

Renting a Car?

Watch Out for that Gap!

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Many of our clients rent passenger autos and light trucks for personal or business use. Until recently, SilverStone Group has been able to provide the necessary coverage for this exposure through auto insurance policies, thus relieving the auto renter of the need to purchase the car rental agency's expensive "Collision Damage Waiver" (CDW), also known as "Loss Damage Waiver" (LDW). However, recent changes in the way car rental agencies manage their damaged vehicles, has made it more difficult to properly cover the rental vehicle exposure.

Rental car companies have created a "gap in coverage" through the use of rental contracts that provide for "Diminution in Value" at the time of loss. Simply defined, diminution of value is the vehicle's loss of value after it sustains damage. This reduction is determined solely by the rental company's contract, which establishes the value of the vehicle before the rental and then compares it to the value of the vehicle after the loss. These new contracts have created problems for unsuspecting renters who experience the misfortune of an accident while operating a rented vehicle. As a result of this change, you may be operating a rented vehicle without the coverage you need.

The problems

The biggest problems arise when a rental vehicle sustains substantial damage, regardless of whether or not the renter was at fault. Previously, when a rental car was involved in an accident, the Hired Auto Physical Damage coverage in an auto policy would pay the bill, less a deductible, and everything was fine. Now, however, if a vehicle incurs damage greater than a certain amount, \$3,500 for example, the resale value is diminished. At resale or trade-in, the repaired vehicle is worth less than an undamaged factory original is worth. This is called "Inherent Diminished Value." The newly implemented rental contracts give the rental agency sole authority to determine this diminution in value, with the charges consequently falling to the renter. Currently, insurance coverage for this loss, which can amount to several thousand dollars, is not available with most commercial auto or personal auto policies.

Another unfortunate trend has recently developed among car rental agencies. When inventory is damaged by renters, many rental agencies simply sell the damaged vehicle at auction without repairing it. Obviously, the value is significantly less than it would be for an undamaged vehicle, leaving an "Immediate Diminished Value" gap between the amount it costs to repair the vehicle and the amount the rental agency receives for the sale. For example, let's say that the value of the rental vehicle when you picked it up was established at \$25,000. After the loss, the cost to repair it is \$9,000. Your insurance offers that amount, less the deductible, but instead of repairing the vehicle and returning it to service, the rental agency sells it "as is" at auction and receives \$10,000. The insurance pays the agency its obligation (\$9,000, less your deductible) toward the \$15,000 loss, but there is an immediate diminished value of \$6,000. As in the inherent diminished value example above, this amount would be charged to the renter's credit card. Also, as illustrated above, standard insurance will not pay this amount.

Another problem that can occur in either of the above scenarios happens when the rental car agency charges the renter for the loss of use of the damaged vehicle from the time of the collision until it is returned to the rental fleet for further service or replacement. The standard commercial auto policy has very limited coverage for this type of loss - \$20 per day for up to 30 days. When rental agency rates for loss of use are combined with potentially lengthy repair schedules, this can add up to a large and unexpected financial setback for renters.

The solutions

In the case of the loss of use, many auto insurers offer an endorsement that can increase the amount provided by a standard policy. Although the amount of payment is still limited, the limit is higher. However, in the case of diminution in value, the majority of insurers are unable to cover this loss. Some can provide limited coverage for inherent diminished value (e.g., \$2,500), but no one presently offers coverage for immediate diminished value.



If the renter chooses to buy the CDW or LDW from the car rental agency at the time the vehicle is rented, all of these expenses will be covered. This can be expensive, however, with charges adding up to \$30 or more per day of rental use. In addition to the added expense, there are some situations when the CDW/LDW won't pay at all and the entire cost becomes the responsibility of the renter. This loss of coverage can occur in any of the following situations:

- Someone who is not listed on the rental agreement is allowed to drive the vehicle.
- The driver tests positive for blood alcohol content, even if the result is under the legal limit.
- The vehicle is driven on unpaved roads.

The list is not limited to the scenarios above, so it is important to read the CDW/LDW agreement and understand the types of situations that may result in termination of coverage.

We know that the CDW/LDW is an excellent revenue source for car rental companies who are forced by competition to pare rates. We offer no opinion as to whether this has any bearing on the practice of deliberately taking less than necessary for the damaged car at auction, thus forcing renters to buy the CDW/LDW, but it is certainly easier for a car rental agency to auction off the damaged vehicle than to go through the repair process.

So what do I do now?

Look at this as an opportunity to practice your risk

management skills. "To buy or not to buy (the CDW/LDW); that is the question!" If you rarely rent vehicles, you might decide to bite the bullet and buy the CDW/LDW. Of course, you must be certain that you understand the specified restrictions and avoid violating them. On the other hand, if you frequently rent vehicles, you may decide to retain this risk yourself (i.e., self-insure it). Either way, we want to be sure you understand the potential scenarios that can occur when you rent a vehicle. We will monitor our insurance carriers for endorsements to cover this exposure and as soon as they are offered, we will make them available to our clients. Now is the time to establish your business or personal procedure, not when you're standing in line at the rental counter.

Now for a personal word

In most situations, a customer will rent a car in his or her own name, not a business name, as most car rental agencies insist on this. Often, response from your insurance company to a loss on a rental vehicle will come from your personal auto policy first and then from your company's commercial auto policy, but state laws differ. Some states require the personal auto policy to respond, while others don't. Personal auto policies are not yet structured to cover the immediate diminished value scenario; some cover the inherent diminished value gap to a limited degree, while others cover the loss-of-use to a limited degree. We recommend that you consider this exposure and add it to your risk management decision-making process.