



Focus on **FINANCE**

Do You Want an Extended Warranty with That?

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GLOSSARY

Coverage: How much risk or liability is protected with an insurance policy.

Deductible: An amount you must pay for expenses before the insurance company pays. The deductible amount is specified by the terms of the insurance policy.

Premium: The fee paid for insurance protection.

Probability: The likelihood or chance of an event occurring.

Risk: The chance of loss.

“Do something today that your future self will thank you for.”
—Sean Patrick Flanery

It’s important to think about the unexpected as you plan for the future. Most consumers buy home and car insurance policies to protect themselves from the cost of an accident or disaster. These policies provide **coverage** to protect a home and vehicle. Some people also buy coverage for day-to-day “wear and tear” issues with their home, car, or even appliances. Extended warranties, also known as service contracts, protect consumers from problems that are not covered by traditional insurance. These warranty plans can cover repairs for a broken dishwasher or new brakes for a car. Providers of extended warranties claim they will pay the cost of these repairs in exchange for the **premiums** consumers pay.

There are lots of extended warranty providers, so it is important to do some research before signing a contract. (See boxed insert, “Protect Yourself from Auto Service Contract and Warranty Scams.”) Another thing to consider is putting the money you would pay for an extended warranty into a savings account. Then you would have the money from the account to pay for home, car, or appliance repairs. And if an appliance or car lasts a long time, you can use the money you’ve saved to buy a new one when it finally wears out.

Whether you buy an extended warranty plan or not first depends on how comfortable you are with **risk**. Those who are more willing to accept personal risk may be much less interested in an extended warranty than those who are less willing to accept personal risk. For consumers who accept less personal risk, an extended warranty company will maintain a collective fund into which it places the premiums consumers pay. In the event of a necessary repair, the company pays for the repair or replacement of the insured item with money from the fund. This means that the risk of something going wrong with an appliance or a car is shared by the consumer and the extended warranty provider. The provider determines the **probability** that a bad event will occur to set the price for a service contract. To make

Protect Yourself from Auto Service Contract and Warranty Scams

The following sites provide additional information from the Federal Trade Commission and the Federal Communications Commission for avoiding auto warranty scams:

<https://www.consumer.ftc.gov/articles/0054-auto-service-contracts-and-warranties>

<https://www.fcc.gov/consumers/guides/beware-auto-warranty-scams>

Additionally, the following site provides some tips and questions to ask to avoid an auto warranty scam:

<https://www.idaholegalaid.org/node/1792/how-steer-clear-auto-warranty-scams>

a profit, these companies must charge their buyers more than what the companies expect to need in coverage.

There are both benefits and costs to buying an extended warranty. The following are some of the benefits:

- **Peace of mind:** You may gain some peace of mind from transferring some risk of potential repair costs to an extended warranty provider.
- **Ease of finding a repair person:** You won't have to find a repair person. The warranty provider will find someone to make repairs.
- **Potential savings:** If you have an expensive repair that is covered under your warranty, it's possible that it will cost you less than if you had paid for the repair out of pocket.

On the other hand, the following are some costs to consider before signing a contract for an extended warranty:

- **Maintenance standards:** For a repair or replacement to be covered, you may have to meet maintenance standards set by the warranty company. If there's a disagreement between you and your provider about what "maintained" means, the provider has the power to decide. In some cases, they can deny your claim. When you purchase a used car or previously owned home, you don't know how well the previous owner maintained them. This means your claim might be denied by the warranty company because of previous ownership.

- **Double coverage:** Appliances and cars are often already covered by a manufacturer's warranty. And some credit card companies provide free extended coverage when you use the card to make purchases. So if you buy an extended warranty plan, you may be paying for coverage you already receive for free.
- **Lack of freedom in choosing a service or repair provider:** It may save you time to have the warranty company find a repair person. But if you dislike the repair person chosen or the service they provide, you may not be able to choose someone else to do the work.
- **Length of wait:** Many service contract providers take a long time to make repairs happen. And sometimes the job isn't completed correctly the first time. According to a 2018 Consumer Reports survey, 17 percent of those with an appliance repaired under an extended warranty said it took an unreasonable amount of time for it to be fixed, compared with 9 percent of individuals who paid for repairs themselves. When it comes to accuracy of the repair, 23 percent of those with a service contract said it took more than one attempt to have their appliances fixed properly versus 15 percent of those who paid to have it repaired themselves.¹

Even with a Service Contract, Repairs Aren't Always Free

Extended warranty companies don't always provide free service.² According to the Federal Trade Commission, some service contracts require consumers to pay a **deductible** or fee each time service work is done. And when replacing an appliance or auto part, the warranty company may pay you only the depreciated value of the item. These values might be based on the age of the appliance or car, and the payment wouldn't be enough to cover the full cost of the repair. It is also important to make sure you are not being charged interest on your extended warranty plan. Sometimes the cost of the extended warranty is added to people's auto loans. This means that a buyer is paying interest on the price of the extended warranty, making it even more expensive.

You May Not Even Use It

According to a 2014 Consumer Reports survey, 55 percent of extended car warranty users didn't use their contract for repairs.³ There is also the risk that your extended warranty provider goes out of business. In this case, you've paid for a warranty you can't use.

Suppose you buy a new car and are wondering if you should buy a service contract. According to the same 2014 Consumer Reports survey, the average initial cost of an extended car warranty is \$1,214. For survey participants, the median amount extended warranty users received for repairs was \$837.⁴ Subtracting the amount received for repairs from the average cost of the warranty shows that the typical consumer overpaid for their service contract by \$377. Also, there were likely some consumers who did not use the extended warranty coverage at all. Instead of paying for an extended warranty, it might be better to place the money you would have spent on an extended warranty into a savings account to use if you have an emergency repair.

Conclusion

Having the ease of someone else find a repair person for you or having some peace of mind when faced with a costly repair might draw you into paying for an extended service contract. But it might be better to take care of your appliance and car repairs yourself. For a limited number of consumers, an extended warranty might help save money in the case of an expensive repair. However, many consumers end up paying premiums and never use the warranty service, or they use it for repairs that cost less than the premiums. Before sealing the deal for a service contract on a home, a car, or an appliance, be sure to read the fine print and weigh the benefits and costs. ■

Notes

¹ Consumer Reports. "Extended Warranty Buying Guide." April 25, 2018; <https://www.consumerreports.org/cro/extended-warranties/buying-guide/index.htm>.

² United States Federal Trade Commission Consumer Information. "Extended Warranties and Service Contracts." August 2012; <https://www.consumer.ftc.gov/articles/0240-extended-warranties-and-service-contracts>.

³ Consumer Reports. "Extended Car Warranties: An Expensive Gamble." February 28, 2014; <https://www.consumerreports.org/extended-warranties/extended-car-warranties-an-expensive-gamble/>.

⁴ Consumer Reports, 2014. See footnote 3.

Name _____ Period _____

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After reading the article, answer the following questions:

1. Which of the following protects a consumer from problems that are not covered by traditional insurance?
 - a. Premiums
 - b. Deductibles
 - c. Risk coverage
 - d. Extended warranties

2. With an extended warranty, you may still have to pay a fee or deductible.
 - a. True
 - b. False

3. How much risk or liability is protected with an insurance policy is the coverage of the policy.
 - a. True
 - b. False

4. What is the fee people pay for insurance protection?
 - a. Coverage
 - b. Deductible
 - c. Premium
 - d. Risk

5. Risk is the
 - a. amount of premium paid for a policy.
 - b. coverage required to insure a car or house.
 - c. likelihood or chance of an event occurring.
 - d. chance of loss.

6. The amount a person must pay for expenses before the insurance company pays is called
 - a. coverage.
 - b. deductible.
 - c. premium.
 - d. risk.

7. The likelihood or chance of an event occurring is called
 - a. coverage.
 - b. deductible.
 - c. premium.
 - d. probability.

8. Which of the following is a possible benefit of extended warranties?
 - a. Ease of finding a repair provider
 - b. Maintenance standards
 - c. Length of wait for a completed repair
 - d. Free repairs

9. Which of the following is a possible cost of extended warranties?
 - a. Peace of mind
 - b. Ease of finding a repair provider
 - c. Maintenance standards
 - d. Free repairs

10. Those who are more willing to accept personal risk are more likely to save each month for unexpected events rather than purchase an extended warranty.
 - a. True
 - b. False