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SUBJECT: "Gap Coverage" – Personal Auto and Commercial Auto

BACKGROUND: Getting a new car is usually fun and exciting. But having a total loss on a new car causes a double-whammy: the extreme disappointment of the loss of a new car, plus the shocking realization that the loan or lease balance can be greater than the amount of the insurance payment.

Owing more than the car is worth is often referred to as "being upside down in the loan or lease." For insureds, still owing money after a car that has been totaled is extremely frustrating. However, there are endorsements available in both Personal Auto and Commercial Auto that solve the problem.

MAIN POINTS: Several years ago, the insurance industry introduced these endorsements that address the so-called "gap" between the amount of the loan or lease, and the amount paid by auto physical damage coverage.

In Personal Auto, the endorsement is **PP 03 35 – Auto Loan/Lease Coverage**. In Commercial Auto, it is **CA 20 71 – Auto Loan/Lease Gap Coverage**.

The endorsements serve two purposes. First, an insured is not left owing money after a new car is totaled. Second, from a purely public relations standpoint, an insured is not left frustrated after an insurance claim.

While the amount of financial risk faced by insureds with a "gap" between loan/lease amount and insurance payment is not usually high, agencies would do well to offer the endorsement, as much for the elimination of frustration and positive public relations, as for the pure monetary benefit to insureds.

In fact, the number of insureds who face a gap in their auto loan/lease and insurance is significant, and growing. According to a recent article in the *Wall Street Journal* (October 8, 2002), approximately 22% of buyers who trade cars this year still owe money on the loan. The average amount owed is $2,163, yet the amount has skyrocketed from two years ago, when the average amount owed at trade-in was $617.

Compounding that situation has been the huge impact of zero-percent financing, which became widespread in the auto industry after 9/11/01. According to the *Wall Street Journal* article, “the enticing deals are triggering sharp declines in the value of cars the minute they drive off the lot. Millions of Americans are snapping up new cars, which is increasing the glut of used cars on the market and driving down their values. In addition, the incentives themselves are effectively slashing the prices on new cars, which is a key factor in determining resale values.”

In effect, the reduced value of used cars is being reflected in industry-standard sources such as NADA, Edmunds, and Kelley Blue Book. And since the Personal Auto Policy and the Commercial Auto Policy pay physical damage claims based on ACV, the “gap” between the loan/lease amount and the ACV is getting larger.

Some eye-opening examples were cited by the *Wall Street Journal* article. The amount of depreciation in certain 2000 model-year cars (i.e., cars that are currently two years old) includes the Oldsmobile Silhouette GL (59.4%), the Ford Taurus SE (57.3%), the Dodge Grand Caravan LE (56.7%), Nissan Maxima GXE (46.3%), and Infiniti QX4 STD 4WD (43.3%). But the most depreciation in any 2000 model-year vehicle was the Ford Expedition, which lost 70% of its original value in just two years. To illustrate the impact of recent events, the 1998 Expedition depreciated just 45% after two years, from 1998 to 2000.

Clearly, insureds who purchased cars in the last two years, and who financed their loans, could face a very nasty surprise should they ever face a total loss.

It would therefore be very important to offer the “gap coverage” to all insureds who purchase or lease new cars today.

NECESSARY ACTION: Circulate this Technical Advisory to all Personal Lines and Commercial Lines staff who handle automobile insurance.