

Travel insurance review

Call for evidence

November 2006



HM TREASURY



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FOREWORD - REGULATING TRAVEL INSURANCE

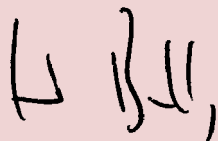
In August I announced an inquiry by HM Treasury into the sale of travel insurance purchased alongside a holiday or other related travel.

Travel insurance is an important product that offers both financial protection and peace-of-mind. However travel insurance is not a comprehensive product and it is important that consumers understand under which circumstances they will and will not be covered. 20 million people buy travel insurance every year and many of these people buy their travel insurance from travel agents. And whilst the stand-alone sale of travel insurance is subject to the same regulatory controls as the sale of other forms of insurance, travel insurance sold with a holiday is currently exempt from these controls.

The Government said in 2003 that it would review whether travel insurance sold along with a holiday should be subject to FSA regulation. Also, there has been growing concern from consumer groups that the travel industry was not selling travel insurance as well as it should be doing. And I am concerned as to how well consumers understand what their travel policy covers them for, particularly where terrorism exclusions are involved.

So in the summer I announced the commencement of a review in to whether travel insurance sold alongside a holiday should be subject to FSA regulation. I will use the outcome from this review to consider whether any changes to the regulatory framework are required to provide greater protection for consumers, balancing the need for proper consumer protection against the additional costs associated with regulation.

This document forms an important part of that inquiry, calling for evidence and views on the potential way forward. I am encouraging all interested parties – including providers of insurance, sellers of insurance, and consumers of insurance – to contribute to the debate. Once we have built up an evidence base and analysed the options we will make a decision on the Government's preferred approach, holding a full public consultation if a legislative option is chosen.



Ed Balls MP

Economic Secretary to the Treasury



EXECUTIVE SUMMARY

1.1 This document seeks views on whether travel insurance sold along with a holiday or related travel should be subject to regulation, as is the case for travel insurance sold on a stand-alone basis.

1.2 The EU's Insurance Mediation Directive (IMD) requires, broadly, the regulation of the selling of insurance contracts. However, regulation is not required by the Directive where a number of conditions are met – travel insurance products sold along with a holiday are typically capable of satisfying these conditions. The decision of whether or not to regulate the sales of such products is left to the discretion of individual EU Member States. In 2002/3 the Government consulted on implementing the IMD in the UK and, as part of that consultation, it sought views on whether travel insurance sold along with a holiday should be subject to regulation. The summary of responses to that part of the consultation is at Annex A.

1.3 Following this consultation the Government decided that, at that time, there was not sufficient justification to regulate travel insurance sold along with a holiday or related travel. However, it recognised that there were concerns with this market. Given these concerns, the Government committed to review its decision, on whether to subject these products to Financial Services Authority (FSA) regulation, two years after the implementation of general insurance regulation - that is by early 2007.

1.4 In August 2006 the Economic Secretary announced that HM Treasury would be conducting its review into whether travel insurance purchased alongside a holiday should be subject to FSA regulation. This call for evidence forms part of the review process. Three options - no regulation; strengthened industry self-regulation; full FSA regulation - are provided and the Government would welcome stakeholders' views on the costs and benefits of each of these options. Views on other potential options would also be welcomed. Responses to the call for evidence, and in particular qualitative or quantitative evidence contained therein, will form the basis for the Government developing its preferred approach in this area.

1.5 The call for evidence runs for 12 weeks – with an additional week for the Christmas break – and will close on 22 February 2007. Following this, the Government will put forward its preferred approach. If a legislative option is chosen it will be subject to a consultation and Regulatory Impact Assessment.

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RESPONDING TO THE REVIEW

HOW TO RESPOND

2.1 The Government welcomes the views of all stakeholders on issues raised in this document. The review period begins with the publication of this document and will run for 12 weeks (with an extension for the Christmas period). Please ensure that responses to this call for evidence reach us by 22 February 2007. We cannot guarantee to consider responses received after this date. Responses should be sent to:

Eve Engledow
Financial Stability and Risk Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
Fax: 020 7451 7524
Email: travel.review@hm-treasury.x.gsi.gov.uk

Enquiries relating to this review can be made to:

Darren Philp or Richard Wronka
Tel: 020 7270 5468/5389
Email: travel.review@hm-treasury.x.gsi.gov.uk

2.2 This document can be found on HM Treasury's website:
<http://www.hm-treasury.gov.uk>.

2.3 When responding, please state whether you are responding on behalf of an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

CONFIDENTIALITY

2.4 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise in writing.

2.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

2.6 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury. HM Treasury will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

2.7 Subject to paragraphs 2.4, 2.5 and 2.6 if you wish part (but not all) of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and another confidential version for use by HM Treasury.

FREEDOM OF INFORMATION CONTACT

2.8 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Telephone: +44 (0) 20 7270 4558
Fax: +44 (0) 207 270 4681
Email: public.enquiries@hm-treasury.x.gsi.gov.uk

HOW THIS CALL FOR EVIDENCE IS BEING CONDUCTED

2.9 Following this call for evidence, the Government will put forward its preferred approach. If a legislative option is chosen it will be subject to an additional consultation and Regulatory Impact Assessment.

2.10 This call for evidence is being conducted in line with the Code of Practice on Consultation. The criteria are listed below (a full version can be found at <http://www.cabinet-office.gov.uk/regulation/consultation/code.htm>). The six consultation criteria are:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows Better Regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you have concerns as to how this call for evidence is being conducted, please contact:

Meenakhi Borooah
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HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

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3

TRAVEL INSURANCE

BACKGROUND

3.1 ONS statistics show that there were 64.2 million visits abroad by UK residents in 2004. Two-thirds of these visits abroad were holidays, just under half of which were package holidays. Spending on visits abroad by UK residents was over £30 billion.

3.2 Travel insurance is a product designed to protect an individual from a variety of adverse events that could occur while they are on holiday or travelling. Some 20 million consumers purchase travel insurance each year in a market worth £670m in 2006¹. Travel insurance sold by travel agents and tour operators accounted for just under 50% of all travel insurance sales in 2004².

3.3 Travel insurance can be bought on an annual or single trip basis. Individuals can purchase travel insurance in a number of ways, for example, over the counter, by telephone, post or over the Internet and through a variety of different retailers, for example:

- Direct from insurers;
- Insurance brokers;
- Travel agents and tour operators;
- Banks and building societies;
- Supermarkets;
- The Post Office.

3.4 Travel insurance is not a comprehensive product. It does not, for example, take on the role of a life insurance policy when an individual is travelling, nor is it a long-term health policy. If an individual needs life insurance then they should ensure they take out a life insurance policy. The coverage of travel insurance will vary from provider to provider, but policies will typically cover³:

- Medical emergency and/or repatriation expenses;
- Providing some financial recompense if the trip is cancelled or curtailed due to circumstances beyond the policyholder's control;
- Loss/damage to personal possessions, including loss/theft of money;
- Expenses incurred due to a delayed departure;
- Expenses incurred replacing a lost passport;
- Legal expenses and third party personal liability cover;
- Limited financial assistance for policyholders or their families if the policyholder suffers permanent disability or death whilst on holiday.

¹ Source: Mintel

² Source: Datamonitor

³ Source: Association of British Insurers website: www.abi.org.uk

3.5 As with any insurance policy the actual cover is specified in the terms and conditions of the policy, which forms the contract between the insurer and the customer. The policy will set out limits on what the insurance will pay out and any excesses that apply to claims made under the policy (i.e. the amount of the claim that the insured person will have to meet themselves).

3.6 The terms and conditions of the policy will also set out any policy exclusions (i.e. what the insurance does not cover). The exclusions relating to a travel insurance policy will vary from product to product, but examples of some important exclusions include claims arising from:

- Pre-existing medical conditions from before you take out the insurance;
- Participation in hazardous/adventure activities for example, rock climbing, skiing, scuba diving, horse riding or cycle touring;
- Acts of terrorism (see box below) and acts of war or civil commotion;
- Airline insolvency⁴.

3.7 It is important that customers understand the terms and conditions of their insurance cover and are aware that policies will generally contain some important exclusions. If, for instance, the traveller has pre-existing medical conditions and want these to be covered, they must tell the insurer before they travel to confirm whether the policy will cover claims arising from these causes. The insurer may respond to this notification by either agreeing to provide cover under the original terms and conditions, offering cover with adapted terms and conditions (e.g. higher excesses or the medical condition excluded), charging a higher premium, or by refusing to offer cover altogether. Similarly, many travel insurance policies will offer to cover the policyholder for hazardous activities such as skiing in return for an additional premium payment.

3.8 Suitable cover is generally available for individuals who are prepared to shop around (or who approach a broker to do so on their behalf). It is not in an individual's best interests to travel under a policy that is unlikely to pay out should they need to make a claim given, for example, the activities they propose to undertake on holiday or any pre-existing medical conditions that they may travel with.

⁴ Only passengers on package holidays are entitled to a refund and assistance in returning home under the ATOL bonding scheme.

Travel insurance and cover for acts of terrorism

According to the Association of British Insurers, about half of the policies in the travel insurance market cover medical expenses caused by a terrorist event, with some of these policies also covering other costs, such as those arising from the loss of luggage or a personal accident. Some insurers that do not explicitly include cover will also make *ex-gratia* payments in the event that a policyholder is caught up in a terrorist incident when travelling.

Anecdotal evidence suggests that it is not always clear that people understand what is and, more importantly, what is not covered by their travel insurance policy. Terrorism cover is an example of where individuals may only realise after the event that they may not be covered.

It is important that individuals taking out travel insurance carefully consider their insurance needs and make sure that any insurance cover they buy adequately protects them.

The Government is working closely with the insurance industry to ensure that, where policies do exclude cover for acts of terrorism, these exclusions are adequately signposted to the consumer prior to the purchase of the policy. In this way, consumers should be able to make an educated decision about the type of cover that is best suited to their own needs. Where insurers *do* offer cover against acts of terrorism, the Government is encouraging insurers to write this cover into the terms and conditions of the contract as opposed to relying on making *ex-gratia* payments.

REGULATION OF GENERAL INSURANCE

3.9 The selling of insurance products by an insurance intermediary is required to be regulated by an EU Directive – the Insurance Mediation Directive (IMD). Insurance intermediaries are commonly brokers (a broker is an individual or firm whose service is to advise the customer on their insurance needs and to find in the marketplace insurance products appropriate to these needs). However, any individual or firm selling or arranging contracts of insurance is captured by the requirements of the IMD, regardless of their main professional activity. The Directive requires the regulation of mediation activities in relation to all contracts of insurance, including long-term and general insurance business, commercial insurance and reinsurance.

3.10 The Government decided to implement the Directive by giving the FSA the responsibility for regulating various activities relating to the sale and administration of general insurance products, whether carried on by intermediaries or insurers. The FSA was already responsible for regulating insurers' business on a prudential basis and regulating mediation activities relating to some contracts of long-term insurance, for example life insurance products.

3.11 The FSA took on responsibility for regulating general insurance on 14 January 2005. The IMD came into force on 15 January 2005. FSA regulation of this area means that those carrying out activities relating to the sale and administration of general insurance products must be authorised by the FSA, and must comply with the relevant FSA rules⁵, in particular the FSA's *Insurance: Conduct of Business (ICOB)* rules. These rules relate to the business processes involved in selling and administering (non-investment) insurance - including marketing, sales, providing literature to customers and claims handling.

⁵ Available on the FSA website: www.fsa.gov.uk

3.12 Retail and small business customers of FSA authorised firms are offered additional protection through access to the Financial Ombudsman Service (FOS) in the case of a dispute with an authorised firm, and to the Financial Services Compensation Scheme (FSCS) in the case of an insolvency of an authorised firm. The FOS provides an independent and impartial complaints service – free of charge to the consumer - that can be used as an alternative to taking action through the courts. The Ombudsman’s decision is binding on an insurer, while not interfering with the right of the complainant to seek an alternative decision through the courts if dissatisfied. The FSCS acts as the UK’s compensation fund of last resort for customers of financial services firms. This means that the FSCS can pay compensation to consumers if an authorised financial services firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by a levy on authorised firms.

3.13 In April 2006 the FSA launched a review of its general insurance regime, including a review of the effectiveness of its ICOB rules in addressing any consumer detriment arising from general insurance (such as travel insurance) and ensuring that disclosure documentation is suitable for the consumer’s needs. The review will also look at pure protection policies (term, critical illness and pure income protection insurance). The review, which will be based on consumer research and discussions with trade bodies, will report in the first quarter of 2007.

REGULATION OF TRAVEL INSURANCE

3.14 Sales of travel insurance sold as a standalone product have been regulated by the FSA since 14 January 2005. For intermediaries this is a requirement of the Directive. However, the Directive does not require regulation if certain conditions are met. The conditions stipulated in the Directive are that:

- The insurance contract only requires knowledge of the insurance cover that is provided⁶;
- The insurance contract is not a life assurance contract;
- The insurance contract does not cover any liability risks [but see B below];
- The principal professional activity of the person [selling the insurance] is other than insurance mediation;
- The insurance is complementary to the product or service supplied by any provider, where such insurance covers:
 - A) the risk of breakdown, loss of or damage to goods supplied by that provider, or
 - B) damage to or loss of baggage and other risks linked to the travel booked with that provider, even if the insurance covers life assurance or liability risks, provided that the cover is ancillary to the main cover for the risks linked to that travel; and

⁶ The Government considers that the first condition means that 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 amount of the annual premium does not exceed €500 and the total duration of the insurance contract, including any renewals, does not exceed 5 years.

3.15 Travel insurance products sold by a travel agent or tour operator alongside a holiday are typically capable of satisfying these conditions. Additionally, the FSA considers that the above conditions apply in circumstances where travel insurance is sold alongside a related travel service. An example of this is where vehicle leasing companies (including retail car-hire companies) sell insurance products that, at the very least, cover damage to or loss of baggage, and other risks linked to the vehicle rental (e.g. personal injury and European breakdown cover).

3.16 The terms of the IMD mean that the sales of travel insurance sold as a standalone product must be regulated in the UK and each EU Member State. There is no requirement to regulate the sales of travel insurance sold alongside a holiday or related travel. Whether the sales of such insurance should be regulated is a matter for the discretion of individual Member States.

3.17 In October 2002 the Government consulted on options for the implementation of the IMD in the UK. In particular, given the potential for differential treatment of travel insurance sold alongside a holiday or related travel, this consultation sought views on the scale of any problem with the sale of such insurance, with a focus on the level of consumer detriment arising from such sales. Three options were also outlined:

- No statutory regulation of such sales;
- FSA regulation of such sales in the same manner as stand alone travel insurance sales;
- Industry specific regulation requiring sellers to be subject to an industry specific code certified by the FSA.

3.18 Following the consultation the Government decided that there was not sufficient justification for FSA regulation of the sales of travel insurance sold alongside a holiday or related travel – in particular, in terms of the evidence of consumer detriment – and the benefits of regulation did not justify the costs.

3.19 Furthermore, the industry specific regulation option was considered inappropriate as the FSA would be required to certify a number of different codes from different trade bodies – leading to a complex situation where there was a danger of competing codes and the risks associated with regulatory arbitrage.

3.20 The Government therefore decided that no statutory regulation for sales of this type of travel insurance was the most appropriate outcome. However, the Government recognised that there were concerns within this market. Given these concerns, the Government decided to hold a review as to whether to subject these products to regulation two years after implementation of general insurance regulation - that is by early 2007. Annex A contains the full HM Treasury summary of consultation feedback from the 2003 consultation.

THE REVIEW

3.21 In recent years, there have been growing concerns from consumer groups and sections of the industry that the market is not working as well as it could do. A recent Which? report⁷ used mystery shopping techniques and real-life case studies to argue that travel insurance bought from travel agents is poor value and often mis-sold. The Which? report found that only 35% of the 26 travel agents surveyed asked medical questions (compared to 81% of banks and insurers), 19% explained what the policy covered (compared to 81% of banks and insurers) and 0% explained what the policy did not cover (compared to 56% of banks and insurers). Whilst this report on its own does not form a comprehensive evidence base, it does indicate genuine concerns around the selling of travel insurance sold alongside a holiday.

3.22 In light of this, on 4 August 2006 the Economic Secretary to the Treasury announced that he would be launching a review into the selling of travel insurance sold alongside a holiday, in order to fulfil the earlier commitment by the Government to review this area and to allow for time to gather evidence in order to inform a decision in early 2007.

3.23 The announcement indicated that HM Treasury would consult as part of its review, before announcing a decision in early 2007. The review will:

- Establish a qualitative and quantitative evidence base to develop a better understanding of any significant problems in this market;
- Consult widely with stakeholders, with particular reference to the scale and nature of any consumer detriment concerning the operation of the market in relation to the sales of travel insurance sold alongside a holiday;
- Consider options for regulating the sale of travel insurance sold alongside a holiday including whether they should be subject to FSA regulation.

3.24 In considering options for regulation there are a number of factors to be taken into account:

- **Complaints about mis-selling and consumer detriment:** there are reports of travel insurance as a problem area in terms of complaints and mis-selling. It is claimed that those selling travel insurance sometimes fail to explain what is and what is not covered by the insurance policy being offered and in particular that sellers sometimes fail to ask the customer about any pre-existing medical conditions that could affect the policy coverage. For instance, the Financial Ombudsman Service's *Annual Review 2005/06* states that: "*The policy terms for travel insurance remain complicated, and the sales process is frequently limited – given the low value of the transactions involved. As a result, whilst there is considerable competition on the pricing of travel insurance, there is also widespread misunderstanding on the part of consumers about the scope of the cover they have and the eligibility criteria that apply*". It should be pointed out that, where there is a dispute over the selling of a travel insurance product, only disputes arising from the selling stand-alone travel insurance currently fall within the FOS' jurisdiction. (There is some FOS protection for consumers of travel insurance sold alongside a holiday, but only where the dispute relates to a claim against the

⁷ "Buy the right holiday cover" from the July 2006 Which? magazine

policy rather than the selling of the policy i.e. where the dispute is between the consumer and an FSA-authorized insurer). However concerns have been raised that those selling travel insurance as secondary to their main business activity (i.e. in conjunction with a holiday or related travel) may be more likely to mis-sell insurance products than professional insurance intermediaries;

- **Wider concerns about bundled goods:** there are further concerns about a lack of transparency and choice for consumers in the sale of insurance in a bundle alongside a non-insurance product (e.g. payment protection insurance offered alongside a loan or other forms of consumer credit). It is also often claimed that travel insurance sold by travel agents can be poor value for money. Regulation would not necessarily improve these consumer issues, although appropriate disclosure requirements should enhance transparency and price comparisons;
- **Level playing field:** it has been argued that regulating travel insurance sold as a standalone product, but not insurance sold with a holiday, could create an uneven playing field between, for example, unregulated travel agents and regulated insurance intermediaries, both in terms of authorisation and compliance costs and disclosure at the point of sale;
- **Availability and propensity for consumers to purchase insurance:** there is a risk that, if FSA regulation is introduced, travel agents or tour operators may cease offering customers insurance when they buy their holiday or the cost of such insurance might increase. This could lead to an increase in those travelling without insurance.

Options 3.25 The Government is seeking views on the scale of any problem with the sale of travel insurance sold alongside a holiday or related travel. In particular, the Government would welcome views on:

- 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 sales of travel insurance sold along with a holiday or related travel, with a particular emphasis on providing qualitative and quantitative evidence. Specifically, the Government would like to know whether there are there systematic problems with the selling of travel insurance;
- The most suitable regulatory framework for the selling of these products i.e. whether they should be subject to:
 - **Option 1: No regulation** – i.e. maintaining the *status quo*. This would mean that there would be no statutory requirement to face regulation for those selling travel insurance alongside a holiday or related travel;
 - **Option 2: Strengthened industry self-regulation** - many sellers of travel insurance sold alongside a holiday or related travel are currently regulated under a voluntary industry code (e.g. the Association of British Travel Agents' Code of Conduct or the British Vehicle Rental and Leasing Association's Code of Conduct). One option here would be to require such codes to meet certain standards to ensure that consumers are sufficiently protected and have access to

an appropriate recourse procedure, such as the Financial Ombudsman Service. Those selling travel insurance alongside a holiday or related travel would then be required to comply with such a code or to be authorised by the FSA;

- **Option 3: Full FSA conduct of business regulation** - in similar terms to sellers of other general insurance products;
- Any other relevant considerations and whether there are other options that should be considered.

3.26 As well as options for regulating the sales of travel insurance sold with a holiday and related travel the Government would welcome views on whether more needs to be done to make travel insurance products as a whole more transparent and easier to understand. This might be in addition to, or instead of, regulating the sales of travel insurance sold with a holiday and related travel.

Costs and benefits 3.27 The following main groups have been identified as potentially being affected by these proposals:

- Travel agents and tour operators;
- Travel companies (for example, airlines, bus companies, shipping companies)
- Insurance companies;
- Vehicle rental firms;
- Insurance intermediaries;
- Customers of vehicle rental firms and travel agents and tour operators.

3.28 The Government welcomes evidence on the costs and benefits associated with the options outlined above, including quantitative or qualitative estimates.

3.29 The benefits provided by any legislative proposals resulting from the review will necessarily depend upon the outcome of the review. If the option favoured at the end of the review increases the level of regulation faced by sellers of travel insurance sold alongside a holiday or related travel then these changes will provide a benefit through increased protection for consumers. Consumers may also benefit from no longer having to consider the difference between regulated and unregulated sales. Similarly, under this option it is likely that insurance intermediaries selling stand-alone travel insurance products and travel insurers selling directly will benefit from a levelling of the competitive environment.

3.30 The costs provided by any legislative proposals resulting from the review will also depend upon the outcome of the review. If the option favoured at the end of the review increases the level of regulation faced by sellers of travel insurance sold alongside a holiday or related travel then such firms may incur increased authorisation/regulatory compliance costs. These costs could be passed on to the consumer through higher prices.

3.31 If some firms decide that any additional burdens made it commercially unviable to sell travel insurance products this could result in a cost through reduced availability of cover for those purchasing travel products or holidays from such firms.

SUMMARY OF ISSUES FOR CONSIDERATION

3.32 To summarise, the Government would welcome views on:

- The factors to be taken into account when assessing whether travel insurance sold alongside a holiday or related travel should be subject to FSA regulation;
- Evidence of consumer detriment in this area;
- Options for regulation going forward, including evidence on the costs and benefits associated with each option.

Following this call for evidence, the Government will put forward its preferred approach. If a legislative option is chosen it will be subject to an additional consultation and Regulatory Impact Assessment.

A

SUMMARY OF RESPONSES TO THE 2002/3 CONSULTATION

COMMENTS OF THOSE FAVOURING FSA REGULATION

A.1 Many respondents favoured FSA regulation of travel insurance sold as part of a package – option 2 in paragraph 2.4 of the consultation document. The views of those in favour of FSA regulation are given below.

A.2 There should be a level competitive playing field regardless of whether travel insurance is sold as part of a package or as a standalone product. Such regulation would also help ensure the credibility and fairness of the overall regulatory regime, and avoid customer confusion. A single regulatory regime would have across the board disclosure, training and competence and redress requirements.

A.3 The complexity of travel insurance products and the bundling of travel insurance sold as part of a package with the holiday is likely to lead to mis-selling, as there is little opportunity for consumers to check that the policy meets all the requirements, let alone for shopping around and comparing prices. It is essential that consumers are aware of medical exemptions before they make a decision to purchase.

A.4 If travel insurance sold as part of a package were not regulated there would be tricky boundary issues between regulated and unregulated insurance. It would be difficult for customers to understand the distinction between policies sold as part of a package and those sold separately perhaps by the same firm under the same brand.

A.5 As some travel agents offer annual travel insurance policies which do not fall within the scope of the exclusion, some travel agents will need to be authorised or become appointed representatives to carry on selling such policies in any case. Three large organisations who have the ability to meet the regulatory requirements should they wish have a substantial market share and at the small business end there will be the opportunity to operate as an appointed representative.

A.6 There is no access to the Financial Ombudsman Service at any point where cover is provided through wholly owned offshore captives (as by some larger travel operations).

A.7 A small number of respondents provided evidence of complaints and mis-selling. A small number of individuals provided evidence of mis-selling in relation to themselves or close friends or relatives. In addition, the following organisations provided evidence of complaints and mis-selling.

A.8 The Financial Ombudsman Service (FOS) received 9437 complaints about general insurance in 2002 of which 1148 (about one in eight) related to travel insurance.

A.9 The Consumers' Association (CA) undertook mystery shopping research in January 2003. 20 outlets of the 4 largest travel agent and holiday chains were visited and 8 independent travel agents. Only 3 of the 20 nationals and 3 of the 8 independents asked about pre-existing medical conditions. Only 3 nationals and 1 independent explained the cover. Only 1 travel agent did both. 34 direct insurers were also contacted. Only half asked about pre-existing medical conditions as well as explaining the basic details of the cover. A 1999 survey of Which? Magazine members showed consumers were twice as likely to be dissatisfied if they had claimed on travel insurance bought

from travel companies or tour operators rather than if they had claimed on travel insurance bought direct from banks, building societies or other specialist advisors.

A.10 Travel insurance represents the third highest category of complaints to the General Insurance Standards Council (GISC) Dispute Resolution Facility.

A.11 Those in favour of FSA regulation of travel insurance sold as part of a package were generally opposed to industry specific regulation involving the FSA certification of an industry code or codes - see option 3 in paragraph 2.4 of the consultation document. Their reasons are summarised below.

A.12 This would be dual regulation, going against the Government's stated policy of the FSA being the sole regulatory authority for the sale of financial services products in the UK. While at present it appears that only the ABTA Code would be capable of meeting the requirements specified by the Treasury, it is possible that other codes might emerge that would meet the same requirements. There is a possibility that in the future, other codes could be certified. This could lead to regulatory arbitrage as travel agents sought out the most cost effective regulatory framework to maintain competitive advantage.

A.13 Some consultees considered that products sold through ABTA members are unlikely to be regulated as rigorously as those sold within the scope of FSA regulation. There is a danger of a conflict of interest between ABTA's role as a trade association and its role as a regulator under this option.

COMMENTS OF THOSE IN FAVOUR OF NO STATUTORY REGULATION

A.14 Those who favoured no statutory regulation of travel insurance sold as part of package (or deemed the industry specific option to be an acceptable alternative to this) did so for the following reasons.

A.15 Given the low unit cost of any one travel insurance product the likely cost of regulation may be prohibitive for many travel agents and tour operators. It is claimed regulation might put some small travel agents out of business. Regulation would be a significant burden for a small travel agent with a low profit margin selling insurance products that, according to ABTA, account for only between 1% and 4% of a typical agent's turnover. Travel insurance is a key part of the travel package that they sell and so not offering insurance would put them at a competitive disadvantage. ABTA state that travel agents tend to trade on low profit margins (1.15% of turnover in a PWC survey for ABTA in 2000). FSA regulation could lead to larger companies being able to put a squeeze on smaller companies to monopolise travel insurance cover. Therefore regulation would have a significant impact on competition within the travel market.

A.16 The general level of complaints about travel insurance does not provide a clear case for sufficient consumer detriment to justify regulation. The numbers of complaints about travel insurance need to be seen in the context of annual sales of travel insurance of 18-20 million policies per annum. In this context the level of complaints is not high when compared with other lines of general insurance.

A.17 The appointed representatives route, which tends to be a cheaper way of ensuring regulatory compliance while avoiding direct authorisation by the FSA, would probably not be appropriate for many travel agents, particularly the small independents. This is because, under the FSA's proposed revision of the appointed

representatives regime (see in particular CP 159), a travel agent could only be the appointed representative of one provider for the selling of travel insurance. Being an appointed representative would thus limit the agent to selling the travel insurance of one insurer or intermediary, and hence probably (as the insurance is sold as a package with the holiday) limit the agent to selling the holidays of one company.

A.18 Financial regulation may not be the best way of dealing with any problems regarding the “bundling” of insurance with the holiday, as this is more of a competition issue. In any case concerns about bundling may be overstated.

A.19 One respondent pointed out that the Foreign and Commonwealth Office (FCO) are keen to see more holidaymakers take out travel insurance. The regulation of travel insurance sold as part of a package could result in some travel agents ceasing to sell such policies. This could mean that fewer people would take out travel insurance leading to potential problems for the uninsured holidaymakers and for the FCO who come under pressure to deal with uninsured holidaymakers in difficulties.

A.20 Those respondents who considered the ABTA option to be acceptable, in general favoured no statutory regulation at all of sales of travel insurance sold as part of a package. The ABTA option was only acceptable since compared to FSA regulation it would reduce the burdens and costs of regulation to small travel agents. This would reduce the effect of gold plating of the Directive, and travel agents would continue to offer insurance sold as part of a package such that cover would still be available.

HMT DECISION

A.21 The Treasury considers the industry specific route to be inappropriate. For competition reasons the FSA would be obliged to consider for certification not only the ABTA code, but the codes that, as the consultation as shown, would likely be put forward by other trade bodies representing travel agents or tour operators. There would be a danger of a complex system of competing codes, which the FSA would have to keep under careful scrutiny, and there would be associated risks of regulatory arbitrage. It therefore appears that this route would be complex for the FSA to administer and potentially confusing for customers.

A.22 The Treasury also considers that FSA regulation of travel agents is inappropriate because there is not sufficient justification for gold plating the Directive and increasing the regulatory burden in this way. The consultation specifically asked for evidence of consumer detriment in this market but few respondents provided such evidence, and that which was provided was not sufficient to justify FSA regulation. The numbers of complaints about travel insurance need to be seen in the context of the large number of policies sold. In this context the level of complaints is not particularly high when compared with other lines of general insurance. The Consumers’ Association did provide some evidence of mis-selling, and mis-selling can potentially lead to consumer detriment. However it was only a one-off survey, and does not demonstrate systematic actual consumer detriment in the market.

A.23 The strongest argument for regulation is the establishment of a level playing field between the regulation of travel insurance sold as part of a package and that of travel insurance sold separately from the holiday. However the Treasury considers this argument to be less compelling than in the two other areas where the Government intends to go beyond the Directive in part for level playing field reasons. One such area is the selling of general insurance directly by insurers, which the Government intends to regulate (the Directive only requires the regulation of the selling of insurance by

intermediaries). The other is motor warranties, which are contracts of insurance where the Directive provides an exclusion for contracts costing less than €500 per annum but where the Treasury intends all such contracts to be regulated.

A.24 Motor warranties are considered in more detail on page 6 below. The Government considers that to regulate all motor warranties that are contracts of insurance (rather than differentiating on price as provided by the Directive) would have fewer adverse effects on dealers than the equivalent regulation for travel insurance. Many car dealers will need to be FSA regulated or become appointed representatives in any case because for example they sell payment protection insurance for car loans. There was little if any opposition to the Government's proposal within the industry. In regard to the selling of general insurance direct by insurers, all insurers are already regulated by the FSA and so there will not result any extra firms being regulated. In addition insurers are used to a culture of FSA compliance as they are already subject to FSA requirements on the prudential aspects of their business. No consultation respondents objected to the FSA regulating the selling of general insurance direct by insurers.

A.25 However for travel insurance sold as part of a package, as stated above, there is the risk that FSA regulation would bring several hundred extra firms into FSA authorisation. This would have a potentially significant impact on the profitability and viability of small independent travel agents and hence a potentially significant impact on competition within the structure of the travel industry. Therefore the impact of establishing a level playing field in travel insurance would probably be far more detrimental than with the other areas described in paragraph 25 above. Another potential cost of regulating travel insurance sold as part of a package is that fewer people may take out travel insurance thus posing risks to themselves whilst abroad and to the Government which comes under pressure to assist travellers in difficulties.

A.26 Given the lack of a clear case to regulate on consumer detriment grounds, the Government considers that the costs of FSA regulation and the potential detrimental impact on smaller travel agents trading in a low profit margin business do not to justify the benefits of FSA regulation.

A.27 Whilst the Government does not consider there to be sufficient justification to regulate travel insurance sold as part of a package, it does recognise that there are concerns about this market. Therefore the Treasury will hold a review as to whether to subject these products to FSA regulation two years after implementation of general insurance regulation, that is in early 2007.

B

CONSULTATION LIST

Air Transport Users Council

Association of British Insurers (ABI)

Association of British Travel Agents (ABTA)

Association of Independent Tour Operators (AITO)

Association of Train Operating Companies (ATOC)

Association of Travel Insurance Intermediaries (ATII)

British Air Transport Association

British Hospitality Association (BHA)

British Insurance Brokers Association (BIBA)

British Vehicle Rental and Leasing Association (BVRLA)

Citizens Advice

Civil Aviation Authority

Confederation of Passenger Transport UK (CPT)

Department for Trade and Industry (DTI)

Department for Transport (DfT)

Department of Culture, Media and Sport (DCMS)

European Low Fares Airline Association

Federation of Tour Operators (FTO)

Financial Ombudsman Service

Financial Services Authority (FSA)

Foreign and Commonwealth Office (FCO)

Holiday Travel Watch

Institute of Insurance Brokers (IIB)

Licensed Taxi Drivers Association (LTDA)

Office of Fair Trading (OFT)

Passenger Shipping Association (PSA)

Scottish Passenger Agents Association

Travel Trust Association

Which?

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ISBN-10: 1-84532-215-0

ISBN-13: 978-1-84532-215-1

Printed on at least 75% recycled paper.

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PU122

ISBN 1-84532-215-0



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