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# CHAPTER I

## BACKGROUND AND TIMETABLE

### Approach to legislation

- 1.1. This document sets out the Government's intended approach to giving the FSA responsibility for regulating various activities relating to the sale and administration of general insurance products. The Financial Services and Markets Act 2000 (FSMA) sets the framework for the Financial Services Authority (FSA) to regulate certain financial services, including giving it the power to make rules governing conduct of business. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("the RAO")<sup>1</sup> specifies the activities and products which are subject to regulation by the FSA. As set out in the RAO, the FSA already regulates all insurers on a prudential basis as well as the sale of most long-term insurance business.
- 1.2. The contracts of long-term insurance whose sale is already regulated are all contracts of long-term insurance<sup>2</sup> which are not contracts of reinsurance or a life protection or critical illness product<sup>3</sup>. These contracts whose sale is already regulated are referred to in this consultation document as "qualifying contracts" of long-term insurance.
- 1.3. The Government intends to implement the Insurance Mediation Directive ("the Directive") by amending the RAO to give the FSA responsibility for regulating the sale of general insurance products within the FSMA framework. This is a key step in completing the single market in financial services.
- 1.4. Under FSMA a range of safeguards are in place to ensure that the FSA adopts a proportionate approach to regulation. In drawing up rules in relation to regulated activities, the FSA have to consult publicly, and this consultation must include a cost benefit analysis of the rules. The FSA has also adopted a "risk-based" approach to regulation, having regard to the different risks involved in different transactions, to the differing degrees of experience and expertise that consumers may have, and to the general principle that consumers should take responsibility

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<sup>1</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI No. 2001/544.

<sup>2</sup> See definition of "contract of long-term insurance" in article 3 of Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI No. 2001/544.

<sup>3</sup> See definition of "qualifying contract of insurance" in article 3 of Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI No. 2001/544.

for their decisions provided they have been given appropriate and sufficient information to enable them to make an informed decision.

### **Timetable**

- 1.5. FSA regulation will be effective from October 2004. Box 1 sets out the principal steps required to implement the new regime.

#### **Box 1**

##### **Timetable for regulation**

The principal steps required to implement the new regulatory regime are:

- **October 2002:** This consultation seeks views on the draft statutory instruments to be made under the Financial Services and Markets Act 2000 (FSMA), which will specify in broad terms what the FSA's responsibilities are to be.
- **Nov 2002** The FSA will start consulting on its high level rules for insurance mediation.
- **Q1 2003** The statutory instruments, incorporating any changes made in the light of consultation will be laid before Parliament
- **Q2 2003** FSA consultation on conduct of business rules
- **H2 2003** Final FSA rules published.
- **October 2004** The new regime for regulating the selling of insurance will come into force (although this may be reviewed if there is a significant delay in publication of the directive in the Official Journal of the European Communities).

Annex B sets out the timetable for implementing the new regulatory regime for insurance mediation linking it to the parallel timetable for mortgage regulation. The parallel implementation of the new regimes will mean that intermediaries carrying on both insurance mediation and mortgage business will only need to apply once to the FSA for authorisation.

## CHAPTER 2

### WHICH CONTRACTS OF INSURANCE WILL BE REGULATED?

2.1. The Directive requires the regulation of mediation activities in relation to all contracts of insurance, including long-term insurance business, commercial insurance and reinsurance. However the Directive provides for certain limited exclusions including the sale of travel insurance as part of a package.

#### **Travel insurance**

2.2. Sales of travel insurance as a stand alone product will be regulated. But the Directive does not require regulation of travel insurance sold as part of a package with a holiday subject to certain conditions. These conditions include that the annual premium is less than €500, that any life assurance or liability risks cover is ancillary to the main cover provided and that the “insurance contract only requires knowledge of the insurance cover that is provided”. The Government considers that this last condition means the insurance contract must be of such a nature that the intermediary only needs to understand the cover provided in order to sell the insurance. So, for example, the terms of the insurance contract must be non-negotiable at the point of sale and the contract must be of such a nature that it is not necessary for an intermediary to advise the customer of the suitability of the cover provided as compared to the cover provided by a different contract. The Government is considering whether to extend regulation to these sales of travel insurance.

#### **Factors to be taken into account**

2.3. In considering the options for regulation there are a number of factors to be taken into account. Issues for consideration include:

- **level playing field:** the extent to which regulating travel insurance sold as a stand alone product, but not insurance sold with a holiday, could create an unlevel playing field between unregulated travel agents and regulated insurance intermediaries, both in terms of compliance costs and disclosure at the point of sale. However relatively few intermediaries sell only travel insurance, and so most would need to be authorised by the FSA for other business;

- **concerns about ‘bundled goods’:** there are concerns about lack of transparency and choice for consumers in the sale of “bundled” insurance. It is also claimed that insurance sold by travel agents can be poor value for money. Regulation would not necessarily solve these consumer issues, although the FSA could impose disclosure requirements which would enhance transparency and price comparisons;
- **complaints and mis-selling:** there are also reports of travel insurance as a problem area in terms of complaints and mis-selling. For example it is claimed that intermediaries sometimes fail to ask about pre-existing medical conditions that are not covered by the policy being offered.
- **availability of insurance:** there is a risk that, if FSA regulation is introduced, travel agents may cease offering customers insurance when they buy their holiday. This could lead to an increase in those travelling without insurance.

## Options

2.4. The options the government is considering in relation to travel insurance sold as part of a package are:

- **no statutory regulation** of sales of travel insurance sold as part of a package;
- **FSA regulation** to cover these sales in the same way as stand alone sales of travel insurance; and
- **industry specific regulation**, requiring sellers of these products to be authorised by the FSA unless they are subject to an ABTA code which would be certified by the FSA. Sellers who were subject to the ABTA code but who also carried on other FSMA regulated activity, including selling any insurance other than packaged travel insurance, would be subject to FSA authorisation in relation to all of their regulated activities (including the activities to which the ABTA code applied).

## What would FSA certification of the ABTA Code mean?

2.5. It would be up to the FSA whether to certify the ABTA code or not – but the FSA would be obliged to ensure that the Code complied with minimum requirements set out in legislation. ABTA might have to amend its Code in order to meet the requirements specified in legislation and by the FSA.

- 2.6. The minimum requirements for the Code relating to the sale of travel insurance could include provisions as to the information to be given to customers; the training, competence, and experience which the seller of the insurance must have; the procedures for dealing with complaints; the good repute of sellers; and the adequacy of the member's own insurance cover.
- 2.7. In addition, if this option is chosen, the Government is minded to set out in the legislation that the FSA must also be satisfied that the Code, as a whole, provides sufficient protection to consumers or potential consumers. The FSA must also be satisfied that steps taken to enforce the code will provide sufficient protection to consumers or potential consumers<sup>4</sup>.
- 2.8. The FSA would not be responsible for enforcing the ABTA Code - this will be for ABTA, although it would be open to the FSA to remove certification if it thought that ABTA was not adequately enforcing the Code.
- 2.9. The FSA would wish to keep the Code under review so as to be sure that it remains appropriate for the Code to be certified, and ABTA will need to liaise with the FSA in relation to amendments to the Code. The legislation would permit the FSA to certify the codes of other bodies which met the criteria specified in legislation and by the FSA, and which had significant coverage within the market of travel insurance sold as part of a package. However the Government and the FSA consider that currently in this market only the ABTA Code would be a potential candidate for certification.
- 2.10. The Government is committed to the principle of the FSA being a single regulator, and the route of allowing the FSA to certify the ABTA code is only available to the Government because travel insurance sold as part of a package is outside the scope of the Directive.

**The Government is seeking views on the scale of any problem with the sale of travel insurance sold as part of a package and on the proposed options. In particular views are sought on:**

- **the factors to be taken into account in determining the nature and extent of regulation, including supporting evidence;**
- **the scale and nature of consumer detriment in relation to travel insurance sold as part of a package;**

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<sup>4</sup> See draft article 72D(8) of the Regulated Activities Order.

- **which of the three options outlined in Para 2.4. is most appropriate in terms of balancing consumer protection against industry costs and competition;**
- **any other relevant considerations;**
- **whether there are any other options that should be considered?**

### **Territorial scope and travel insurance**

- 2.11. The Directive excludes from regulation mediation activities relating to insurance contracts for risks outside the European Community. However, in the UK's current regime for "qualifying contracts" of long-term insurance<sup>5</sup>, if mediation takes place in the UK, it is caught by the RAO, even if it relates to a life-insurance policy in relation to, say, a US resident. In relation to mediation of general insurance risks outside the Community, the Government does not intend to exclude non-commercial risks. So mediation of a travel insurance policy not sold with the holiday which provides cover for travel in Brazil would be caught by regulation.
- 2.12. However the Government does intend to exclude mediation activities in relation to contracts for large risks<sup>6</sup> outside the Community from regulation. This exclusion from regulation applies only to the extent that the large risk is situated outside the EEA.
- 2.13. These and other issues of territorial scope are considered further in chapter 4.

### **Extended warranties**

- 2.14. The Directive requires the UK to regulate extended warranties which are contracts of insurance costing more than €500 (about £300) per annum. However extended warranties which are contracts of insurance and cost less than €500 are excluded from the scope of the Directive. All extended warranties which are not contracts of

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<sup>5</sup> See Para 1.2. of Chapter 1 for definition.

<sup>6</sup> "large risks" are defined as having the same meaning as Article 5(d) of the First Life Directive 73/239/EEC. Broadly, this includes risks relating to railway stock, aircraft, ships, goods in transit, aircraft liability and shipping liability; risks relating to credit and suretyship where the risk relates to the commercial or professional activities of the policyholder; and risks relating to land vehicles, fire, property damage, motor vehicle and certain financial loss where the policyholder meets certain criteria as to balance sheet total, turnover and number of employees.

insurance but which are service contracts are excluded from the scope of the Directive.

### **Motor warranties**

2.15. Some motor warranties which are contracts of insurance cost more than €500 per annum, and so fall within the scope of the Directive. However the Government considers that the new regime should cover all extended warranties for motor vehicles, including those which fall below the exemption threshold of €500. This will avoid market distortions which might occur if some warranties for motor vehicles were regulated and some were not. Many motor retailers offer creditor protection insurance against loans to purchase cars and will be caught by the Directive in any case. The Government therefore proposes that all extended motor warranties which are contracts of insurance should be regulated.

**Should all motor warranties which are contracts of insurance be subject to regulation by the FSA or only those costing more than €500 (about £300) per annum?**

### **Extended warranties on domestic electric appliances and other goods**

2.16. On 2 July 2002 the Office of Fair Trading (OFT) asked the Competition Commission to investigate the market for extended warranties on domestic electrical appliances. The Government intends considering the issue of FSA regulation of such contracts in the light of the Competition Commission's conclusions.

2.17. Extended warranties on other goods, such as jewellery or carpets, are not covered by the OFT and Competition Commission investigations, and most are likely to fall below the price threshold for regulation under the Directive. The Government has little evidence of consumer detriment in these markets, although some of the same competition issues may arise as in the market for domestic appliances. The Government therefore intends to consider the issue of FSA regulation of such contracts in the light of the Competition Commission's conclusions relating to extended warranties on domestic electrical appliances.

**Are there other factors which the Government should take into account in considering regulation of extended warranties on domestic appliances or other goods?**

## CHAPTER 3

### WHICH ACTIVITIES WILL BE REGULATED?

- 3.1. The Directive requires the UK to regulate various activities involved in selling and administering insurance (or “insurance mediation” as the Directive describes these activities). The activities to be regulated are:
- introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance;
  - concluding contracts of insurance; and
  - assisting in both the administration and performance of such contracts, in particular in the event of a claim.
- 3.2. The Government intends to implement the Directive by extending the existing domestic regime that applies to the mediation of those “qualifying contracts” of long-term insurance, the sale of which is already regulated<sup>7</sup>, to the mediation of all other contracts of insurance<sup>8</sup>. The Regulated Activities Order (RAO) sets out the activities and investments that the FSA currently regulates. The RAO will be amended to extend the current regulated activities of dealing in investments, arranging deals in investments, managing investments and advising on the merits of transactions in investments to cover all contracts of insurance. This will implement the Directive.
- 3.3. The activities in the RAO which will be extended to apply to all contracts of general insurance are summarised below. The decision trees in Annex C give readers an indication of whether particular activities are likely to fall within the scope of regulation.

#### **Arranging and introducing**

- 3.4. There are two types of arranging of insurance contracts which will be regulated:
- arranging for a person to enter a particular insurance contract with an insurer; and

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<sup>7</sup> See Para 1.2. of Chapter 1 for definition.

<sup>8</sup> subject to the possible exclusions detailed in Chapter 2.

- making arrangements with a view to another person who takes part in those arrangements buying an (unspecified) insurance contract will also be regulated, for example introducing a policyholder or a potential policyholder to an insurer or insurance intermediary.
- 3.5. It will be for the FSA to issue guidance on what amounts to regulated introducing. However, the Government (and the FSA) consider that such introducing has to have an active element - for example speaking to a client to recommend an insurer or their products. But merely displaying leaflets with details about a particular insurer and doing no more would probably not be regarded as introducing and therefore would not be a regulated activity.

### **Advising**

- 3.6. The Government considers that advising on a particular insurance contract is caught by the Directive, and that in any case it is appropriate to subject the activity of advising on contracts of general insurance to regulation.
- 3.7. Generic advice, such as simply advising someone to take out household contents insurance, will not be regulated. This distinction between generic advice being unregulated and advice on a particular contract being regulated mirrors the current position in the RAO for regulated investment products.

### **Are there other activities in relation to work preparatory to the conclusion of contracts of insurance that should be regulated?**

### **Concluding contracts of insurance**

- 3.8. Insurers who conclude contracts of insurance by way of business are already subject to regulation. An intermediary who enters into a contract as agent for a policyholder or an insurer by way of business will in future also be subject to regulation. For example an intermediary who completes the contract of insurance for customers and sends them to the insurer would be likely to be regulated.

## **Post contract activities**

3.9. The Government intends to regulate certain post contract activities, in particular in the event of a claim. The Directive requires regulation of persons who are “assisting in the performance and administration of a contract”<sup>9</sup>.

3.10. The Government considers that a person would have to assist in both the administration and the performance of a contract to be subject to regulation. For example:

- a windscreen repairman assists the insurance company in “performing” the contract by providing the service which the insurer is contractually required to provide. But assuming he does not also assist in the “administration” of the contract he would not be subject to FSA authorisation;
- an employer who collects premiums on behalf of his or her employees through the payroll would be engaging in activity which is assisting in the administration but *not* the performance of the contract, and would probably not be caught by regulation;
- a contractor who sends out reminders to policyholders that renewal of a policy is due, arguably assists in the administration of the contract. However this person would probably not be caught by FSA regulation unless she/he also assisted in the performance of the contract, and carried on these activities by way of business (or unless the renewal reminder amounted to a fresh introduction).

3.11. The post contract activities of insurance brokers are likely to be regulated as brokers are likely to be assisting in both the administration and performance of the contract. In any case the brokers will need to be authorised for their other mediation activities, and the FSA has some powers<sup>10</sup> to issue rules governing the non-regulated activities of authorised persons.

3.12. The FSA will issue more detailed guidance on whether particular activities will fall within the scope of regulation.

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<sup>9</sup> See the proposed definition of “manage”, in relation to contracts of insurance in Article 3(1) of the Regulated Activities Order.

<sup>10</sup> Section 138, Financial Services and Markets Act 2000.

### **Claims handling**

3.13. Claims handling by intermediaries on behalf of insurance companies, expert appraisal and loss adjusting will not be regulated directly<sup>11</sup>. These activities are excluded from regulation in the Directive and the Government considers that other measures provide adequate consumer protection. Insurers are already FSA authorised, and therefore the systems and controls relating to insurers' claims handling processes whether in-house or outsourced, are already subject to some FSA regulation as the FSA has some powers to make rules governing the non-regulated activities of authorised persons<sup>12</sup>. Intermediaries who assist in claims handling will be regulated indirectly through this process. Customers have a right of redress against insurers if the claim is not handled appropriately.

**Do you agree that claims handling by intermediaries on behalf of insurance companies, expert appraisal and loss adjusting should not be subject to direct FSA regulation? If not, do you have evidence of consumer detriment that would warrant such regulation?**

### **Reinsurance**

3.14. The Directive also applies to mediation of reinsurance. The Government intends regulating *reinsurance* mediation activities in the same way as insurance mediation activities. But in the light of the risks and parties involved, the FSA will consider whether both the regulatory regimes should differ or not. In this consultation document references to contracts of insurance include contracts of reinsurance.

### **Misleading statements and practices**

3.15. FSMA<sup>13</sup> specifies two criminal offences relating to misleading statements and practices regarding certain financial services and products:

- knowingly or recklessly making a false statement which is intended to induce another person to enter into, or fail to enter into, a “relevant agreement”, or exercise, or refrain from exercising, rights conferred by a “relevant investment.

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<sup>11</sup> See the proposed Article 38A of the Regulated Activities Order.

<sup>12</sup> Section 138, Financial Services and Markets Act 2000.

<sup>13</sup> Financial Services and Markets Act 2000, s. 397.

- engaging in conduct which creates a false or misleading impression as to the value of “relevant investments”, and thereby inducing a person to deal, or refrain from dealing, in those investments.

3.16. These matters are essentially crimes of fraud. The coverage of these offences is defined by the “relevant agreements” and “relevant investments” concerned. These are defined in secondary legislation<sup>14</sup>.

3.17. These offences are a key part of the FSMA regulatory framework providing protection for consumers against misleading statements and practices for certain financial services activities. As far as possible, the coverage of these offences is aligned with the coverage of investments and activities set out in the financial promotion regime. The mediation of “qualifying contracts” of long-term insurance business<sup>15</sup> is already within the scope of these offences.

3.18. The Government therefore intends extending the coverage of these offences to all insurance mediation activities.

### **Financial promotions**

3.19. The FSMA financial promotion regime restricts the communication of “an invitation or inducement to engage in investment activity”. Promotions by unauthorised persons must usually be approved by an authorised person. Promotions by authorised persons are not subject to the financial promotion restriction, but are instead governed by FSA rules. However the FSA cannot impose restrictions on authorised persons that are greater than those imposed on unauthorised persons<sup>16</sup>.

3.20. Promotions which encourage the recipient to enter into a contract of insurance are already subject to the financial promotion regime. Promotions which encourage the recipient to use the services of an intermediary for “qualifying contracts” of long-term business<sup>17</sup> are also subject to the financial promotion regime.

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<sup>14</sup> The Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001, SI 2001/3645.

<sup>15</sup> See Para 1.2. of Chapter 1 for definition.

<sup>16</sup> See section 145(3) of the Financial Services and Markets Act 2000.

<sup>17</sup> See Para 1.2. of Chapter 1 for definition.

- 3.21. The Government is minded not to extend the financial promotion regime to promotions of services of mediation of general insurance. If the financial promotion regime was extended, some persons who will be excluded from the RAO (for example by the exclusion for the provision of information in the context of a professional activity) might be brought back into regulation if they provide information that falls short of advice or arranging but can be construed as a promotion of insurance mediation services.
- 3.22. In addition the available evidence of consumer detriment does not suggest a need to regulate promotions of mediation services (eg advisory services) in relation to general insurance products to the same extent as promotions of advisory services in relation to investment products or “qualifying contracts” of long-term insurance where the sale is already regulated.
- 3.23. The Government considers that the regulation of the sales activity itself will provide sufficient consumer protection. In addition applying the misleading statements and practices regime to insurance mediation activities will protect consumers from promotions relating to such activities which are misleading or fraudulent.
- 3.24. However if there was strong evidence of consumer detriment, it would be possible for promotions of advisory services to be regulated in the same relatively light touch way as promotions of general insurance products, where such promotions escape regulation if basic information including the name and the address of the provider is provided.
- 3.25. This would apply the broad exemptions in Part V of the Financial Promotion Order<sup>18</sup> to promotions of these activities. In brief an advertisement would be exempt from regulation provided certain basic information including the name, address, and where appropriate, the regulator of the promoter were included in the advertisement. This would enable the consumer to know who to complain to if there is a problem with the promotion.

**Do you agree that the financial promotion regime should not apply to the promotion of general insurance mediation activities? Is there sufficient consumer detriment to justify bringing general insurance mediation activities into the Financial Promotion Order with the broad Part V exemptions applying?**

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<sup>18</sup> Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 SI 2001/1335

### **Implications for “qualifying contracts” of long-term insurance whose sale is already regulated**

3.26. The FSA already regulates certain mediation activities in relation to “qualifying contracts” of long-term insurance<sup>19</sup>. The existing regime for such long-term business will need to be amended to make it consistent with the Directive. The generic range of activities in relation to such contracts which are currently regulated (dealing, arranging, managing etc.) reflect the requirements of the Directive. However the RAO contains exclusions from these activities which have been reconsidered in the light of the Directive.

3.27. The Government intends to remove certain current exclusions in the RAO for “qualifying contracts” of long-term insurance which are not compatible with the Directive. However the Government also intends to apply certain new exclusions contained in the Directive to long-term business. The most important changes to the regime for long-term business are:

- the Directive does not permit retaining the existing exclusion for those who introduce clients to an authorised person for independent advice (article 33 of the RAO). The Government therefore intends to amend this exclusion so it does not apply to introductions for “qualifying contracts” of long-term insurance. The exclusion will also not apply to other contracts of insurance when mediation activities in relation to them are brought into the RAO. Those who introduce to, for example, an authorised Independent Financial Advisor (IFA), may now need to be authorised;
- however, some introducers will be able to benefit from the broad exclusion in the Directive for the provision of information about insurance contracts on an incidental basis in the context of another professional activity. The Government intends applying this exclusion to “qualifying contracts” of long term insurance<sup>20</sup>, subject to public consultation. For more details on this exclusion please see Paras 4.8. to 4.10. of Chapter 4.
- the Government intends to modify the appointed representative and professional regimes to ensure that they comply with the Directive (see Chapter 4). This will have an impact on existing appointed representatives and

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<sup>19</sup> See Para 1.2. of Chapter 1 for definition.

<sup>20</sup> See Para 1.2. of Chapter 1 for definition.

professionals who act as intermediaries of “qualifying contracts” of long-term insurance.

**Should the exclusion for information provided on an incidental basis in the context of another professional activity apply to “qualifying contracts” of long-term insurance? Would this cause significant consumer detriment and if so, how?**

### **Traded Endowment Policies (“TEPs”) and Viatical Investments**

- 3.28. The Government intends that the regulation of mediation will also apply to rights under contracts of insurance, even though the Directive does not require it. Mediation of rights to, and interests in, “qualifying contracts” of long-term insurance<sup>21</sup> (e.g. traded endowment policies or viatical investments which are whole of life policies sold by the terminally ill – but not interests under the trusts of an occupational pension scheme) is already regulated. The primary effect of the Government’s proposals on the current regulatory regime for these activities is that the new exclusions, such as the provision of information on an incidental basis will apply.
- 3.29. The second hand market for general insurance products will be regulated for the first time. As far as the Government is aware the second-hand market for insurance contracts mainly relates to rights under contracts of life-insurance, and this extension of the FSMA regime is unlikely to have a significant effect. But consultees’ views on whether it is appropriate to extend the regulatory regime to mediation activities in relation to rights to and interests in, all contracts of insurance are sought.

**Should the regulatory regime be extended to mediation activities in relation to rights to and interests in, all contracts of insurance?**

### **Long-term care insurance**

- 3.30. The Government announced in October 2001 that mediation of long-term care insurance would be fully regulated by the FSA. Long-term care insurance falls within the scope of the Directive, and hence will fall within the remit of the FSA.

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<sup>21</sup> See Para 1.2. of Chapter 1 for definition.

The FSA will implement a regime that will take account of the risks and parties involved in purchasing these products and this fulfils the Government's commitment to bring the selling of long-term care insurance into regulation.

## **Box 2**

### **Remuneration and by way of business**

Under the Directive, those who sell insurance need only be subject to regulation if they “for remuneration, take up or pursue” selling activities. This is similar to the current FSMA regime which provides that regulation only applies to those carrying on regulated activities “by way of business”. (note 1)

The Government therefore intends to implement the “for remuneration, takes up or pursues” concept by applying the “by way of business” test under FSMA to the activities of selling insurance, making it clear that remuneration is a key part of that test. It should be noted that remuneration need not be pecuniary and may take any form of economic benefit.

Whether a person is carrying on the activities “by way of business” will be a matter for the FSA to determine on a case-by-case basis. Relevant factors in addition to remuneration would probably include; the frequency with which the activity is carried on; the nature of the activity; and whether the person is acting in the course of a trade or profession.

(1) see Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 S.I. 2001/1177

## CHAPTER 4

### WHO WILL BE REGULATED AND HOW?

#### **Mediation by employees of insurance companies**

- 4.1. The Directive requires the UK to regulate certain insurance mediation activities carried on by intermediaries but these activities are not within the scope of the Directive when carried on by employees of insurance companies.
  
- 4.2. The Government considers that to regulate the activities of intermediaries but not insurers would cause confusion to customers, and create an unlevelled playing field in terms of competition between intermediaries and insurers' direct sales forces. Also as insurers are already subject to regulation on the basis that they carry on insurance business, the FSA could make rules about their mediation activities in any event.<sup>22</sup> Therefore to ensure clarity the Government intends to regulate these activities in the same way whether carried on by intermediaries or by persons directly employed by insurers. Chapter 3 describes how the RAO will be amended to extend the current regulated activities of dealing in investments, arranging deals in investments, managing investments and advising on the merits of transactions in investments to cover all contracts of insurance. This extension of the RAO will also apply to insurance companies and their direct sales forces.

#### **Appointed representatives**

- 4.3. In general terms only persons authorised by the FSA are able to carry on regulated activities. However FSMA creates an important exemption for "appointed representatives"<sup>23</sup>. Appointed representatives of authorised persons can carry on regulated activities without themselves being authorised. The appointed representative has to be party to a contract with an authorised person that permits the appointed representative to carry on regulated activities. The authorised person has to accept responsibility in writing for the conduct of all the regulated activities the appointed representative carries on, and the contract must comply with any further requirements that the Treasury has prescribed.

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<sup>22</sup> by virtue of the Financial Services and Markets Act 2000 s. 138(1)(b).

<sup>23</sup> Financial Services and Markets Act 2000, s. 39.

- 4.4. A person wishing to carry on regulated activities can either be an appointed representative *or* be FSA authorised for all the regulated activities carried on. It is *not* permitted to be an appointed representative for some activities and FSA authorised for others.
- 4.5. The advantage of the appointed representatives regime is that appointed representatives do not have to go through the process of FSA authorisation, but customers benefit from the protection that FSA regulation provides through regulation of the appointed representative's principal.
- 4.6. The Government intends applying the appointed representatives regime to insurance mediation activities. The appointed representatives regime delivers many of the requirements of the Directive but will require some modifications.

These are as follows:

- the Government will require the FSA to maintain a register of appointed representatives, and give the FSA powers to deregister them directly<sup>24</sup>;
  - the FSA will make rules which require the principal, by way of his contract with the appointed representative, to require the appointed representative to comply with certain standards, including those set out in the Directive.
- 4.7. To ensure that a person who has been appointed as an appointed representative cannot carry on regulated activities relating to the selling of insurance before he is registered, the Government intends making it a requirement that the principal, in the contract with the representative, bar the appointed representative from carrying on such activities if he is not registered with the FSA. This will implement the Directive requirement that intermediaries must be registered with the designated competent authority before carrying on insurance mediation. The effect of this is that a person who is not on the FSA's register of appointed representatives does not benefit from the exemption for appointed representatives<sup>25</sup>.

**Do you agree that the appointed representatives regime should be extended to insurance mediation activities? Would this cause significant consumer detriment and if so, how?**

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<sup>24</sup> See the proposed Article 93 of the Regulated Activities Order.

<sup>25</sup> See section 39(1)(a)(i) of the Financial Services and Markets Act 2000 and the proposed amendment to Article 3 of the Appointed Representatives Regulations SI 2001/1217 to be made by Part 3 of the Insurance Mediation Directive (Miscellaneous Amendment) Regulations.

## **Professionals**

### **Exclusion for information provided**

- 4.8. The Government intends applying the exclusion in the Directive for “the provision of information on an incidental basis in the context of another professional activity provided that the purpose of that activity is not to assist the customer in concluding or performing an insurance contract”. This exclusion applies to any professional, and the Government intends replicating this exclusion in relation to mediation of insurance in the RAO. As set out in Para 3.27. above this will need to take account of the modifications required in respect of “qualifying contracts” of long-term insurance<sup>26</sup>.
- 4.9. The Government considers that this exclusion applies not just to professionals such as lawyers and accountants who are members of designated professional bodies (see Paragraphs 4.11. to 4.14. below) but that it also applies to groups such as doctors, dentists, car mechanics and retailers. The Government considers that the “provision of information” may include an introduction.
- 4.10. The Government considers that that permitting such a large class of persons to provide advice without FSA regulation would give rise to potentially serious consumer protection issues. Therefore the Government intends that this exclusion will not apply to the provision of advice, although the Directive permits the exclusion to apply to advice. The provision of information exclusion only applies to communications between the customer and the intermediary. If the intermediary negotiates with the insurer over the terms of a policy or potential policy for a customer or potential customer this would go beyond the scope of the exclusion.

**Should the provision of information exclusion also cover advice? Would this cause significant consumer detriment?**

## **Designated Professional Bodies**

- 4.11. Part XX of FSMA provides that members of Designated Professional Bodies (DBPs) can carry on certain regulated activities incidental<sup>27</sup> to their main

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<sup>26</sup> See Para 1.2. of Chapter 1 for definition.

<sup>27</sup> For more information regarding the current meaning of incidental in the context of currently regulated activities see FSA guidance. This guidance may be subject to review by the FSA.

profession without being authorised by the FSA provided they comply with the rules of their DPB. DPBs include the Law Society, the Institute of Chartered Accountants and others. The Government intends extending the existing Part XX regime to the mediation of general insurance.

**Do you agree that the FSMA Part XX regime for Designated Professional Bodies should apply to insurance mediation activities? Would this cause significant consumer detriment and if so, how?**

4.12. The current Part XX regime does not permit professionals to deal as principal and imposes certain limits on the extent to which professionals can manage investments. The Government does not consider it necessary or appropriate to alter the scope of the existing Part XX regime in these areas. The current regime also imposes limitations on the extent to which a member of the professions can give advice to an individual. Broadly, advice can only be given to individuals who are acting in the course of business or as a trustee of a pension scheme, or where the professional is merely endorsing a recommendation given by an authorised person. While the Government continues to consider that these restrictions are appropriate in relation to long-term insurance, the Government does not intend that these restrictions should apply in relation to advice on the merits of entering into a contract of general insurance. Therefore DBP firms would be able to advise on and recommend both retail and commercial contracts of general insurance.

**Do you agree that limitations that currently apply to the advice that a professional can give under Part XX in relation to long term contracts of insurance should not apply to advice given in relation to general insurance?**

4.13. The Government intends modifying the Part XX regime for activities of insurance mediation. As with appointed representatives, the FSA will have to maintain a register of members of DPBs who carry on mediation activities. To ensure that a member of a DPB cannot provide mediation services unless on the register, the Government proposes to make registration a condition of access to the Part XX regime for insurance mediation<sup>28</sup>. The Part XX regime with these modifications will implement the Directive in relation to DPB professionals.

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<sup>28</sup> by way of amendment to the Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001 SI 2001/1227 to be made by Article 3 of the Financial Services and Markets Act 2000 (Insurance Mediation) (Miscellaneous Amendments) Order.

4.14. As the FSA already has the power to prevent a particular professional from carrying on regulated activities under Part XX,<sup>29</sup> the Government does not consider it necessary to give the FSA a power to de-register a member of a DPB. If the DPB rules were not compatible with the Directive then the FSA would be able to use its power to prevent classes of professionals or particular professionals from using Part XX<sup>30</sup>. It would also be open to the Treasury to de-designate the DPB for the purposes of insurance mediation if the Treasury considered that the DPB rules were not Directive compatible.

### **Lloyd's**

4.15. The Government intends to bring insurance mediation activities as defined in the Directive in relation to contracts of insurance underwritten at Lloyds within the scope of regulation.

4.16. *Managing agents* are already regulated under the RAO. The Government intends to extend the investment services activities in the RAO to cover general insurance as described in Chapter 3, meaning the activities of Lloyd's managing agents would be treated in terms of the RAO in same way as the activities of insurers and insurance intermediaries outside Lloyd's. This will implement the Directive in relation to managing agents.

4.17. *Lloyd's brokers* are not currently regulated under FSMA (unless they act as brokers for long-term insurance business<sup>31</sup>). The Government intends to apply the regime it develops for other insurance intermediaries to Lloyd's brokers. This will implement the Directive in relation to Lloyd's brokers.

### **Territorial scope**

4.18. In most cases, the FSA only regulates activities which are carried on in the United Kingdom<sup>32</sup>. It can often be difficult to determine where an insurance mediation activity takes place where the intermediary and the potential policyholder are in different countries. It is for the FSA and, ultimately, for the courts to resolve these

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<sup>29</sup> Financial Services and Markets Act 2000 S. 329.

<sup>30</sup> Financial Services and Markets Act 2000 S. 328.

<sup>31</sup> See Para 1.2. of Chapter 1 for definition.

<sup>32</sup> Financial Services and Markets Act 2000 S.418 specifies certain cases in which activities carried on outside the United Kingdom will be taken, for the purposes of the Act, to be carried on in the United Kingdom.

difficult issues. Consultees may find the FSA’s guidance relating to existing regulated activities (AUTH 2.4 – accessible on the FSA’s website<sup>33</sup>) of assistance.

### **Intermediaries established outside the UK**

4.19. Intermediaries established in an EEA state who have obtained registration in their home Member State will have a right to passport into the UK to establish a branch or provide services<sup>34</sup>. Broadly speaking the Government proposes to treat providers of insurance mediation activities established outside the UK who wish to carry on mediation activities in the UK in the same way as it currently treats non-UK providers of investment services. This approach means that non-UK intermediaries intending to provide mediation services through a branch in the UK will have to seek FSA authorisation or, in the case of an EEA-based intermediary, seek a passport from their home state regulator under the Directive. However, non-UK intermediaries who merely intend to provide services in the UK, without establishing a branch, may do so without FSA authorisation where they deal with an authorised or exempt person<sup>35</sup> or where they are acting as a result of a legitimate approach (broadly, an approach which was not solicited in breach of the financial promotion regime)<sup>36</sup>. The FSA will be covering issues of territoriality in their guidance.

### **Threshold conditions**

4.20. The FSA can only provide authorisation if satisfied that the applicant meets the “threshold conditions”. The threshold conditions for regulated activities are set out in broad terms in FSMA.<sup>37</sup> The FSA defines the detail of how the threshold conditions apply for various regulated activities, and then determines whether an applicant meets them.

4.21. The threshold conditions cover such areas as “location of offices”, “adequate resources”, and “suitability” - in other words whether the applicant is a fit and proper person to carry on the regulated activities. The Government intends to

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<sup>33</sup> [www.fsa.gov.uk](http://www.fsa.gov.uk)

<sup>34</sup> See the proposed amendments to Schedule 3 to the Financial Services and Markets Act 2000 in the Insurance Mediation Directive (Miscellaneous Amendments) Regulations.

<sup>35</sup> An exempt person can legitimately carry on a regulated activity without needing to be authorised by the FSA, for example an appointed rep, see Chapter 4.

<sup>36</sup> See article 72 of the Regulated Activities Order – exclusion for overseas persons.

<sup>37</sup> Schedule 6 to the Financial Services and Markets Act 2000.

apply the threshold conditions as set out in Schedule 6 to FSMA, making only one minor change required by the Directive to the threshold condition relating to location of offices detailed below.

- 4.22. The Directive provides that a provider of mediation activities should be registered with a competent authority in its home Member State. Were the provider to purport to register with a competent authority in another state it would not be “registered” for the purposes of the Directive.
- 4.23. However the Directive definition of “home Member State” does not quite match the relevant FSMA definition<sup>38</sup>. In relation to legal persons, the Directive provides that the home state is the state in which the registered office is situated or, if it has no registered office, the state in which the head office is situated. In other words the Directive does not require the head office of a registered provider of mediation services to be in the same state as its registered office. However, the current FSMA regime requires the head office to be in the same member state as the registered office.
- 4.24. The Government intends amending the threshold conditions, as they will apply to insurance mediation activities to replicate the position in the Directive. This would mean for example that the home state of a provider of insurance mediation activities whose registered office was in the UK but whose head office was in France would be the UK and such an intermediary should seek authorisation from the FSA.
- 4.25. In relation to individuals, the Directive specifies that the home state is the place where the individual is resident and in which he or she carries on business. The current FSMA regime however focuses on the location of the individual’s head office, not the place of his or her residence. The Government intends amending the threshold conditions, as they will apply to insurance mediation activities to ensure that the home state is the place where the individual is resident and in which he or she carries on business. An individual cannot live in the UK and be registered in another member state.

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<sup>38</sup> Para 2 of Schedule 6 to the Financial Services and Markets Act 2000.

## **Risks located outside the Community**

- 4.26. The Directive excludes from regulation mediation activities relating to insurance contracts for risks outside the European Community. However in the UK's current regime for "qualifying contracts" of long-term insurance<sup>39</sup>, such mediation which takes place in the UK is caught by the RAO, even if it relates to a life-insurance policy in relation to, say, a US resident. In relation to mediation of general insurance risks outside the Community, the Government does not intend to exclude non-commercial risks. So mediation of a travel insurance policy not sold with the holiday which provides cover for travel in Brazil would be caught by regulation.
- 4.27. However the Government does intend to exclude mediation of contracts for large risks<sup>40</sup> outside the Community from regulation. This exclusion from regulation applies only to the extent that the large risk is situated outside the EEA. The effect of this will be that mediation of large commercial contracts which relate to risks outside the Community, such as insuring a chain of American hotels via a UK intermediary where the policyholder is a large company would not be caught by regulation. It should be noted that reinsurance of non EEA companies will also be excluded from the scope of regulation.

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<sup>39</sup> See Para 1.2. of Chapter 1 for definition.

<sup>40</sup> "large risks" are defined as having the same meaning as Article 5(d) of the First Life Directive 73/239/EEC. Broadly, this includes risks relating to railway stock, aircraft, ships, goods in transit, aircraft liability and shipping liability; risks relating to credit and suretyship where the risk relates to the commercial or professional activities of the policyholder; and risks relating to land vehicles, fire, property damage, motor vehicle and certain financial loss where the policyholder meets certain criteria as to balance sheet total, turnover and number of employees.

## CHAPTER 5

### WHAT WILL THE REQUIREMENTS OF REGULATION BE?

5.1. The Government's intended approach is to give the FSA responsibility for regulating various activities relating to the sale and administration of general insurance products. The Financial Services and Markets Act 2000 (FSMA) sets the framework for the Financial Services Authority (FSA) to regulate certain financial services, including giving it the power to make rules governing conduct of business, and powers to enforce those rules. Much of the detail of the regulatory requirements will be addressed in FSA rules, directions and guidance. What follows is a brief outline of the main regulatory requirements, which will be placed on insurance intermediaries.

#### **Authorisation and registration**

5.2. Individuals or firms who want to carry on insurance intermediary activity by way of business will have to apply to the FSA in order to be "authorised" to carry on such business. In order to become an "authorised person" various requirements have to be met including being a "fit and proper person". It is for the FSA to set the fitness and properness requirements.

5.3. Certain persons will be able to carry on insurance intermediation activities in certain circumstances without needing to be authorised (see Chapter 2). However the Directive requires the FSA to keep a register of all those carrying on insurance mediation activity by way of business whether authorised or not. The register will therefore include details of those appointed representatives and DPB professionals carrying on insurance mediation activity (see Chapter 4). The register will be publicly available on the FSA's website.

#### **Information requirements for intermediaries**

5.4. The Directive defines various information requirements for intermediaries, which will be defined in the FSA's rules. The FSA will be able to add to these Directive requirements subject to its own consultation processes. Prior to concluding, amending or renewing a contract the intermediary will have to provide the customer with information including the intermediary's name, address, any

relevant interests that it holds in an insurance company, and complaints procedures, see below.

### **Complaints handling**

- 5.5. The Directive requires the UK to set up procedures allowing customers and other interested parties (including consumer associations) to register complaints about insurance and reinsurance intermediaries. In relation to authorised persons and appointed representatives, it is for the FSA to implement this provision.
- 5.6. In relation to professionals who are members of Designated Professional Bodies (DPBs), the DPB rules provide for complaints procedures for customers. For more information on the insurance mediation regime and DPBs, see Chapter 4.

### **Insolvency of insurance intermediaries**

- 5.7. The Directive requires the UK to take measures to protect customers against the inability of the insurance intermediary to transfer the premium to the insurance undertaking or to transfer the amount of claim or return premium to the insured. It will be for the FSA to implement this provision.

### **Sanctions**

- 5.8. The Directive requires the UK to provide for appropriate sanctions against those not on the register who carry on insurance mediation and against those registered intermediaries who fail to comply with any of the regulatory requirements described above.
- 5.9. The Government intends to make insurance mediation activities regulated activities under FSMA, which means that a person who carries on these activities without being authorised or exempt will commit a criminal offence, and the contracts that person has entered into will be unenforceable by him or her, although consumers will be able to enforce their side of such contracts<sup>41</sup>.
- 5.10. The FSA has a range of sanctions against authorised persons including the ability to issue fines, and statements of public censure. Authorised persons can challenge

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<sup>41</sup> See Sections 19 and 27 of the Financial Services and Markets Act 2000 respectively.

the decisions of the FSA in the Financial Services and Markets Tribunal (“the Tribunal”) which acts as a court of first instance.

### **Controllers**

- 5.11. FSMA contains various provisions relating to the control of authorised persons.<sup>42</sup> It creates an obligation to notify the FSA of an intended acquisition of a controlling interest in an authorised person, of an intended increase in that interest or of an actual or intended reduction in such an interest. The FSA has an obligation to either approve, with or without conditions such acquisitions or changes in control, or to issue an objection to an acquisition or change in a controlling interest, according to criteria set out in FSMA. FSMA also contains provisions relating to controlling interests that have been acquired in breach of these notification or approval requirements and creates a number of offences relating to such breaches.
- 5.12. Certain obligations relating to controllers are set out in European law. However where the Directives do not require it the Treasury has power to exempt controllers of authorised persons from the entire controllers’ regime, or from the obligation to notify the FSA. The Directive does not require the application of a controllers’ regime.
- 5.13. The Government considers that the notification by controllers reduces the risk of fraud or other irregularities in the operation of financial services firms by enabling the FSA to establish whether those controlling financial services firms are fit and proper and do not have a track record of involvement in fraudulent or irregular activity.
- 5.14. The Government therefore intends applying a streamlined controllers’ regime to general insurance intermediaries. Controllers of such firms will only be required to notify the FSA of an actual or intended increase or decrease above or below a single threshold of 20% of the shares or voting rights in the company. The other thresholds set out in FSMA<sup>43</sup> would not apply but certain other qualitative conditions set out in FSMA would apply.<sup>44</sup>

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<sup>42</sup> Part XII, Financial Services and Markets Act 2000

<sup>43</sup> Financial Services and Markets Act 2000, sections 180 and 181

<sup>44</sup> the duty to notify would also apply where the controller or would be controller becomes able to exercise a significant influence over the management of an authorised person (“A”) either by virtue of his shareholding or

**Do you agree that the notification requirements for the controller’s regime for general insurance intermediaries should be streamlined as outlined in Para 5.14. above? Would this cause significant consumer detriment and if so, how?**

**Regulatory Impact Assessment**

5.15. Annex E contains the draft Regulatory Impact Assessment (RIA) setting out the expected impact, costs and benefits of regulating insurance mediation activities.

**The Government would welcome views on the assumptions made in the Regulatory Impact Assessment. It would be helpful to receive views on both the costs and benefits to businesses and consumers of the proposed regulation. We would particularly like to receive views on the likely impact on the small firms that will be covered by FSA regulation of general insurance mediation.**

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voting power in the company, or is able to exercise significant influence over the management of A’s parent company (“P”) by virtue of his voting power or shareholding in P.