposes of such retained provisions of an insurance code. Nevertheless, some cases have held that service contracts are insurance,²⁷ while cases others have found that these products are not insurance,²⁸ for state insurance law purposes.

Automobile dealers, many of which also sell motor vehicle service contracts, have their own specific exemption under the Consumer Financial Protection Act of 2010. The CFPB is prohibited from exercising its authorities over a motor vehicle dealer that is predominantly engaged in selling or leasing and servicing motor vehicles,²⁹ except to the extent that a motor vehicle dealer is involved in extending retail credit or retail leases for motor vehicles directly with consumers and the credit or lease agreements are not routinely sold in secondary market transactions.³⁰ Motor vehicles include not only private passenger automobiles but also boats, motorcycles and motor homes.³¹ A motor vehicle dealer is a person who is licensed under state law to sell motor vehicles and owns or take physical possession of them.³² The CFPB recently fined a bank and an auto dealer aggregator that was the bank's primary servicer under their Military Installment Loans and Educational Services auto loan program for allegedly misrepresenting the true cost and nature of the coverage under vehicle service contracts and certain other related auto finance products in connection with subprime auto loans made to active duty military personnel, which required the military service persons to repay their loans using their military pay allotments.³³



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The fact that there are some cases which have held that extended warranties and service contracts are not insurance under state law or the McCarran-Ferguson Act should be a concern for the extended warranty and service contract industry should the CFPB attempt to regulate these products. Moreover, in attempting to thwart any such potential encroachment by the CFPB, the industry may find itself in the awkward position of having to argue that extended warranties and service contracts are insurance products to prevail under the business of insurance exemption to the CFPB's limitation of authority, which stands in stark contrast to the fact that most extended warranties and service contracts expressly disclaim that they are insurance and are exempt from the state insurance codes in many states. Finally, in the few states in which extended warranties and service contracts are not regulated by state insurance departments, but rather by another state agency, the

Consumer Financial Protection Act of 2010's business of insurance exception may not exist for these products.³⁴ Even if the CFPB were to fail in an attempt to classify service contracts and extended warranties as a consumer financial product or service, it could still try indirectly to exercise its consumer financial protection function powers over these products through Regulation Z where lenders finance their purchase or through its authority to preventing unfair, deceptive or abusive sales practices where lenders sell them, or by spinning issuers of service contracts and extended warranties as "service providers" to the lenders.

Endnotes

- 1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat 1376 (2010).
- 2 Noel Canning v. National Labor Relations Board, 705 F.3d 490 (D.C. Cir. 2013); cert granted 81 U.S.L.W. 3629 (U.S. June 24, 2013) (No. 12-1115).
- 3 See e.g., Consumer Financial Protection Bureau: American Express Travel Related Services Company, Inc. October 1, 2012. File No. 2012-CFPB-0004 (levying a CFPB fine of \$14.1 million and requiring \$85 million to be refunded to customers; Consumer Financial Protection Bureau: In the Matter of Discover Bank Greenwood, Delaware September 24, 2012. File No. 2012-CFPB-0005 (levying a CFPB fine of \$7 million and requiring \$200 million to be refunded to customers; and Consumer Financial Protection Bureau: In the Matter of: Capital One Bank, (USA) N.A. July 18, 2012. File No. 2012-CFPB-0001 (levying a CFPB fine of \$25 million and requiring \$140 million to be refunded to customers).
- 4 Consumer Financial Protection Bureau v. Radian Guaranty Inc., Case No.: 1:13-cv-21188 April 9, 2013 (levying a fine of \$3.750 million); Consumer Financial Protection Bureau v. United Guaranty Corporation, Case No.: 1:13-cv-21189 April 8, 2013 (levying a fine of \$4.5 million); Consumer Financial Protection Bureau v. Genworth Mortgage Insurance Corporation, Case No.: 1:13cv21183 April 4, 2013 (levying a fine of \$4.5 million); and Consumer Financial Protection Bureau v. Mortgage Guaranty Insurance Corporation, Case No.: 1:13-cv-21187 April 4, 2013 (levying a fine of \$2.65 million).
- 5 Consumer Financial Protection Bureau v. Mission Settlement Agency, et al. No. 13-3064 (SD NY filed May 7, 2013).
- 6 Dodd-Frank Wall Street Reform and Consumer Protection Act., Pub. L. No. 111-203, 124 Stat 1376 §1061; codified at 12 U.S.C. § 5581 (transferring to the CFPB the consumer financial protection functions of the Board of Governors of the Federal Reserve, Comptroller of the Currency, Director of the Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, and Department of Housing and Urban Development relating to the Real Estate Settlement Procedures Act of 1974, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 and the Interstate Land Sales Full Disclosure Act.
- 7 Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act; Federal Register, Volume 78 Issue 31 Pages 10695-10899 (February 14, 2013) to be codified at (Regulation X, 12 CFR 1024).
- 8 Dodd-Frank Wall Street Reform and Consumer Protection Act., Pub. L. No. 111-203, 124 Stat 1376 §1002(15)(A)(i) (2010); codified at 12 U.S.C. § 5481(15)(A)(i).
- 9 id, § 1002(5); codified at 12 U.S.C. § 5481(5).
- 10 id, § 1002(15)(A)(i)-(x); codified at 12 U.S.C. § 5481(15)(A)(i)-(x).
- 11 id, § 1002(15)(A)(xi); codified at 12 U.S.C. § 5481(15)(A)(xi).
- 12 id, § 1002(15)(C)(i); codified at 12 U.S.C. § 5481(15)(C)(i).
- 13 id, § 1002(3); codified at 12 U.S.C. § 5481(3).
- 14 id, § 5517(M); codified at 12 U.S.C. § 5517(m).
- 15 id, § 5552(D)(3); codified at 12 U.S.C. § 5552(d)(3).
- 16 id, § 5481(22); codified at 12 U.S.C. § 5481(22).
- 17 15 U.S.C. §§ 41-58 and 15 U.S.C. §§ 2301 et seq.
- 18 Federal Trade Commission, Request for Comment Concerning Interpretations of the Magnuson-Moss Act Warranty Act, Federal Register, Vol. 76, No. 163 (August 23, 2011).
- 19 McCarran-Ferguson Act Pub. L. No. 79-15, 59 Stat 33 (1945); codified at 15 U.S.C. §§1011-1015.
- 20 U.S. Dept. of Treasury v. Fabe, 508 U.S. 491 (1993), citing Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982).
- 21 See e.g., Kennedy, et al. v. Butler Financial Solutions, LLC, et al., 2009 U.S. Dist. Lexis 8303 (N.D. Ill. 2009) (holding that a vehicle service contract is not insurance only if the service contract provider complies with the state service contract act, and if there is such compliance, the vehicle service contract is subject to the Magnuson-Moss Warranty Act because the contract is not insurance).
- 22 See e.g., Jim Clark Ford v. City of Tucson, 154 Ariz. 48(Ariz. Ct. App. 1987) (holding that a vehicle service contract was insurance and thus exempt from local sales tax).
- 23 See e.g., In Re: Automotive Professionals, Inc. 379 B.R. 746 (Bankr. N.D. Ill. 2007) (affirming the bankruptcy court's decision that the debtor service contract provider was eligible for protection under the federal bankruptcy code and not an insurance company, which is ineligible and subject to state insurance company insolvency law) and In Re: First Assured Warranty Corp. 383 B.R. 502 (Bankr. D. Colo. 2008) (holding that vehicle service contract provider was not a domestic insurance company under the Colorado Insurance Code for purposes of the federal bankruptcy code and thus was an eligible debtor thereunder).
- 24 See e.g., IRS PLR 201314020 (December 19, 2012) and PLR 201004004 (October 19, 2009) (each holding that vehicle service contracts constitute insurance contracts for federal income tax purposes).
- 25 See e.g., Ark. Ins. Code § 4-114-102 (b), Ky. Rev. Stat. § 304.5070 (q) (expressly stating that a service contract shall not construed as the business of insurance), Miss. Code § 75-24-91, Mo. Code Regs. § 385.220.1 (expressly stating that service contract providers and administrators are not deemed to be engaged in the business of insurance), Okla. Stat. tit. 15, § 141.2 14.f. and Tex. Occ. Code § 1304.005 and Va. Code § 59.1-436.
- 26 See e.g., Ala. Code § 8-32-2 (13), Ariz. Ins. Code § 20-1095.10 (C), Minn. Stat. § 59B.03 and N.M. Stat. § 59A-58-8.
- 27 See e.g., McMullan v. Enterprise Financial Group, Inc., 247 P.3d 1173 (Okla. Sup. Ct. 2011) (holding that a vehicle service contract is insurance for insurance bad faith law purposes).
- 28 See e.g., Griffin Systems, Inc. v. Ohio Dept. of Ins., 575 N.E.2d 803 (Ohio Sup. Ct. 1991) (holding that vehicle service contracts are not contracts "substantially amounting to insurance").
- 29 Dodd-Frank Wall Street Reform and Consumer Protection Act., Pub. L. No. 111-203, 124 Stat 1376 § 1029(a); codified at 12 U.S.C. § 5519(a).
- 30 id, § 1029(b); codified at 12 U.S.C. § 5519(b).
- 31 id, § 1029(f)(1); codified at 12 U.S.C. § 5519(f)(1).
- 32 id, § 1029(f)(2); codified at 12 U.S.C. § 5519(f)(2).
- 33 Consumer Financial Protection Bureau: In the Matter of Dealers' Financial Services, LLC, Lexington Kentucky June 25, 2013. File No. 2013-CFPB-0004. The CFPB has authority over service providers of "covered persons" who offer or provide a consumer financial product or service. Dodd-Frank Wall Street Reform and Consumer Protection Act., Pub. L. No. 111-203, 124 Stat 1376 § 1031(a); codified at 12 U.S.C. § 5531(a).
- 34 See e.g., Cal. Business and Professions Code §§ 98000 et. seq. and Tex. Occ. Code §§ 1304.001 et seq.

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About the Author



Brian T. Casey is a partner in the Atlanta office of Locke Lord LLP.

As co-leader of Locke Lord's Regulatory and Transactional Insurance Practice Group, and a member of the firm's (a) Corporate, (b) Capital Markets and (c) Health Care Practice Groups, Mr. Casey focuses on (i) corporate, (ii) merger & acquisition, corporate and structured finance and other transactional, and (iii) regulatory matters for corporate clients in the insurance, financial services and health care industries. One significant facet to Mr. Casey's practice is a focus on insurance-linked securities and related insurance capital markets transactions. His clients include insurance companies, insurance holding companies, managing general agents and insurance agencies, third party and claims administrators, banks and other financial institutions, investment banks and reinsurance companies.



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