Collision damage waiver (CDW) is optional insurance offered by rental car companies when you rent a car. It provides coverage in the case of an accident or other event that could damage your rental car. Over the years, the concept of the CDW (also referred to as loss damage waiver or liability insurance contract principles in construing these [CDW] provisions.) Generally, state insurance regulators have agreed, although some courts over the years have heavily relied on “insurance contract principles in construing these [CDW] provisions.” In recent years, however, car rental companies have begun transferring third-party risks in addition to first-party risks onto consumers via “add-ons” to the rental agreement. This includes shifting responsibility to the consumer for both bodily injury and property damage to others not subject to the rental agreement.

History of CDWs
Rental car companies began selling a product known as a CDW to consumers in the 1970s. If accepted by the renter, this waiver would transfer the risk of any collision-related losses from the person renting the car back to the rental company for the cost of a few dollars a day. If the renter declined CDW, the consumer could be held liable for a deductible amount, often around $100. Since the dollar amounts were fairly small, both declination or acceptance of the waiver was a minor risk. As a result of the limited risk and the small amount of money involved, little attention was paid by state insurance regulators.

However, over time, rental car companies began raising both the daily fee for accepting the waiver and the deductible amount for declining it. By 1986, the average daily cost to accept a CDW had increased to between $9 and $13 per day. Eventually, rental car companies began holding consumers who declined the CDW liable for the entire cost of repairing or replacing the vehicle. Consumers were faced with a choice of paying a high daily fee or accepting a large liability when renting a vehicle. By 1987, CDW sales accounted for about one-sixth of the rental car industry’s annual profit.

Costs to the consumer has continued to increase substantially over the years. A 2013 study found an average daily CDW rate of $27. Annualized, this works out to nearly $10,000—arguably many times more expensive than a traditional personal auto insurance policy. Because of the high profit margin for CDWs, car rental companies typically expend particular effort and focus on selling them. Consumers often do no need such coverage because their own personal auto insurance policy may extend to a rental car, or their credit card company may possibly cover rental car damages.

An investigation by the eastern district of New York in the mid-1980s revealed the CDW was highly profitable both when it was accepted or declined because of surcharging. The investigation also found rental car companies often engaged in unfair or fraudulent practices, including charging inflated prices for repairs, billing consumers for repairs that had not been made, and failing to disclose surcharges and contract limitations. As a result, the industry faced a wave of inquiries from both state and federal lawmakers and state insurance regulators. Investigations were launched by the National Association of Attorneys General (NAAG), several state insurance departments and the U.S. Congress.

This increased scrutiny raised a central question: Is the CDW a proper insurance contract? Rental car companies argued the CDW is a simple two-party contract waiving their right to damages from the renter and, therefore, not insurance. Generally, state insurance regulators have agreed, although some courts over the years have heavily relied on “insurance contract principles in construing these [CDW] provisions.” In recent years, however, car rental companies have begun transferring third-party risks in addition to first-party risks onto consumers via “add-ons” to the rental agreement. This includes shifting responsibility to the consumer for both bodily injury and property damage to others not subject to the rental agreement.

NAIC Action
In 1985, the NAIC Market Conduct Surveillance Task Force discussed drafting model legislation to bring CDWs “within the definition of insurance for rating purposes, purposes of the unfair trade practices act and for purposes of premium taxation.” The Task Force asked the Market Conduct and Consumer Affairs Advisory Committee to further study the issue and the variation of approaches taken by states to address it.

The Iowa Department of Insurance, headed by then-Commissioner Bruce Foudree, gave a report on the background of the CDW to the Task Force, explaining a survey in Iowa found the average daily CDW charge was approximately
ly $7. On a monthly basis, the result is $500 worth of coverage for a payment of $200—far more than standard auto collision coverage. To address the situation, Iowa proposed model legislation to include the CDW within the definition of insurance for rating, unfair trade practices and premium tax purposes, but exempting CDW sellers from licensing requirements.9

Ultimately, the Task Force had concerns about classifying a product as insurance simply because it is “insurance-like” and argued the application of a CDW actually ensured risk was never placed on the consumer. The risk of property loss or damage remained with the rental company. A rental company did not agree to compensate the renter for any damage as would a traditional auto insurer; it simply agreed “not to pursue its legal claim against the renter for the renter’s failure to return the vehicle undamaged.”10 Furthermore, as a car rental company had no obligation to pay out claims to the renter like an insurer, solvency regulation was found to be unnecessary.

The Advisory Committee proposed three possible alternatives to traditional insurance regulation: 1) granting authority to a state agency to regulate car rental companies; 2) granting the Federal Trade Commission (FTC) or other federal agency the authority to regulate car rental companies; or 3) referring the issue to the National Association of Attorneys General (NAAG) for study.

The Advisory Committee opted for the first approach and began work drafting model legislation. The first iteration of the Collision Damage Waiver Model Act (#728), adopted at the 1986 Summer National Meeting, specified the CDW was not an insurance contract, but provided for regulation and licensing of companies issuing CDWs by the insurance department or other state agency. Following the model’s adoption, state insurance regulators became aware of widespread modifications to rental agreements in which deductibles of a few hundred dollars had been raised to the limit of the entire cost of the vehicle, while previously noted abuses continued. A Task Force report observed the CDW or other coverages can amount to 40% or more of the total cost of the rental transaction, calling into question “the rationale that the offering of the package is merely ‘incidental’ or ‘peripheral.’”11

In 1987, the Task Force revisited the issue once more,12 sending a survey to many car rental companies seeking data and requesting comments.13 The Task Force used this information to send a letter to the NAAG and ultimately to draft a new version of Model #728 prohibiting the imposition of liability on renters, with a few narrowly stipulated exceptions. This version of the model, adopted in 1988, limits a car rental company’s recourse for damages caused by the renter except in a few narrowly defined cases of misconduct and effectively prohibits CDWs. Therefore, rental car companies would be required to build the risk of vehicle damage into normal operating expenses (and could subsequently be reflected in rental rates). This approach was supported by many of the large rental car companies at the time.14

Model #728 remains unchanged since its adoption, although the Market Conduct Surveillance Task Force noted many states had difficulties getting the model enacted by their legislatures.15 A 1990 report noted the success of the model hinges on national implementation due to the interstate nature of the rental car industry.16 The 1988 version of the model was introduced in the U.S. House of Representatives but failed to pass.17 Today, not a single state has the NAIC model on the books. Approximately half of the states have some kind of legislation addressing CDWs, mostly in the form of disclosure rules, while the other half allow unregulated use of CDWs.

In reflecting back on the model drafting process, former Commissioner Foudree is clear the focus was solely on the CDW as a simple two-party contract. In a recent interview I conducted with him, he said, “The auto rental company waived the consumers’ obligation to them if the car was damaged; there was no third party involved. It appears the industry has greatly expanded its products in the intervening years.”18

**Are Rental Car Companies Selling Insurance?**

Insurance is fundamentally pooling risk where the “losses of a few are paid by many.”19 An element of indemnity is required for a contract to be considered insurance. The average CDW sold today extends beyond a simple two-party contract where the rental car company waives a consumer’s obligation to pay a deductible if the car is damaged. Often, coverage includes loss of use, replacement cost of the car, or even damage to or loss of renters’ baggage. Rental car agreements today cover responsibility for any damage, caused by the renter or otherwise, onto the renter, and then also sell a CDW to cover this risk for an significant daily fee. While this liability protection may be unnecessary for someone with a personal auto policy, this disclosure is generally in the fine print and may not be clear to the renter.

Essentially, for the average consumer, a CDW serves the same purpose as standard automobile liability and collision coverage. He or she may not even be aware CDWs are not

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Rental Car Insurance Explained (Continued)

Legally classified as insurance. Because CDWs are not regulated as insurance, daily rates do not have to be actuarially based. In fact, car rental companies can essentially charge any amount they wish. Furthermore, some rental car companies will add surcharges on to the bills of customers who decline CDW coverage, leaving consumers with no choice but to pay some kind of CDW-related fee.

For the initial rental of a car, consumers have plenty of choices among several competitors. However, there is no option to shop around for CDWs. Once consumers select their desired rental car, only then are they exposed to an “add-on purchase from the same seller, in a market in which the price for the second purchase is unobservable.” Consumer choice is limited by the seller to a simple opt-in or opt-out. Consequently, consumers pay prices significantly higher than what would be paid in a reasonably competitive market.20

Moreover, rental car agreements with CDWs now almost always include restrictions, prohibitions or exclusions. These commonly include damage occurring while the driver is intoxicated, committing a crime or if an unauthorized person operates the vehicle. While these types of exclusions may seem perfectly reasonable, several courts have found some rental car companies have taken exclusions too far.

In Val Preda Leasing, Inc. v. Rodriguez, the court found the terms of the CDW “substantially unfair” due to the sweeping list of exclusions; “the exceptions swallow the protection.”21 Likewise, courts in Automobile Leasing & Rental, Inc. v. Thomas and Lauvetz v. Alaska Sales & Serv. found ambiguous, overly broad or misleading language in rental agreements confound the “reasonable expectations of the insured” and ruled in favor of the lessee.

That is not to say CDWs are always and completely unnecessary. As noted earlier, many consumers will have collision coverage via their own personal auto policy or, in some cases, their credit card company, and the effect of opting in to a CDW will be to cover any deductible amount. However, for renters without other collision coverage, a CDW could be an important risk-management tool and could serve to reduce risk of a potentially modest loss. Further, personal auto policies and contracts from credit card issuers might not cover the loss of use a car rental company might claim while the car is being repaired. The car rental company might also add the value of lost rental fees and, therefore, might not be motivated to expeditiously repair the car.

∙ Next Steps
The rental car industry has engaged in a slow creep over many years, gradually increasing CDW daily rates and then adding additional liability products. However, before any next steps can be taken, gathering more data on the scope of the CDW is needed.

Data on consumer complaints about rental car companies is hard to come by. The FTC does take these complaints, but lumps all “auto-related” complaints in together. Furthermore, unlike state insurance regulators, the FTC does not assist consumers with complaint resolution. In the absence of good data, information-gathering is a crucial first step. A coordinated multistate examination could give state insurance regulators additional insight.

One common strategy to combat consumer issues like these is mandatory disclosure intended to improve consumer decision-making. Disclosures have been used by regulators in many industries in many markets for years, but the evidence for their efficacy is mixed.22 According to researchers at the University of Pennsylvania, “disclosers invariably struggle to interpret the disclosure mandate, assemble the required data, and communicate it in meaningful ways … and consumers routinely ignore the information disclosed, fail to understand the terms, or fail to make appropriate use of them.”23 Studies on consumer decision-making find more information does not necessarily lead to better decisions. While disclosures are an easy legislative win, increasing consumer access to choice is likely a more efficacious solution.

Moreover, purchase of products like the CDW are closely linked to a consumer’s risk tolerance. In the case of the CDW, however, it is difficult for consumers to quantify the amount of risk they are taking on when renting a car. In the face of a yes-or-no choice like a CDW, even consumers with moderate risk aversion may be tempted to opt in. A 2002 study by Progressive found nearly 40% of rental car consumers at least sometimes purchased a CDW.24

A possible strategy for combating current CDW practices could be to increase consumer choice. Whether consumers book a car online or at the counter, allowing them to choose between multiple collision and liability coverage products perhaps from multiple coverage providers (including the rental car company) would create savvier and more empowered consumers and a more transparent purchasing process. Some researchers have even suggested setting up an independent, online marketplace for rental car consumers.

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to access at the point of sale in order to eliminate the situation monopoly.25

◆ CONCLUSION
The CDW has changed significantly in the intervening years since the NAIC Collision Damage Waiver Model Act (#728) was adopted. Rental car consumers are faced with ever-increasing daily fees and a higher burden of risk than even a commercial auto insurer should. Drivers should educate themselves before they reach the auto rental counter and carefully review their auto insurance policy and check with their credit card issuer about auto insurance benefits.

ENDNOTES
1 Ibid.
8 Ibid.

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28 Interview with Bruce Foudree. May 10, 2018.
30 See supra note 3.
31 See supra note 6.
33 See supra note 3.
34 See supra note 3.
35 See supra note 3.
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