

Deregulating freight forwarding insurance

Final Regulatory Impact Assessment

June 2007



HM TREASURY



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FINAL REGULATORY IMPACT ASSESSMENT

TITLE OF PROPOSAL

1.1 Removing freight forwarders' and storage firms' insurance activities from the scope of Financial Services Authority (FSA) regulation.

PURPOSE AND INTENDED EFFECT

Background, objective and rationale

1.2 Since the introduction of FSA regulation of the selling of general insurance in the UK on 14 January 2005, which followed extensive consultation by HM Treasury and the FSA, the Government has considered it necessary for the FSA to regulate freight forwarders' insurance activities in order to comply with the requirements of the Insurance Mediation Directive (IMD)¹. Following discussions with the UK's freight forwarding industry – initiated by concerns from the industry that other EU Member States are not regulating freight forwarders' insurance activities - HM Treasury has approached the European Commission to discuss whether the insurance activities of freight forwarders should be subject to regulation. Following this dialogue, the Government now believes that it will be possible to comply with the requirements of the IMD without requiring the regulation of freight forwarders' insurance activities. The Government also believes that the potential for consumer detriment in this area is low, and that the cost of regulation borne by the UK's freight forwarding industry has a significant impact on the international competitiveness of the sector.

1.3 Given these considerations, the Government believes that it is appropriate to remove freight forwarders' insurance activities from the scope of FSA regulation. However, FSA regulation will still apply to the selling of the original insurance policy to the freight forwarder² and, where insurance rights are then passed on to the customer, the customer will continue to be afforded protection associated with the insurance product (e.g. access to the Financial Ombudsman Service (FOS) and Financial Services Compensation Service (FSCS) in respect of the insurance policy, subject to certain eligibility limits³).

CONSULTATION

1.4 This RIA concerns removing freight forwarders' insurance activities from the scope of FSA regulation.

1.5 A consultation seeking views on the proposed changes was launched on 21 December 2006 and closed on 22 March 2007. 14 responses were received to the consultation from individuals, firms or representative bodies. A summary of responses to the consultation is available on HM Treasury's website (www.hm-treasury.gov.uk).

1.6 This RIA sets out the options open and considers the qualitative, and where possible, quantitative costs and benefits. Risks, unintended consequences and any

¹ EU Directive 2002/92/EC

² Assuming, of course, that the insurer is itself FSA authorised.

³ This protection is subject to more detailed rules on the jurisdiction of the FOS and the coverage of the FSCS. For instance, only individuals and small businesses are eligible to make claims to the FSCS and the FOS. The eligibility definition of a small business for FSCS claims depends on the type of activity. For the purpose of complaints to the FOS, a small business is one with a group turnover of less than £1 million. Further information on the FOS can be found at www.financial-ombudsman.org.uk. Further information on the FSCS can be found at www.fscs.org.uk

compliance and enforcement issues have also been incorporated as costs and benefits. Competition issues and the impact on small firms have also been considered.

OPTIONS

Do nothing **1.7** As with all proposals for legislation, HM Treasury has considered the option of making no changes. This would mean that freight forwarders' insurance activities remain inside the scope of FSA regulation. However, the Government believes that this option would have a significant impact upon the international competitiveness of the UK's freight forwarding industry. The Government also believes that the risk of consumer detriment in this area is low.

HM Treasury's Statutory Instrument **1.8** HM Treasury is therefore proposing to remove freight forwarders' insurance activities from the scope of FSA regulation through an amendment to the Exemption Order⁴. This Order provides for certain persons to be exempt from the general prohibition on carrying out regulated activities imposed by the Financial Services and Markets Act 2000 (FSMA). Exempt persons are not required to be authorised to carry on regulated activities.

1.9 This proposed approach will exempt freight forwarders from the general prohibition in respect of any regulated activity of the kind specified by the following articles of the Regulated Activities Order⁵ (RAO):

- Article 21 (dealing in investments as an agent);
- Article 25 (arranging deals in investments);
- Article 39A (assisting in the administration and performance of a contract of insurance); and
- Article 53 (advising on investments).

The RAO defines the perimeter of FSA regulation under powers afforded to it by FSMA.

1.10 In practice, freight forwarders manage and organise the transport of the customer's goods and insurance is provided as an optional element of the service. The freight forwarder typically does this through the use of a "master cover" insurance policy. The forwarder purchases this policy directly from an insurance company or through an insurance broker. The freight forwarder holds the master policy in its own name. However, if the customer decides to take up the insurance option, the rights of the policy are passed to the customer so that in the event of loss, or damage to, the customer's goods, the customer can make a claim directly against the insurance policy. This exemption from the scope of FSA regulation is only applicable where the freight forwarder passes on rights under an insurance policy directly to the customer in respect of loss or damage to the customer's goods.

1.11 For the purpose of the legislation, freight forwarders are defined as persons whose principal business is arranging or carrying out the transportation of goods. The Government believes that, where storage firms arrange their insurance activities in the same way as freight forwarders, i.e. where rights under a master cover insurance policy are passed to the customer, these firms should also be exempted from regulation. This is due to the low risk of consumer detriment and also the desire to maintain a

⁴ Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001

⁵ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

consistent approach for firms who conduct both traditional freight forwarding and storage activities. The Statutory Instrument (SI) has therefore been extended to include storage firms within the scope of the exemption from regulation. Storage firms are defined as those whose principal business is storing goods or arranging storage for goods.

1.12 At first, this measure will only apply to commercial customers of freight forwarding and storage firms. The Government will therefore lay a SI that will exempt only insurance activities relating to commercial customers of these firms. The Government does, however, consider that there is a case for extending the exemption to cover retail customers as well as commercial customers, since, somewhat counter-intuitively, it is likely that consumers will receive better redress and protection outside of regulation. Paragraph 1.24 gives further details of this argument.

1.13 However, the Government wants to ensure that freight forwarders and storage firms maintain high standards during the course of their insurance activities. So these insurance activities will only be exempted from regulation once the Government is satisfied that the relevant trade associations have introduced appropriate self-regulation, including an appropriate independent redress mechanism, in order to guarantee sufficient consumer protection. At this point, a second-stage SI will be laid before Parliament to extend the deregulation of insurance activities to retail customers of freight forwarding and storage firms.

1.14 A further technical change to the SI has also been made to clarify that the exemption relates to rights passed to the customer under the freight forwarder's "master cover" insurance policy rather than the limited liability policy held by the freight forwarder.

Other options **1.15** A different legislative approach would be to amend the RAO directly in order to exclude freight forwarders' insurance activities from the scope of FSA regulation. This approach could be used to achieve the same policy intention as that achieved by the SI. However, HM Treasury believes that this approach would be less transparent than its preferred approach outlined above.

COST AND BENEFITS

Groups affected **1.16** The following main groups have been identified as potentially being affected by these proposals:

- freight forwarding firms;
- the logistics industry more widely, including storage firms;
- customers of freight forwarding firms or the logistics industry;
- insurers and insurance brokers involved in the provision of insurance covering loss of, or damage to, the goods of a freight forwarders' customer.

1.17 There are around 2,500 freight forwarding firms in the UK. Freight forwarding as a sector contributes around £16 billion per annum to the UK's GDP and employs around 15,000 people⁶. The UK's storage industry generates revenue of approximately £310 million per annum and employs more than 2,000 staff members⁷.

⁶ Source: British International Freight Association (BIFA)

⁷ Source: Mintel survey for the Self Storage Association UK, 2006

Benefits 1.18 This measure is deregulatory in nature. Excluding freight forwarders' insurance activities from the scope of FSA regulation will provide a significant benefit to these firms through reduced authorisation and compliance costs. The FSA estimate that they currently authorise the insurance activities of approximately 150 freight forwarding firms. Freight forwarding firms spent around £4million on FSA authorisation fees in 2005⁸ (with costs to individual firms ranging from £1,500 to £160,000). A regulated freight forwarder will incur additional burdens through higher paperwork requirements and the cost of ensuring ongoing compliance with FSA rules. There is also a one-off 'understanding' cost that a regulated firm will incur upon authorisation as it becomes familiar with the requirements of regulation. This measure will remove that cost for new entrants to the market.

1.19 Ultimately, these costs will be borne – at least in part – by customers of freight forwarding firms. In an industry where business is highly internationally mobile, the removal of these costs should provide a significant positive impact on the international competitiveness of the UK's freight forwarding sector.

1.20 For those freight forwarders who have decided not to seek authorisation from the FSA, lost revenue was estimated to total £24million in 2005⁹. The removal of the requirement for FSA regulation of freight forwarders' insurance activities will allow these freight forwarders to increase their level of business accordingly.

1.21 The Government is also aware of concerns that customers of freight forwarding firms, who have decided to cease their insurance activities in light of the requirement of FSA regulation have experienced higher premiums or difficulties in obtaining suitable insurance cover when approaching insurers or insurance brokers directly. Anecdotal evidence provided by the British International Freight Association (BIFA) suggests that the cost of equivalent cover may be significantly higher in such circumstances. However, a number of respondents suggested that these customers are generally smaller companies or individuals. The Government is also aware of concerns that the number of uninsured goods consignments has increased as the price of cover has increased.

Costs 1.22 This measure is deregulatory and will result in no new costs for the freight forwarding and storage industries.

1.23 FSA regulation provides consumer protection. Ultimately, there is a risk that removing FSA regulation in any area can increase the risk of consumer detriment. However, FSA regulation will still apply to the selling of the original insurance policy to the freight forwarder and, where insurance rights are then passed on to the customer, the customer will continue to be afforded protection associated with the insurance product (e.g. access to the FOS and FSCS in respect of the insurance policy, subject to certain eligibility limits).

1.24 The Government also believes that there is a case to extend the exemption to cover retail customers as well as commercial customers since, somewhat counter-intuitively, it is likely that consumers will receive better redress and protection. This is because, to avoid regulation, many freight forwarding companies have chosen to use a system of extended liability insurance. In the event of a complaint customers will only have a contract with the freight forwarder and importantly, will not have access to the FOS or the FSCS. Under the "master cover" policy commonly used prior to regulation,

⁸ Source: BIFA

⁹ Source: BIFA

insurance rights are passed on from the freight forwarder on behalf of the insurer to the client, giving the consumer the right to go directly to the insurer in the event of a claim, as well as being able to use the FOS or FSCS. The protection provided by the FOS and FSCS is subject to a small business eligibility limit, and is not applicable in circumstances where the customer is a larger business. However, the Government will only consider this case further when the relevant sectors have put in place robust measures for self-regulation that include an appropriate consumer redress mechanism. Further details are provided below.

1.25 The Government believes the risk of consumer detriment is low. The role of the freight forwarder or storage firm is, in practice, simply one of passing on rights under the policy to the customer. In addition to this, customers of freight forwarders are generally also commercial entities and this further reduces the risk of consumer detriment. Indicative figures provided by BIFA suggest that the number of transactions on behalf of retail customers is very low and in terms of value it is less than 1%. Whilst the Government is aware that the FOS does look into a number of cases relating to complaints from consumers and small businesses regarding insurance covering the loss of, or damage to, goods or possessions in transit, the FOS have pointed out that the majority of these cases arise from disputes between the insurer and the customer over unpaid claims and the role of commercial freight forwarders has seldom been the subject of complaints. Such cases will remain within the FOS' jurisdiction whether or not freight forwarders are regulated (subject to the small business eligibility limit).

1.26 The Government also understands that in this area it is common for insurers to expect that freight forwarders will conduct their insurance activity in accordance with good insurance practice. Insurers typically maintain the existing (pre-FSA regulation) practice of accepting responsibility for any poor practice by the freight forwarder, whether regulated or unregulated.

1.27 However, the Government wants to ensure that freight forwarders and storage firms maintain high standards during the course of their insurance activities. The Government will therefore use a two-stage approach and will only consider changes to exempt the retail insurance activities of freight forwarding and storage firms once these sectors have introduced and promoted an industry code of practice that will ensure high standards by promoting transparency in connection with the insurance contract and putting in place an appropriate independent complaints mechanism. BIFA has indicated that they will be willing to develop such self-regulation. The Government will also work with other relevant trade associations in the freight forwarding and storage sectors in order to develop codes of practice that will provide sufficient protection for retail customers.

1.28 There is a risk of unintended consequences if this measure can be used to exempt an insurance intermediary from the scope of FSA regulation in an area unrelated to the intended scope of the policy. This exemption is not intended, for instance, to be used to exempt the passing on of rights under a group payment protection insurance policy from a retailer to a customer. The legislation has been deliberately drafted narrowly in order to avoid such unintended consequences.

SMALL FIRMS IMPACT TEST

1.29 There are around 2,500 firms in the UK's freight forwarding sector and BIFA estimate that around 90% of these are small firms. Since this proposal is deregulatory in nature, it is likely that it will have a beneficial impact on these small firms. All but one of

the approximately 150 freight forwarding firms whose insurance activities are currently authorised by the FSA are the responsibility of the FSA's Small Firms Division.

COMPETITION ASSESSMENT

1.30 This proposal is likely to have a positive impact on competition in the market for the provision of insurance cover for the loss of, or damage to, goods in transit. Reducing regulatory costs will generally lower the barriers to entry in this market.

ENFORCEMENT, SANCTIONS AND MONITORING

1.31 This measure effectively removes the FSA's responsibility for enforcing regulation of certain regulated activities under the circumstances defined by the legislation. The Government will continue to monitor the insurance activities of freight forwarders.

IMPLEMENTATION AND DELIVERY PLAN

1.32 HM Treasury will take forward laying the Statutory Instrument which is subject to the negative resolution procedure. Subject to Parliamentary approval, it is intended that the revised arrangements will apply as soon as possible. Further legislation exempting freight forwarding and storage firms' insurance activities relating to retail customers may be made once satisfactory codes of practice and complaints procedures are in place.

POST-IMPLEMENTATION REVIEW

1.33 The Government will monitor the insurance activities of freight forwarders. The Government will not hesitate to act if evidence of misselling or consumer detriment emerges as a result of removing freight forwarders from regulation.

SUMMARY AND RECOMMENDATION

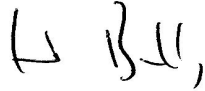
1.34 The Treasury has decided to remove freight forwarders' insurance activities from the scope of FSA regulation.

1.35 FSA regulation will still apply to the selling of the original insurance policy to the freight forwarder and, where insurance rights are then passed on to the customer, the customer will continue to be afforded protection associated with the insurance product (e.g. access to the FOS and FSCS in respect of the insurance policy, subject to certain eligibility limits).

1.36 The option of doing nothing was considered, but it was judged that this would have a significant impact upon the international competitiveness of the UK's freight forwarding industry. The Government also believes that the risk of consumer detriment in this area is low.

MINISTERIAL DECLARATION

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.



ED BALLS MP,

ECONOMIC SECRETARY TO THE TREASURY

18 June 2007

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