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AL REDMER, JR.
Commissioner

NANCY GRODIN
Deputy Commissioner

JOY HATCHETTE
Associate Commissioner
Consumer Education & Advocacy

200 St. Paul Place, Suite 2700, Baltimore, Maryland 21202
Direct Dial: 410-468-2029 Fax: 410-468-2430
Email: joy.hatchette@maryland.gov
1-800-492-6116 TTY: 1-800-735-2258
www.insurance.maryland.gov

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Consumer Alert: Maryland Insurance Administration Offers Tips on GAP Insurance and Debt Cancellation Agreements

Car owners sometimes assume – incorrectly – that if their cars are considered a total loss as a result of a collision, theft, or other covered cause of loss, their auto insurance claim will be settled for the amount they paid for the vehicle, or at the very least, the amount they owe. Often, this is not so.

Instead, when your vehicle has been deemed a total loss, which generally means the damage exceeds 75 percent of the actual cash value of the vehicle, most insurance policies provide for payment of the actual cash value of the vehicle at the time of loss. This may be less than the actual amount you still owe on your loan or the amount due for a lease payoff. The difference between your car's actual cash value and the balance on your loan or lease is the "gap" for which you will be responsible. Fortunately, there are alternatives.

Many auto insurance companies offer GAP (Guaranteed Auto Protection) insurance as an optional coverage that is available for purchase when physical damage coverage (comprehensive and collision coverage) is included in the policy. GAP insurance can provide valuable protection if you have a loan or a lease. If a loss occurs, GAP insurance generally will pay the difference between the actual cash value of the vehicle and the current outstanding balance on your loan or lease. It is important to ask questions regarding the extent of coverage, as some GAP policies will limit the amount paid to a percentage of the vehicle's actual cash value. In certain situations, a policyholder who is extremely "upside down" on the loan — that is, owes more than the car is worth — may still be left with a balance due to the lender or lessor if the policy contains a specific dollar limitation.

Another option available to borrowers is to enter into a debt cancellation agreement. A debt cancellation agreement is a contract between the lender and the borrower that cancels out a debt in the event of a listed condition or contingency. A debt cancellation agreement is not insurance

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coverage. Typically, an auto dealership, bank, savings and loan, credit union or finance company offers this kind of protection to its customers for an additional fee, which may be incorporated into the financing agreement. If the vehicle is declared a total loss and a balance remains due to the lender or lessor after the auto insurer pays the actual cash value of the vehicle, the debt cancellation agreement requires no further action be taken by the lender or borrower. The debt is simply forgiven. The lender does not provide or pay a benefit to the borrower.

Debt cancellation agreements are not insurance, so they are not regulated by the Maryland Insurance Administration (MIA). However, when a third party, such as your auto insurance company, agrees to pay the lender on the borrower's behalf in the event of a total loss, that is considered an insurance product and is regulated by the MIA. This means that if you have a problem, you can file a complaint with the MIA.

Be sure to understand what you have purchased. Always read your policy to determine the coverage provided and any limitations. For instance, your policy may exclude payments for overdue loan or lease payments and penalties on leases where it is determined that there is excessive use, abnormal wear and tear, or high mileage. It also may not cover deposits on leases, extended warranties, or credit life, health or disability insurance purchased with the lease or loan.

For more information on GAP insurance, visit the Maryland Insurance Administration website at www.insurance.maryland.gov or call 1-800-492-6116.

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