

## **Extended Warranty, a Service Plan or an Insurance Product?**

An extended warranty is a prolonged warranty offered to customers in addition to the standard warranty on a new item. It is provided for various products, such as automobile, electronic and electrical appliance in household and similar. It has been a popular dispute that whether an extended warranty is an insurance product for a long time.

According to Article 2 of the *Insurance Law of the People's Republic of China*, "Insurance" is defined as: "The commercial insurance activities where an insurance applicant pays an insurance premium to an insurer under an insurance contract and the insurer undertakes to pay the insurance proceeds to compensate for the property loss caused by the occurrence of a potential incident specified in the insurance contract or pay the insurance proceeds when the insured dies, becomes disabled or sick or reaches a specified age, time limit or any other condition specified in the contract. "

China Insurance Regulatory Commission (hereinafter referred to as "CIRC") did not give more explanation on detailed elements of "Insurance", but issued other regulations on the implied factors of "Insurance", which indicates clues on distinction between extended warranty and insurance product.

The distinctions between an extended warranty and an insurance product are as follows:

### **1. Covered Risks**

According to *Reply of the China Insurance Regulatory Commission on Issues Concerning Determination of Property Insurance Coverage* [Bao Jian Ting Han (2008) No. 361] (hereinafter referred to as "Reply on Coverage") issued by CIRC in December 18, 2008, CIRC replied Yueyanglou Branch of the Administration for Industry and Commerce of Yueyang City of Hunan Province: "This is to acknowledge our receipt of your Letter on Whether the Insurance Extension Activity Named "Jia'anbao" for Electric Appliance Carried out by A Certain Mall in Yueyang City Constitutes the Provision of Insurance Consulting Service. After discussion, we hereby reply as follows: Property insurance is against the losses to insured property subject matter caused by dangerous accidents and such losses occur due to unexpected external force. If the losses are only due to natural wear and tear or damage due to use of subject matter based on its nature, such losses are not within the coverage of property insurance. In this case, whether the insurance extension activity named "Jia'anbao" for electric appliance carried out by the mall constitutes the provision of insurance services shall be

analyzed and determined based on specific contents and pursuant to aforesaid principle and criterion.”

Based on “Reply on Coverage” above, we conclude the first distinction between extended warranty and insurance product, which is that extended warranty covers the losses only caused by natural wear and tear or damage caused by use of subject matter based on its nature, while insurance product covers the losses caused by accident or other unexpected external force. That is to say as long as an extended warranty plan uses wording like “the plan covers natural wear and tear” instead of “the plan covers unexpected external force”, the extended warranty plan, in essence, is not an insurance product.

## **2. Forms of Compensation**

According to *Reply of the General Office of the China Insurance Regulatory Commission on the Issue of Alleged Illegal Operation of Insurance Business* [Bao Jian Ting Han(2012)No1. 62] (hereinafter referred to as “Reply on Illegal Operation”) issued by CIRC on February 22, 2012, CIRC replied to the China Insurance Regulatory Commission Guangdong Bureau and stated that “In practice, an act can be determined as illegal operation of commercial insurance business if such an act fits the characteristics of commercial insurance, collecting charges from the public in the name other than insurance premiums and undertaking to perform the obligation including making insurance compensation, payment or other similar risk warranty liabilities. The final determination shall be made by taking into consideration the actual situation of the case.”

The “Reply on Illegal Operation” above concludes the second distinction between extended warranty and insurance product that insurance product is a contract that an applicant pays insurance premium to an insurer and the insurer is obligated to make compensation, payment or other risk warranty liabilities to the applicant, while extended warranty is a plan that the provider would compensate by repair or replacement rather than paying cash or in other similar monetary forms. To be more specific, an extended warranty is a service plan, offering after-sale or replacement services instead of making payments directly to the applicant, which is totally different than an insurance product that can be realized only by making monetary payments.

Additionally, an extended warranty provider can make contract with a third party who would offer repair or replacement service to the customers. An extended warranty provider acts as an agent of the third party, introducing customers to the third party and charging commissions from the third party. However, an insurance product provider could only pay the losses in person.

### **3. Providers**

According to Article 6 of *Insurance Law of the People's Republic of China* "Insurance business shall be conducted by insurance companies established in accordance with this Law or other insurance organizations as prescribed by laws and administrative regulations, and no other entities or individuals may carry out insurance business", and Article 77 "The insurance company or its branch office approved for established shall conduct the registration formalities with the administrative authority for industry and commerce by presenting the insurance business license, and obtain a business license."

Based on two articles above, the providers of insurance products should be insurance companies with insurance business license in compliance with the Insurance Law and other laws and administrative regulations. While no specific qualification requirement applies to the provider of extended warranty service which can be product manufacturer, retailer, insurance company, or non-insurance company, etc. Conclusively, an extended warranty service is different from an insurance product for the reasons of covered risks, forms of compensation and providers.

Concretely speaking (1) an extended warranty service covers losses caused by natural wear and tear, while an insurance product covers losses caused by unexpected external force; (2) an extended warranty service indemnifies losses by offering repair or replacement services by extended warranty service providers or by third parties in a contract with the providers, while an insurance product indemnifies losses by making monetary payments only by insurance companies; (3) an extended warranty service can be provided by manufacturer, retailer, insurance company or non-insurance company, etc., while an insurance product can only be provided by licensed insurance company issued by administrative authority for industry and commerce. In the light of reasons above, it is more persuasive to take an extended warranty as a service plan rather than an insurance product.

In the meantime, some PRC extended warranty providers are planning to draft an industry guideline for extended warranty, including the qualification of providers, quality standard, the relation between extended warranty and its back insurance, etc.. If such guideline goes public, it will help to mitigate the compliance concerns for the extended warranty providers in PRC.

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