

# **Travel insurance review**

## **Summary of consultation responses and final Impact Assessment**

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December 2007



HM TREASURY





HM TREASURY

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**Summary of consultation responses**  
**and final Impact Assessment**

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# INTRODUCTION

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**1.1** This document summarises the responses to the consultation stage of HM Treasury's review of the selling of travel insurance sold alongside a holiday or other related travel. Final legislation has also been published alongside this document. A final Impact Assessment<sup>1</sup> is provided at Annex B.

**1.2** This review was launched in August 2006 with a call for evidence published on 23 November 2006. On 26 June 2007 the Government announced its intention to extend Financial Services Authority (FSA) regulation to the selling of travel insurance sold alongside a holiday and a next stage of consultation<sup>2</sup>, including draft legislation and a partial Regulatory Impact Assessment (RIA), was opened. This consultation stage closed on 18 September 2007.

**1.3** HM Treasury is grateful to all those who responded to the consultation and commented on the partial RIA.

## QUESTIONS ASKED BY THE CONSULTATION AND PARTIAL RIA

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### Consultation

**1.4** The questions raised in the consultation were:

- Do you have any comments on the Government's preferred approach?
- Do you have any comments on the partial RIA?
- Do you have any comments on whether the draft Statutory Instrument achieves the stated policy objective?
- Do you have any comments on the extent to which travel firms would be able to make use of the Appointed Representatives route, or whether the exemption offered by Article 72C of the Regulated Activities Order will be used by travel firms as an alternative business model?
- Do you agree that, where currently exempt from FSA regulation, both car hire companies and event management companies (the latter when selling to commercial customers) should continue to be exempt from regulation?
- Do you have any comments on the proposed interim authorisation regime for travel firms selling insurance?

### Partial RIA

**1.5** The question raised in the partial RIA was:

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<sup>1</sup> The Better Regulation Executive (BRE) introduced a new format of Impact Assessment, replacing the Regulatory Impact Assessment, in May 2007. All Impact Assessments produced from November 2007 are required to be in this new format.

<sup>2</sup> The consultation was contained within the *Travel insurance review: summary of responses and next steps* document, published on 26 June 2007, which also summarised responses to the call for evidence stage of the review

(see [www.hm-treasury.gov.uk/consultations\\_and\\_legislation/travelinsurance\\_review/consult\\_travelinsurance\\_review\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/travelinsurance_review/consult_travelinsurance_review_index.cfm)).

- Do you agree with the analysis of costs and benefits for the different implementation options, and in particular with the assumptions made in quantifying these costs, as well as the impact on competition and small firms?

**1.6** Chapter 2 summarises the responses received to these questions and on other issues raised during the consultation period. Chapter 3 summarises the conclusions and sets out next steps.

# 2

## SUMMARY OF RESPONSES

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### CONSULTATION

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**2.1** The consultation sought views on the proposed extension of FSA regulation to the selling of travel insurance sold alongside a holiday.

**2.2** 15 responses were received to the consultation from firms, representative associations, and an individual. A list of respondents is attached at Annex A.

**2.3** 8 of the responses were supportive of the Government's preferred approach (i.e. the extension of FSA regulation). Several arguments were provided in support of the approach:

- it would raise insurance selling standards in the travel industry and hence, reduce the risk of consumer detriment;
- it provides a backstop through access to the Financial Ombudsman Service (FOS), in cases of alleged mis-selling, and the Financial Services Compensation Scheme (FSCS);
- it would lead to a greater consistency between the consumer protections in place when buying travel insurance direct from an insurer or from an insurance broker.

**2.4** 2 respondents disagreed with the Government's proposed approach. These responses argued that the call for evidence had not provided substantive evidence of consumer detriment relating to the selling of travel insurance sold alongside a holiday. One of these responses questioned the evidence provided to the call for evidence in terms of organisational bias, the anecdotal nature of some of the responses and the small samples used to produce consumer survey evidence.

**2.5** The remaining 5 responses did not offer an explicit view on the desirability of the Government's proposed approach.

**2.6** On the whole, these arguments do not differ greatly from those presented to the call for evidence. Little in the way of new evidence has been presented in response to this consultation stage on either side of the argument. The Government acknowledges the concern raised with the quality of the evidence submitted to the review but does not feel that these concerns undermine the overall assessment that there is a weight of evidence that FSA regulated firms do a better job in terms of product disclosure and navigating the consumer through a sometimes complicated sales process.

**Car hire and event management firms** **2.7** One response explicitly supported the exemption provided with in the draft legislation for car hire firms' insurance sales and one response explicitly supported the exemption provided for event management firms' insurance sales. A further response agreed with both exemptions. One response disagreed with the exemptions. However, no new evidence was provided in support of either side of the argument.

**Reaction of travel firms** **2.8** Many of the responses commented on the likely reaction of travel firms to the introduction of FSA regulation relating to their insurance sales. Several of these responses noted that many travel firms would be unlikely to find it economically viable to seek FSA authorisation given the costs associated with this option and the low level of income derived from insurance sales. Furthermore, several responses also noted that

the Appointed Representative route<sup>1</sup> would be constrained by a limited appetite within regulated firms to accept travel firms as agents, given the increased regulatory risks and compliance and monitoring costs associated with this option. The Association of Travel Insurance Intermediaries' response noted that only 5 out of 25 members surveyed indicated that they would be prepared to act as a Principal in an Appointed Representative relationship, and then that they would only consider discussing this option with larger travel firms. Other responses echoed the feeling that FSA authorisation or Appointed Representative status would only be viable options for larger travel firms. One response did, however, predict that the Appointed Representatives route would be the most popular amongst travel firms.

**2.9** Some responses also noted the perception of extra compliance costs for regulated firms associated with accepting more than five agents as Appointed Representatives, given the FSA's approach to regulating such firms<sup>2</sup>. The FSA's Handbook does not, however, specifically distinguish between networks and other Appointed Representative arrangements<sup>3</sup>.

**2.10** Several responses expressed the view that the most likely option for most travel firms would either be to act as an (unregulated) introducer<sup>4</sup>, or to seek Introducer Appointed Representative (IAR) status<sup>5</sup>, which would imply lower regulatory burdens on the Principal than the full Appointed Representative route. The Association of British Travel Agents' (ABTA) response stated that they expected the IAR route to be the most popular amongst their membership. However, one response noted that many travel insurance intermediaries are wholesale intermediaries who lack the direct sales processes to take part in an introducer or IAR arrangement. Another response also noted that the popularity of the introducer route might be diminished by the lower commissions that travel firms could expect to receive from this option.

**2.11** Some responses expressed the view that, given that the likely reaction of many travel firms would be to stop selling travel insurance, the level of those travelling uninsured could increase significantly. One response estimated that the number of those travelling uninsured would rise from 13% at present to over 20%. One response suggested the level of those travelling uninsured would be dependent on the level of burden implied by the FSA's regime, rather than solely the decision to extend regulation. However, some responses predicted that the effect on the level of those travelling uninsured would, in fact, be negligible, given the accessibility of the travel insurance from distribution channels that are already regulated.

<sup>1</sup> An Appointed Representative is allowed to carry on certain regulated activities by an authorised firm (his Principal) under a contract by which the Principal accepts the responsibility for the regulated activities carried on by its Appointed Representatives.

<sup>2</sup> When an insurance intermediary Principal has a number of Appointed Representatives it becomes a 'network'. The FSA expects networks to apply appropriate controls over their ARs so that they maintain the same standards as directly authorised firms. An insurer Principal does not become a network irrespective of the number of Appointed Representatives they may have.

<sup>3</sup> The FSA's approach is to look to satisfy itself that the Principal has the appropriate systems and controls in place to ensure they can fulfil their obligations as a Principal. The FSA might also pay extra supervisory attention to systems and controls in assessing the risks associated with networks and in developing solutions to mitigate those risks.

<sup>4</sup> Some forms of information provision related to insurance services are not required to be regulated. For example, the passive display of advertising leaflets in a reception would not be caught. Further activities, such as giving generic advice about the sort of cover which may be required, explaining the terms of the policy, or giving consumers information about how to fill in forms might not fall within the scope of regulation. For these types of activity, article 72C of the Regulated Activities Order provides a limited exemption for professions or businesses that only provide such information or introduction incidentally to their main business.

<sup>5</sup> If a firm's only activity in relation to the selling of a general insurance product is to introduce customers to a regulated firm and/or distribute certain kinds of marketing material in relation to general insurance, that firm can apply to become an Introducer Appointed Representative. Fewer rules apply to an IAR, but the relationship between the Agent and the Principal is equivalent to that in the Appointed Representative regime, i.e. both parties have the same responsibilities.

**Draft Statutory Instrument** **2.12** Most respondents thought the draft Statutory Instrument (SI) met the policy intention set out in the consultation.

**2.13** One response noted that the exemption within the draft SI restricts the exemption to event management firms to circumstances where the client of the event management firm is not an individual or a business with an annual turnover of less than £1,000,000. The response argued that the restriction should not apply to businesses below a turnover limit, given that:

- having to establish this breakpoint introduces an additional burden for event management firms;
- most companies under the turnover limit would be protected by other consumer protection measures, such as ATOL licensing or ABTA's Code of Conduct;
- the breakpoint could create anomalies, for instance for firms whose turnover fluctuated around the £1,000,000 limit.

**2.14** However the Government feels that the restriction is appropriate, given the additional protection it would provide small businesses, for instance through access to the Financial Ombudsman Service in situations where the small business believed that mis-selling might have occurred.

**2.15** Other comments received went wider than the specific issues being consulted on and are addressed below.

## **PARTIAL REGULATORY IMPACT ASSESSMENT**

**2.16** Respondents were also asked to comment on the partial RIA and, specifically, the analysis of costs and benefits for the different implementation options, including the assumptions made in quantifying these costs.

**2.17** As discussed above, several respondents felt that the number of travel firms pursuing the Appointed Representatives route would be low. By inference, these responses suggest that the analysis in the partial RIA might have overestimated the number of travel firms for which the Appointed Representatives route is the most likely option. One response suggested that the cost burden applying to this measure might have been significantly overestimated, since many firms would not seek authorisation at all. However, none of the consultation responses offered alternative estimates on the precise proportion of travel firms that would seek Appointed Representative status. ABTA's response estimated that less than 50 of its members would apply for FSA authorisation; another response suggested that less than 5% of travel firms would apply.

**2.18** A few responses suggested that the partial RIA significantly underestimated the level of commission earned by travel firms. One response estimated the average level of travel firms' commission to be around 30-60% and another estimated the commission earned by travel agents to be at least 40% (but noted this would be significantly lower for tour operators).

**2.19** One response suggested that the partial RIA should specifically reflect the fact that no evidence of consumer detriment relating to the insurance sales of car hire firms had been received during the call for evidence stage of the review.

**2.20** These comments are addressed in further detail in the final Impact Assessment published alongside this document.

## OTHER ISSUES RAISED DURING THE CONSULTATION

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**2.21** Several of the responses addressed the issue of how the FSA should regulate travel insurance sales following the introduction of regulation. One response argued that the FSA's regime should be focussed on: (i) information provided to the consumer at the point of sale including, specifically, information about the need to disclose pre-existing medical conditions; (ii) the consumer's right to cancel; (iii) training of staff; (iv) the consumer appeals/redress process. Other responses argued for consistent, proportionate regime for travel insurance across different distribution channels (i.e. including those sales that are currently regulated).

**2.22** The FSA's ongoing review of its Insurance: Conduct of Business (ICOB) rules – the regime for the selling of general insurance products - demonstrates the FSA's risk-based, proportionate approach to regulation. Whilst the Government fully expects the FSA to design a proportionate regime for the regulation of the selling of travel insurance sold alongside a holiday, decisions on the nature of this regime rest with the FSA.

**2.23** The FSA are required by the Financial Service and Markets Act 2000 (FSMA) to conduct cost-benefit and market failure analysis and to consult on any new rules. The Government understands that the FSA are in the process of preparing the cost-benefit and market failure analyses and intend to consult on draft rules shortly. The consultative stage of the ICOB review closed on 28 September 2007, with final rules expected in December 2007.

**2.24** One response supported the work on disclosure information in travel insurance policies, outlined in the consultation document. One response went further by suggesting that all travel insurance policies should be required to offer cover in certain 'core' areas, including aftercare and repatriation claims relating to acts of terrorism. The Government does not feel that at this stage it would be appropriate to require insurers to cover claims arising from terrorist incidents, or to put in place any other specific requirements relating to cover provided in the policy. As explained in the *Summary of responses and next steps* document, travel insurance policies that offer cover for at least medical and repatriation expenses are widely available in the market<sup>6</sup> and imposing a mandatory requirement on insurers could increase premiums and lead to less choice for individuals.

**2.25** The Government will continue its work with the insurance industry to identify any issues around the transparency of travel insurance policies and disclosure documents, with the aim of increasing consumer awareness around the need to consider the cover provided by their travel insurance policy and the advantages of shopping around for the most appropriate cover. The Association of British Insurers (ABI) is currently conducting an exercise to scope and evaluate these issues with reference to quantifiable evidence, such as insurers' records of complaints and data from the Financial Ombudsman Service, wherever possible.

**2.26** The findings of this exercise will feed into a second stage of work, in early 2008, led by HM Treasury and involving the ABI, the Foreign and Commonwealth Office, the Department for Culture, Media and Sport, the Financial Services Authority and the British Insurance Brokers' Association. This second stage will seek to identify practical ways of promoting among consumers a better understanding of their protection needs before they travel.

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<sup>6</sup> The Association of British Insurers (ABI) estimate that around 60% of travel insurance policies provide cover for such claims.

**2.27** The ABI is already committed to produce a good practice guide for firms if their analysis shows that this will help to raise consumer awareness. This is likely to involve highlighting concerns over terrorism cover in travel policies to its Member firms, and ensuring they know how best to communicate this cover, or its exclusion, to consumers.

## CONCLUSIONS AND NEXT STEPS

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### CONCLUSIONS

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**3.1** The call for evidence stage of this travel insurance review established a weight of evidence suggesting that travel insurance was a relatively more complex product compared to other general insurances and that FSA regulated firms tend to do a better job throughout the selling process. Given the responses received to this consultation stage of the review, the Government's view remains that a proportionate, risk-based regime will strike the right balance between consumer protection and the burden that regulation will place on travel firms. **Therefore, the Government intends to proceed with its decision to extend FSA regulation to the selling of travel insurance sold alongside a holiday.**

**3.2** The Government is aware that some concerns have been raised around the effect of extending FSA regulation to the selling of travel insurance sold alongside a holiday on the number of travel firms selling travel insurance and the level of those travelling uninsured. However, the Government's view is that a proportionate, risk-based regulatory regime, alongside the various options open to travel firms, including the Appointed Representative and Introducer Appointed Representative routes and the option of becoming a non-regulated introducer, should limit this effect. Crucially, irrespective of the regulatory arrangement, the selling process will take place in a regulated environment, with the ensuing consumer protections, including access to the FOS when things go wrong.

**3.3** The Government also remains of the view that the stand alone travel insurance market provides a mature, competitive, and easily accessible route to the market for customers of travel firms who no longer wish to offer any insurance services.

**3.4** Given that no evidence relating to consumer detriment arising from insurance sales by event management firms or car hire firms has been presented to this review, the Government has decided to maintain the exemptions for these two sectors.

### NEXT STEPS

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**3.5** A final Impact Assessment is published alongside this document. The final legislation implementing the extension of FSA regulation to the selling of travel insurance sold alongside a holiday is also provided at annex B. This legislation will be made on 13 December 2007. Parliamentary approval will need to be achieved by a resolution of both Houses of Parliament within 28 days, beginning with the day on which the Order was made.

**3.6** To ease the transition into FSA regulation the final legislation provides for an interim authorisation regime. This will allow travel firms to continue selling travel insurance if their application is still being processed once regulation starts. Travel firms will be able to apply for FSA authorisation from 30 June 2008 onwards, with a cut-off date for applications to be considered eligible to the interim authorisation regime of 15 November 2008. Completed applications will then be processed by the FSA within 6 months. The interim authorisation regime will remain in place until 31 December 2009, to allow any firms that have decided to appeal the FSA's application decision to continue selling travel insurance whilst this appeals process is ongoing.

**3.7** The FSA will consult on draft rules shortly. Details of this consultation will be available in due course from the FSA's website at [www.fsa.gov.uk](http://www.fsa.gov.uk). The FSA will be responsible for authorising firms to do business in line with FSMA and is required to consult on any rules or guidance that it will apply to firms.



# A

## RESPONSES TO THE CONSULTATION

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Association of British Insurers

Association of British Travel Agents

Association of Travel Insurance Intermediaries

British Insurance Brokers' Association

British Vehicle Rental and Leasing Association

Eventia

Financial Services Authority

Global Travel Insurance

HBOS

Journeys Travel Insurance

Lexham Insurance Consultants

MPI Brokers

Towergate Chase Parkinson

*Which?*

One response was received from an individual.

# B

## FINAL IMPACT ASSESSMENT

### Summary: Intervention & Options

**Department /Agency:**  
HM Treasury

**Title:**  
Impact Assessment of the regulation of the selling of travel insurance sold alongside a holiday or other related travel

**Stage:** Implementation

**Version:** Final

**Date:** 13 December 2007

**Related Publications:** Travel insurance review: summary of consultation responses

**Available to view or download at:**

[http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/travelinsurance](http://www.hm-treasury.gov.uk/consultations_and_legislation/travelinsurance)

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**What is the problem under consideration? Why is government intervention necessary?**

Unlike the selling of most general insurance products, the selling of travel insurance sold alongside a holiday or other related travel is not currently subject to statutory regulation. Concerns have been raised around the level of consumer detriment arising from mis-selling in this area.

The Government has reviewed this area and thinks that statutory regulation of these sales, through the Financial Services Authority (FSA), is necessary. This Impact Assessment provides further details of the costs and benefits of this measure.

**What are the policy objectives and the intended effects?**

The Government's intention is to raise standards in the selling of travel insurance sold alongside a holiday or related travel with the intended effect of minimising consumer detriment related to mis-selling.

The Government also intends to ensure that consumers have access to appropriate redress measures where they have been mis-sold travel insurance sold alongside a holiday or related travel.

**What policy options have been considered? Please justify any preferred option.**

Option 1 - do nothing.

Option 2 - some form of strengthened industry self-regulation including access to the Financial Ombudsman Service (FOS).

Option 3 - FSA regulation. Option 3 is the Government's chosen option. The main benefits of FSA regulation are that firms will have to meet the FSA's high-level principles, for instance on treating customers fairly, as well as meeting any rules or guidance issued by the FSA, for instance on clear disclosure information. Consumers will also have a statutory right to redress, through the FOS.

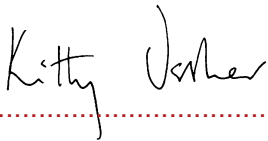
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Government keeps all legislation under review, and in line with good practice would expect to review the policy within three years.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible Minister:



Date: 13 December 2007

## Summary: Analysis & Evidence

Policy Option: Option 2

Description: Strengthened industry self-regulation including access to the Financial Ombudsman Service

COSTS	ANNUAL COSTS		Description and scale of <b>key monetised costs</b> by 'main affected groups' Key monetised costs will fall to the travel industry trade associations responsible for industry self-regulation and to travel firms selling insurance.
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	£ 0.1 - 0.2m	1	
	<b>Average Annual Cost (excluding one-off)</b>		
£ 0.68 - 1.46 m	<b>Total Cost (PV)</b> £ 5.95 - 12.77m		
<p><b>Other key non-monetised costs</b> by 'main affected groups'</p> <p>The cost to firms of implementing improvements, including an annual levy or per case fee (or combination of both) to fund disputes taken to the FOS.</p>			

BENEFITS	ANNUAL BENEFITS		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Key monetised benefits will fall to consumers of travel insurance sold alongside a holiday or other related travel that purchase the insurance from a member of a trade association.
	<b>One-off</b>	<b>Yrs</b>	
	£ None		
	<b>Average Annual Benefit (excluding one-off)</b>		
£ 15.65 - 16.08m	<b>Total Benefit (PV)</b> £ 134.70 - 138.42m		
<p><b>Other key non-monetised benefits</b> by 'main affected groups'</p> <p>Possibility of improvement in selling practices by some travel firms. Some consumers will have access to an independent, impartial and low cost method of redress through the FOS.</p>			

**Key Assumptions/Sensitivities/Risks** Key assumptions include the level of mis-selling by travel firms and the likelihood of mis-selling leading to a claim being rejected.

Price Base Year 2007	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £ 121.93m - 132.47m	<b>NET BENEFIT (NPV Best estimate)</b> £ 127.2m
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	N/A
Which organisation(s) will enforce the policy?	Travel industry
What is the total annual cost of enforcement for these organisations?	£ 0.2 - 0.5m
Does enforcement comply with Hampton principles?	No

Will implementation go beyond minimum EU requirements?		Yes		
What is the value of the proposed offsetting measure per year?		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of £ N/A	Decrease £ N/A	<b>Net Impact</b>	£ N/A

Annual costs and benefits: Constant Prices

(Net) Present Value

## Summary: Analysis & Evidence

Policy Option:  
Option 3

Description: The selling of travel insurance sold alongside a holiday or related travel to be regulated by the FSA

COSTS	ANNUAL COSTS		Description and scale of <b>key monetised costs</b> by 'main affected groups'
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	£ 7.25m - 8.14m	1	
	<b>Average Annual Cost</b> (excluding one-off)		<b>Total Cost (PV)</b> £ 28.6m - 52.39m
£ 2.48 - 5.14m			
<p><b>Other key non-monetised costs</b> by 'main affected groups' These include the cost of entering the jurisdiction of the FOS (both case fees and awards made by the FOS) and the cost of the Financial Services Compensation Scheme levy.</p>			

BENEFITS	ANNUAL BENEFITS		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	£ None	N/A	
	<b>Average Annual Benefit</b> (excluding one-off)		<b>Total Benefit (PV)</b> £ 168.37 - 173.01m
£ 19.56 - 20.1m			
<p><b>Other key non-monetised benefits</b> by 'main affected groups' These include: (i) an increase in travel firms' insurance selling standards through reference to FSA principles and more specific rules, and (ii) access for the consumer to the FOS where they think they have been mis-sold insurance.</p>			

### Key Assumptions/Sensitivities/Risks

Key assumptions include: the average commission level earned by travel firms; the likely reaction of travel firms to the introduction of regulation; the level of mis-selling by travel firms; the likelihood of mis-selling leading to a claim being rejected.

Price Base Year 2007	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £ 115.98 - 144.4m	<b>NET BENEFIT (NPV Best estimate)</b> £ 130.19m
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	1 January 2009
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these organisations?	£ Minimal
Does enforcement comply with Hampton principles?	Yes

Will implementation go beyond minimum EU requirements?		Yes		
What is the value of the proposed offsetting measure per year?		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of £ N/A	Decrease £ N/A	<b>Net Impact</b>	£ N/A

Key: Annual costs and benefits: (Net) Present Value

## Evidence Base (for summary sheets)

The costs and benefits of the Government's three proposed options are provided below.

Some 21m travel insurance policies are sold each year<sup>1</sup> in a market worth £670m in 2006<sup>2</sup>. According to Datamonitor, travel insurance sold by travel agents and tour operators accounted for around 44% of all travel insurance sales by Gross Written Premium in 2006<sup>3</sup>. However, estimates by Mintel put the share of policies sold by travel agents at 24%<sup>4</sup>. The Association of British Travel Agents (ABTA) estimate that the travel industry's share of the travel insurance market is no more than 25%<sup>5</sup>. Only 8% of the members of consumer association *Which?* purchasing travel insurance bought from a travel firm<sup>6</sup>, although this figure is not necessarily indicative of the market as a whole.

ABTA's response to the call for evidence estimated that the number of customers that will make a claim against their policy is approximately 3%. Defaqto estimate the frequency of travel insurance claims to be around 4%<sup>7</sup>. They also estimate the level of claims paid by insurers to be at most 70% of premiums received. ABI statistics show that their members paid around 850,000 claims in 2006 – a claims frequency of 4% (assuming 21m policies sold per annum). The cost of these claims totalled £330m, suggesting an average claim size of around £388.

### OPTION 1 – COSTS AND BENEFITS

Option 1 is no change. Sales of travel insurance sold along with a holiday would remain unregulated, although subject to some degree of industry self-regulation, such as the ABTA Code of Conduct and the Association of Independent Tour Operator's (AiTO) Code of Business Practice.

The Unfair Commercial Practices Directive (UCPD) will require that by April 2008 consumers in EU Member States are protected from unfair, misleading and aggressive selling practices. Under Option 1, the selling of travel insurance sold alongside a holiday would be subject to the regulations implementing the Directive. The Department for Business, Enterprise and Regulatory Reform<sup>8</sup> (BERR) have recently consulted on draft regulations. The Office of Fair Trading (OFT) would be responsible for enforcing these regulations.

### Benefits

There are no incremental benefits arising from option 1 as it maintains the status quo.

The attractive features of this option are that:

<sup>1</sup> Source: Association of British Insurers (ABI). ABI estimate that their members account for 93% of the travel insurance market.

<sup>2</sup> Source: Mintel, *Travel Insurance, Finance Intelligence, February 2007*

<sup>3</sup> Source: Datamonitor *UK Travel Insurance 2007*

<sup>4</sup> Source: Mintel, *Travel Insurance, Finance Intelligence, February 2007*

<sup>5</sup> Source: ABTA response to consultation stage of this review

<sup>6</sup> Source: *Which?* response to consultation stage of this review

<sup>7</sup> Source: Defaqto, *Travel Insurance in the UK, May 2007*

<sup>8</sup> See <http://www.dti.gov.uk/consumers/buying-selling/ucp/index.html>

- no additional costs of regulation are imposed on the travel sector;
- all travel agents/tour operators would be able to continue selling travel insurance without any additional restrictions;
- some additional protection, against the current baseline, provided through implementation in the UK of the UCPD.

## Costs

There are no incremental costs associated with option 1 as it maintains the status quo.

However, the potential remains for consumer detriment, including:

- a lack of statutory requirements on a travel firm to take steps to ensure that the consumer understands the policy, for example through providing disclosure information at the point-of-sale or explaining the features of the cover;
- the relative complexity of travel insurance as a product means that bundling may be likely to lead to mis-selling, since there is little opportunity for customers to check that the policy meets his or her requirements, or to shop around and compare prices;
- consumer difficulty in understanding the distinction between policies sold along with a holiday and those sold as a stand-alone product;
- a lack of access to the Financial Ombudsman Service (FOS) whenever a dispute concerns the mis-selling of the insurance product by a travel firm, and there is no access to the FOS at all where cover is provided through a non-UK insurer. Anecdotal evidence suggests that non-UK insurers underwrite a significant proportion of the insurance policies offered by travel firms in the UK.

## OPTION 2 – COSTS AND BENEFITS

Option 2 would involve some form of strengthened industry self-regulation along with access to the FOS. The travel industry would be responsible for ensuring high standards of selling, but consumers would ultimately have recourse through the FOS if things go wrong. Primary legislation would be required to make the jurisdiction of the FOS compulsory. An independent body would also be required to certify that the relevant industry Codes were of an appropriate standard.

## Benefits

The benefits of option 2 include:

- a market-led solution to improve consumer protection;
- possibility of improvement in selling practices by some travel agents and tour operators through strengthened requirements on disclosure information;
- consumers have access to an independent, impartial and low cost method of redress through the FOS.

Benefits arising from this measure can be quantified if we assume that, under the status quo, mis-selling can lead to some consumers buying policies that are of reduced value since they will become void in certain situations. However, under Option 2, this effect will be decreased through raised selling standards. Compliance with industry self-regulation is unlikely to be 100%, but there will be access to the FOS in circumstances where the consumer feels that mis-selling has been responsible for a claim being rejected. This will only be the case where the firm selling the travel insurance is the member of a relevant trade association.

Making the simplifying assumptions that:

- travel firms sell 24% of travel insurance policies out of a total market worth £670m;
- 80% of these sales are made by firms within the membership of a relevant trade association;
- 25% of these policies are mis-sold;
- mis-selling leads to an average reduction in value of the policy of 50%;

**the total quantifiable benefits arising from this option are £16.08m per year.**

The level of mis-selling is an estimate based on the evidence provided to the review from a number of organisations including ABTA, the British Insurance Brokers' Association and *Which?*. The estimate around the loss of value of a travel insurance policy is a best estimate, given that no firm data is available.

The estimate above is sensitive to the assumptions used. The following gives an idea of how the numbers would be affected by changing some of the assumptions:

- If travel firms' share of the market was 40% the total benefit would be £26.8m per year. If travel firms' share of the market was 10% the total benefit would be £6.72m per year;
- If 50% of policies sold by travel firms are mis-sold the total benefit would be £32.16m. If 10% are mis-sold the total benefit would be £6.72m;
- If mis-selling leads to an average reduction of 75% in the value to the consumer of the policy the total benefit would be £24.12m. If mis-selling leads to an average reduction of 25% in the value to the consumer of the policy the total benefit would be £8.04m.

This estimate uses the total value of travel insurance premiums underwritten by insurers as the starting point for calculating the benefits arising from Option 2. An alternative methodology would be to look at the total value of lost claims arising from mis-selling of travel insurance sold alongside a holiday.

Assuming that:

- 21m travel insurance policies are sold annually;
- 24% of these policies (i.e. 5.04m) are sold by travel firms;
- 80% of these sales are made by firms within the membership of a relevant trade association;
- 4% of these policies are claimed upon;

- 25% of these claims are rejected on the basis of mis-selling;
- the average claim size is £388;

**the total quantifiable benefits arising from this option are £15.65m per year, in terms of the value to consumers of the lower likelihood of a claim being rejected due to mis-selling, given the likely improvement in selling standards, and access to the FOS where consumers have been mis-sold a policy.**

The estimate above is sensitive to the assumptions used. It is possible to consider the effect if some of the variables move:

- If 2% of policies are claimed upon the total benefit would be £9.78m. If 6% of policies are claimed upon the total benefit would be £29.33m;
- If only 10% of these claims are rejected on the basis of mis-selling the total benefit would be £7.82m. If 50% of these claims are rejected due to mis-selling the total benefit would be £39.12m;
- If the average size of a rejected claim were £200 the total benefit would be £10.08m. If the average size of a rejected claim were £615 the total benefit would be £31.0m.

There are some risks associated with this approach. First, there is a risk that using average claims sizes undervalues the role of insurance as a tool for managing risk. A key role of travel insurance is to provide protection against a heavy financial loss (for instance costs incurred relating to hospital treatment whilst abroad). Using average claims sizes fails to pick up the value of this protection.

Second, it is possible that claims rejected due to mis-selling are likely, on average, to be larger than the total average claims size. This could be the case if mis-selling is more likely to occur in regard of medical conditions, and hence claims rejected are more likely to be for medical expenses. ABI data shows that the average claim for medical expenses is £615 compared to the overall average of £388. Whilst no evidence has been presented directly on this point, the *Which?* and BIBA evidence does highlight specific problems relating to mis-selling regarding the disclosure of pre-existing medical questions.

## Costs

The exact nature of the costs associated with Option 2 would depend entirely on the nature of the industry self-regulation. Broadly, these costs can be disaggregated into:

- one-off direct costs – such as the costs to trade associations of introducing new self-regulation or rewriting existing requirements;
- ongoing direct costs – such as the costs to trade associations of monitoring and enforcing the strengthened industry self-regulation. These costs would usually be passed to firms through increased Membership fees (perhaps specifically aimed at those selling insurance). These costs also include the cost of taking disputes to the FOS through an annual levy or per case fee (or combination of both);
- ongoing indirect costs - the incremental cost to firms of compliance with the strengthened requirements, for instance the cost of ensuring the adequate provision of key disclosure information to all consumers.

It is difficult to say with any degree of certainty what these costs will be. However, it is possible to make some best estimates.

The incremental one-off costs might be quite small, given that some form of industry self-regulation is already in place. Strengthening these requirements might cost travel trade associations in the region of £0.1 – 0.2m in terms of rewriting and reprinting Codes of Practice and marketing new features to their Members.

However it seems reasonable that ongoing direct costs, in particular the costs of adequately enforcing and monitoring any credible industry-led scheme, would be significant, **perhaps in the range of £0.2 - 0.5m per year.**

Additionally, it also seems reasonable that the ongoing indirect costs would be significant, given the concerns around the level of selling standards by travel firms. Assuming that:

- travel firms sell 24% of travel insurance policies out of a total of 20m sales per year;
- improved selling standards would impose a cost on firms, in terms of the extra staff time taken to make the sale and the managerial cost of ensuring that firms are complying with the increased requirements (perhaps in the range of 10 – 20p per policy sold);

**the ongoing indirect costs associated with this option would be in the range of £0.48 - 0.96m per year.**

**On this basis, the ongoing costs associated with this option would be in the range of £0.68m - £1.46m per year.**

A major limitation associated with this option is that travel firms outside of trade association membership would not be required to comply with any non-statutory requirements. ABTA Member firms are responsible for the sale of around 80% of all package holidays sold in the UK<sup>9</sup>. Additionally, trade associations' ultimate sanction is only to expel the firm from membership of the trade association. It is possible therefore that there might be a regulatory arbitrage effect, where firms decide to relinquish membership of trade associations that have signed up to the strengthened industry self-regulation, leading to a reduction in overall consumer protection.

### **OPTION 3 – COSTS AND BENEFITS**

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This option involves giving the FSA responsibility for regulating the selling of travel insurance sold along with a holiday or other related travel. This would mean that all firms would require authorisation to sell travel insurance no matter what the distribution method used. Firms would be responsible for meeting high-level principles set by the FSA as well as any conduct of business rules. Consumers would have full access to the FOS as a method of redress and access to the Financial Services Compensation Scheme (FSCS) in the event of an insurer/travel agent insolvency in relation to travel insurance, assuming that the FSA continues to give the FOS jurisdiction in relation to all regulated activities.

This option involves maintaining an exemption from regulation for insurance sales by event management firms – in respect of commercial customers - and car hire firms. The

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<sup>9</sup> Source: ABTA *Travel Statistics and Trends 2005*

call for evidence and consultation stages provided no evidence of consumer detriment arising from these sales.

## Benefits

The benefits of option 3 include:

- FSA regulation would require firms to meet the FSA's high-level principles for conducting business, for instance on treating customers fairly, as well as meeting any rules or guidance issued by the FSA. At present, authorised firms selling insurance are required to comply with the FSA's Insurance: Conduct of Business (ICOB) rules, especially on clear disclosure information. This means that firms need to ensure a high-standard in selling insurance, reducing the potential of consumer detriment through mis-selling;
- subject to FSA proposals, consumers would also get increased consumer protection through:
  - access to the FOS in the event of a dispute concerning the selling of travel insurance, rather than having to rely on: a) an industry trade body dispute resolution scheme (sometimes perceived as being inadequate or against the consumer); or, b) taking the travel agent or tour operator to court;
  - access to the FSCS in respect of the travel insurance policy if a travel agent or tour operator becomes insolvent (although any benefit to the consumer would be limited to the FSCS covering payments resulting from outstanding FOS disputes, in circumstances where travel firms' insurance sales are currently made on a 'risk transfer' basis, i.e. the insurer will cover any risks from the time that the consumer pays the premium to the travel firm);
- more transparent information and moving away from an inertia (bundled) sale could have a positive impact on consumers if it encourages them to shop around and seek the best policy in terms of coverage and price;
- a core baseline of statutory protection for consumers when buying travel insurance, irrespective of the distribution channel. There is evidence of consumer confusion regarding what protections are available when buying essentially the same type of insurance. The results of BIBA's consumer survey indicate that 54% of consumers believe that all sellers of travel insurance are currently covered by the same regulations. However, it should be noted that it will be up to the FSA to determine how best to regulate the selling of travel insurance through different distribution channels;
- there is likely to be a benefit to regulated travel insurers and insurance intermediaries through some levelling of the cost base across the market.

In this way FSA regulation goes further than the requirements of the UCPD. A major limitation of the protection afforded by implementation of the UCPD is that it does not offer guaranteed access to the FOS, or to the FSCS. Such access could only be achieved through primary legislation. Additionally, the Government does not believe that enforcement of implementing regulations by the OFT would be comparable to

enforcement by FSA under option 3, given the relative complexity of travel insurance as a product and financial services in general. The FSA is the single unified regulator for financial services and has the greatest experience in regulating the selling of insurance products, whether by financial services firms or by firms for whom selling insurance is a secondary activity.

The FSA's approach to the implementation of the UCPD in financial services is that it does not see the need for additional rules because its Handbook already sets out principles and rules which have the same effect as the Directive. The FSA has also stated that where feasible, they will seek deregulatory measures made possible as a result of the implementation of UCPD to remove any duplication<sup>10</sup>.

Benefits arising from this measure can be quantified if we assume that, under the status quo, mis-selling can lead to some consumers buying policies that are of reduced value since they will not respond in certain situations. Under FSA regulation, this effect is diminished through raised selling standards. As with option 2, compliance with FSA regulation is unlikely to reach 100%. But it is plausible to imagine that compliance will be higher than under option 2, given for instance the enforcement and monitoring capabilities of the FSA compared to trade associations. And access to the FOS will allow consumers to seek redress where they feel that mis-selling has led to a claim being rejected.

Assuming that:

- travel firms sell 24% of travel insurance policies out of a total market worth £670m;
- 25% of these policies are mis-sold;
- mis-selling leads to an average reduction in value of the policy of 50%;

**the total quantifiable benefits arising from this option are £20.1m per year, given the likely improvement in selling standards and access to the FOS where consumers have been mis-sold a policy.**

As with Option 2, the level of mis-selling is an estimate based on the evidence provided to the review from a number of organisations including ABTA, the British Insurance Brokers' Association and *Which?*. The estimate around the loss of value of a travel insurance policy is a best estimate, given that no firm data is available.

The estimate above is sensitive to the assumptions used. The following gives an idea of how the numbers would be affected by changing some of the assumptions:

- If travel firms' share of the market was 40% the total benefit would be £33.5m per year. If travel firms' share of the market was 10% the total benefit would be £8.4m per year;
- If 50% of policies sold by travel firms are mis-sold the total benefit would be £40.2m. If 10% are mis-sold the total benefit would be £8.04m;
- If mis-selling leads to an average reduction of 75% in the value to the consumer of the policy the total benefit would be £30.15m. If mis-selling leads to an average reduction of 25% in the value to the consumer of the policy the total benefit would be £10.05m.

<sup>10</sup> See [http://www.fsa.gov.uk/pubs/policy/ps07\\_06.pdf](http://www.fsa.gov.uk/pubs/policy/ps07_06.pdf)

This estimate uses the total value of travel insurance premiums underwritten by insurers as the starting point for calculating the benefits arising from this measure. An alternative methodology would be to look at the total value of lost claims arising from mis-selling of travel insurance sold alongside a holiday.

Assuming that:

- 21m travel insurance policies are sold annually;
- 24% of these policies (i.e. 5.04m) are sold by travel firms;
- 4% of these policies are claimed upon;
- 25% of these claims are rejected on the basis of mis-selling;
- the average claim size is £388;

**the total quantifiable benefits arising from this option are £19.56m per year, in terms of the value to consumers of the lower likelihood of a claim being rejected due to mis-selling, given the likely improvement in selling standards, and access to the FOS where consumers have been mis-sold a policy.**

The estimate above is sensitive to the assumptions used. It is possible to consider the effect if some of the variables move:

- If 2% of policies are claimed upon the total benefit would be £9.78m. If 6% of policies are claimed upon the total benefit would be £29.33m;
- If only 10% of these claims are rejected on the basis of mis-selling the total benefit would be £7.82m. If 50% of these claims are rejected due to mis-selling the total benefit would be £39.12m;
- If the average size of a rejected claim were £200 the total benefit would be £10.08m. If the average size of a rejected claim were £615 the total benefit would be £31.0m.

There are some risks associated with this approach. First, there is a risk that using average claims sizes undervalues the role of insurance as a tool for managing risk. A key role of travel insurance is to provide protection against a heavy financial loss (for instance costs incurred relating to hospital treatment whilst abroad). Using average claims sizes fails to pick up the value of this protection.

Second, it is possible that claims rejected due to mis-selling are likely, on average, to be larger than the total average claims size. This could be the case if mis-selling is more likely to occur in regard of medical conditions, and hence claims rejected are more likely to be for medical expenses. ABI data shows that the average claim for medical expenses is £615 compared to the overall average of £388. Whilst no evidence has been presented directly on this point, the *Which?* and BIBA evidence does highlight specific problems relating to mis-selling regarding the disclosure of pre-existing medical questions.

## Costs

**There are various monetary costs associated with being regulated by the FSA<sup>11</sup>.** These costs are a matter for the FSA to determine, subject to the statutory requirements on the

<sup>11</sup> The latest on FSA fees is set out in the FSA's consultation paper 07/3 'Regulatory fees and levies 2007/08', published in February 2007.

FSA to conduct cost-benefit and market failure analysis and to consult publicly before introducing new rules. In the examples given below, FSA fees for general insurance intermediaries are used as a guide, although the FSA is able to set up a different fee regime specifically for travel firms.

As well as its own fees, the FSA invoices on behalf of the FSCS and the FOS. The FSA charges firms:

- periodic fees (paid yearly), which provide most of the funding needed to carry out its statutory duties;
- application fees, which recover some of the costs of processing certain applications under its rules or FSMA;
- special project fees where activity is undertaken at the request of fee-payers.

The amount a firm pays as an annual fee depends on its potential impact on the FSA's statutory objectives. The FSA uses an appropriate size of business measure in each fee block as a proxy for potential impact. In general this means that the larger the firm is the more it has to pay. Application fees for authorisation are based on the complexity of the application, which is a product of the permission being applied for. More information on fees is available from the FSA's website: [www.fsa.gov.uk](http://www.fsa.gov.uk).

### The initial direct cost of FSA regulation

The FSA will charge a flat authorisation fee of £1500 for general insurance intermediaries in the financial year 2007/08<sup>12</sup>. Although there are no definitive figures for the number of travel agents, there are around 1600 ABTA Members. It also appears fair to assume that there are at least as many non-ABTA travel firms. Assuming therefore that there are around 3,200 travel agents and tour operators, in the hypothetical case that all of these firms sought authorisation **the maximum initial cost would be around £4.8 million for the industry as a whole.**

### Ongoing costs

The FSA also charges firms a periodic fee to cover the ongoing costs of its regulation. This is based on: (i) the regulated activities that the firm undertakes; and (ii) the amount of business related to its regulated activities<sup>13</sup>.

The FSA's fee structure for general insurance intermediaries is based on a minimum fee plus a sliding scale of additional fees based on turnover from regulated activities. The minimum fee for general insurance intermediaries with an annual turnover from regulated activities of under £100,000 will be £410 for the financial year 2007/08. For additional fees the sliding scale is:

- for the firm's annual turnover from regulated activities from £100,000 to £1m an additional fee of £3.88 per £1000 income from regulated activities is payable

<sup>12</sup> See FEES 3 Annex IR: *Authorisation fees payable* of the FSA's Handbook.

<sup>13</sup> For firms carrying out general insurance intermediation, this is the net amount retained by the firm of all brokerages, fees, commissions and other related income (e.g. administration charges, overrides, profit shares) due to the firm in respect of or in relation to insurance mediation activity. See FEES 4 Annex IR *Activity groups, tariff bases and valuation dates applicable* of the FSA's Handbook.

- from £1m to £5m an additional periodic fee of £3.39 per £1000 income from regulated activities is payable;
- from £5m to £15m a further additional fee of £2.45 per £1000 income from regulated activities is payable;
- from £15m to £100m a further additional fee of £0.98 per £1000 income from regulated activities is payable;
- and above £100m a further additional fee of £0.40 per £1000 income from regulated activities is payable.

ABTA figures show the following for the size and distribution of its members:

- £100m plus: 51 firms with total turnover of £21,556m;
- £50m – £100m: 28 firms with total turnover of £1,957m;
- £15m - £50m: 135 firms with total turnover of £3,621m;
- up to £15m: 1329 firms with total turnover of £3,755m.

So, assuming that:

- travel firms sell 24% of travel insurance policies out of a total market worth £670m;
- travel firms earned, on average, 20% commission on each insurance policy sold;
- all ABTA's member firms become authorised, along with 1600 non-ABTA members;

**the total direct cost of ongoing regulation would be £1.37m per year or 27 pence per policy.** This estimate is based on an average firm and does not take into account the different sizes of firms within the turnover brackets outlined above.

The numbers above are sensitive to the assumptions used. The following gives an idea of how the numbers would be affected by changing some of the assumptions:

- If the number of non-ABTA firms was instead 3,200, the total ongoing direct cost of FSA regulation would be £1.99m per year or 40 pence per policy sold;
- If the commission travel firms earned on travel insurance was 5% instead of 20% then the total direct cost of ongoing regulation would be £1.31m or 26 pence per policy sold. If commission was 40% then the total direct cost of ongoing regulation would be £1.45m or 29 pence per policy sold;
- If travel firms were responsible for 50% of all travel insurance sales then the total cost of ongoing regulation would be £1.45m or 14 pence per policy sold. If they were responsible for 15% of all travel insurance sales the total cost of ongoing regulation would be £1.34m or 43 pence per policy sold.

Some responses to the consultation suggested that assuming an average commission level of 20% from travel firms' insurance sales was a significant underestimate of the true level. However the sensitivity analysis indicates that the costs estimates are relatively insensitive to changes in the commission level.

### **The indirect cost of FSA regulation**

The indirect cost of FSA regulation is uncertain and would depend on the regulatory regime that was introduced by the FSA and how firms who decided to get authorised adapted to the new regulation. It is likely that the indirect costs would be significantly more than the direct costs and would primarily comprise compliance costs for firms under the FSA regime. Estimates would depend on the regime that the FSA decided to introduce. The FSA are looking, as part of the current review of their Insurance: Conduct of Business (ICOB) rules, to move towards a more principles-based style of regulation for the majority of general insurance products, which will allow firms more freedom in the way they interpret and implement the high-level standards set by the FSA.

On introducing the general insurance regime the FSA undertook a cost-benefit analysis of the impact of its ICOB Rules. This was undertaken by NERA and set out in the publication: *“Estimated compliance costs of conduct of business regulation for general insurance”*.

This report estimated costs associated with ICOB of £197.4 million one-off plus £163.9m ongoing (annually). Costs associated with minimum Directive requirements (arising from notably the Distance Marketing Directive (DMD) and the Insurance Mediation Directive (IMD)) were estimated at £179.9m in one-off costs and £143.8m annually. It should be noted that IMD requirements would not necessarily be applicable to firms selling travel insurance along with a holiday since these sales are exempt from the Directive.

The NERA figures are based on a population of 45,220 firms selling insurance.

Uprating for inflation, and assuming the FSA introduces the same ICOB rules as estimated in the NERA report, this means that the initial indirect cost per firm was in the order of £4,750, while ongoing costs would be in the region of around £4,000. There are likely to be other indirect costs associated with being regulated – for example, authorisation costs, training and competence costs, although there is likely to be some overlap in costs. Importantly, the FSA’s recent review of the selling of general insurance is proposing removing many of the ICOB rules, which may lead to cost reductions for firms.

Assuming there are 3,200 travel firms, and all of these firms seek FSA authorisation, this would result in indirect one-off costs of £15.2m and ongoing costs of £12.8m (£2.54 per policy sold, assuming travel firms sell around a quarter of all travel policies).

However, academic research<sup>14</sup> suggests that the indirect costs of FSA regulation might be around four times the direct costs. Given the direct costs outlined above, this would suggest a one-off indirect cost to travel firms of around £19.2m and on-going annual indirect costs of £5.48m.

Indirect costs imposed by FSA regulation will not all be additional costs. Travel firms should already be providing staff training and firms that are members of a trade association, such as ABTA, will need to comply with its rules. It is also worth pointing out that, under the requirements of the Distance Marketing Directive<sup>15</sup> (DMD), where travel firms make a ‘distance’ insurance sale, for example, over the telephone or on the internet, they are already required to provide the consumer with certain information, including a description of the main characteristics of the product.

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<sup>14</sup> “The direct and compliance costs of financial regulation” Franks, Schaefer and Staunton, Journal of Banking & Finance, Volume 21, Issues 11-12, December 1997

<sup>15</sup> Implemented in the UK by SI 2004 No. 2095: The Financial Services (Distance Marketing) Regulations 2004.

## Costs where not all travel firms seek FSA authorisation

It would of course be for travel firms to decide whether or not to become authorised to continue to sell travel insurance and **in practice it is highly unlikely that all travel firms will seek FSA authorisation following the implementation of this measure.**

Other routes available to travel firms would be to become either an Appointed Representative or an Introducer Appointed Representative (IAR) of an insurer or an insurance intermediary. Travel agents and tour operators could also look to team up with others selling insurance services to ensure insurance is still offered to their customers or simply provide information to consumers. Under this option it is not possible to determine how many travel firms will go down the Appointed Representatives route, although anecdotal evidence suggests that some are actively considering it.

The Appointed Representatives route is generally seen as a lower cost way for firms to ensure regulatory compliance without becoming directly authorised by the FSA. The IAR route is similar in structure to the Appointed Representative route, however Agents (i.e. travel firms) are only allowed to introduce clients to the Principal or to distribute certain forms of financial promotions (such as press or internet advertising) relating to its Principal's products. Another option would be for the travel firm to undertake an 'introducer' role, whereby the travel firm simply directs the individual to a regulated intermediary or insurer in return for a fee from the regulated firm. **The number of firms actually seeking FSA authorisation may actually turn out to be quite low given these alternative routes available.**

Assuming that: (i) 5% of travel firms seek FSA authorisation; 15% become Appointed Representatives (AR); 40% become IARs; and, 40% either make use of the Article 72C exemption to act as unregulated 'introducers' or curtail their insurance activities altogether; and, (ii) the cost of becoming an AR is 75% of the total direct and ongoing costs under FSA authorisation and the cost of becoming an IAR is 50% of the total ongoing costs under FSA authorisation:

- there will be a total direct one-off cost to travel firms of £1.74m;
- there will be a total direct ongoing cost to travel firms of £0.50m per year;
- there will be total indirect one-off costs to travel firms in a range of £5.51m and £6.96m;
- there will be total indirect ongoing annual costs in a range of £1.99m and £4.64m.

This suggests that the total costs to travel firms following the introduction of FSA regulation amount to one-off costs of between £7.25m and £8.7m and ongoing annual costs of between £2.48m and £5.14m. **These costs are sensitive to the assumptions made and would depend on the nature of the regime the FSA decide to introduce.**

It is not possible at this stage to split the costs associated with this option into policy compliance costs and administrative burdens. This will only be possible when the FSA has indicated the regime that it intends to apply. At this point in time, the Government expects that policy compliance costs (such as the costs of ensuring that the details of insurance policies are disclosed in a fair and transparent way, FSA authorisation fees, FOS case fees) will constitute a higher proportion of total costs than administrative burdens.

Subject to the underlying assumptions, these figures for the costs of regulation are maximum figures as it is likely that the introduction of regulation will cause firms to alter their business models.

### Additional costs

Other costs associated with regulation include:

- **Financial Services Compensation Scheme** - the FSCS is funded by levies on firms authorised by the FSA. For levying purposes, FSCS business is split into sub-schemes, including one for insurance mediation (from 14 January 2005). For each sub-scheme there are one or more contribution groups, based on the "fee blocks" used by the FSA for allocating its own fees to regulated firms. Firms are allocated to a contribution group (or groups) according to their regulated permissions, i.e. the type of business they are authorised to transact<sup>16</sup>. There are limits to the amounts FSCS can levy in a financial year. For compensation payments the limit for general insurance intermediaries is currently 0.8% of annual eligible income (from regulated activities). It is estimated that travel firms' income from selling travel insurance policies is around £19.5m, **which would indicate that the maximum contribution from regulated travel firms in any one year to the FSCS would be £156,000** – although this is an upper limit and is only likely to be reached following several firm failures in that specific contribution group. The FSA is currently reviewing the funding of the FSCS and has proposed an increase in the maximum levy payable by insurance intermediaries, to 3.5%<sup>17</sup>. If this is adopted, the maximum levy payable would rise to £682,500 across regulated travel firms;
- **Financial Ombudsman Service** - there is an annual fee for access to the FOS. This is currently £50 for general insurance mediation. Each firm is not charged a case fee for the first two disputes in each year for which the FOS are required to reach a decision. For additional cases, charges are levied at £400 per case no matter what the outcome of the complaint. There will be additional costs to travel firms wherever the FOS makes an award to the consumer on the basis of a mis-selling complaint.

### Second round effects

It has also been argued that regulation might lead to a loss of claims handling services and advice on the suitability of the product that may currently be provided by travel firms.

Where travel firms decide to become an Appointed Representative of a regulated firm there will also be additional indirect and ongoing costs on the authorised firm. However, authorised firms are only likely to enter into an Appointed Representative agreement where this is in the firms' best interests, for instance where they believe that the increase in premium income brought about by the activities of the Appointed Representative will more than compensate for these costs.

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<sup>16</sup> Full details of the funding rules for FSCS are available in the FSA's Handbook.

<sup>17</sup> See the FSA's *Consultation Paper 07/5: Financial Services Compensation Scheme Funding Review* at [http://www.fsa.gov.uk/pages/library/policy/cp/2007/07\\_05.shtml](http://www.fsa.gov.uk/pages/library/policy/cp/2007/07_05.shtml). The consultation period closed on 20 June 2007.

It is possible that these costs may be passed onto the consumer through travel firms charging higher premiums. It is also possible that some travel firms might stop selling insurance altogether, given the increased costs of regulation. This could have a negative impact in terms of its impact on the number of people taking out insurance for trips abroad. The consultation unearthed differing views amongst some stakeholders over the extent to which this measure might impact upon the level of those travelling uninsured. Some responses suggested that the impact would be significant, with one respondent suggesting a rise in percentage terms from a current estimate of 13% to around 20%. However, other respondents felt that any impact would be negligible.

The UK has a very well developed stand-alone travel insurance market across several distribution channels including telephone sales, internet sales and face-to-face sales by insurance brokers. Many travel firms would remain under an obligation under the Package Travel Directive to provide information on the availability of travel insurance, so even if full FSA authorisation is inappropriate they are likely to consider the alternative options including the Appointed Representatives route, the IAR route, or taking advantage of the exemption in article 72C of the Regulated Activities Order to team up with insurers and/or brokers to provide information on insurance to their customers. **Given these alternative options, and consumers' ability to access the stand-alone travel insurance market, the Government is confident that any impact upon the aggregate level of those travelling uninsured will not be substantial.**

There may be a further cost to travel firms who stop selling insurance through lost profit streams that had been provided through insurance sales. Alternatively there may be a lost profit stream for travel firms who decide to take the IAR or unregulated introducer route, given that any commission earned through these routes is likely to be lower than the commission level where the firm makes the sale independently. It is not possible to quantify this effect. Responses to the call for evidence suggested that many travel firms make only a small margin from sales of insurance alongside a holiday and so it seems reasonable to assume that, if firms do stop selling insurance products as a result of this decision, this will not have a large impact on the profitability of the sector. Some responses to the consultation stage offered the view that, in fact, many travel firms (and especially travel agents, as opposed to tour operators) earn a substantial level of commission from travel insurance sales. There may, however, be an opportunity for travel firms to offset any lost income by advertising or introducing travel insurance.

Research by the Association of British Insurers<sup>18</sup> looking at the overall costs and benefits of general insurance regulation concluded that regulation has had a positive effect for customers who purchase insurance alongside other goods or services.

### Impact on small firms

Some responses to the call for evidence stage and the consultation stage argued that smaller travel firms would be less able to meet the additional costs imposed by a requirement for travel firms selling travel insurance to be regulated.

It is likely that smaller firms will be less likely to seek FSA authorisation. Instead it is likely that they will look for alternative methods of providing insurance services, either through becoming an Appointed Representative or an IAR of a regulated firm or by undertaking an unregulated introducer role. Some responses to the consultation stage also noted that smaller travel firms might be less able to make use of the Appointed

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<sup>18</sup> *The Regulation of General Insurance Sales: One Year On*, March 2006.

Representatives route. This is because capacity within the regulated sector to accept agents in an Appointed Representative relationship is constrained due to the increased compliance costs and regulatory risks. Given this constraint it is likely that larger travel firms will be more attractive to regulated firms, given the potential for larger increases in revenue for the regulated firm. However, the Government believes that the benefits afforded by proper consumer protection, coupled with these options for travel firms to continue providing insurance services, justify seeking to have the selling of travel insurance products taking place in a regulated environment.

### **Impact on competition**

It has been argued that a requirement for the selling of travel insurance alongside a holiday to be regulated would lead to fewer firms selling travel insurance, and hence lower competition in this area. However it can also be argued that inertia sales inhibit competition as they discourage individuals from shopping around to find the most appropriate product.

The UK's travel insurance market is widely regarded as being competitive and presents an obvious alternative route for consumers to purchase cover, should the number of travel firms selling insurance shrink. These firms would also have the opportunity to introduce customers to brokers and insurers who sell travel insurance. On this basis, the Government does not consider that the introduction of regulation for the selling of travel insurance sold alongside a holiday would adversely affect competition.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No









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