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Extended Warranties and Insurance:
Consumer Awareness and Perception

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Executive Summary
I. Introduction

A. Why EW/insurance confusion a problem?
Extended warranties are frequently referred to as insurance products in the academic literature as well as in the media. Their shared similarities provide good reason for those assumptions however, legal and regulatory systems have consistently concluded that extended warranties are indeed, not insurance. The point of differentiation is an important one compared to insurance products in terms of the coverages they provide. While it is true that they share many contractual characteristics, case law in many jurisdictions has concluded that they are indeed, not

Particularly distressing are the findings that those least capable of managing their finances (Huysentruyt and Read, 2010) and those most financially disadvantaged are most likely to purchase EWs (Chen, Kalra, and Sun, 2009) at typically inflated prices.

B. EW and insurance share an intertwined history
Early work – are ESCs insurance?
Definition of insurance

C. Who cares?
Regulators, legislators, consumer protection groups

D. Structure of paper

II. Background

A. Define EWs and explain how they are sold
EW markets
The characteristics of each underlying asset that serve as the basis of the extended warranty contract differ significantly and thus, the nature of the contracts may differ significantly. Additionally, the regulation of such contracts may not only differ across state lines but across industries, as well. Thus, the extended warranty marketplace can only be discussed in general terms.

1 Major industries that distribute extended warranties include: auto original equipment manufacturers (OEM), auto parts, aerospace, computers, telecom equipment, semiconductors and PCB, consumer electronics, medical and science equipment, data storage, peripherals, appliance and HVAC, homebuilders, building materials, and power generators. Of those industries, auto OEM and computer manufacturers represent about half of the market.
B. Product Differentiation

Define insurance

Insurance provides indemnification for covered qualifying losses. First-party coverages provide indemnification for losses due to an occurrence that is covered within the policy and not otherwise excluded.

Wiki

Home insurance, also commonly called hazard insurance or homeowner's insurance (often abbreviated in the real estate industry as HOI), is a type of property insurance that covers a private residence, such as a condominium or renters' insurance or home or multiple unit buildings (duplex, triplex or quadplex so long as the owner lives in one of the units). It is an insurance policy that combines various personal insurance protections, which can include losses occurring to one's home, its contents, loss of use (additional living expenses), or loss of other personal possessions of the homeowner, as well as liability insurance for accidents that may happen at the home or at the hands of the homeowner within the policy territory. If a home does not meet the underwriting guidelines of a standard homeowners policy (such as more than 15-20 year old shingled roof, 20-30 year old heating system, no central heating, etc) the residence could qualify for a limited coverage dwelling policy (DP).

Homeowners’ insurance policy, is referred to as a multiple-line insurance policy, meaning that it includes both property insurance and liability coverage, with an indivisible premium, meaning that a single premium is paid for all risks. Standard forms divide coverage into several categories, and the coverage provided is typically a percentage of Coverage A, which is coverage for the main dwelling.

The cost of homeowner’s insurance often depends on what it would cost to replace the house and which additional endorsements or riders are attached to the policy. The insurance policy is a legal contract between the insurance carrier (insurance company) and the named insured(s). It is a contact of indemnity and will put the insured back to the state he/she was in prior to the loss. Typically, claims due to floods or war (whose definition typically includes a nuclear explosion from any source), amongst other standard exclusions (like termites), are excluded. Special insurance can be purchased for these possibilities, including flood insurance. Insurance should be adjusted to reflect replacement cost, usually upon application of an inflation factor or a cost index.

The home insurance policy is usually a term contract—a contract that is in effect for a fixed period of time. The payment the insured makes to the insurer is called the premium. The insured must pay the insurer the premium each term. Most insurers charge a lower premium if it appears less likely the home will be damaged or destroyed: for example, if the house is situated next to a fire station or is equipped with fire sprinklers and fire alarms; if the house exhibits wind mitigation measures, such as hurricane shutters; or if the house has a security system and has insurer-approved locks installed. Perpetual insurance, a type of home insurance without a fixed term, can also be obtained in certain areas.
C. Define EWs

Coverage, wear and tear, breakdown, defective products.

An extended warranty is a contract that provides limited indemnification for the breakdown of the underlying asset that serves as the basis for the contract. Indemnification most often comes in the form of repair or replacement. Extended warranties are typically sold at the point of sale of the underlying asset, although other distribution models also exist. The sales of such warranties are associated with a number of specific industries, including: auto original equipment manufacturers (OEM), auto parts, aerospace, computers, telecom equipment, semiconductors and PCB, consumer electronics, medical and science equipment, data storage, peripherals, appliance and HVAC, homebuilders, building materials, and power generators. Of those industries, auto OEM and computer manufacturers represent about half of the market.

Extended warranties commonly extend the OEM’s warranty (or some limited aspect of that warranty) for a period of time, e.g. three years. While a great deal of variation exists within the industry, extended warranties commonly cover mechanical breakdown due to wear and tear and/or product defect – neither of which meets the definition of an accident. Notably, extended warranties seldom cover accidental breakdown where the breakdown is caused by an accident. This stands in contrast to typical insurance coverages that only provide coverage for accidents...from the perspective of the insured.

In general, an accident may be defined as an unplanned, unexpected, and undesigned (not purposefully caused) event which occurs suddenly and causes:

- injury or loss,
- a decrease in value of someone’s assets, or
- an increase in liabilities.

In insurance terminology, an accident is an event which is not deliberately caused by the insured and which is not inevitable.

For example, if a driver (who is covered under personal automobile insurance for injury and losses due to negligence) willfully drives the vehicle into a tree, the resulting injury or loss is not insured. Similarly, insurance policies do not compensate for obsolescence or wear and tear because their occurrence is inevitable in normal course of things.

Accident defined (http://www.businessdictionary.com/definition/accident.html)

Extended warranties have terms and conditions which may not match the original terms and conditions. For example, these may not cover anything other than mechanical failure from normal usage. Exclusions may include commercial use, "acts of God", owner abuse, and malicious destruction. They may also exclude parts that normally wear out such as tires and lubrication on a vehicle.
These types of warranties are provided for various products, but automobiles and electronics are common examples. Warranties which are sold through retailers such as Best Buy may include significant commission for the retailer as a result of reverse competition.[1] For instance, an auto warranty from a car dealership may be subcontracted and vehicle repairs may be at a lower rate which could compromise the quality of service. At the time of repair, out-of-pocket expenses may be charged for unexpected services provided outside of the warranty terms or uncovered parts.

A. Extended Warranty Coverages
Most state insurance regulators have approved the inclusion of normal wear and tear, accidental damage from handling, rental car and towing, power surge and other coverages in addition to the standard coverage for defects in materials and workmanship.

B. Application of Insurance Coverages

C. Why are EWs a problem?
Inefficient markets
Situational monopoly
Asymmetries of information

D. Legal & Regulatory history – Is it or isn’t it insurance
The shared similarities of extended warranties and various types of insurance contracts sometimes makes it almost impossible for the average person (and even sometimes experts) to differentiate between them. But the ability to differentiate between them is a significant matter for a variety of reasons, most stemming from a significantly differing regulatory structure. Overtly, these contracts of indemnification may share multiple similarities, e.g. the obligation to indemnify, replace, or repair a damaged asset that serves as the basis for the contract. However, nuanced differences, sometimes not obvious to the consumer, have resulted in the distinct differentiation of extended warranties and insurance from a regulatory perspective. One key outcome of that differentiation is a significantly differing set of regulatory expectations.

While insurance products are commonly considered among the most highly regulated products/industries in the world, the regulatory structure for extended warranties is far less rigorous and consistent by comparison. Thus, while the products themselves may seem similar from a consumer’s perspective, they operate under vastly differing regulatory regimes.

Brief summary of court decisions and SCMA

Case law

SCMA
Subsequently, the majority of the state insurance departments that comprise the NAIC’s membership adopted varying versions of the act. Schmitz (2012) reports that 28 states adopted comprehensive versions of the SCMA for regulatory use in the sale of EWs while 13 states adopted more limited regulatory schemes. Additionally, of the 40 or so states that adopted some aspects of the SCMA, many of those standards apply only to the auto EW marketplace (Myer, 2003). The regulation of EWs in the remaining states typically remains under the jurisdiction of various state level departments or not regulated at all. The overall effect of this regulatory infrastructure is that regulation for national EW programs is difficult, confusing, and anything but uniform.

E. Goals of regulation to protect people – so what do people think?
In its publication entitled, *State Insurance Regulation: History, Purpose and Structure*, the NAIC declares the fundamental reason for regulation is to protect the public by seeing to it that fair competition exists to achieve these goals while protecting buyers from anticompetitive or unfair practices.

such as an auto, an electrical appliance, a home, etc.

F. Comparison of the Coverage provided by EWs and Homeowners’ Insurance
Know what’s covered — and what’s not covered — by the extended warranty you’re considering. Does the service contract cover breakdown as well as wear and tear? Under a "breakdown" warranty, coverage is extended only to parts that break. Such a policy can prove less inclusive than is desirable, since not all parts fail due to breakage. Some need to be replaced because they’ve worn down over a period of time; a "wear-and-tear" warranty extends coverage to worn-down parts in need of replacement. Additionally, some "entry level" contracts don’t cover ABS brakes, so if your vehicle has this feature, you should consider upgrading to this level. And overheating — regardless of its cause — isn’t covered in many warranties. Thus, if overheating occurred due to problems with an expensive part such as your radiator, you’d be stuck with a hefty repair bill. Before committing to a warranty, take the time to fully explore the ins and outs of its coverage implications. The distinctions between the various plans might seem slight, but they can prove quite important.

### Table 1. Product Comparison

<table>
<thead>
<tr>
<th></th>
<th>Extended Warranties</th>
<th>Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment</td>
<td>Upfront</td>
<td>Term coverage</td>
</tr>
</tbody>
</table>

2 While the various state insurance departments constitute the membership of the NAIC, it is important to note that those departments typically do not have unilateral authority to engage in the regulation of non-insurance products/industries — such as EWs. Rather, elected state legislatures must grant expanded regulatory authority to their respective state insurance departments to engage in such regulation.

3 One notable exception is the state of Florida which imposes arguably the strictest EW regulation. Indeed, Florida views EWs as if they were insurance and requires similar regulation.
<table>
<thead>
<tr>
<th>Part of financing arrangement</th>
<th>Non-negotiable</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Price</strong></td>
<td></td>
</tr>
<tr>
<td>Typically negotiable at the point of sale</td>
<td>Non-negotiable at the point of sale</td>
</tr>
<tr>
<td>The price charged to the customer is typically under the control of the seller of the contract, e.g. the auto finance and insurance person</td>
<td>Price offered to the customer is typically under the control of the insurer</td>
</tr>
<tr>
<td><strong>Regulation</strong></td>
<td></td>
</tr>
<tr>
<td>Fragmented</td>
<td>Extensive</td>
</tr>
<tr>
<td>Inconsistent</td>
<td>Subject to previous federal case law</td>
</tr>
<tr>
<td>Intertwined with various industry practices</td>
<td>Relatively more consistent</td>
</tr>
<tr>
<td><strong>Trigger Coverage</strong></td>
<td></td>
</tr>
<tr>
<td>Wear and tear</td>
<td>First-party property damage</td>
</tr>
<tr>
<td>Defective parts/manufacture</td>
<td>Specific perils</td>
</tr>
<tr>
<td>Other limited coverages are also sometimes included</td>
<td></td>
</tr>
<tr>
<td><strong>Distribution</strong></td>
<td></td>
</tr>
<tr>
<td>Add-on product at the point of sale</td>
<td>Agency</td>
</tr>
<tr>
<td>Aftermarket</td>
<td>Direct marketing</td>
</tr>
<tr>
<td>Direct marketing</td>
<td>Online presence</td>
</tr>
<tr>
<td>Online presence</td>
<td></td>
</tr>
<tr>
<td><strong>Underwriting</strong></td>
<td></td>
</tr>
<tr>
<td>Contract obligor is often an entity other than an insurance company thus rendering the contract as merely a bi-lateral contractual arrangement that provides services in a manner similar to those of insurance contracts</td>
<td>Requires insurer be the contract obligor and thus, the contract is recognized as insurance</td>
</tr>
<tr>
<td><strong>Underlying Asset</strong></td>
<td></td>
</tr>
<tr>
<td>Varies, including autos, electrical and other appliances, durable goods, homes, etc.</td>
<td>Autos, homes, personal property</td>
</tr>
<tr>
<td><strong>Coverage</strong></td>
<td></td>
</tr>
</tbody>
</table>

In the end, extended warranties are often bi-lateral risk transfer contracts between two parties whereas insurance is always implemented under an “insurance regime” that is licensed, regulated, and subject to significant oversight.

**G. Mechanical breakdown insurance**

Mechanical breakdown insurance (MBI) represents the most comparable insurance product....

http://www.dmv.org/insurance/mechanical-breakdown-insurance.php
III. Extended Warranties as Insurance: Public Perception

A. Survey Details
In late 2010, we surveyed 622 individuals who had recently been offered the opportunity to purchase an extended warranty subsequent to a purchase they had made. The opportunity to purchase the extended warranty was made at the point of sale. Of our pool, 288 had purchased at least one appliance from a regional Midwest appliance retailer while the remaining 334 individuals had recently purchased an auto from a major national auto manufacturer.

There was a 30.5 percent pickup rate (88 individuals reported purchasing an extended warranty) for extended warranties among those purchasing appliances while there was a 53.9 percent pickup rate (180 individuals) for automobile purchasers. The average price of the appliance purchased was $840 and the average extended warranty cost was $130. The average cost of the auto purchased was $24,586 and the average cost of purchased warranties was $1,455.

Using a Likert-scale with response values from 1-7 (where the larger value indicates stronger agreement), we asked 622 individuals that had recently made appliance purchases and who were subsequently offered the opportunity to purchase an extended warranty at the point of sale:

To what extent do you agree (or disagree) with the following statement:

Extended warranties are essentially the same thing as insurance

B. Results
For the purposes of presentation we aggregate the responses of the two pools. About 25 percent of the total respondents agreed with that statement in the strongest terms and 63.7 percent chose values of five or higher, suggesting a strong positive predisposition toward a belief that extended warranties are indeed the same thing as insurance. Conversely, about nine percent strongly disagree with that statement. Figure 1 below presents the complete results in graphic format.
Also of interest is the fact that those who actually purchased extended warranties were relatively more inclined to view them as insurance; purchasers of extended warranties were more resolute in their opinion that extended warranties are essentially the same thing as insurance.\footnote{A statistical mean value comparison of the two groups found a statistically significant difference (at the 0.001 level of significance).}

These results are significant as they stand in contrast to the legal opinions of multiple jurisdictions in earlier case law. Additionally, the formal position of the National Association of Insurance Commissioners (NAIC) is that extended warranties are not insurance. Thus, it would seem that the perceptions of the public-at-large differ significantly from the formal positions of most jurisdictions as well as with that of the de facto coordinating body of the nation’s insurance industry.

The resulting conundrum is that the broader public may possess certain expectations that the operations of the extended warranty industry are subject to regulation that broadly parallels that of the insurance industry – an expectation that is far from the current reality.

\section*{IV. Consumer Awareness of Extended Warranty and Insurance Coverages}

\subsection*{C. Survey Details}

The appliance survey pool identified above were also presented with a short five question quiz designed to assess the respondent’s knowledge of the coverages typically provided by extended warranties and homeowners’ insurance. Of that pool we obtained 253 usable responses.

The respondents were provided with the following background information and were then asked to identify whether coverage (if any) would be provided by a “typical” homeowners insurance policy or possibly by a generic extended warranty contract.
For the following questions, please assume that you bought a TV three years ago that included a three year manufacturer warranty on parts and services.

Additionally, you bought an extended warranty contract at the time of the TV purchase that essentially extends the coverage of the manufacturer’s warranty for another three years after the original manufacturer warranty expires. Assume also that you have a homeowner’s insurance policy that covers the usual kinds of property damage included in such contracts.

Now assume that you have had the TV for three years and that the manufacturer’s warranty has recently expired and consider each of the following unrelated scenarios and identify which contract/s (if any) might likely offer you some coverage in the situation.

The respondent was then presented with each of the scenarios below and asked to choose the “best” answer for each scenario among the following choices:

- Both
- The extended warranty
- Your homeowners’ insurance policy
- Neither

Scenarios

1. You wake up one morning and the TV doesn’t work; no outward sign of any damage or accident – it simply doesn’t work. Which contract/s (if any) might likely offer you some coverage in the situation?

2. The TV no longer works after your home experiences an electrical power surge. Which contract/s (if any) might likely offer you some coverage in the situation?

3. Your brother is watching the Superbowl on the TV at your home and his favorite team loses. In a fit of rage, he kicks the TV and accidentally breaks it. Which contract/s (if any) might likely offer you some coverage in the situation?

4. You are watching the TV and you find that you are suddenly unable to change channels, i.e. the TV is unresponsive to the remote control and any attempts to manually change the channel. Despite turning the TV on and off many times, the problem persists. Which contract/s (if any) might likely offer you some coverage in the situation?

5. Your TV is broken when your dog accidentally knocks it off its stand. Which contract/s (if any) might likely offer you some coverage in the situation?

D. Coverage Rationale

Rationale for HO3

Our standards for the assessment of the responses to the quiz are based on the general standards applied in the insurance and extended warranty industries. That said, both the insurance and extended warranty industries sell a variety of contracts that are essentially variations on a theme; the industries’ regulatory authorities have not imposed a singular, universal standard of required coverages. That said, the insurance industry, with its significantly developed regulatory structure, presents a far more coherent product in terms of coverages than do extended warranties.
According to the National Association of Insurance Commissioners, almost 90 percent of the U.S. homeowners’ insurance market insures personal property, e.g. clothing, electronic appliances, furniture, etc., under what is called “named peril” coverage. Named perils include 16 specifically identified perils (see the appendix for a list of those perils). Therefore, to the extent that an individual might be familiar with homeowners’ insurance coverage, we adopt the “named peril” coverage as our basis for determining insurance coverage in our quiz.

While virtually all personal lines insurance companies offer a variety of coverages aimed at indemnification for covered losses to the insured’s dwelling and/or personal contents, there are some common coverages typically provided by most insurers. Those standard coverages are summarized by the Insurance Standards Organization.

As a means of understanding the critical points of differentiation between the typical homeowners’ insurance policy and a typical extended warranty, we examine the three critical hurdles (in comparison to extended warranties) that serve as differentiating factors. Given the more complex contractual structure, we begin with an examination of the typical homeowners’ insurance policy.

Subject to other miscellaneous clauses and conditions of the contract, three critical elements need to be met in order for a personal property loss to be covered under the typical homeowners’ insurance policy. First, the loss has to be the result of a covered “occurrence.” Second, the loss must be caused by a covered peril. Third, none of the exclusions can be invoked.

“Occurrence” is a defined term in homeowners’ insurance contracts and “means and accident, including continuous or repeated exposure to substantially the same harmful conditions, which results, during the policy period, in: bodily injury or property damage.” While the term “accident” is not a defined term within the realm of insurance, its typical interpretation implies that the occurrence was an “unforeseen and unplanned event or circumstance” from the perspective of the insured. That definition is a seminal point of differentiation when endeavoring to differentiate insurance coverage from extended warranty coverage. The core “perils” covered by extended warranties are the indemnification/replacement/repair for wear and tear and for product defect; neither of which arguably meets the definition of an accident.

The list of named perils invoked under the homeowners’ insurance policy also serves as a significant point of differentiation; “wear and tear” and “product defect” are not included in that list. Thus, even if one were able to include wear and tear and product defect within the definition of a covered occurrence, i.e. they were accidents, the list of

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6. ISO (http://www.iso.com/) is a leading source of information about property/casualty insurance risk. It serves the needs of the property/casualty insurance industry and provides information and resources for a broad spectrum of commercial and personal lines of insurance.
exclusions included in the typical homeowners’ insurance policy commonly specifically excludes “wear and tear” (see the appendix for a list of the common exclusions).

Thus, it is clear that while homeowners’ insurance policies and extended warranties share a number of similarities and may cover damages to the same property, they do not cover the same damages.

between homeowners’ insurance policies and extended warranties as the latter specifically do not cover losses due to accident

As key points of differentiation between the coverages provided by the typical homeowners’ insurance policy and a typical extended warranty, it is helpful to understand the coverage hurdles that must be cleared in the more complex homeowners’ policy

As such, insurance policies do not typically compensate insureds for obsolescence or wear and tear because their occurrence is viewed as inevitable – such mechanical breakdown is not typically viewed as an accident within the scope of the typical homeowners’ insurance policy.

According to the National Association of Insurance Commissioners, almost 90 percent of the U.S. homeowners’ insurance market insures personal property, e.g. clothing, electronic appliances, furniture, etc., under what is called “named peril” coverage which limits coverage to 16 specific covered perils. Therefore, to the extent that an individual might be familiar with homeowners’ insurance coverage, we adopt the “named peril” coverage as our basis for determining insurance coverage in our quiz.

Typical exclusions found in homeowners’ insurance policies include:

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- Flood
- Earth movement
- Ordinance or law (some coverage may be provided in your policy)
- Water damage (sudden and accidental water damage is automatically included)
- Power failure
- Neglect
- War

- Nuclear hazard
- Intentional loss
- Government action
- Collapse (some coverage may be provided in your policy)
- Mold, fungus, or wet Rot (some coverage may be provided in your policy)
- Birds, vermin, rodents, or insects
- Wear and tear, or deterioration

EWS

By comparison, extended warranties represent a far more diverse set of contracts and thus, can only be described in generalities. The complexities stem from the significantly differing characteristics of the underlying asset that serve as the subject of the extended warranty. The sale of extended warranties is common across a variety of disparate industries.8

To simplify our assessment, we focus on the attitudes of consumers who recently purchased either an automobile or an appliance. Additionally, our assessment of “knowledge of coverage” was limited to only those who had recently purchased an appliance and assessed their understanding of potential coverage for a property loss under a “typical” homeowners’ insurance policy and a generic extended warranty that may have been considered when purchasing the appliance in question.

E. Results

Table 1 presents the five scenarios, the correct answer (with the percentage of respondents answering the question correctly in parentheses), and the associated rationale for the correct answer. It is important to note that any number of variations on a theme exist with respect to homeowners’ insurance contracts and extended warranties and we are asking the respondent for their opinion without providing them a succinct standard against which they might assess their answer. For our purposes,

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8 Major industries that distribute extended warranties include: auto original equipment manufacturers (OEM), auto parts, aerospace, computers, telecom equipment, semiconductors and PCB, consumer electronics, medical and science equipment, data storage, peripherals, appliance and HVAC, homebuilders, building materials, and power generators. Of those industries, auto OEM and computer manufacturers represent about half of the market.
### Table 1. Scenarios, Responses, and Rationale

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Correct Answer</th>
<th>Rationale for the Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. You wake up one morning and the TV doesn’t work; no outward sign of any damage or accident – it simply doesn’t work. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>The extended warranty (75%)</td>
<td>No apparent accident, thus insurance would not apply. A product defect would be the most likely explanation and thus, a valid extended warranty would be the most likely source of coverage.</td>
</tr>
<tr>
<td>7. The TV no longer works after your home experiences an electrical power surge. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Your homeowner’s insurance policy (55%)</td>
<td>This is not wear and tear nor a product defect and thus, extended warranty coverage would not apply. The incident is accidental from the perspective of the insured and power surges are a covered peril under most homeowners’ policies.</td>
</tr>
<tr>
<td>8. Your brother is watching the Superbowl on the TV at your home and his favorite team loses. In a fit of rage, he kicks the TV and accidentally breaks it. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Neither (73%)</td>
<td>This is not wear and tear nor a product defect and thus, extended warranty coverage would not apply. While the damage is accidental from the insured’s perspective, the peril is not listed among the covered perils of a standard HO2 form.</td>
</tr>
<tr>
<td>9. You are watching the TV and you find that you are suddenly unable to change channels, i.e. the TV is unresponsive to the remote control and any attempts to manually change the channel. Despite turning the TV on and off many times, the problem persists. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>The extended warranty (80%)</td>
<td>No apparent accident, thus insurance would not apply. A product defect would be the most likely explanation and thus, a valid extended warranty would be the most likely source of coverage.</td>
</tr>
<tr>
<td>10. Your TV is broken when your dog accidentally knocks it off its stand. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Neither (50%)</td>
<td>This is neither wear and tear nor a product defect and thus, extended warranty coverage would not apply. While the damage is accidental from the insured’s perspective, the peril is not listed among the covered perils.</td>
</tr>
</tbody>
</table>
F. Summary
The results of Table 1 are presented in graphic form in Figure 2, below. The average score of the 253 respondents was 66.5 percent. We interpret those results to suggest a weak understanding of the applicability of homeowners’ insurance and extended warranty coverages.

Figure 2. Correct Answers

![Bar Chart showing correct answers for five scenarios]

V. Summary

VI. Appendix
Those perils include:
- Lightning or fire
- Hail or windstorm
- Damage caused by aircraft
- Explosions
- Riots or civil disturbances
- Smoke damage
- Damage caused by vehicles
- Theft
- Vandalism
- Falling objects
- Volcanic eruption
- Damage from the weight of snow, ice, or sleet
- Water damage from plumbing, heating, or air conditioning overflow
- Water heater cracking, tearing, and burning
G. Insurance

Insurance contracts are typically intended to cover accidental events not under the control of the insured. EWs on the other hand are intended to cover wear and tear and defective products – neither of which are included under the definition of an accident by insurance contracts. Thus, the perils covered by insurance and EWs have traditionally been recognized in legal and regulatory circles as a key point of differentiation.

Another seminal point of differentiation considered by legal and regulatory entities are the character of the parties to the contract. While individuals commonly serve as the customer for both personal lines insurance contracts and EWs, the character obligor of those contracts is often not the same. Licensed and legally recognized insurance companies are virtually always the obligor of insurance contracts. As such, both the product and the obligor come under the regulatory domain of the state insurance department. The obligor in an EW contract is often not an insurance company but rather, a third party provider who assume the (financial) responsibility for meeting the covenants of the contract. Given that lack of recognition as a licensed insurer, the contract has sometimes been found not to be insurance in some jurisdictions and thus, is not subject to state insurance regulation.

Additionally, the contract distribution channels have traditionally differed, although that line is becoming increasingly blurred. Personal lines insurance has traditionally been distributed using an agency network recognized as being either independent or exclusive. Technological advances have created new distribution channels, e.g. online outlets such as Progressive, Geico, etc. Additionally, direct marketing, e.g. mailings, phone calls, etc., have also made their own respective inroads in reaching prospective customers.

While each insurance company sells its own version of a homeowners’ policy that provides coverage for the insured’s own property as well as liability coverages, the specific coverages may vary from company to company. There are however, industry standards.

Coverage under a homeowners’ insurance contract is triggered by the occurrence of a covered peril. Typically the wording of the contract requires that the occurrence be an accident from the perspective of the insured.

H. Named Perils

In addition to the requirement that the occurrence of the event be accidental from the perspective of the insured, most policies also limit the coverage to a specific set of perils.
identified in the contract. As identified by the Insurance Services Office (ISO), the standard set of “named perils” include:\(^9\)

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\(^9\) ISO (http://www.iso.com/) is a leading source of information about property/casualty insurance risk. It serves the needs of the property/casualty insurance industry and provides information and resources for a broad spectrum of commercial and personal lines of insurance. The “named perils” are specifically delineated in the HO2 homeowner form.
- Lightning or fire
- Hail or windstorm
- Damage caused by aircraft
- Explosions
- Riots or civil disturbances
- Smoke damage
- Damage caused by vehicles
- Theft
- Vandalism
- Falling objects
- Volcanic eruption
- Damage from the weight of snow, ice, or sleet
- Water damage from plumbing, heating, or air conditioning overflow
- Water heater cracking, tearing, and burning
- Damage from electrical current
- Pipe freezing
VII. Test of Consumer Insurance/EW Coverage Knowledge

1. Both
2. The extended warranty
3. Your homeowner's insurance policy
4. Neither

VIII. Are Service contracts the same as Insurance?

Using a Likert-scale with response values from 1-7 (where the larger value indicates stronger agreement), we surveyed 2,100 recent new car buyers of a major U.S. brand across all major geographic regions in the U.S. Each had been presented with the opportunity to also purchase an EW and were asked to what extent do you agree (or disagree) with the following statement:

*Extended warranties are essentially the same thing as insurance*

The average automobile transaction cost was $24,590 and the average price paid for an EW, when purchased, was $1,455. Of that group, 341 provided usable responses.

A majority of the respondents (67 percent) chose a value of five or higher, revealing a significant predisposition in the belief that EWs are indeed the same thing as insurance (see Figure 1). Conversely, only 13% selected values of three or lower, which may be interpreted to mean a disagreement with the statement.

Also of interest is the fact that those who actually purchased EWs were relatively more inclined to view EWs as insurance than those who didn’t purchase EWs. A statistical mean value comparison of the two groups found a statistically significant difference (at the 0.001 level of significance) in the degree to which they agreed with that statement. Purchasers of EWs (5.09) were more resolute in their opinion that extended warranties are essentially the same thing as insurance.
Figure 1. Consumer Perception of Vehicle EWs as Insurance

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Correct Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. You wake up one morning and the TV doesn’t work; no outward sign of any damage or accident – it simply doesn’t work. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>The extended warranty (75%)</td>
</tr>
<tr>
<td>2. The TV no longer works after your home experiences an electrical power surge. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Your homeowner’s insurance policy (55%)</td>
</tr>
<tr>
<td>3. Your brother is watching the Superbowl on the TV at your home and his favorite team loses. In a fit of rage, he kicks the TV and accidentally breaks it. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Neither (73%)</td>
</tr>
<tr>
<td>4. You are watching the TV and you find that you are suddenly unable to change channels, i.e. the TV is unresponsive to the remote control and any attempts to manually change the channel. Despite turning the TV on and off many times, the problem persists. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>The extended warranty (80%)</td>
</tr>
<tr>
<td>5. Your TV is broken when your dog accidentally knocks it off its stand. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>Neither (50%)</td>
</tr>
</tbody>
</table>
### Scenario vs Rationale for the Correct Answer

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<th>Rationale for the Correct Answer</th>
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<td>1. You wake up one morning and the TV doesn’t work; no outward sign of any damage or accident – it simply doesn’t work. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>No apparent accident, thus insurance would not apply. A product defect would be the most likely explanation and thus, a valid extended warranty would be the most likely source of coverage.</td>
</tr>
<tr>
<td>2. The TV no longer works after your home experiences an electrical power surge. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
<td>This is not wear and tear nor a product defect and thus, extended warranty coverage would not apply. The incident is accidental from the perspective of the insured and power surges are a covered peril under most homeowners' policies.</td>
</tr>
<tr>
<td>3. Your brother is watching the Superbowl on the TV at your home and his favorite team loses. In a fit of rage, he kicks the TV and accidentally breaks it. Which contract/s (if any) might likely offer you some coverage in the situation?</td>
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</tr>
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