Will insurance pay off my car loan if the vehicle is totaled?

This story starts when you buy a new car.

Ahhh, look at the sheen of the paint! Can you see how the new rims glimmer in the sun?

Your financial situation when you buy a car:

When you buy a car it's shiny and wonderful. You sign the auto loan documents, eager to grab the keys and jump into the driver's seat. Caught up in the moment, paying back your auto loan is probably the furthest thing from your mind. You roll down the window and enjoy the rush of the wind as you hit top gear.

2 Years later…

As time goes by, the car gets dirty, it gets dinged, and it loses value. Even though you've diligently making your auto loan payments, your car has depreciated, so after a couple of years your financial situation may look like this.

Often during the first couple of years that you own a car, it depreciates quite a bit. Even if you've made all your auto loan payments, that's no guarantee that the depreciation hasn't out-paced your loan pay-down. As their car loses value, many people ask themselves,

"Will insurance pay off my car loan if the vehicle is totaled?"

To tackle this question, let's look at what it means to have a "totaled" vehicle.

If you get into a serious accident--with tons of damage--there's a chance that the **cost to repair the damage** might be greater than the **actual cash value** of the vehicle (sometimes called ACV).

- If that's the case, then the insurance company will declare it a **total loss** and will pay out the actual cash value of the vehicle instead of paying to repair it.
- In those situations, if you have a loan on the vehicle, the insurance company will make the payment to your bank or finance company instead of to you.
- If you owe less than the value of the vehicle, you'll also receive some money back from the claim settlement.
- If you owe more than the value of the vehicle, you'll have to pay off the remaining balance on your loan even though you don't have the car anymore.

So how do you protect yourself from still having to pay your loan in case your vehicle is totaled?

That's gap insurance, which is typically sold at the time your purchase your vehicle, but may also be available through your auto insurance company.

Gap insurance is also commonly called loan/lease payoff coverage, because it pays the difference between the settlement amount and the balance on your loan. Some companies have restrictions on the percentage of the vehicle value that gap insurance will pay for (this is typically 25% of the ACV), so make sure you ask about that before you buy.

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