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Combining VSCs and Pre-Paid Maintenance

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One of the most profitable, and highest penetration products sold in the F&I office is the vehicle service contract (VSC). Dealers and providers alike are constantly looking for new ways to add value to F&I products, and the VSC is no exception. *AE Magazine* spoke to Larry Dorfman, Tim Brugh and Mark Cohen to get their take on the latest trends in the VSC arena, and where they see the most opportunity for adding value.

One of the current trends in the F&I market is to bundle or combine several products into one package. While this works with ancillary products very successfully, it turns out that, for many reasons, it is very challenging to combine a VSC with another product on a single contract.

"It's more clear-cut to break it out," said Larry Dorfman, chairman and CEO, EasyCare. "The more stuff you add together, the more the CFPB will give us a hard time." He went on to note that the VSC is probably one of the most important tools in the F&I office – not only is it profitable, but it is extremely valuable to the consumer. He believes that keeping it clean is critical, to ensure customers always have the option to protect themselves from the largest potential financial drain – vehicle repairs – even if they don't take any other F&I products.

One product that is a strong fit to offer alongside the VSC is a prepaid maintenance plan. While, many believe the prepaid maintenance is better off remaining as a separate contract, prepaid maintenance and service contracts do go hand-in-hand. "[Prepaid maintenance] is a logical progression," said Tim Brugh, president, American Auto Guardian Inc. (AAGI). "If a customer wants to have maintenance taken care of, it is a 1-2 conversation – they are already trying to protect the car, and the prepaid maintenance protects the car even further."

Dorfman noted that some of his dealers have started offering maintenance plans free for the first year along with their service contracts, as it acts as a great retention tool, and gets the consumer used to coming in to the dealership for maintenance. He noted that the dealers he has seen use this method generally include several oil changes and a safety inspection, at minimum, and have seen a great deal of success, with up to 70% penetration rates.

Agreeing, Brugh noted that offering prepaid maintenance alongside the VSC helps to ensure the car remains within the contract parameters. "The odds are we can't cover the contract if they didn't maintain the car," he noted. But if a dealership ensures the customer is coming in for regular oil changes, inspections, etc., they can ensure that if the customer does need to make a claim on their service contract, they don’t have to worry about being disqualified.

Another reason the maintenance-VSC combination works so well, Dorfman noted, is that, by law, VSCs cannot require that a customer comes into a specific service department to maintain their vehicle. The contract can require them to maintain it to a set standard, but it cannot specify where they go to have that maintenance performed. He believes the pre-paid maintenance plan is the best way for dealers to ensure that the customer does not think about taking the vehicle elsewhere for maintenance or service.

Brugh went on to note, however, that one of the big reasons he still believes it is better to keep the two separate is lender approval. “I think it would be very valuable to bundle them together if you could get the lenders to approve it,” he said. “One of the problems is getting them to approve the additional variations. Because your VSC is always approved if you have the right type of carrier, there usually aren’t any problems – but you start to have problems when other products are added on. Lenders are as important to the process as compliance is today. You can build it, and you can make it compliant, but getting lenders to approve it can often be the biggest challenge..”

The Compliance Puzzle

Speaking of compliance, there is a complex process going on behind the scenes to ensure the contracts offered to the dealers – and in turn sold to the consumers – are not just profitable, but are compliant with a large, complicated web of regulations dedicated just to service contracts.

Mark Cohen, senior vice president and general counsel, AAGI, noted that, today, about half of the states have regulations or statutes that govern service contracts. But the problem gets more complex – every state’s regulations are a bit different, with all of them requiring slightly different wording or clauses, as well as either allowing or disallowing specific types of provisions. Further, some of those states simply have statutes that providers and administrators – and dealers and agents – are required to be aware of and follow, but they don’t actually look at the contract unless a complaint is filed. Other states require providers or administrators to submit and gain approval for every version of every contract sold.

“There are 50 kingdoms and each one is a little different,” said Cohen. “Some don’t have any regulations on VSCs at all. Other kingdoms say ‘you have to be licensed to be a VSC provider, and here’s what you have to have, but we don’t need to approve them. Just make sure they comply.’ And then there are some where you have to be licensed and submit the contracts for approval.”

And as if that weren’t complicated enough, providers and administrators have to constantly update their products to comply with new regulations, or new interpretations of old regulations, and go through the entire approval process all over again, every time. “Every state is so different, and constantly changing,” said Brugh. “You used to be able to file a product, and until you renewed it, you were okay. Now if they change the law, you have to keep changing the contract to meet their standards; we are constantly redoing contracts in the VSC industry.”

So what does that approval process actually entail? Cohen, like Brugh, noted that it often starts with the lenders – providers and administrators make sure, before they go any further, that a contract is something a lender would be willing to finance. Once that approval is obtained, depending on the state and what is required, the contract is submitted to the Department of Insurance, or a similar government body, who will review it and send it back with notes. Typically, Cohen noted, the provisions on cancellations are the sections that are the most scrutinized.

"And that's just in the states where you have to file before you can use it," said Cohen. "But you had better be on your game in states where you are licensed but contracts do not need to be approved; you have to make sure it complies. You have to have a compliance department, which reviews the contracts to make sure they're in compliance with each statute. This is a highly regulated industry, and if you don't want to be regulated, this is not the business for you."

At the end of the day, Dorfman noted, the key is to make the entire process as easy and painless for consumers as possible. If they are relaxed and confident in the products, they will walk away happy with their purchase, and will be more likely to not only return to that dealership, but to purchase additional products in the future. And regulators will have less reason to create new regulations or add additional stipulations to current laws if consumers are getting contracts they feel are fair and valuable. "Treat customers well, and they will buy anything. But don't treat them well, and they will scorch you," he said.

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