GAP Performance Outlook for 2023:

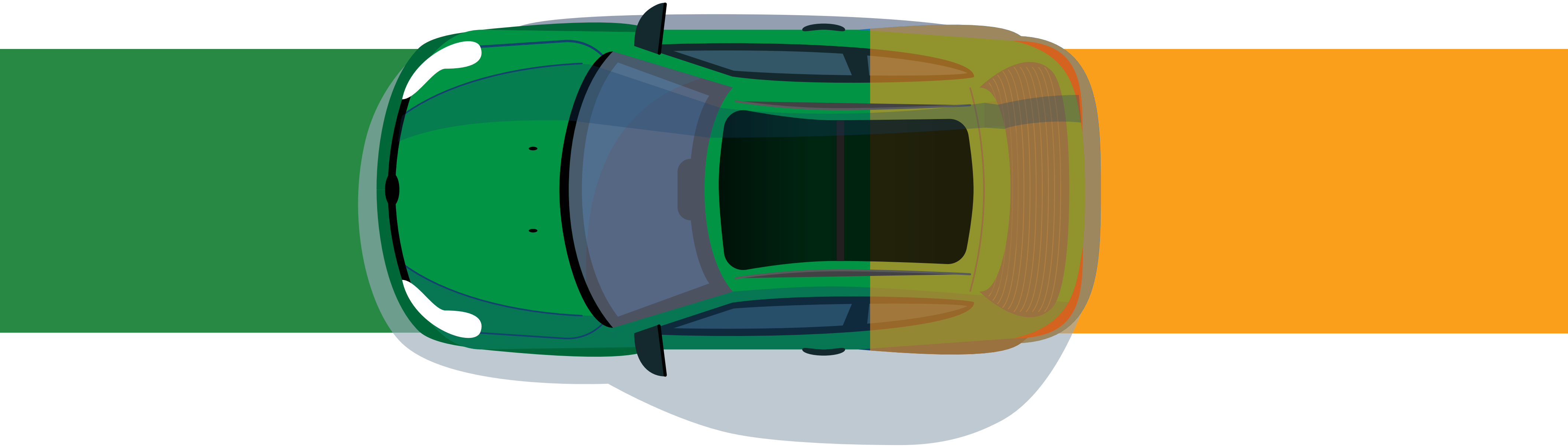
Is the Boom Coming to an End?

Get Started

ASSURANT®

Analyzing GAP performance:
data and expertise

GAP, or guaranteed asset protection, is an important part of the dealership F&I profit center. In a market of rising car prices, it can provide real value to car buyers. But, just like the stock market, it can be tough to predict, and a range of factors impacts its profitability. And, while shown to be profitable over time, it's critical for dealers to understand the drivers of GAP performance to make it easier to navigate. Since GAP is sensitive to market pressures and has historically been countercyclical, with performance that rises when the rest of the economy falls and vice versa, knowing where GAP might be headed next takes a keen eye backed by deep industry experience and historical data.



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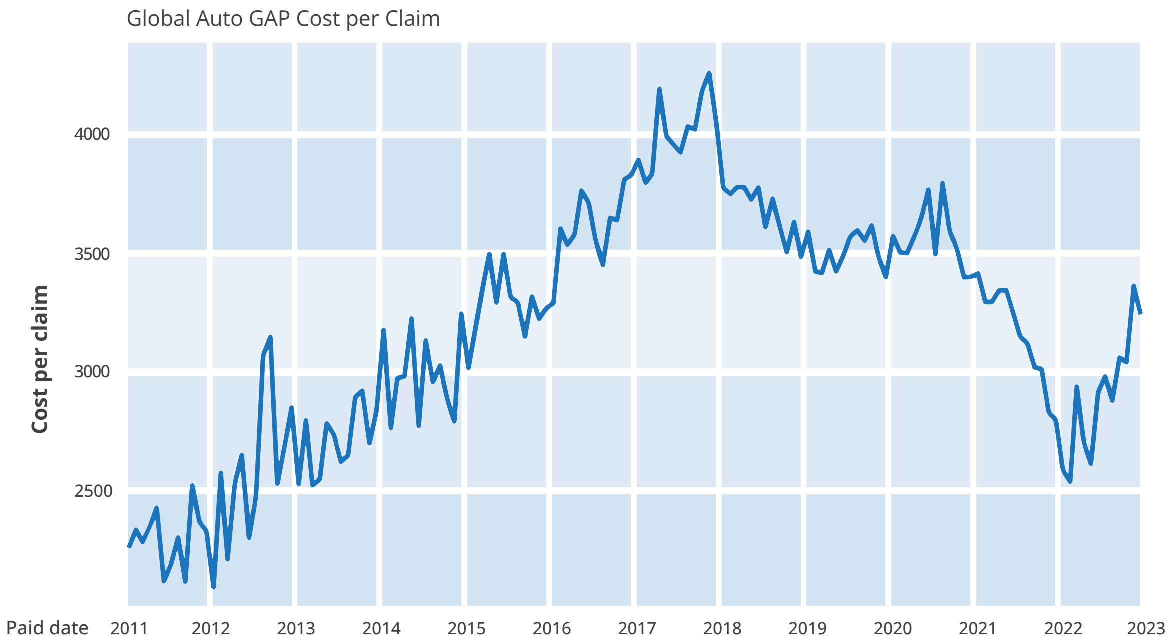
GAP performance: from COVID to today

During the pandemic, GAP lived up to its maverick reputation, achieving record performance and profit as the rest of the economy temporarily wavered. And, even as the economy recovered and trended strongly upwards, GAP continued to perform. This was partly due to a shortage in vehicle supply that drove prices up dramatically — by up to 60% in some cases.[1] As car values rose, the amount insurance companies paid out for totaled vehicles rose with them. This was good for GAP profit as claims frequency and severity, or the amount paid out by GAP providers, dropped. In fact, GAP cost per claim dropped below $2,700 in January 2022,[1] allowing dealers to keep more of their GAP reserves than before the pandemic. This profit trend was enhanced by the fact that, as commuters stopped driving during the lockdowns, total accidents were reduced.

Cost per Claim **GAP**

- GAP costs per claim dropped below $2,700 in Jan/Feb 2022 and have since risen to $3,300 in Dec 2022
- The increasing trend in 2022 lines up with start of decline in used vehicle prices after January



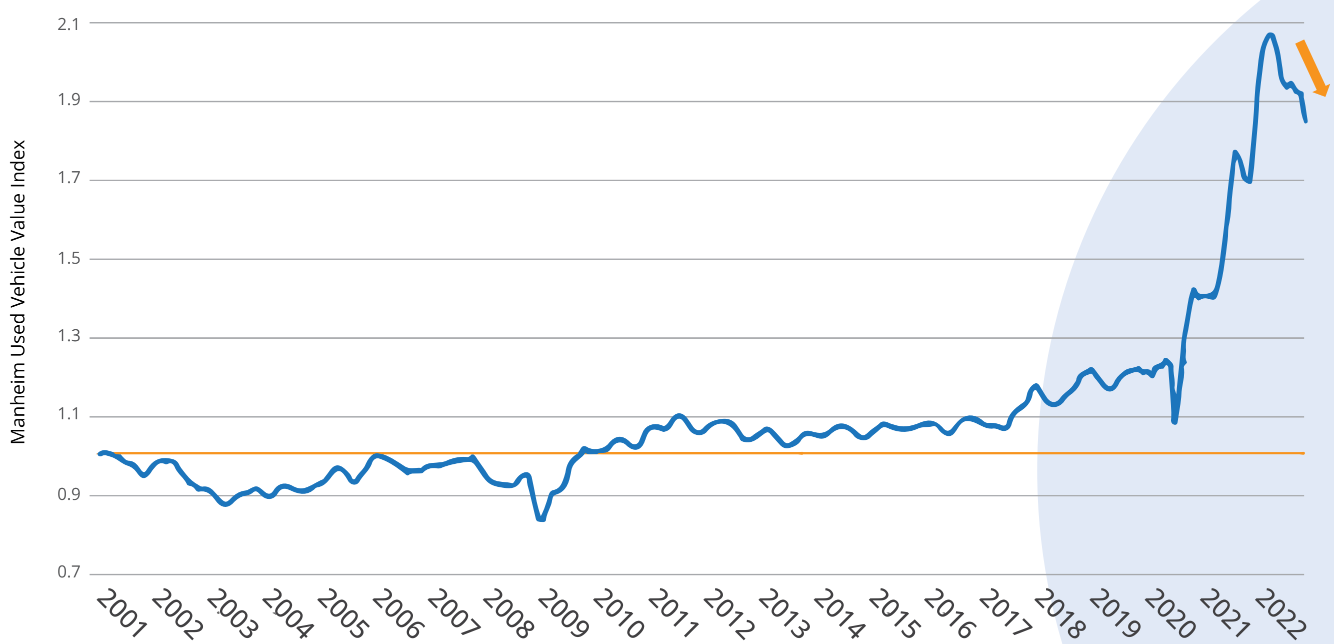
[1]Confidential source company

Trouble ahead for GAP? What do the indicators say?

The COVID-19 pandemic was the perfect storm for record GAP profitability with historically high vehicle values and low claim frequency coupled with reserve strengthening in 2017 to 2019. But its performance hinges on a set of economic indicators that are quickly changing. For instance, used vehicle prices, while still high, are decreasing, which jeopardizes GAP profit. According to JD Power, the average trade-in equity for December 2022 was projected to be $9,316 — down 7.8% since the June 2022 peak — and down 3.1% from Dec 2021. If used car values continue to decrease, this would potentially result in a rise in negative equity along with GAP claim frequency and severity. Rising interest rates also put GAP at risk by inflating the total amount drivers owe. In fact, increased vehicle pricing and multiple interest rate increases have led to record loan and monthly payment levels during 2022.[2] Another key trend that's reversing is miles driven. Miles driven has almost recovered to pre-pandemic levels as early as late 2021.[2] The further we move on from the pandemic, the more people take to the road — and the more accidents and resulting total losses there are to be covered.

Used Vehicle Prices

- After reaching all-time highs in January 2022, used vehicle values continued to decrease into year-end 2022
- Primary carrier recoveries have significantly increased from elevated vehicle values, thereby reducing or eliminating the "gap"
- As used vehicle values continue to decrease, that GAP frequency and severity will increase again



-4.3%

Dec. 2023 Y/Y Manheim Used Vehicle Value Index

[2] Manheim Used Value Index as of Dec. 2022

Time to panic?

Not so fast!

With GAP performance slowing due to economic headwinds, many dealers are beginning to worry whether the current boom in profitability may be coming to an end. Could GAP's record performance soon become losses? The answer isn't as simple as one might think. First, while profit is indeed expected to decline, it will be declining from record highs — an important buffer for dealers. Other key market trends also remain in GAP's favor. For instance, new vehicle transaction prices remain high — although price growth has slowed dramatically. And, while inventory is clearly improving, there still isn't enough supply to meet demand,[3] which is keeping used vehicle prices significantly elevated versus pre-2020 levels. Most importantly, market data suggests that the all-important loan-to-value (LTV) rate is not dramatically increasing, indicating that dealer exposure should be manageable.

"At Assurant, we expect positive GAP results to continue in the near term."

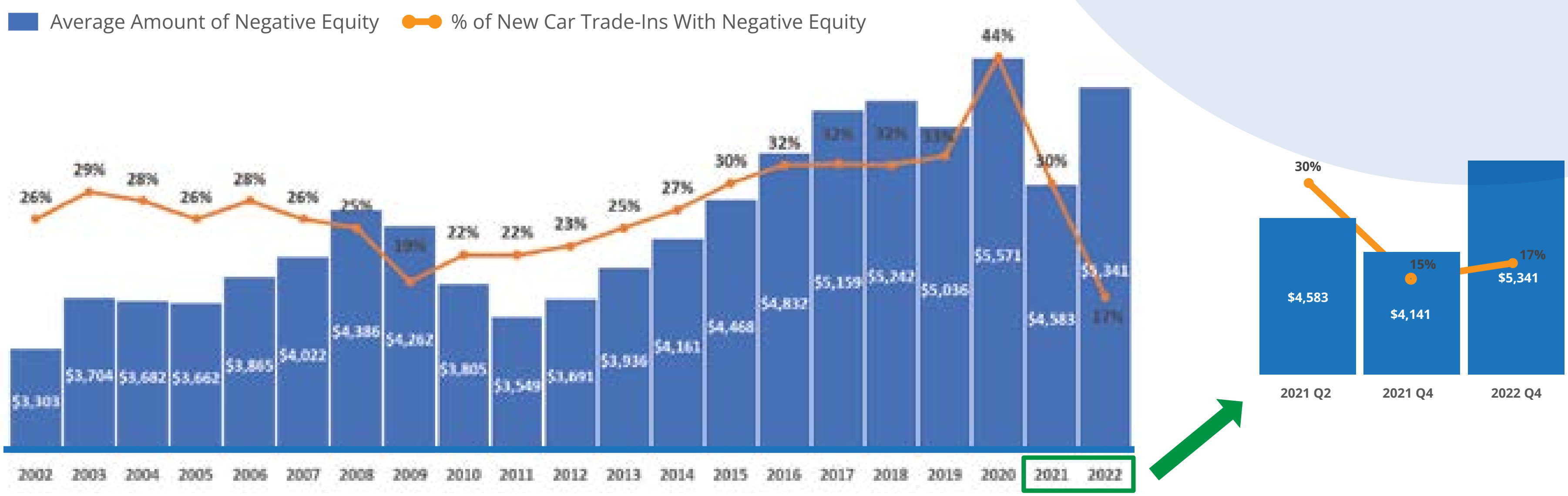
[3] Cars.com January 2023 Is the inventory shortage coming to an end?

The view from Assurant — playing the long game

At Assurant, we expect positive GAP results to continue in the near term. However, GAP does appear to be moving toward a period of decreased performance. But GAP is cyclical, and we've been through these ups and downs before. Historically, dealers that have maintained their position over time have enjoyed consistent growth. Having the right GAP product with the right pricing structure and the right risk mitigation strategy can help minimize volatility. Assurant will be introducing an updated GAP product as part of our Assurant Vehicle Care rollout coming midyear. By leveraging one of the world's largest actuarial databases, we've refined the way our GAP products are priced to reduce risk based on characteristics including geography, make, and model. Dealers that reinsure their Assurant GAP products may see higher reserves reflecting vehicle prices and market uncertainties, safeguarding their profitability in this changing market. We'll continue to monitor the need for changes and can serve as an early warning system for changing trends that may affect our partners.

Negative Equity **GAP**

- Only 17% of new car trade-ins had negative equity in 2022 Q4, which is a slight increase from the 15% at 2021 Q4, but still much lower than prior years
- As used car values continue to decline, this negative equity will increase



Source: Edmunds, Morgan Stanley

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