

Credit Shortfall Explained:

For many of us, driving that dream car means getting finance through a bank or another financial services provider. However, should your new car be stolen or written off in an accident, there may be a gap between its insured value and the amount owing to the finance company. This gap is known as 'credit shortfall' and when it occurs, it can leave you owing money on a car you don't have.

Insurance policies cover the market, retail or trade value of your vehicle. Particularly with new cars, the value drops considerably the instant it is driven off the showroom floor – but there is no such corresponding drop in the amount owing to the bank.

Should an insured event occur, such as a theft or an accident that writes off the vehicle, your insurer will cover it for the replacement value – which is now less than the purchase price.

Credit shortfall insurance, also called top-up or gap insurance, is designed to cover this gap so you don't have debt on a vehicle you no longer own.

It is advisable to add this optional extra to your policy particularly with new cars, but also on any vehicle purchase where a credit shortfall might arise. For example, purchasers of used cars where the price is 90% paid by finance should consider credit shortfall insurance.



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Scenario: Anne buys a car for R200 000 finances it through BestBank. She insures the car with InsurerX for its retail value and takes credit shortfall insurance as an optional add-on. The car is stolen months later when the retail value is R150 000. Anne still owes BestBank R180 000. The shortfall amount is R30 000, which is covered by the credit shortfall add on. If she did not take credit shortfall cover, Anne would have had to cover this amount from her own pocket.

What you need to know

When insuring your vehicle, you have a choice of covering it for retail value, trade value or market value.

The retail value of your car is the average of what the same vehicle is currently selling for at car dealerships, and is the highest price you can insure it for. The trade value is what you would get if you traded it in. The market value or fair value is the average between retail and trade value. The value of your car further depends on the condition and mileage on the car.

It is necessary to determine if, in the event of a total loss, there would be a credit shortfall. If so, consider credit shortfall insurance.

The following are not included as part of credit shortfall:

- Unspecified sound equipment or accessories.
- The excess payable on your claim
- Arrear instalments that may be over due and the interest that may have accumulated
- Additional finance charges
- Any early settlement penalties

Useful tip: Credit shortfall insurance is essential for people who have recently bought a new car or a recent model on hire purchase. As you pay off your instalments, there will come a time where the amount owing is less than the value of the vehicle. When this point is reached, credit shortfall insurance is no longer required. Considering credit shortfall insurance is strongly recommended for those vehicle buyers who don't have the cash for a large deposit. If there is a major loss, the credit shortfall can be crippling, not only leaving you owing money on a car you no longer have, but also potentially preventing you from buying a replacement.

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