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STATE CORPORATION COMMISSION
BUREAU OF INSURANCE
May 20, 1982

Administrative Letter 1982-10

TO: All Automobile Manufacturers, Automobile Dealers Licensed in Virginia, Property and Casualty Insurers Licensed in Virginia, and Persons Issuing Motor Vehicle Service Contracts in Virginia.

RE: Motor Vehicle Service Contracts

The purpose of this letter is to address the area of "motor vehicle service contracts", "extended automobile warranties", "extended service contracts", "limited service agreements", and similar instruments indemnifying consumers for mechanical breakdown of motor vehicles.

There appears to be some confusion in the minds of consumers, insurers, providers of motor vehicle service contracts, and other interested parties as to the legal status of such contracts. Additionally, there has been considerable regulatory interest in these contracts on the part of a number of states in light of the insolvency of North American Dealer Group, a major provider of motor vehicle service contracts.

Under section 38.1-21 of the Code of Virginia, motor vehicle and aircraft insurance is defined to include, among other things, loss or damage resulting from any cause to motor vehicles. Pursuant to this section, the Bureau of Insurance has approved "mechanical breakdown insurance" policy forms filed for use in the Commonwealth of Virginia by several licensed motor vehicle insurers. Typically, these policies provide coverage for the cost of repair or replacement of specified parts of a motor vehicle resulting from mechanical breakdown. Mechanical breakdown is usually defined as the inability of a part to perform the function for which it was designed.

It has come to the Bureau's attention that numerous other entities, including motor vehicle manufacturers, motor vehicle dealers, and independent third parties are offering for sale, selling, or providing within the Commonwealth contracts called "motor vehicle service contracts" or some similar name, which contracts are virtually identical in coverage to mechanical breakdown insurance policies offered by licensed motor vehicle insurers. Some motor vehicle service contracts do differ from mechanical breakdown insurance policies in that they contain provisions that would not be permitted if the contracts were filed for approval as insurance policies. Notwithstanding such differences, the Bureau, after a careful examination of numerous motor vehicle service contract forms, is unable to perceive any substantive difference between motor vehicle service contracts and mechanical breakdown insurance policies.

In light of the substantial identity of motor vehicle service contracts and mechanical breakdown insurance, it is the opinion of the Bureau of Insurance that such

contracts, by whatever named called, are policies of mechanical breakdown insurance if offered by a person other than the manufacturer or seller of the covered motor vehicle.

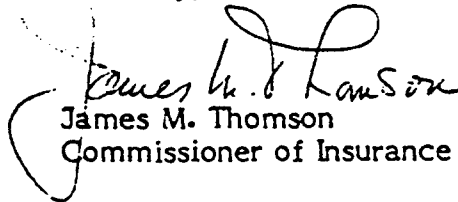
Accordingly, the Bureau of Insurance is of the opinion that the offer to sell, the sale, or the providing of such contracts within the Commonwealth of Virginia by a person other than the manufacturer or seller of the covered vehicle constitutes the transacting of an insurance business, and that persons transacting such business must be licensed as insurers under applicable provisions of Title 38.1 of the Code of Virginia.

The Bureau is of the opinion that contracts offered by the manufacturer or seller of the covered motor vehicle are more in the nature of warranties than of insurance. The primary risk of loss under such contracts must remain with and be borne by the manufacturer or seller, or the contract will be deemed to be an insurance policy.

The Bureau is also aware that some dealers are issuing motor vehicle service contracts and then purchasing contractual liability or reimbursement insurance policies to cover or back up their losses under the contracts. The Bureau regulates these back up policies as contractual liability insurance and there is no objection by the Bureau to this arrangement.

The Bureau of Insurance hopes that this administrative letter eliminates the confusion regarding the legal status of motor vehicle service contracts and similar arrangements. The Bureau suggests that all parties issuing, selling, or providing such contracts familiarize themselves as quickly as possible with the applicable provisions of the Virginia insurance laws, as the Bureau intends to enforce all applicable laws dealing with the sale of this type of insurance.

Sincerely,


James M. Thomson
Commissioner of Insurance

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