Ebook

2025

From Afterthought to Strategic Approach:

A guide to establishing an ancillary product refund process

Financing and managing the lifecycle of optional ancillary voluntary protection products, such as GAP and other product contracts, can be challenging. Auto loan servicers—including captives, auto finance companies, banks, and credit unions—face increasing regulatory pressure to calculate and issue product refunds to borrowers. This resource guide offers a proactive, strategic approach to help you respond effectively.

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Introduction

Financial institutions are in the regulatory crossfire: caught between adapting to increasing scrutiny around lending best practices and supporting their borrowers' financial wellbeing throughout the life cycle of their auto loan.

While servicing auto loans (both direct and indirect), financial institutions often facilitate the lifecycle of add-on products consumers purchase at the onset of the auto loan. In many cases and for various reasons, these products may require a cancellation of service. When a product is cancelled before the consumer receives the full and original benefits, this poses the question,

"Who is responsible for ensuring the consumer receives a refund?"

According to many state and federal regulations, pending litigation, and emerging best practices, financial institutions bear this responsibility. In this ebook, we'll dive into why disregarding the responsibility is no longer an option, and how few lenders have the infrastructure to take on the refund process.

CHAPTER 1

Under the Spotlight: Ancillary Products

Regulations related to ancillary vehicle products are ever-changing. How do ancillary products affect lenders' portfolio risk management approach? This chapter answers just that.

Consumers often purchase ancillary products in addition to the auto loan financing, especially as vehicle prices rise. These ancillary products are typically serviced by a third-party vendor or product provider and may be purchased directly through the financial institution or indirectly through a dealer.

Ancillary products may also be known as:

- Vehicle Protection Products (VPP)
- Point of Sale (POS) products
- Aftermarket products
- Aftermarket services
- Extended warranties

Types of ancillary products can include:

- GAP (Guaranteed Asset Protection)
- DPW (Debt Protection Waiver)
- Credit Insurance (e.g. Credit Life, Credit Disability, Credit Property, Involuntary Unemployment Insurance)
- Vehicle Service Contracts (VSCs) such as extended warranties, and tire & wheel protection products

Pros and Cons for Financial Institutions

Ancillary products protect consumers and provide a level of assurance for their financed vehicle. For financial institutions, there are both benefits and challenges in providing support for these products. However, facets of ancillary products can become challenging.

Advantages and Opportunities:

- Value-add for consumer: Consumers can opt-in to purchase additional products that offer environmental protections, increased peace of mind, or to extend the life of the vehicle
- Increased revenue and organic growth: Ancillary products help boost additional loan volume and borrower retention
- Additional risk mitigation: These products help provide supplementary protection for financed collateral

Disadvantages and Drawbacks:

- Multiple stakeholders: Increased difficulty in navigating the relationship between lender, dealer, and product provider
- Lack of infrastructure: Burdensome need for software and technology to service products
- Changing compliance standards: Difficulty adjusting best practices and processes to meet evolving Federal and state guidance

If an ancillary product is cancelled before the borrower receives the full benefit, who is responsible for facilitating the refund?

New regulatory reviews are questioning this and it is known in the industry as **product refund liability**.

> ***Most early loan payoffs have an ancillary product attached.***

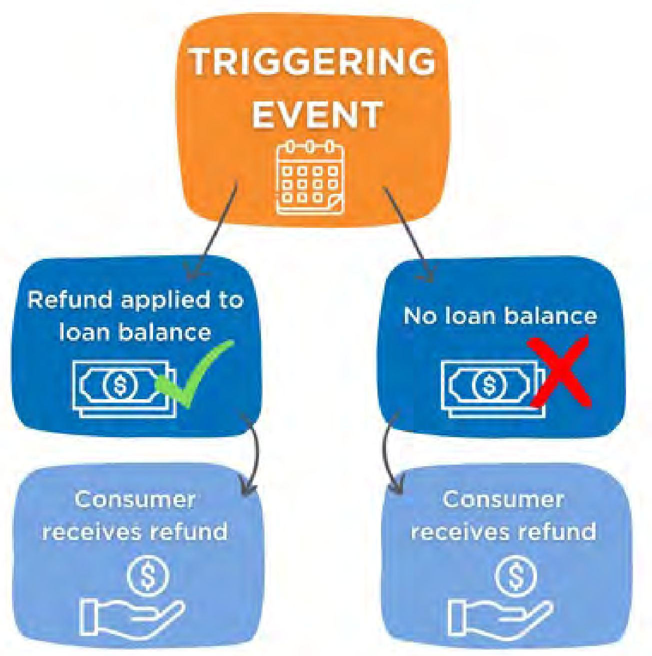
Product Refunds: Why is this happening?

There are a variety of triggering events that can cause an ancillary product to be cancelled prior to the loan's maturity date. Premature loan termination can be due to:

- Early payoff of loan
- Repossession of collateral
- Total loss of collateral
- Charge offs

The average GAP refund to the borrower is ***$400-$600****.*

When a triggering event occurs and the product is cancelled, it is likely that the ancillary product outlived the loan. In fact, as loan terms trend longer, most loans are paid off early and the majority of those loans have an ancillary product attached.[1] **When a triggering event occurs, a cash refund, or rebate, of the unused product may be due.** This refund may be used to cover a deficiency balance and/or the unused portion of the product.



For example, if a deficiency balance exists on the loan the product refund may be due to the financial institution holding the loan. The refund can then be applied to the loan balance. A refund applied to a deficiency balance is most likely the case for triggering events of repossession, abandonment, or total loss. If there are remaining funds after the balance is covered or if there was no deficiency balance, the consumer is eligible for a refund. For example, if a vehicle loan is paid off early a consumer may be eligible for a refund on the unused remainder of the ancillary product.

Challenges Impacting Borrower Experience

Lack of technology and infrastructure: Few lenders have the necessary infrastructure to handle this complex operation of managing all ancillary products in-house. Technology integrations are necessary to ease the burden of managing product cancellations to ensure accurate, and timely refund remittance to the consumer.

Increasing costs: The strain of the supply chain is immense and rising inflation is a growing risk to the future livelihood of many businesses and accountholders.

Increasing regulations: All financial institutions, regardless of size and location, may be subject to potential liability if effective processes aren't in place.

Staff shortages: Frontline employees felt the weight of the job market as many financial institutions minimize branch accessibility to consumers. Industry staffing attrition combined with these increasing regulations, has additional strain on balancing compliance with consumer expectation which may result in a negative impact to the consumer with errors or delays, which may equate to fines, penalties, or legal costs to the financial institution.

> ***All financial institutions, regardless of size and location, may be subject to potential liability if effective refund processes aren't in place.***

CHAPTER 2

Refund Regulatory Rundown

The regulatory landscape for ancillary products is changing, bringing along significant penalties. This chapter highlights the evolving regulations that financial institutions need to be aware of to navigate the changes and potential fallout of product refund liability.

The Current Regulatory Landscape for Financial Institutions

Staying abreast of the many changes affecting the regulatory landscape surrounding product refunds is challenging. One of those challenges is not all ancillary products are cancelled in the same way. Some ancillary products follow the lifecycle of the loan, and some follow the lifecycle of the vehicle. For example, in the event of repossession, all ancillary products must be cancelled, yet for an early loan payoff only certain products should be cancelled. The complexity of product cancellation continues to increase as state and Federal guidelines shift to the benefit and protection of the borrower.

The complexity of product cancellation continues to increase as state and Federal guidelines shift to the benefit and protection of the borrower.

Across all financial institution markets the liability, timeliness, and accuracy of product refunds are being called to question.

Who is responsible?

Currently, the regulatory scrutiny and repercussions are extending across the entire financial institution industry, including banks, auto finance companies, and credit unions of all portfolio sizes. However, this is the third time the CFPB promotes lenders making the refunds, regardless of state law.[2] In most cases, the cancelled product is not owned by the financial institution but is provided and serviced by a third-party provider or dealer. This increases the number of stakeholders and adds another layer of complexity to the process, particularly for the lender because the liability of the product refund falls to the lender.

When is the refund due?

Many state regulations vary on the required timeframe in which the consumer must receive their refund following a triggering event, ranging anywhere from a 60-day window to a 90-day window. These various regulations and timeframes make the cancellation and refund process complex and difficult to ensure compliance with various timeframes and negatively affect the borrower experience.

How is the final refund calculated?

How the final refund amounts are calculated is sometimes unclear and being called into question. Although sometimes state laws specify methodologies for calculating refunds (e.g. pro rata method, Rule of 78 etc.) miscalculations are still far too frequent. When a financial institution does not have ownership over the refund process, it is difficult to evaluate the accuracy of the refund amount and disbursement.

Important Compliance Factors: A shift in interpreting UDAAP

Back in 2019, the Consumer Finance Protection Bureau (CFPB) noted "unfair and deceptive practices regarding rebates for certain ancillary products" as a topic of current and upcoming regulatory scrutiny.[3] This supervisory highlight indicated a heightened focus on ancillary product refund management and liability, and it has come up more frequently since. Since the CFPB's expansion of UDAAP, several financial institutions in multiple states failed to refund unearned GAP fees to consumers who paid off their loans early. The results have been multiple class action lawsuits against the financial institutions. Interestingly enough, some of these lawsuits were filed in states that had previously remained silent on the issue of refund liability.

The CFPB's expansion of Anti-Discrimination through UDAAP should serve as a warning to lenders.

In many cases a consumer may not know that they are eligible for a refund. However, if a consumer is eligible for a refund but does not receive one, this can be considered a violation of UDAAP (unfair, deceptive, or abusive acts or practices). Additionally, if a refund is issued but not in a timely manner, the effect on the consumer could also be a violation of UDAAP. As indicated by the CFPB, "This applies in instances of default or total loss, and upon early payoff where the products no longer provide benefits at the termination of the loan. Servicers also identified and remediated consumers from all states who did not receive such refunds."[2] UDAAP violations can be impacted by state and/or Federal regulations and guidelines. It's important to keep in mind that maintaining compliance with state and/or Federal regulations does not guarantee compliance with UDAAP guidance and best practice.

Regardless of the origination of the ancillary product (either product provider, dealer, or financial institution), **the financial institution that authorizes or accepts the assignment of the loan on the collateral is being held liable for ensuring the consumer receives an accurate refund in a timely manner.** Even states without current laws addressing refund liability face product refund liability risk from plaintiff's attorneys and consumer friendly auditors. Thus, the compliance landscape of product refunds calls for transparency, efficiency, and accuracy. Financial institutions will continue to be scrutinized by regulators to ensure a compliant process for correct and timely consumer refunds.

Auditor scrutiny, financial penalties, and brand damage are causing many financial institutions to re-evaluate their processes. Often times, consumers are not receiving these refunds at all, or if they do, the refund is often inaccurate or slow to be issued.

The Spotlight is on GAP

Common Misunderstanding: GAP refunds are only provided in states where legally mandated.

Reality: This is false. GAP is gaining attention and controversy at the state and Federal level. As indicated by the latest CFPB Supervisory Highlights: "In response to these findings, servicers implemented processes to ***ensure consumers receive refunds of unearned premiums for ancillary products in all states, including those that do not mandate such refunds.*** This applies in instances of default or total loss, and upon early payoff where the products no longer provide benefits at the termination of the loan. Servicers also identified and remediated consumers from all states who did not receive such refunds."[6]

Scrutiny from the CFPB and certain state courts directed at financial institutions for GAP waivers indicates that more regulatory examination is coming. These GAP-related legal developments are impacting and will continue to impact business practices for auto loan servicing. All in all, GAP refunds are controversy and costly, requiring adequate infrastructure to manage.

Additional Compliance Factors

When discussing regulatory oversight in the auto industry, it's important to remember that the CFPB (Consumer Financial Protection Bureau) is not the sole enforcer of consumer protections. The FTC (Federal Trade Commission) also plays a critical role in safeguarding consumer rights and ensuring fair practices, as highlighted by its CARS Rule (Combating Auto Retail Scams). This rule addresses long-standing issues in auto sales and leasing, focusing on eliminating deceptive practices and promoting transparency.[7]

The Amplified Liability of Product Refunds

March 2019

The CFPB publishes a supervisory highlight regarding "unfair and deceptive practices rebates for certain ancillary products."

June 2021

Large national bank settled for $500M to end the GAP Insurance Class Action Lawsuit.

February 2022

California introduces new legislation regarding the sale and facilitation of GAP.

March 2022

Three credit unions in a single state collectively refund more than $6M in GAP fees to over 22,000 members.

September 2022

California AB 2311 and SB1311 are signed into law, making it the first state to take a strict stance on GAP waiver servicing.

June 2022

The FTC proposes new rule on "junk fees"

October 2023

The CFBP publishes a special edition Supervisory Highlight, focusing on add-on products and lenders that fail to or miscalculate refund amounts.

November 2023

Large auto finance business is fined $60M, paying out millions to borrowers who did not receive accurate refunds or did not receive refunds on GAP at all.

January 2024

FTC deems dealer has violated UDAAP regarding add-on products.

CHAPTER 3

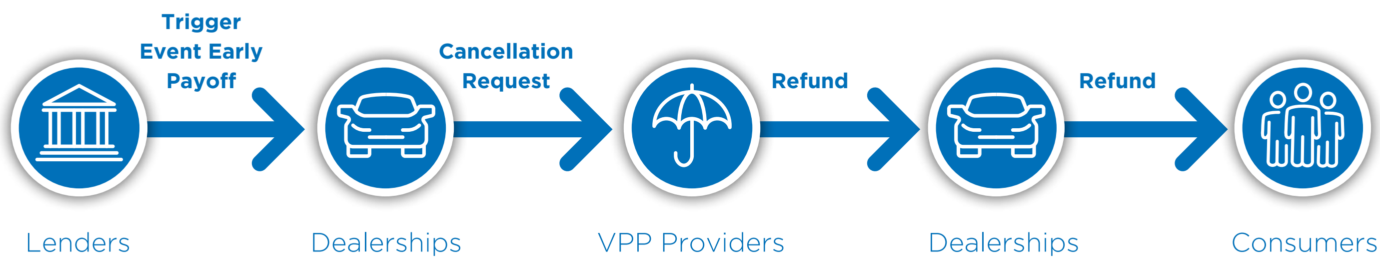
Revolutionizing Product Refunds

Few lenders have the immense infrastructure that is required to take on an audit-worthy, comprehensive refund process. This chapter offers an approach that solves for compliance and infrastructure concerns.

How to Get Started: Solving for Product Refund Liability Challenges

Historically, a financial institution would redirect the consumer to the dealership (or a product provider) to issue the correct refund amount. This approach is no longer best practice and it will not fulfill financial institutions' regulatory obligation.

HISTORICAL PRODUCT REFUND PROCESS



Alternatively, FIs have tried to build and manage the process internally. Managing the product refund process in-house is no small task. It requires:

- Significantly increasing staff resources
- Developing internal refund processes and clear business rules
- Ensuring internal legal, operations, and accounting teams are in sync with processes and changing Federal and state guidelines
- Tracking receipt of all refunds to provide an audit trail to auditors and regulators

Internal management of the process can be burdensome, with high operating expenses and involvement across multiple internal departments. Additionally, it is very difficult to monitor regulations across multiple states. The rigorous audit requirements for product refunds can become stressful and taxing to an underprepared infrastructure.

Automation is proven to streamline the product refund process

With an automation-based approach, the financial institution still accepts the liability of refunding the consumer but does not have to develop an internal process to monitor, track, calculate, and remit refunds to the consumers. Instead, the financial institution partners with a third-party vendor that has the technology and infrastructure in place to manage the product refund process. This way, a financial institution can maintain ownership and control of the refund process and the timeframe in which refunds are issued without building the product refund technology. Even though product refunds are an arduous process, this approach diminishes many of the challenges posed by servicing ancillary products.

This approach helps financial institutions maintain regulatory alignment by:

- Implementing an end-to-end product refund solution from the filing of the triggering event to when the refund is received by the consumer
- Accurately defining payoff and/or deficiency balance amounts for credit bureau reporting
- Maintaining an auditable trail of the refund amount for audits
- Reducing cycle times to 45 days or less to ensure staying beneath the 60-day threshold (the shortest required cycle time currently documented)
- Tracking receipt of refund payment to consumer
- Real-time access to dealer contact information or out of business updates
- Gaining timely updates on changing compliance requirements

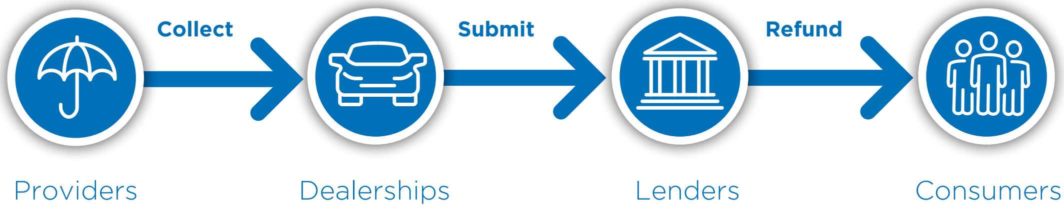
Choosing a vendor partner to oversee the process can transfer the operational difficulties and optimize the process. For example, a product refund vendor can provide lockbox services, which greatly reduces the accounting load on refund payments by compiling, logging, validating, and remitting all refund proceeds directly to you with specific instructions.

> *It's progressively more difficult to navigate the relationship between lender, dealer, product provider, and borrower.*

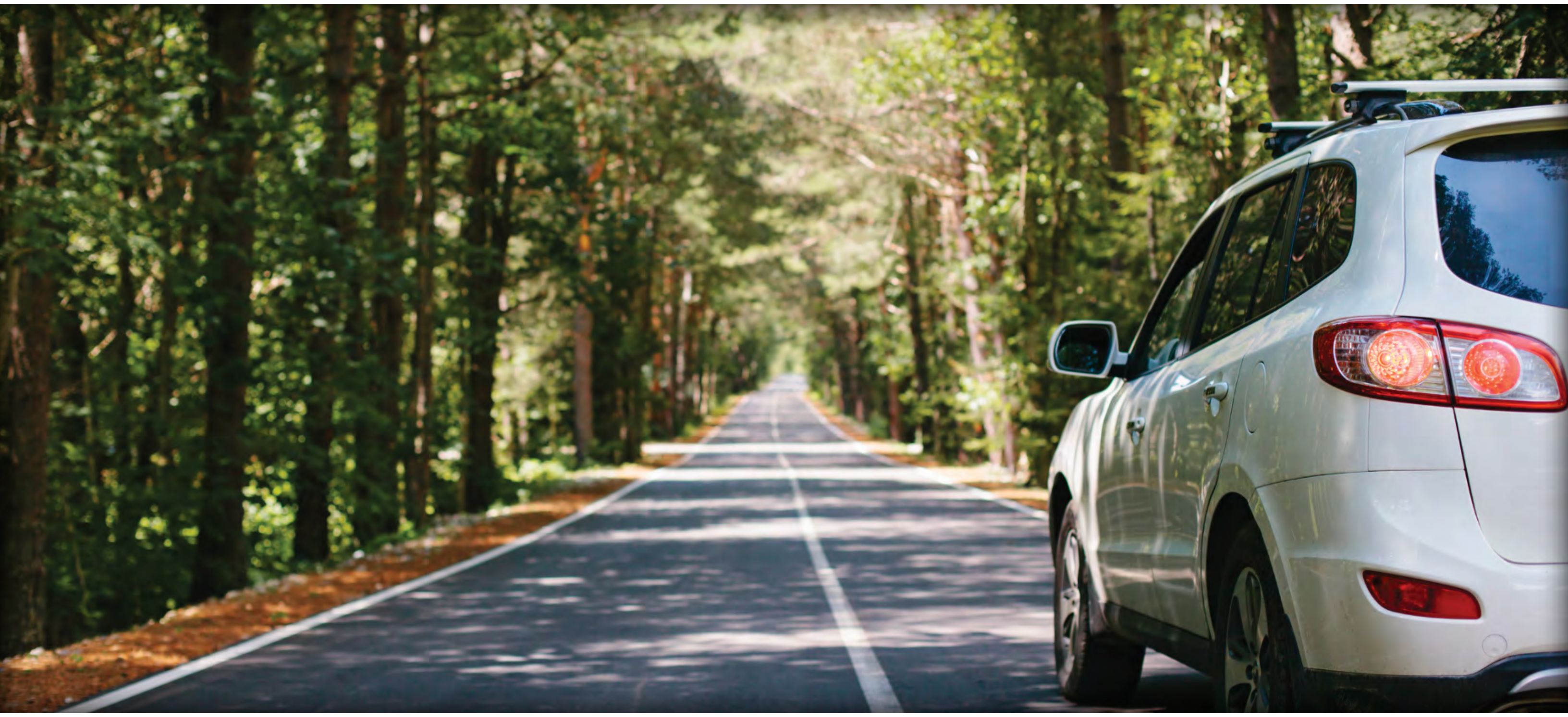
The New Standard of Success

It is time for financial institutions to take ownership with a proactive and borrower-centric stance. While lender compliance is a primary concern, the byproducts of a product refund solution benefit the consumer as well, by ensuring that consumers are receiving accurate refunds.

BEST PRACTICE REFUND PROCESS



When a financial institution implements a comprehensive product refund process, they gain much needed efficiencies while maintaining compliance and protecting the borrower relationship.



Next Steps: 5 Takeaways for Product Refund Liability

Regulators are keenly focused on ensuring ancillary products are serviced and cancelled properly, so managing and servicing ancillary product refunds is a critical business practice for financial institutions. These considerations can help financial institutions take product refunds from an afterthought to a strategic approach:

1. Recognize compliance complexities

Refund processes are intricate, involving varied rules for different products, state-specific regulations, and multiple stakeholders like dealers, product providers, and consumers. With UDAAP operating on principles rather than technical rules, the risk of noncompliance is significant, as recent lawsuits demonstrate. Lenders are held accountable, making compliance a top priority.

2. Emphasize transparency

Transparency isn't optional—it's essential. Clear processes ensure accurate tracking, calculation, and communication of refunds, reducing errors and strengthening relationships with dealers and product providers. Transparency benefits regulators, who need audit trails, and consumers, who receive timely, accurate refunds.

3. Leverage automation

Automation minimizes errors, streamlines processes, and ensures accurate calculations and timely refunds. Integrated systems can track refund timelines, validate consumer receipts, and enable collaboration with dealers and product providers, enhancing overall efficiency.

4. Mitigate compliance risks

Automating refund processes helps institutions comply with UDAAP and other regulations, reducing financial and reputational risks. Benefits include accurate deficiency balance calculations, expedited refund recovery, robust audit trails, and stronger consumer trust.

5. Adopt a strategic approach

Shifting from reactive to proactive management mitigates regulatory and reputational risks. Develop a comprehensive refund strategy by engaging legal, operations, and accounting teams to create an infrastructure that identifies and addresses potential risks while maintaining compliance and operational efficiency.

In Summary

When a triggering event cancels an ancillary product, financial institutions have an opportunity to take the lead by strategically managing the process. Facilitating the lifecycle of ancillary products is not without its challenges. Ancillary product servicing can be optimized with a comprehensive process for refunding consumers money due on their cancelled ancillary auto loan products. With a streamlined process for refunding consumers, multiple areas of the business are optimized, the consumer relationship is enhanced, and compliance is improved.

About Allied Solutions

Allied Solutions is one of the largest providers of insurance, lending, risk management, and data-driven solutions to financial institutions in North America. Allied Solutions uses technology-based solutions customized to meet the needs of over 6,000 banks, credit unions, finance companies, mortgage servicers, and auto dealers, along with a portfolio of innovative products and services from a wide variety of providers. Allied Solutions is headquartered in Carmel, Indiana and maintains several offices strategically located across the country. Allied Solutions is a wholly owned and independently operated subsidiary of Securian Financial Group.

RefundPlus® from Allied Solutions is the industry's most comprehensive solution that helps financial institutions tackle product refund liability and optimize the refund process. This solution combines our mastering knowledge of the financial institution industry with technology to streamline product refunds on cancelled products, improving consumer experience, and ensuring refund efficiency and accuracy.

Sources and Citations

[1] Based on data from Allied Solutions. 2024.

[2] Consumer Finance Protection Bureau. October 2024. https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights-special-ed-auto-finance_2024-10.pdf

[3] Consumer Finance Protection Bureau. March 2019.

[4] Consumer Finance Protection Bureau. May 2022. https://www.consumerfinance.gov/about-us/newsroom/cfpb-supervisory-report-finds-unlawful-auto-repossessions-breakdowns-in-credit-report-disputes/

[5] National Credit Union Association. Unfair, Deceptive Acts And Practices (UDAAP). May 2022.

[6] https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights-special-ed-auto-finance_2024-10.pdf

[7] https://www.ftc.gov/business-guidance/resources/ftc-cars-rule-combating-auto-retail-scams-dealers-guide

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