EXTENDED WARRANTY

"When you see three GPO mailbags full up with cheques every day, somebody has got a good business going". Malcolm Watson (Cavalier Insurance Co.) in a Sunday Times article on the early problems of Extended Warranty, 11th December, 1983.

Extended Warranty insurance on home appliances was first introduced to the British market in early 1981 and is now estimated to be generating premiums of about £100m per annum.

The insurance covers the cost of repairs or replacement of parts in the event of mechanical or electrical breakdown due to faulty workmanship or materials in manufacture, extending the manufacturers usual one year guarantee for a further four years.

It has proved a popular cover for consumers despite early problems with the demise of the Cavalier and the collapse of Multiguarantee. Most retailers of electrical goods now offer warranty insurance to their customers and, apart from commission income, this usually ensures that future repairs will be directed to their servicing arms.

The five year policy terms and the reasonably fast report and settlement of claims makes this class long term, short tail business. As both the labour and parts content of each claim are subject to VAT there is full exposure to VAT changes in addition to the increases in parts, costs and labour rates during the period of cover.

Rating is still somewhat subjective as no scheme has yet run its full term. Potential fifth year experience can generate endless discussions! Investment income is a significant factor and a sizeable proportion is earned before any claims are paid.

Earning premiums on an even basis is clearly not prudent and will certainly result in accelerating loss ratios. Clearly, the taxation position needs careful consideration. Statistical requirements are relatively straightforward with the concensus on type of applicance and manufacturer being the right level of sophistication.

Both Quota Share and Stop Loss reinsurance is available with co-insurance as an alternative to Quota Share.

The aim of the discussion is to briefly tackle the following questions :-

1. What basis should be used for calculating Unearned Premiums? Is the fund approach the answer?

2. Is 5 years too long a term? Should we be pushing for a reduction to 3 years?

3. What allowance, if any, do we build into the premiums for differences between investment returns and claims costs escalation?

4. Given the option to participate in a scheme, how many of us would recommend participation?

5. Is this a line of business that we should wrestle away from the underwriters?

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Stavros Christofides
Sentry (UK) Insurance Co. Ltd.
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