

# **Deregulating retail freight forwarding insurance: a consultation**

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June 2008



HM TREASURY





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**Deregulating retail freight  
forwarding insurance:  
a consultation**

June 2008

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# CONTENTS

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		Page
Chapter 1	Introduction	3
Chapter 2	Responding to the consultation	5
Chapter 3	Removing freight forwarders and storage firms from the scope of regulation	7
Chapter 4	Partial Impact Assessment	15
Annex A	Consultation list	25
Annex B	Current Statutory Instruments	27





# INTRODUCTION

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**1.1** This consultation document seeks views on the Government's intention to remove the retail insurance activities of freight forwarders and storage firms from the scope of Financial Service Authority (FSA) regulation.

**1.2** A freight forwarder, whose business involves the organisation of the movement of goods by all modes of transport, and a storage firm, whose business involves the storage of goods, will typically offer insurance to their customers to cover loss of, or damage to, their goods whilst these goods are in the freight forwarder or storage firm's possession. Freight forwarders and storage firms were brought within the scope of FSA regulation following the UK's implementation of the European Union's Insurance Mediation Directive (IMD), which requires, broadly, the regulation of the selling of insurance contracts by intermediaries. Implementation of the Directive was subject to extensive public consultation, the outcome of which was announced on 5 June 2003. The Directive was implemented in the UK by giving the FSA the power to regulate the selling of insurance contracts and the FSA began regulating this area on 14 January 2005.

**1.3** Following representations from the freight forwarding industry, HM Treasury entered into discussions with the European Commission about whether the insurance activities of freight forwarders should be subject to regulation under the terms of the IMD. Following this dialogue and after extensive consultation, the practice of freight forwarders and storage firms extending their all risk 'open cover' insurance policy to their commercial customers was removed from the scope of FSA regulation in 2007. The consultation also found that there was "a case for extending the exemption to cover retail customers as well as commercial customers" provided these sectors "introduced and promoted an industry code of practice that ensures high standards and promotes transparency in connection with the insurance contract, as well as putting in place an appropriate independent complaints mechanism."

**1.4** The British International Freight Association (BIFA), British Association of Removers (BAR) and Self Storage Association (SSA) have now proposed industry codes of practice. As a result, HM Treasury is now seeking views on the appropriateness of this exemption. In particular, HM Treasury would welcome evidence on the costs and benefits of its proposal and also views and evidence on the potential costs and benefits of extending this exemption to similar activities.

**1.5** This consultation will run for 12 weeks and will close on 12 September 2008. Following this consultation the Government will announce its chosen approach alongside a summary of the consultation responses and, if appropriate, final legislation.



# 2

## RESPONDING TO THE CONSULTATION

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### HOW TO RESPOND

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**2.1** The Government welcomes the views of all stakeholders on issues raised in this document. The consultation period begins with the publication of this document and will run for 12 weeks. Please ensure that responses to this consultation reach us by 12 September 2008. We cannot guarantee to consider responses received after this date. Responses should be sent to:

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**2.2** This document can be found on HM Treasury's website:

[www.hm-treasury.gov.uk](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

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**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**

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

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## **HOW THIS CONSULTATION IS BEING CONDUCTED**

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**2.9** This consultation 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.berr.gov.uk/bre>). 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 consultation is being conducted, please contact:

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# 3

## REMOVING FREIGHT FORWARDERS AND STORAGE FIRMS FROM THE SCOPE OF REGULATION

### FREIGHT FORWARDING AND STORAGE FIRMS

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**3.1** There are around 2,500 freight forwarding firms in the UK. Freight forwarding as a sector contributes around £16 billion per annum to the UK's GDP and employs around 15,000 people.<sup>1</sup> Freight forwarding is a sub-sector of the logistics industry – an extremely diverse sector that includes a number of activities other than freight forwarding including home contents removers. Collectively the logistics industry consists of 65,000 firms that contribute £55 billion per annum to the UK economy and employ around 1.7 million people.<sup>2</sup>

**3.2** The basic service provided by the freight forwarding industry is the international movement of freight by any mode of transport. Whilst there is no such thing as a 'typical' freight forwarding firm, freight forwarders generally provide one or more of the following services:

- European road and rail distribution;
- maritime intermodal services;
- air freight consolidation and forwarding;
- customs broking and consultancy;
- packing of goods for export;
- warehousing and distribution;
- logistics and supply chain management.

**3.3** Within these activities, the freight forwarder is often independent of the physical carrier of the freight, allowing the forwarder to advise on the customer's distribution needs.

**3.4** There are currently over 250 storage firms operating in the UK, contributing around £360m to the UK's GDP with over 230,000 customers per year.<sup>3</sup> The retail business of freight forwarders and storage firms is currently estimated at around £2 billion per annum.<sup>4</sup>

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<sup>1</sup> Source: British International Freight Association (BIFA)

<sup>2</sup> Source: Skills for Logistics

<sup>3</sup> Source: Self Storage Association (SSA)

<sup>4</sup> Source: British Association of Removers (BAR) and SSA

## FREIGHT FORWARDERS' RETAIL INSURANCE ARRANGEMENTS

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**3.5** As part of their service, freight forwarders typically arrange insurance that allows the owners of goods to insure their cargo against loss or damage whilst it is carried by, or in transit with, third parties who do not otherwise have an insurable interest<sup>5</sup>. In practice, the freight forwarder manages and organises the transport of the customer's goods and insurance is provided as an optional element of the service.

**3.6** This was traditionally done through the use of an 'open cover' policy to supplement the contractual limited liability of the freight forwarder for the goods. An 'open cover' policy is one where a freight forwarder or storage firm holds a policy of insurance which insures it against loss of, or damage to, goods being transported or stored and makes available to a customer rights under that policy such that the customer can claim directly against the insurer in respect of loss of, or damage to, its goods. The forwarder would purchase a standard policy directly from an insurance company or through an insurance broker, paying an annual deposit premium, which would be reviewed on an annual basis. During contract negotiations with the customer, the forwarder would include the option for the customer to have the cargo insured. If the customer agreed, the cargo would be added to the monthly policy declaration. The policy would remain in the name of the freight forwarder and all customers requiring insurance would be covered by this one policy. The policy was non negotiable by customer or forwarder.

**3.7** The customer who had requested insurance would be charged a premium for the service and this premium would be included with all the other charges for services provided by the forwarder. Periodically, normally once a month, the freight forwarder would submit a list to the insurer or broker declaring those of the customers' consignments that are to be covered by the policy. A periodic adjustment of the premium would be made in line with actual declared carryings. Every customer who requested insurance would be covered even if the forwarder forgets to declare the goods on his monthly declaration.

**3.8** It is common in the freight forwarding industry for the ownership of the cargo in transit to change hands. With this change of ownership, so the benefit of the insurance cover also needs to change. An 'open cover' policy recognises this and provides for either the seller or, if ownership of the goods has passed into his hands, the buyer to make a claim against the policy and be entitled to direct compensation from the insurer. Additionally, the customer's direct right under the 'open cover' policy helps to facilitate the purchase of goods on credit.

**3.9** Currently, only those firms who are authorised by the FSA may use 'open cover' insurance extension with retail customers. However, authorisation by the FSA can be a significant expense for those firms for whom financial services is only a secondary activity. Consequently alternatives to offering insurance requiring authorisation by the FSA have developed. 'Limited liability' is normally written into Freight Forwarder's contracts. In many cases, to avoid the expense of FSA regulation, freight forwarders have adopted a system of 'extended liability' whereby they take on greater responsibility for the goods, which they then insure themselves against, charging a higher fee. However, this system provides no direct link between the individual and the insurer. As

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<sup>5</sup> Insurance of this type is known as 'marine' insurance, regardless of the mode of transportation used in the movement of the goods.

such, the individual has no recourse should there be any problems, other than any internal complaints procedures the freight forwarder may have, or taking action through the courts. An ‘open cover’ policy, on the other hand, passes on rights against the authorised insurer direct to the individual, and provides a link to the Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS) in respect of those rights.

**3.10** Some retail customers seek insurance independently but this can be difficult to find and can be more expensive.

### STORAGE FIRMS’ RETAIL INSURANCE ARRANGEMENTS

**3.11** Storage firms traditionally arranged their insurance activities in a number of ways, including via an extension of rights under an ‘open cover’ policy. FSA regulation has made the insurance provided more homogeneous. The largest storage firms are regulated by the FSA and are able to offer all types of insurance. Smaller firms tend to insure the goods themselves if the individual does not provide insurance. An increase is made to the charge to the individual to reflect this. As a result, much like in the ‘extended liability’ system above, while coverage may be comparable, there is not the security of rights against the insurer, and access to either the FOS or FSCS in respect of those rights, that an ‘open cover’ policy provides.

**3.12** Storage firms were less affected by the deregulation of the practice of extending ‘open cover’ insurance to commercial customers because the majority of their customers are retail.

**3.13** Of the 3,000 or so firms involved in either freight forwarding or storage, the FSA estimate that only 100 are currently authorised.

### THE INSURANCE MEDIATION DIRECTIVE

#### General insurance regulation

**3.14** The EU’s Insurance Mediation Directive (IMD)<sup>6</sup> requires that the selling of insurance products by an insurance intermediary be regulated. All insurance intermediaries<sup>7</sup> are captured by the requirements of the IMD, regardless of their main professional activity.

**3.15** The Government implemented the Directive in the UK by giving the FSA the responsibility for regulating activities relating to the sale and administration of general insurance products, whether carried out by intermediaries or insurers on 14 January 2005. As part of its move to more principles-based regulation, the FSA introduced a new Insurance Conduct of Business sourcebook<sup>8</sup> in January 2008.

#### Regulation of freight forwarders and storage firms’ insurance activity

**3.16** During the implementation phase of the Directive, the European Commission had made it clear that the wording of the IMD was deliberately wide. The Government’s original assessment was that freight forwarders should be regulated in order to fulfil the requirements of the IMD. Given this, the Government had no discretion simply to exempt the freight forwarding or storage firm sector from the effects of the IMD.

<sup>6</sup> EU Directive 2002/92/EC

<sup>7</sup> Individuals or firms conducting activities including: introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance; concluding contracts of insurance; and assisting in the administration and performance of such contracts, in particular in the event of a claim. See Article 2.3 of the IMD

<sup>8</sup> *Insurance Code of Business sourcebook*, <http://fsahandbook.info/FSA/html/handbook/ICOBBS>, January 2008

**3.17** Subsequent clarification from the Commission indicated the practice of freight forwarders and storage firms extending their all risk ‘open cover’ insurance policies to their customers does not require regulation in order to comply with the IMD. The notification to the insurer of the customer’s rights in the policy does not imply that the freight forwarder or storage firm is carrying out insurance mediation for the purpose of the IMD, as the policy remains in the name of the freight forwarder or storage firm who concluded the contract.

**3.18** Consequently the Government revisited this area of regulation baring in mind two key aspects: first, the Government’s over-arching framework of risk-based regulation, balancing the need for consumer protection with the cost of regulation on business; second, the impact on the international competitiveness of the UK freight forwarding sector’s insurance activities being subject to regulation, given that competitors in other Member States are not subject to such requirements.

**The risk of consumer detriment**

**3.19** 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. If the consumer accepts the Ombudsman’s decision, it is binding on both the firm and the consumer, while not interfering with the complainant’s right to seek an alternative decision through the courts if they do not accept the Ombudsman’s decision. 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. As noted above, these protection schemes only apply to individuals or small business customers<sup>9</sup>.

**3.20** The practice of extending ‘open cover’ policies to commercial customers has now been deregulated because the Government believes that the risk of consumer detriment presented by removing freight forwarders and storage firms’ commercial insurance activity from FSA regulation is low, as under an ‘open cover’ policy they simply pass on rights under the policy to the customer.

**3.21** However, the Government stated that it would hold off from deregulating freight forwarding and storage firms who offer to extend their ‘open cover’ insurance policy to retail customers until it was satisfied that the relevant trade associations had introduced appropriate self-regulation, including an appropriate independent redress mechanism, to guarantee sufficient consumer protection. The relevant trade associations have now drafted suitable codes of practice requiring members to introduce independent complaints procedures and join the Voluntary Jurisdiction of the FOS. This will provide retail customers with the ability to access the FOS should they have a problem with either the insurance company (via the ‘open cover’ contract), or the manner in which freight forwarder or storage firm extended the cover (via the freight forwarder or storage firm’s membership of the FOS). The associations will make all members aware of their new duties. The Government is satisfied that this will minimise potential consumer detriment.

<sup>9</sup> This protection is subject to more detailed rules on the jurisdiction of the FOS and the coverage of the FSCS. For instance, only individuals and small businesses are eligible to make claims to the FSCS and the Financial Ombudsman Service. The eligibility definition of a small business for FSCS claims depends on the type of activity. For the purpose of complaints to the FOS, a small business is one with a group turnover of less than £1 million. Further information on the FOS can be found at [www.financialombudsman.org.uk](http://www.financialombudsman.org.uk). Further information on the FSCS can be found at [www.fscs.org.uk](http://www.fscs.org.uk).

**3.22** While BIFA, BAR and the SSA membership covers the majority of business (over 80% by turnover<sup>10</sup>) in their industries, they do not provide complete coverage. Where a freight forwarder or storage firm is not a member of one of these trade organisations, it will not be required to join the FOS. The Government's view is that, while this does leave room for misselling on the part of some freight forwarders or storage firms, so too does the existing practice of 'extended liability' (or its equivalent). Very few freight forwarders or storage firms are FSA authorised. The introduction of Codes of Practice by the associations, which include joining the Voluntary Jurisdiction of the FOS, will offer greater security than current practice in the majority of cases. Customers will also be able to shop around to find the deal most suited to their needs if unhappy with the options presented to them by their freight forwarder or storage firm. Furthermore, FSA regulation will still apply to the selling of the original insurance policy to the freight forwarder. If an FSA authorised insurer provides the insurance, as an 'open cover' policy passes on rights against the insurer direct to the individual, the retail customer will be afforded protection in respect of their rights against the insurer (but not against the freight forwarder).

Question 1

Do you have any evidence on the potential for consumer detriment arising from removing the practice of freight forwarders (including removers) and storage firms extending their all risk 'open cover' insurance policy, to their retail (private) customers, from the scope of FSA regulation?

Question 2

Do you think the risk of consumer detriment will be adequately mitigated by the introduction of the appropriate consumer codes?

**The impact on international competitiveness**

**3.23** The freight forwarding industry has consistently argued that the cost arising from regulation of its insurance activities puts it at a competitive disadvantage compared to freight forwarders based abroad, especially those in other EU Member States where similar practices are not subject to regulation.

Question 3

Do you have any views on the impact of the current requirement for FSA regulation upon the international competitiveness of the UK's freight forwarding sector?

## PROPOSED CHANGES TO THE SCOPE OF FSA REGULATION

**3.24** Given the considerations laid out above, the Government believes it is appropriate to remove freight forwarders and storage firms extending 'open cover' insurance policies to retail customers from the scope of FSA regulation.

**3.25** The Government's proposed approach is to remove freight forwarders and storage firms from the scope of FSA regulation by amending paragraph 50 of the Schedule to the Exemption Order.<sup>11</sup> That paragraph was inserted into the Exemption

<sup>10</sup> Source: BIFA, BAR and SSA

<sup>11</sup> Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001

Order to deregulate their insurance activities in relation to commercial customers, and is set out in Annex B. The Exemption Order provides for certain persons to be exempt from the general prohibition on carrying out regulated activities imposed by the Financial Services and Markets Act 2000 (FSMA). Exempt persons are not required to be authorised to carry on regulated activities.

**3.26** The amendment we propose will exempt freight forwarders and storage firms from the general prohibition in respect of any regulated activity of the kind specified by the following articles of the Regulated Activities Order (RAO)<sup>12</sup>:

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

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

**3.28** The exemption in paragraph 50 of the Schedule to the Exemption Order is restricted to circumstances where a freight forwarder or storage firm holds a policy of insurance which insures it against loss of, or damage to, goods being transported or stored and makes available to a customer rights under that policy such that the customer can claim directly against the insurer in respect of loss of, or damage to, its goods. For the purpose of this measure, a freight forwarder is defined as a person whose principal business is arranging or carrying out the transportation of goods and a storage firm is defined as a person whose principal business is the storage of goods. As this paragraph is currently drafted, a customer is defined as a person who is not an individual who uses the service of a freight forwarder or storage firm. The Government proposes to amend this definition so that any person who uses the service of a freight forwarder or storage firm will be a 'customer' whether or not that person is an individual.

**3.29** The Government would welcome comments on the proposed extension of the exemption to paragraph 50 of the Schedule to the Exemption Order.

**3.30** There will be firms whose business activities are similar in nature to those conducted by freight forwarders, and whose insurance activities are, or could be, structured in a way that would fall outside the scope of the IMD. These firms could benefit from a wider exemption from FSA regulation. However, the Government would only consider doing so in areas where the risk of consumer detriment can be shown to be low. The Government would welcome comments on any such business activities, in particular evidence on the risk for any consumer detriment related to such businesses insurance activities.

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<sup>12</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544)

**Question 4**

Should the Government's proposed approach be widened to include an exemption from legislation for other activities which are similar in nature to freight forwarding and what are the arguments for doing so?

**Question 5**

Do you have any comments on the partial Impact Assessment in Chapter 4?

**Question 6**

Do you have any comments on the proposed extension to paragraph 50 of the Schedule to the Exemption Order?



# 4

## PARTIAL IMPACT ASSESSMENT

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

**4.2** Insurance is essential for both freight forwarders and storage firms. The retail market for both combined is estimated at £2 billion per year. Groups affected by the proposed legislation will be freight forwarders (including removers), storage firms, insurers and insurance firms and customers.

### OPTION 1 – COSTS AND BENEFITS

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**4.3** Option 1 is no change. Freight forwarders and storage firms operating 'open cover' policies for retail customers would remain regulated by the FSA.

#### Benefits

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

**4.5** The attractive features of this option are that:

- no additional costs would be imposed on the freight forwarding or storage firm sector; and
- the FSA would maintain regulation of all 'open cover' insurance transactions involving retail customers.

#### Costs

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

**4.7** However:

- this is out of sync with the rest of the EU which does not regulate the extension of 'open cover' insurance to retail customers;
- FSA regulation can be expensive for firms for whom financial services is not their main business; and
- there is currently potential for consumer detriment because of the development of the system of 'extended liability' as an alternative to FSA regulated insurance. While the cover offered may be equivalent to an 'open cover' policy extension, it does not offer the individual the safety of access to the FOS or the FSCS.

### OPTION 2 – COSTS AND BENEFITS

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**4.8** Option 2 would remove the practice of freight forwarders (including removers) and storage firms extending their 'open cover' insurance policy to their retail customers from the scope of FSA regulation.

## Benefits

**4.9** The benefits of option 2 include:

- would bring UK regulation of this sector inline with the rest of the EU;
- would enable a greater prevalence of ‘open cover’ insurance which would provide individuals with greater access to insurance and protection via the FOS and FSCS; and
- would reduce costs for freight forwarding and storage firms who are currently regulated by the FSA.

**4.10** The FSA estimate that the annual incremental cost of compliance with the Insurance Conduct of Business Sourcebook is between £3,800 and £5,700 (including the £60 Compulsory Jurisdiction FOS fee) per firm for small firms (the majority of firms affected will be small firms). Deregulation would provide a significant financial benefit to freight forwarders and storage firms currently authorised by the FSA through reduced authorisation and compliance costs. A regulated freight forwarder or storage firm typically incurs additional burdens through ensuring ongoing compliance with the FSA rules. There is also a one-off ‘understanding’ cost that a regulated firm incurs upon authorisation as it becomes familiar with the requirements of authorisation. This measure would remove that cost for new entrants to the market.

**4.11** Benefits and costs under this option can be quantified if we assume that all firms currently offering ‘extended liability’ cover (or its equivalent) would switch to offering ‘open cover’ instead, while all firms currently regulated by the FSA and offering only ‘open cover’ insurance would no longer be regulated by the FSA. Using the median saving figure of £4,750:

- for Removers this would be around 2,400 firms not regulated by the FSA and around 70 firms who are. Of these 70, all would cease to be authorised at a saving of around £332,500
- for Freight Forwarders (not including removers) who deal with retail customers this would be around 230 firms not authorised by the FSA, and around 15 who are. Of these 15, all would cease to be authorised at a saving of around £71,250 per year;
- for storage firms this would mean around 300 firms not regulated by the FSA, and around 15 who are. Of these 15, only the largest few who sell other insurance would remain regulated in the long term, saving around £71,250; and
- the total saving would be around £475,000 per year.

**4.12** Anecdotal evidence also suggests that customers of freight forwarders who have ceased their insurance activities in the light of FSA regulation have experienced higher premiums or difficulties in finding suitable cover when approaching insurers or insurance brokers directly. These benefits have not been monetised but would add to the net benefit range.

**4.13** The benefits of access to the FOS and FSCS have not been monetised because the principal estimated benefit would be one of reputation and reassurance to the customers. However, they would add to the net benefit range. The trade associations report very minimal retail complaints received each year. BAR, the freight forwarder

trade organisation covering the largest section of the retail market, estimate that less than 0.05% of transactions generate a complaint to them and that they have internal processes in place to deal with them.

## Costs

**4.14** Option 2 is deregulatory and would not result in additional costs for freight forwarders or storage firms other than transitional costs.

**4.15** We estimate that around 3,000 freight forwarders (including removers) and storage firms would change their insurance practices as a result of this measure. Freight forwarders and storage firms that continue to offer only 'open cover' following deregulation would not be able to remain authorised by the FSA (those offering other insurance solutions may be able to remain authorised). Of these, 2,900 would change from extended liability (or its equivalent) to 'open cover'. Around 100 FSA-authorized firms would cease to be regulated but would be likely to continue to offer 'open cover' policies. Almost all affected firms would be SMEs, the majority removers.

**4.16** The average transition cost from FSA authorisation to 'open cover' is estimated at £1,000. The average transition cost from 'extended liability' or equivalent to 'open cover' is estimated at £500. The overall transition cost would be around £1,600,000.

**4.17** FSA regulation provides consumer protection. Ultimately there is a risk that removing FSA protection in any area could increase the risk of consumer detriment. There is scope for consumer detriment in deregulating the retail market because it involves individuals who are approaching the market for the first time. However, the Government believes that the risk of consumer detriment is low. The FSA estimates that only around 100 freight forwarders and storage firms are currently authorised. Following deregulation, an estimated 3,000 firms will offer 'open cover' policies. 'Open cover' policies extend rights of access to the FSCS and FOS to the individual via the insurance contract between the freight forwarder and FSA authorised insurance firm. Importantly, however, should an individual feel that the freight forwarder or storage firm had misinformed them about 'open cover', they would have no recourse to the FOS or FSCS.

## OPTION 3 – COSTS AND BENEFITS

**4.18** Option 3 would remove the practice of freight forwarders (including removers) and storage firms extending their 'open cover' insurance policy to their retail customers from the scope of FSA regulation while requiring that the relevant trade organisations have in place suitable codes of practice that would minimise consumer detriment. This would include joining the Voluntary Jurisdiction of the FOS.

## Benefits

**4.19** The benefits of option 3 are as for option 2, but with additional recourse for consumers who feel that they have been mistreated. Option 2 allows the customer to take complaints against the insurer to the FOS, but not complaints against the freight forwarder or storage firm. Option 3 would allow the customer to take complaints against both the insurer and the freight forwarder or storage firm to the FOS as freight forwarders or storage firms belonging to one of the trade associations will be subject to the Voluntary Jurisdiction of the FOS under their code of practice. While this will not provide the protection of the FSCS against the failure of a freight forwarder, this protection has yet to be called on. The industry has supported the introduction of codes

of practice with a provision for joining the Voluntary Jurisdiction of the FOS, and clearly values the additional customer security and enhanced reputation that this would provide. These benefits have not been monetised but would add to the net benefit range.

## Costs

**4.20** The costs of Option 3 are as for Option 2, plus the additional costs of joining the FOS. There is an annual fee for access to the FOS, currently £60 for freight forwarders and storage firms as insurance intermediaries. There is no case fee payable for the first three FOS cases per firm per year. For additional cases, case fees are charged at £450 per case no matter what the outcome of the complaint. There would be additional costs to freight forwarders and storage firms where the FOS makes an award to the consumer on the basis of a mis-selling complaint.

**4.21** Assuming that, in the long term, 10% of members of BIFA (those who deal with retail customers), all members of the SSA who do not offer alternative means of insurance, and all members of BAR will join the FOS, the total annual cost of Option 3 will be around £53,000 per year higher than for Option 2.

## Impact on small firms

**4.22** The vast majority of freight forwarders and storage firms are SMEs. SMEs are far less likely to seek FSA authorisation. Instead the majority have relied upon 'extended liability' or equivalent schemes and will likely revert to 'open cover' in the long run because of the greater protection it affords their customers.

## Competition assessment

**4.23** This proposal is likely to have a positive impact on competition in the market for the provision of insurance cover for the loss of or damage to private goods in transit. Reducing regulatory costs will generally lower barriers to entry in this market, and UK freight forwarders will not be subject to a super-equivalent regulatory regime compared to EU freight forwarders. These benefits have not been monetised but would add to the net benefit range.

## Race, disability, gender and human rights

**4.24** This proposal will have no impact on race, disability, gender or human rights.

## Summary: Intervention & Options

Department /Agency:

Her Majesty's Treasury

Title:

Impact Assessment of deregulating retail freight forwarding insurance

Stage: Consultation

Version: Final

Date: 20 June 2008

**Related Publications:** Deregulating freight forwarding insurance: a consultation (Dec 2006), response and IA (Jun 2007)

**Available to view or download at:**

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

**Contact for enquiries:** Tom Allebone-Webb

**Telephone:** 02072705389

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

It is now apparent that the practice of extending 'open cover' insurance policies to include the goods of customers in exchange for a premium does not come under the scope of the EU's Insurance Mediation Directive. As such, if Government is assured there will be little or no consumer detriment, this practice can be deregulated for retail customers of freight forwarders (including removers) and storage firms. Intervention will reduce business costs, reduce the FSA workload and improve consumer protection.

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

Meet Governmental risk based objectives for better regulation by removing unnecessary regulation;  
Stop unnecessary FSA authorisation fees for businesses and unnecessary work for the FSA;  
Bring UK regulation in line with the rest of the EU;  
Provide retail customers with better protection and redress through the FOS and FSCS since, following the 2005 regulation, many freight forwarders and storage firms have adopted a system of 'extended liability' or its equivalent that does not offer this protection.

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

1. Do nothing;
2. Remove the practice of freight forwarders (including removers) and storage firms extending their all risk 'open cover' insurance policies to retail customers from the scope of FSA regulation; or
3. Remove the practice of freight forwarders (including removers) and storage firms extending their all risk 'open cover' insurance policies to retail customers from the scope of FSA regulation, provided Codes of Practice are in place to minimise possible consumer detriment. This option is preferred as it will offer both greater consumer protection and savings for industry.

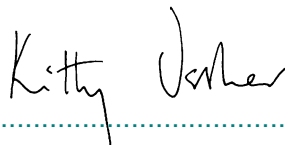
**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

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

**Ministerial Sign-off** For SELECT STAGE Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 20 June 2008

## Summary: Analysis & Evidence

**Policy Option: 3**

**Description: Deregulating retail freight forwarder and storage firm insurance while minimising consumer detriment**

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Transitional costs in changing insurance practices. Members of BIFA, BAR and the SSA who wish to operate 'open cover' insurance would also join the FOS at a cost of £60 per year.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ 1,600,000</b>	1	
	<b>Average Annual Cost</b> (excluding one-off)		
	<b>£ 53,000</b>		<b>Total Cost (PV)</b> <b>£ 2,130,000</b>
Other <b>key non-monetised costs</b> by 'main affected groups' Will remove FSA authorisation from an estimated 100 firms which might result in consumer detriment. However, all of these firms are likely to join the FOS for added customer security.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Removes cost of FSA authorisation from freight forwarders and storage firms wishing to offer 'open cover'.
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ 0</b>	1	
	<b>Average Annual Benefit</b> (excluding one-off)		
	<b>£ 475,000</b>		<b>Total Benefit (PV)</b> <b>£ 4,750,000</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Greater consumer protection afforded by access to FOS and FSCS through 'open cover' contract and additional voluntary membership of the freight forwarder or storage firm. This has not been monetised because reported complaints are so few. Greater insurance availability.			

### Key Assumptions/Sensitivities/Risks

Nearly all freight forwarders and storage firms will revert to offering unregulated 'open cover' in the first year. If increasing access to the FOS increases the customer base only slightly, this has a significant effect on the benefits, but is not certain so is not included in the net benefit.

Price Base Year 2008	Time Period Years 10	<b>Net Benefit Range (NPV)</b> <b>£ £1,650,000 - £4,070,000</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 2,620,000</b>
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What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			As soon as possible	
Which organisation(s) will enforce the policy?			BIFA, BAR, SSA	
What is the total annual cost of enforcement for these organisations?			£ Minimal	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro £60	Small £60	Medium £60	Large £0
Are any of these organisations exempt?	Yes	Yes	N/A	N/A

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

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

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

The evidence and analysis of the policy proposal is largely set out in the Partial Impact Assessment. Supplemental information is detailed below.

### Option 3

#### Cost of compliance with FSA Insurance Conduct of Business Sourcebook

The IA explains that the FSA estimate that the annual incremental cost of compliance with the Insurance Conduct of Business Sourcebook is between £3,800 and £5,700 (including the £60 Compulsory Jurisdiction FOS fee) per firm for small firms. The IA assumes that all firms currently regulated by the FSA and offering only 'open cover' insurance would no longer be regulated by the FSA, and uses the median saving figure of £4,750 to arrive at a total saving of around £475,000 per year.

In order to inform the 'Net Benefit Range' field, it is necessary to consider the savings at either end of the range given by the FSA. So:

		£		
		Lower	Median	Higher
		3800	4750	5700
	Number of deregulated firms			
Removers	70	266000	332500	399000
Freight forwarders	15	57000	71250	85500
Self Storage cos	15	57000	71250	85500
Total		380000	475000	570000

At the **lower** end of the range, the total saving is **£380,000**.

At the **higher** end of the range, the total saving is **£570,000**.

#### Non-monetised benefits that would add to the net benefit range

There are 4 non-monetised benefits listed:

1. the benefits of customer access to the FOS and FSCS for redress against the insurer, under 'open cover' policies;

2. the benefits of customer access to the FOS for redress against the insurer, under 'open cover' policies, and against the freight forwarder/remover/storage firm under the FOS' Voluntary Jurisdiction;
3. anecdotal evidence of customers of freight forwarders who have ceased their insurance activities experiencing higher premiums or difficulties in finding suitable cover; and
4. lowering of barriers to entry and removing super-equivalent regulatory regime.

Taking these 4 non-monetised benefits together, while it is impossible to make an assessment of their combined monetary value, we have made the following assumptions to arrive at a possible range value:

1. most freight forwarders and storage firms are not currently regulated and do not provide 'open cover' policies, but will do so after deregulation;
2. the cost of FOS membership is likely to be low. The base membership costs of the FOS and FSCS are included in the cost of compliance with FSA Insurance Conduct of Business Sourcebook. However, should a firm have more than 3 cases per year at the FOS a £450 case fee is payable. But complaint levels within the industry are low (BAR estimate that less than 0.05% of transactions generate a complaint to them) so, these costs are unlikely to be incurred. **So a minimal cost of £2,000 per year is assumed;**
3. FOS membership may encourage consumers at the margin to use a freight forwarder or storage firm where they otherwise would not. If the retail business of freight forwarders and storage firms were increased by 0.05%, the benefit would be in the region of £200,000 per year. However, it is not possible to predict this, so **we have assumed a conservative estimate of £50,000 per year;** and
4. It is not possible to provide an estimate based on anecdotal evidence that other types of insurance may be more expensive, or on the effect of lowering barriers to market entry.
5. Therefore the estimated range for the non-monetised benefits is **£-2,000 per year to +£50,000 per year.**

#### Net benefit range

Taking the cost of compliance with FSA Insurance Conduct of Business Sourcebook and the non-monetised benefits together:

$$\begin{aligned} \text{Lower range} &= (\text{£}380,000 - \text{£}2,000 \times 10 \text{ years}) - \text{£}2,130,000 \\ &= \text{£}1,650,000 \end{aligned}$$

$$\begin{aligned} \text{Higher range} &= (\text{£}570,000 + \text{£}50,000 \times 10 \text{ years}) - 2,130,000 \\ &= \text{£}4,070,000 \end{aligned}$$

#### Net benefit (NPV best estimate)

We have not taken the non-monetised benefits into account when calculating the Net Benefit as the assumptions made are too broad.



## Annexes

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# A

## CONSULTATION LIST

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Association of British Insurers  
British Association of Removers  
British International Brokers Association  
British International Freight Association  
The Despatch Association  
The Federation of Independent Removers and Storers  
Financial Ombudsman Service  
Financial Services Authority  
Freight Transport Association  
Institute of Chartered Shipbrokers  
International Underwriting Association of London  
Lloyds Market Association  
National Courier Association  
National Guild of Removers  
Rail Freight Group  
Removals Industry Ombudsman Scheme  
Road Haulage Association  
Self Storage Association of the UK  
United Kingdom Warehousing Association



**Paragraph 50 of the Schedule to the Financial Services and Markets Act 2000 (Exemption)  
Order 2001, as currently in force.**

*Freight forwarders and storage firms*

**50**

(1) A freight forwarder or storage firm is exempt from the general prohibition in respect of any regulated activity of the kind specified by article 21, 25, 39A or 53 of the Regulated Activities Order (dealing in investments as agent, arranging deals in investments, assisting in the administration and performance of a contract of insurance or advising on investments) in the circumstances referred to in paragraph 2.

(2) The circumstances are—

(a) where a freight forwarder (“F”)—

(i) holds a policy of insurance which insures F in respect of loss of or damage to goods which F transports or of which F arranges the transportation, and

(ii) makes available to a customer rights under that policy to enable the customer to claim directly against the insurer in respect of loss or damage to those goods; or

(b) where a storage firm (“S”)—

(i) holds a policy of insurance which insures S in respect of loss of or damage to goods which S stores or for which S arranges storage, and

(ii) makes available to a customer rights under that policy to enable the customer to claim directly against the insurer in respect of loss or damage to those goods.

(3) In this paragraph—

(a) “freight forwarder” means a person whose principal business is arranging or carrying out the transportation of goods;

(b) “storage firm” means a person whose principal business is storing goods or arranging storage for goods;

(c) “customer” means a person who is not an individual who uses the service of a freight forwarder or storage firm.

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