EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (EXEMPTION) (AMENDMENT) (No. 2) ORDER 2009

2009 No. 264

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The purpose of the instrument is to amend the Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201)("the Exemption Order"), to ensure that freight forwarders and storage firms who extend rights under their all-risk 'open cover' insurance policies to include the goods of retail customers in exchange for a premium are not subject to regulation by the Financial Services Authority (FSA).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Exemption Order provides for those persons specified in it to be exempt from the general prohibition imposed by section 19 of the Financial Services and Markets Act 2000 (FSMA) on any person carrying on a regulated activity in the United Kingdom, or purporting to do so, unless he is (a) an authorised person; or (b) an exempt person. "Regulated activities" for the purposes of this provision, are those specified under section 22 of FSMA in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. Where a freight forwarder or storage firm extends rights under its policy of insurance to cover its customers it is carrying on the following regulated activities under that Order:

- 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)
- Article 53 (advising on investments).

4.2 Freight forwarders and storage firms were exempted from the requirement to be authorised by the FSA to provide this service to their commercial customers by the Financial Services and Markets Act 2000 (Exemption)(Amendment No 2) Order 2007 (SI 2007/1821) ("the First Exemption Amendment Order"), which inserted Article 50 into the Exemption Order. This Order extends that exemption so that freight forwarders and storage firms may also provide this service to individual customers without being authorised by the FSA.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 Freight forwarders manage and organise the transport of customers' goods, and insurance is provided as an optional element of the service. Before the selling of general insurance was subjected to regulation under FSMA in 2005, the freight forwarder typically did this through the use of an all-risk 'open cover' policy. The forwarder purchases this policy directly from an insurance company or through an insurance broker. The freight forwarder holds the 'open cover' policy in its own name. However, if the customer decides to take up the insurance option, the rights of the policy are passed to the customer so that in the event of loss or damage to the customer's goods, the customer can make a claim directly against the insurance policy.

7.2 From 2005, the practice of passing on of insurance rights under an 'open cover' policy to the customer by the freight forwarder in this way has been a regulated activity, following the implementation by the Government of EU Directive of 9 December 2002 on insurance mediation ("the Insurance Mediation Directive"). Following dialogue with the European Commission and freight forwarders, the Government took the view that these specific insurance activities of freight forwarders did not require regulation in order to comply with the Insurance Mediation Directive. Following consultation, the Government was convinced that the potential for commercial customer consumer detriment was low, and that the cost of regulation borne by the UK's freight forwarding industry had a significant impact on the international competitiveness of the sector.

7.3 When the Government made the First Exemption Amendment Order it said that there was also a case for extending the exemption to cover retail customers, provided freight forwarders introduced and promoted an industry code of practice that ensured high standards and promoted transparency in connection with the insurance contract, as well as putting in place an appropriate complaints mechanism.

7.4 The British International Freight Association (BIFA), the British Association of Removers (BAR), and the Self Storage Association (SSA) have subsequently produced industry codes of practice that, among other things, require membership of the voluntary jurisdiction of the Financial Ombudsman Service.

7.5 HM Treasury published “Deregulating Retail Freight Forwarding Insurance: a Consultation” in June 2008 to seek views on whether the 2007 exemption for commercial customers should be extended to retail customers as well.

- ***Consolidation***

7.6 There are no current proposals to consolidate the Exemption Order.

8. Consultation outcome

8.1 The consultation took place over twelve weeks between June and September 2008. A full analysis of the consultation responses, together with a final Impact Assessment is available on HM Treasury’s website.

8.2 Nine responses were received, all of which supported the Government’s proposal. There was some discussion among respondents on how detailed the proposed Codes should be. Some respondents felt that they should attempt to anticipate every eventuality, whilst others thought that they should aim to set out a ‘road map’ for the resolution of disputes. All, however, were agreed that the Government’s proposals represented an improvement on the current position and nobody dissented from the view that the 2007 exemption for commercial customers should be extended to retail customers as well.

9. Guidance

9.1 HM Treasury will publish a Press Notice when the Order comes into force.

10. Impact

10.1 The government does not expect that there will be any direct impact on charities or voluntary bodies. The details of the expected impact on businesses are set out in the attached Impact Assessment.

10.2 The Government does not expect that there will be any impact on the public sector.

10.3 An Impact Assessment is attached to this memorandum.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The Regulations will mainly affect SMEs, removing the requirement for them to seek FSA authorisation when extending ‘open cover’ insurance policies to include the goods of retail customers in exchange for a premium. The Regulations will reduce costs for firms that no longer need be authorised to offer ‘open cover’ insurance. They will enable unauthorised freight forwarders and storage firms to offer greater customer security through extending ‘open cover’ insurance.

11.3 The basis for the final decision on what action to take to assist small business was widespread agreement following consultation.

12. Monitoring & review

12.1 As indicated in the Impact Assessment, the Government keeps all legislation under review and would expect to review the effectiveness of the Regulations in three years time in the normal course of events.

13. Contact

Tom Allebone-Webb at HM Treasury Tel: 0207 270 5389 or email: freightforwarding@hm-treasury.x.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency: Her Majesty's Treasury	Title: Impact Assessment of deregulating retail freight forwarding and storage insurance	
Stage: Laying SI	**Version:** Final	**Date:** 12/02/2009
Related Publications: Deregulating freight forwarding insurance: consultation (Dec 2006), response and commercial IA (Jun 2007) and retail consultation (Jun 2008)		

Available to view or download at:

http://www.hm-treasury.gov.uk/deregulating_retail_freight.htm

Contact for enquiries: Tom Allebone-Webb **Telephone:** 0207 270 5389

FINAL IMPACT ASSESSMENT

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

It is now apparent that the practice of extending all risk '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. Following consultation, the Government is assured there will be little or no consumer detriment as a result of this practice being deregulated for retail customers of freight forwarders (including removers) and storage firms. Intervention will reduce

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

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

1. Do nothing;

2. Remove from the scope of FSA regulation the practice of freight forwarders and storage firms extending ‘open cover’ insurance policies to retail customers; or

3. Remove from the scope of FSA regulation the practice of freight forwarders and storage firms extending ‘open cover’ insurance policies to retail customers. HMT and FSA would also work with the relevant trade associations to ensure that they have in place suitable codes of practice that would minimise consumer detriment

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 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:

[IAN PEARSON MP]

Date: 09/02/2009

Summary: Analysis & Evidence

Policy Option: 3	Description: Deregulating retail freight forwarder and storage firm insurance while minimising consumer detriment

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'	
One-off (Transition)	**Yrs**	Transitional costs in changing insurance practices. Members of BIFA, BAR and the SSA who wish to operate 'open cover' insurance would also join the Voluntary Jurisdiction of the FOS at a cost of £75 per year.	
£ 1,550,000	1		
Average Annual Cost (excluding one-off)			
£ 57,000		**Total Cost** (PV)	**£ 2,120,000**

Other **key non-monetised costs** 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.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'	
One-off	**Yrs**	Removes the cost of FSA authorisation from freight forwarders and storage firms wishing to offer 'open cover'.	
£ 0	1		
Average Annual Benefit			
£ 475,000		**Total Benefit** (PV)	**£ 4,750,000**

Other **key non-monetised benefits** by 'main affected groups'

Greater consumer protection afforded by access to the FOS and the FSCS through 'open cover' contracts 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	**Net Benefit Range** (NPV) **£ 1,660,000 - 4,080,000**	**NET BENEFIT** (NPV Best estimate) **£ 2,630,000**

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	£ 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 £75	Small £75	Medium £75	Large £0
Are any of these organisations exempt?	Yes	Yes	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase - Decrease)
Increase	£ N/A	Decrease	£ N/A	**Net**	**£** N/A

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

Evidence base

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

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

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

Benefits

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

The 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

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

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

Benefits

Option 2 would:

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

The FSA estimate that the annual incremental cost of compliance with the FSA Handbook is between £3,800 and £5,700 (including the 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.

Benefits and costs under this option will depend upon the number of firms that change their insurance practices as a result of deregulation. They can be estimated 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, the total saving would be around £475,000 per year. This figure is calculated as follows:

- 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; and
- for storage firms this would mean around 300 firms not regulated by the FSA, and around 15 who are. Of these 15, the largest few who sell other insurance may seek to remain authorised in the long term, so the saving would be up to £71,250.

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.

'Open cover' policies, unlike 'extended liability' policies, extend rights of access to the FSCS and the FOS to the individual via the insurance contract between the freight forwarder and the FSA authorised insurance firm against the behaviour and failure of the insurer. These benefits 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 removers 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

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

We estimate that around 3,000 freight forwarders (including removers) and storage firms would change their insurance practices as a result of this measure because of the consumer benefits. 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, we estimate that 2,900 would change from extended liability (or its equivalent) to 'open cover', as prior to regulation 'open cover' was prevalent. Around 100 FSA-authorised 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.

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 £1,550,000 should all 3,000 firms adopt 'open cover' insurance once it was made available without authorisation – although this would not be compulsory. This figure is calculated as follows:

- 100 firms that are currently FSA authorised would deregulate at a transition cost of £1,000 each – £100,000 overall; and
- 2,900 firms that currently use 'extended liability' would change to 'open cover' at a transition cost of £500 each – £1,450,000 overall.

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 the FOS to the individual via the insurance contract between the freight forwarder and the FSA authorised insurance firm.

Importantly, however, should an individual feel that the freight forwarder or storage firm had misinformed them about 'open cover', or the firm became insolvent, the individual would have no recourse to the FOS or the FSCS as these rights will only be available in respect of the contract between the insurer and freight forwarder (not the freight forwarder and the individual).

Option 3 – Costs and Benefits

Option 3 would remove from the scope of FSA regulation, the practice of freight forwarders (including removers) and storage firms extending their 'open cover' insurance policy to their retail customers. HMT and FSA would also work with the relevant trade associations to ensure that they have in place suitable codes of practice that would minimise consumer detriment. This would include joining the Voluntary Jurisdiction of the FOS.

Benefits

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. Access to the Voluntary Jurisdiction of the FOS would only apply to freight forwarders and storage firms that were members of a trade association. Trade association membership currently covers the majority of business (over 80% by turnover[1]).

Costs

The costs of Option 3 are as for Option 2, plus the additional costs of joining the Voluntary Jurisdiction of the FOS. There will be an annual fee for access to the FOS for freight forwarders and storage firms as insurance intermediaries (£75 in

[1] BIFA, BAR and SSA.

2009/10[2]). There is no case fee payable for the first three FOS cases per firm per year. For additional cases, case fees would be charged at £500 per case[2], 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.

Assuming that, in the long term, around 5% of BIFA members (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 £57,000 per year. This figure is calculated as follows:

- all 483 BAR members[3], all 200 or so SSA members[4] and around 5% of the 1,419 BIFA members[5] that provide services to retail customers would be required to join the Voluntary Jurisdiction of the FOS at a cost of £75. This equates to an annual cost of £56,550.

Assessing the range of benefit for Option 3

The cost of compliance with the FSA Handbook is between £3,800 and £5,700 (including the Compulsory Jurisdiction FOS fee) per firm for small firms. The IA assumes that all 100 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:

Savings range for removal from FSA authorisation

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

There are 4 non-monetised benefits listed:

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2 The Financial Ombudsman is currently consulting on the corporate plan and 2009/10 budget, including levy and case fees: http://www.financial-ombudsman.org.uk/publications/pb09/pb09_annex_d.html.

3 BAR 2009.

4 SSA 2009.

5 BIFA 2009.

1. the benefits of customer access to the FOS and the FSCS for redress against the insurer, under 'open cover' policies (as opposed to 'extended liability' policies);
2. the benefits of customer access to the FOS for redress against the freight forwarder/remover/storage firm under the FOS' Voluntary Jurisdiction;
3. anecdotal evidence of customers of freight forwarders who, under the current regime, have ceased their insurance activities, as a result of experiencing higher premiums or difficulties in finding suitable cover; and
4. lowering of barriers to entry and removing the 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 Handbook. However, should a firm have more than 3 cases per year at the FOS a £500[2] case fee would be payable. But complaint levels within the industry are low (BAR estimate that less that 0.05% of transactions generate a complaint to them) so these costs are unlikely to be incurred. **A minimal cost of £2,000 per year is assumed**[6];
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 0.01%, the benefit would be in the region of £200,000[7] 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.**

[6] An additional 4 complaints to the FOS per year above the 3 case per firm cut-off.

[7] 0.01% of Value of freight forwarding and storage retail market (£2bn) = £200,000.

Net benefit range

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

Lower range = [(£380,000 – £2,000) x 10 years] - £2,120,000[8] = **£1,660,000**
Higher range = [(£570,000 + £50,000) x 10 years] - 2,120,000[8] = **£4,080,000**

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.

Impact on small firms

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

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

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

[8] £1,550,000 million transition costs + (£56,550 FOS membership costs x 10 years) = £2,115,500 (rounded up).

Specific Impact Tests: Checklist

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