Insurance Regulation

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Contracts/Extended Warranties –
A Regulatory Overview

The sale of service contracts has become a burgeoning industry for many retailers and manufacturers of consumer products, as well as third party providers and insurers, over the past decade. In response to the growing number of service contract offerings in the marketplace, states have increasingly begun to regulate such products in a patchwork manner which require those offering such products to pay particular attention to the specific regulatory schemes of the states in which they do business.

Service contracts, more commonly referred to as “extended warranties” or “extended service plans,” provide consumers with the ability to protect their investment in various types of consumer products against defects in materials or workmanship. The key difference between a written warranty, which is given to the consumer as part of the purchase of the consumer product, and a service contract is the payment by the consumer of a segregated charge for the service contract.

The Magnusson-Moss Warranty Act, a federal law passed in 1975, governs written warranties and service contracts. Prior to the passage of Magnusson-Moss, service contracts were simply viewed as warranties; thus, the language of the Act did not reflect the concept of selling a service contract for a separate charge. To this day, the Act’s definitions of “written warranty” and “service contract” do not reflect this difference. Thus, a written promise to repair a defective product could constitute both a warranty and service contract under the Act.

Over time, state insurance regulators began to view service contracts as a type of indemnity contract over which they could assert jurisdiction. This lead to the adoption of the Service Contracts Model Act by the National Association of Insurance Commissioners in 1995. While the Model Act has been used by a number of states as the basis, in whole or in part, for the adoption of legislation creating a regulatory scheme governing the sale and issuance of service contracts in those states, this has lead to a patchwork of inconsistent regulatory schemes.

Thus, although the entities and products may be the same, differing regulatory schemes may affect the manner in which a company’s sale and issuance of service contracts is regulated in one state as opposed to another. For instance,
certain states generally exempt a “manufacturer” from licensure under their regulatory schemes; however, those states have varying definitions of “manufacturer” which, depending on a company's exact circumstances, may require licensure in one state, but exempt the entity in another. Or, the sale of a service contract on a dishwasher or air conditioning unit may change depending on whether it is sold as a stand-alone product by a retailer, or as part of the purchase of a home.

The most common state regulatory schemes provide, in varying degrees, certain licensure, solvency, and record-keeping requirements, as well as provisions detailing mandatory disclosures to be made on the documentation given to the consumer. And, as the definition of “service contract” expands to include coverage for items that do not solely consist of “defects in materials and workmanship” – such as accidental damage from handling, power surges, and certain road hazards – regulators are increasingly scrutinizing their ability to regulate such coverages. Recently, Florida and Ohio amended their statutes to require that service contracts covering “accidental damage from handling” be backed by a contractual liability insurance policy issued by an authorized insurer. Texas recently amended its statutes to require the filing of biographical affidavits for all “controlling persons” of a service contract provider.

As the service contract industry continues to evolve and push the envelope of what types of coverages are offered, and as regulators become increasingly concerned with monitoring the activities of companies involved in the industry, the trend toward further regulation of the service contract industry will likely continue. Companies involved in any aspect of the industry are well-cautioned to review their activities in light of the numerous and differing state regulatory schemes applicable to service contracts.

Frost Brown Todd has advised a number of clients with regard to the implementation and maintenance of comprehensive, nationwide service contract programs, including state licensure, solvency, and disclosure requirements. If you would like additional information, please feel free to contact Greg E. Mitchell at 859-244-7548 or gmitchell@fbtlaw.com, Christopher J. Karo at 859-244-7555 or ckaro@fbtlaw.com, or other members of the FBT Insurance Industry Group.