

<b>Title:</b> Offshore Hallmarking by UK Assay Offices <b>IA No:</b> BIS1017 <b>Lead department or agency:</b> BIS <b>Other departments or agencies:</b> National Measurement Office / British Hallmarking Association	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 7 <sup>th</sup> June 2012		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Primary legislation		
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**Summary: Intervention and Options** **RPC Opinion: Fit for purpose**

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
£3.44m	£3.44m	£0m	No
			N/A

**What is the problem under consideration? Why is government intervention necessary?**  
 Globalisation of Hallmarking has created a market whereby UK Assay Offices cannot compete on even terms with non-UK assay offices in the provision of hallmarks for jewellery to be placed on the UK market. Consequently, hallmarks to which UK consumers, retailers and enforcement agencies are familiar will be replaced by a plethora of unfamiliar marks reducing consumer protection. More importantly UK Assay Offices will lose considerable income and future profitability threatening their viability and in turn threatening the viability of the hallmarking regime (UK Assay Offices fund the British Hallmarking Council (BHC). Government intervention is required to remove the legislative prohibition such that UK Assay Offices can apply UK controlled hallmarks outside the UK.

**What are the policy objectives and the intended effects?**  
 The policy objective is to provide a level playing field such that UK Assay Offices will be able to compete efficiently on an equal basis with other UK recognised EEA Assay Office marks. At present this is not possible as similar legislative restrictions are not present in those countries the consequence of which is that the market is skewed in favour of other recognised marks.  
  
 The intended effect is to reduce or stop the ongoing loss of UK hallmarking business to overseas Assay Offices thus helping to preserve UK jobs.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**  
 Options considered are:  
  
 0. Amend the Hallmarking Act - thus providing a level playing field for UK Assay Offices by removing legislative restrictions so they can compete on an equal basis with the application offshore of other UK recognised EEA Assay office hallmarks e.g. the Netherlands  
 1. Do nothing – for which the most likely outcome is that hallmarking for the UK mass produced jewellery market will be dominated by non-UK Assay Offices with the potential loss bringing into question the viability of at least one of the UK Assay Offices.  
 2. De-regulate hallmarking  
  
 The preferred option is 0. Amend the Hallmarking Act

**Will the policy be reviewed?** It be reviewed by the BHC. If applicable, set review date: Month/Year

Does implementation go beyond minimum EU requirements?	No				
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 No	Small No	Medium No	Large No
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)	Traded:		Non-traded:		

*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 SELECT SIGNATORY: DLW Wietts Date: 4/10/12

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Amend the legislation to enable UK assay offices to compete with overseas assay offices on an even footing.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)			
			Low: 0	High: 6.89	Best Estimate: 3.44	
<b>COSTS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Cost (Present Value)</b>	
Low	Optional	1	Optional		<b>Optional</b>	
High	Optional		Optional		<b>Optional</b>	
Best Estimate	0.		0		0	
<b>Description and scale of key monetised costs by 'main affected groups'</b>						
There are no new costs.						
<b>Other key non-monetised costs by 'main affected groups'</b>						
There will be one off costs to the British Hallmarking Council of setting up a regime to deal with applications for overseas sub-offices and to create subsequent monitoring and review arrangements (£25,000). Also, monitoring costs of £2,500 per year for each Assay Office that chooses to set up overseas. All these costs will be passed on to Assay Offices that choose to set up overseas, and are captured in the profitability estimates given below (i.e. netted off), and so are not captured in the monetised costs section.						
<b>BENEFITS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Benefit (Present Value)</b>	
Low	Optional	1	0		0	
High	Optional		0.8		6.89	
Best Estimate	0		0.4		3.44	
<b>Description and scale of key monetised benefits by 'main affected groups'</b>						
The major benefits arise as a result of untapping the potential of markets which are not available to UK Assay Offices due to the current regulation, allowing them to make an additional £400k per year in profit. This figure has been arrived at by means of extrapolation from estimates provided by the Assay Offices on a confidential basis. The BHC's view on the confidence level which can be attached to it is in the order of 70% to 80%. These benefits would be indirect, and so out of scope for One In One Out. The current market structure and market outcome for hallmarking services provided for the UK jewellery market is not sustainable as a result of globalisation of both precious metal jewellery manufacture						
<b>Other key non-monetised benefits by 'main affected groups'</b>						
UK hallmarks with which Jewellery retailers, and their customers, are most familiar remain the most widely used for jewellery on the UK market. Consumer confidence in hallmarking remains high, leading to higher levels of jewellery purchase, as a result of the continued use of familiar hallmarks. Trading Standards enforcement activities are made easier, as the number of hallmarks exposed on the UK market is minimised. UK Assay Offices more able to make use of economies of scale, and UK jobs are protected.						
<b>Key assumptions/sensitivities/risks</b>					<b>Discount rate (%)</b>	3.5
In order to create the counter-factual a number of assumptions are made in the way the market will develop in the "do nothing" option, as the current market structure and outcome are not sustainable in the face of globalisation of the provision of hallmarking services. These assumptions mainly concern the likely consumer perception of non-UK hallmarks struck in third party jurisdictions (i.e. not the home jurisdiction of the authority applying the hallmark).						

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	No	N/A

# Evidence Base

## Introduction

This impact assessment relates to a proposal to allow UK Assay Offices, located outside the UK, to assay and mark precious metal jewellery outside of the UK in such a way that those marks are recognised on the UK market as conforming to the requirements of the Hallmarking Act. This IA updates the Consultation Stage IA dated May 2011 and incorporates the recommendations of the Regulatory Policy Committee's opinion dated 28/07/2011 (reference RPC11-BIS-1017).

The consultation paper posed a number of questions in accordance with the requirements of the Legislative and Regulatory Reform Act 2006. A total of eight responses to the consultation were received comprising four from the hallmarking community, two from consumer protection bodies, one from a company engaged in jewellery valuation and one from a member of the public. There was broad support from stakeholders for the proposals overall with almost unanimous and unqualified support for the most important change to the Act which will allow the UK Assay Offices to conduct hallmarking operations offshore. The consultation sought views on the expected impacts of the proposals as identified in the Impact Assessment, and in light of this we have reaffirmed our estimates of these.

The value of the hallmarking system to UK consumers has been recognised by the Government on a number of occasions in recent years including during implementation of the Hampton Report – "Reducing administrative burdens: effective inspection and enforcement" (March 2005) and the review of non departmental public bodies for the purposes of the Public Bodies Bill.

The proposed changes to the regulatory regime under the UK Hallmarking Act should, in the first instance, be evaluated against the counterfactual of the status quo (ie the 'do nothing' option). As a result of changes in the manufacturing of jewellery for the UK (and other European) markets the current market dynamics are not stable. Hence the 'do nothing' option does not result in the continuation of the market as it is currently structured, but in significant changes. Clearly these changes can only be estimated, but based on both the continuation of current trends and an analysis of the underlying economics of precious metal jewellery manufacture, distribution and retailing, a number of reasonable predictions can be made as to the likely future market structure under a do nothing option. It is against these counterfactuals that the impact of any proposals to change the regulatory regime should be evaluated.

The potentially different outcomes under both the do nothing option and the option that allows UK to mark off-shore stem from the position that marks struck in the UK hold on the UK market. At present this is unknown and there are differences in predictions made by different stakeholders over how the market will develop. However, the approach being proposed by the British Hallmarking Council is designed to take into account this uncertainty and to provide benefits to UK consumers irrespective of which precise market dynamic actually unfolds.

The policy that has been adopted by the British Hallmarking Council is that UK Assay Offices should be allowed to mark off-shore under its auspices, using marks that are distinguishable from those struck in the UK. If marks struck in the UK are valuable, then very little marking of jewellery on the UK market will be done off-shore. Although the change in the UK market will be minimal, the costs are also very low and Assay Offices will have been given the ability to mark off-shore and potentially develop a world brand of off-shore marks outside the UK market. On the other hand, if marks struck off-shore are acceptable to the UK market then the UK will continue to be supplied by UK Assay Office marked jewellery, which should increase consumer welfare compared to a market dominated by non-UK Assay Office marks.

In both cases the necessary costs incurred in allowing UK Assay Offices to mark off-shore are minimal and in the second case, Assay Offices themselves will take a commercial decision in actually creating a marking capacity off-shore, which will only occur if the relevant office believes that it will be commercially viable to do so.

The problem as it currently stands is that UK regulation prohibits UK Assay Offices from making that commercial decision. This would appear to be due to regulatory oversight at the time. It must also be borne in mind that the Hallmarking Act was drafted at a time when the broadening of domestic hallmarking operations to overseas locations would probably not have been foreseen.

It is against this background that this impact assessment has been carried out. It is also against that background that in 2009 over 16,000,000 items of precious metal were hallmarked by the UK Assay Offices, and these items had a scrap metal value in excess of £500,000,000. Ensuring that consumers continue to be adequately protected from undercarrating is, therefore, extremely valuable. The necessary costs of adopting the British Hallmarking Council approach are in the order of £25,000. This is the estimated cost of setting up a regime to deal with applications for overseas sub-offices and to create subsequent monitoring and review arrangements.

## Background

Statutory hallmarking is an effective method of protecting consumers (including business consumers) from purchasing under-carated precious metals because it is impossible to know the purity of the metal without laboratory testing (assaying). It is illegal to trade items described as gold, silver, platinum or palladium unless they have been independently assayed (tested) by any one of four UK Assay Offices regulated by the British Hallmarking Council. By regulating precious metals at the time of manufacture via assaying and hallmarking, there is virtually no need for routine inspections or test purchases by the enforcement authorities as the market is inherently compliant (i.e. low risk). This is firmly in line with "Hampton Principles".

Regulation is strongly supported by all stakeholders in a sector worth in excess of £4 billion<sup>1</sup>. A positive side-effect of hallmarking is that it can stimulate economic activity. Businesses like the added-value that hallmarking gives to their products and helps the trade in antique objects. The UK hallmarking regime helps the Assay Offices to maintain their position as world leaders in the field and in turn helps them to generate new business. The recent high price of gold has resulted in the generation of new business (and jobs) in the 'cash for gold' market. The presence of hallmarks on goods showing both buyer and seller the fineness (or standard) of precious metal being traded provides confidence in the market and encourages trade.

The recent prescription of palladium as a new precious metal has resulted in increased manufacture and sales of palladium jewellery. This demonstrates that regulation of precious metals rather than being a burden on business can actually provide and stimulus for economic activity and growth.

## Problem under consideration

Globalisation of Hallmarking has created a market whereby UK Assay Offices cannot compete on even terms with non-UK assay offices in the provision of hallmarks for jewellery to be placed on the UK market. There are two reasons for this:

- (1) the relocation of mass produced jewellery for the UK market to low labour cost countries (e.g. India, Thailand), and
- (2) countries with UK-recognised hallmarks (e.g. Netherlands) allow their assay offices to hallmark in these low labour cost countries – an option currently not available to UK Assay Offices. Consequently, hallmarks to which UK consumers, retailers and enforcement agencies are familiar will be replaced by a plethora of unfamiliar marks reducing consumer protection. More importantly UK Assay Offices will lose considerable income and future profitability threatening their viability (and a threat to the viability of the hallmarking regime).

## Rationale for intervention

Government intervention is required to remove the legislative prohibition such that UK Assay Offices can apply UK controlled hallmarks outside the UK.

## Policy objective

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<sup>1</sup> Figure from The National Association of Goldsmiths

The policy objective is to provide a level playing field such that UK Assay Offices will be able to compete efficiently on an equal basis with other UK recognised EEA Assay Office marks. At present this is not possible as similar legislative restrictions are not present in those countries the consequence of which is that the market is skewed in favour of other recognised marks.

The intended effect is to reduce or stop the ongoing loss of UK hallmarking business to overseas Assay Offices thus helping to preserve UK jobs.

## **Underlying changes in the economics of the jewellery trade**

A distinction should be drawn between high volume, mass market, jewellery and, at the other end of the market, bespoke designer jewellery. The market dynamics are significantly differentiated. However, the high volume market dominates in terms of number of pieces, and therefore, dominates, in volume terms, hallmarking activity. This part of the market is analysed first, and the implications for other parts of the market are then explored.

### **Mass produced/high volume market**

Over the last decade or more the manufacture of high volume precious metal jewellery for the UK (retail) market has moved from the UK to lower cost countries – principally India, China and, to a lesser extent, Eastern Europe. The move to low manufacturing cost countries results in lower cost, and therefore lower priced, jewellery on the UK market. This move is already almost complete with less than 15% of UK Hallmarked jewellery being manufactured in the UK. (Note: this will represent an underestimate of the proportion, because not all jewellery manufactured outside the UK, but put on the UK market, is hallmarked in the UK (see below), but all jewellery manufactured in the UK for the UK market will be hallmarked in the UK.) This contrasts with situation a decade ago where the UK manufactured proportion was more like 50%.

This shift to non-UK manufacture has arisen from cost reduction pressures in the (highly competitive) retail market. The cost reduction comes from reduced labour costs in the manufacturing and packaging phase of the production process, and is mirrored by all sorts of manufacturing processes that have moved from the UK to, for example, the far east.

Notwithstanding this move of the manufacturing processes to low labour cost countries, the regulatory requirements for the sale of precious metal jewellery in the UK (and other hallmarking countries) meant that the activity of hallmarking took place mainly in the UK. Legally alternative locations for hallmarking to take place existed, but these also tended to be in high labour cost countries [such as those countries which are members of the International Hallmarking Convention]. As a result, in the period up to around 2007, as the manufacturing of precious metal jewellery moved from the UK to, for example Thailand and China, the volume of hallmarking in the UK remained high.

In this period various initiatives were introduced to reduce the total costs of the manufacturing to retailing processes for the remaining UK manufactured jewellery. In particular, the marking and, to a lesser extent, assaying processes which constitute the hallmarking activity were more closely aligned with the manufacturing processes by the creation of sub Offices of Assay Offices located within manufacturers premises. This reduced the price of hallmarking services purchased by the manufacturers (from one or more of the UK Assay Offices) by up to 10% and helped to reduce the manufacturing costs up to the point of packaging the retail goods. The precise reduction in internal costs available to manufacturers is not available and difficult to estimate, but from the fact that sub Offices have been opened in major manufacturers premises ( Carrs of Sheffield, Curteiss Chain, Cookson Precious Metals , Optima and Domino) it is apparent that the costs saving benefit is significant. In view of the cost of establishment, sub Office facilities are only available to manufacturers with a substantial volume throughput.

However, the increase in efficiency available from hallmarking being placed adjacent to the manufacturing process through sub Offices did not remove the cost advantage that *jewellery* manufacturing could reap by moving the manufacturing process itself to low labour cost locations. Where a manufacturer has a volume not sufficient for sub Office marking in the UK there is no loss of aligned manufacture by moving manufacture to a low wage location, and where there is sufficient volume for sub-office marking in the UK the advantage of aligned marking may not be sufficient to overcome the

lower cost manufacturer, and then incurring higher costs by reverting to a less efficient process for obtaining UK hallmarks once the jewellery had been imported to the UK.

**The three economic forces in operation here can be summarised as:**

- Aligning independent marking with the manufacturing process can reduce the overall production costs, but requires high manufacturing volumes at single locations;
- Manufacturing in low wage economies reduces the costs of jewellery placed on the UK market;
- Marking in low wage economies reduces the costs of marking.

Against this set of dynamics, the current position of the vast majority of high volume jewellery being manufactured outside the UK but marked in the UK is likely to be stable only if Hallmarking services that are acceptable to UK consumers (of high volume jewellery) are not available within low labour cost countries

If such Hallmarking services are available then manufacturers will be able to produce jewellery for the UK market either by putting manufacturing and marking together in a low wage location, or outside the manufacturing process itself, the marking being available from a low cost supplier in the same location. Under these circumstances manufacturing outside the UK and marking within the UK will not be competitive.

Critical to whether or not these conditions arise is the acceptability on the UK market of these marks.

**Two levels of acceptability can be identified:**

Legal acceptability where the marks on the jewellery are sufficient to pass the test required by the Hallmarking Act and therefore retailers will be able to offer for sale such items and describe them as containing the relevant precious metal(s).

Consumer acceptability where jewellery marked with these marks is seen as being as good as jewellery with Hallmarks applied in the UK. (Or, in a less absolute sense, marks struck in the UK do not attract a sufficient price premium to more than cover the additional costs of applying such marks compared to marks applied outside the UK.)

The legal acceptability of marks that have been applied in any location, including in low wage locations, has been clarified in that for EEA countries (all EU countries plus Norway, Iceland and Lichtenstein), it is dependent on the equivalence of the mark and the legal authority of the application of the mark. It is not open to lower wage cost locations to themselves become hallmarking countries, such that their own domestic marks would become legal on the UK market. There is however some evidence that at least some low cost jurisdictions are looking at this route in the form of application of the Hallmarking Convention Common Control Mark (a unique mark denoting that an article has been struck under the Hallmarking Convention).

In relation to EEA countries this is currently the position of Dutch marks struck in low cost jurisdictions, and for the purposes of this impact statement it is assumed that now, or in the very near future, it will be legally possible to offer jewellery for sale on the UK market precious metal jewellery that has been hallmarked in low wage locations.

Critically, therefore, the outcome of the status quo (the do nothing option) depends on the acceptability to customers (or retailers) of marks struck outside the UK. Or, more precisely, whether or not UK consumers will be prepared to pay some additional price for jewellery that have Hallmarks that have been struck in the UK.

If UK consumers place a significant premium on UK struck Hallmarks (which under the present rules means UK Assay Office Hallmarks) then high volume jewellery with, say Dutch Hallmarks would need to be significantly cheaper than the equivalent UK marked jewellery to be competitive. Under these circumstances the status quo is stable. That is, high volume manufacturing takes place in low cost locations, but that output which is destined for the UK market will be shipped to the UK and marked here.

However, if UK consumers (or retailers) do not place a significant premium on UK struck marks the cost advantage of either integrated manufacture and marking in low cost jurisdictions, or having split processes (manufacturing and marking) but both still in low cost locations, will mean that high volume jewellery marked in the UK will be uncompetitive. As a result, marks struck outside the UK will displace marks struck in the UK, which in the status quo means non UK Assay Office marks will displace UK marks on the UK market. These marks will either be Assay Offices from Hallmarking countries that can mark off-shore, or suitable domestic marks applied by the low cost jurisdiction.

Because markets have not yet developed where there are both domestic and off-shore marks it is difficult to find robust evidence as to how consumers (and retailers) would react to non UK struck marks in the presence of a price differential. As a result there is no consensus within the industry on the value placed on UK struck marks by consumers. In addition, retailers as intermediaries may also have a significant influence on whether or not non-UK struck marks are placed on the UK market as retailers (or at least some) will be concerned about their own reputation and may, therefore, act as gatekeepers for jewellery marked with non-UK struck marks. If these retailers “trust” non-UK struck marks then they may be able to use their own reputation to overcome any customer resistance to non-UK marks. On the other hand, if they do not trust these non-UK marks they may not be prepared to risk selling such jewellery, even if their customers are indifferent between UK struck and non-UK struck marks.

In practice, neither retailers nor customers will be homogeneous, and it is unlikely, therefore, that the market for hallmarks would settle at either extreme.

In the face of some uncertainty with the future structure of the market under the status quo, the market impact analysis that follows is undertaken for two types of outcome. Firstly where UK struck marks are seen as sufficiently valuable by customers and/or retailers so that a significant proportion of high volume jewellery on the UK market remains hallmarked in the UK (although manufactured in low cost locations). And secondly under the assumption that UK struck marks do not have a significant value to customers and/or retailers to overcome any cost disadvantage of striking marks in the UK. As a result, non-UK struck marks dominate the market.

### **What is the problem?**

As indicated above, the outcome of the do nothing option is uncertain. Therefore the analysis has been done against two potential outcomes. Each outcome is evaluated separately and in sequence

#### **Outcome 1: UK struck marks are valuable**

What is the problem - the general impact of the do nothing option

Under this assumption very little changes from the current (2011) outcome. In the extreme version of this outcome, manufacturing moves outside the UK but marking remains within the UK. In the less extreme versions, some marking will move off-shore, and some jewellery will be placed on the UK market that is marked with non-UK Assay Office Hallmarks. A more detailed description of the impact of non-UK Assay Office marks being placed on the UK market is set out below under outcome 2, and is not repeated here as in this scenario the impact is limited.

As there is limited change from the current position with respect for demand for hallmarking from the four UK Assay Offices, the impact on the low volume, bespoke jewellery market that remains being manufactured or created in the UK is minimal.

#### **The general impact of allowing UK Assay Offices to mark outside the UK**

There are two variants of this scenario that are relevant. The first is where the marks struck are clearly distinguishable from that Assay Office’s marks struck in the UK – ie a distinction is still made between marks struck in the UK and marks struck outside the UK, notwithstanding that such marks would also clearly be under the control of the relevant UK Assay Office (ie London, Birmingham, Sheffield or Edinburgh). The second is where the marks struck by the UK Assay Offices are the same (at least as far as the consumer is concerned) irrespective of where they are struck.

#### ***Variant 1 – UK “off-shore” marks are struck off-shore***

Where the value of a hallmark is derived from *where* it is struck, and not *who* it is struck by, the effect of allowing UK Assay Offices to apply “off-shore” marks is limited. In which case a significant amount of jewellery on the UK market will continue to be marked in the UK. However, for that part of the market where price/cost is more important, UK “off-shore” marks are likely to be competitive with other, non-UK office marks. As a result, UK Assay Offices can operate in the wider global market for off-shore marking, but in practice this market (at least in respect of jewellery for the UK market) is limited. The outcome is that generally jewellery on the UK market is marked by UK Assay Offices with the marks applied in the UK, and for that part of the market where “off-shore” marks are struck, these are still likely to be struck by UK Assay Offices (unless this is a really small part of the market).

### ***Variant 2 – UK domestic marks are struck off-shore***

Under this variant the value of the UK mark is limited, because its value did derive from *where* it was struck (in the UK) and this can no longer be guaranteed. However, it is possible that under this scenario one or more of the UK Assay Offices would not mark off-shore. Its mark would, therefore, remain as an ‘applied in the UK’ mark, which would then be more valuable than the marks applied by other UK Assay Offices. Most of the demand for ‘marked in the UK Hallmarks’ could then be expected to flow to that (or those) office(s) that did not mark off-shore.

In addition, for those Assay Offices that did mark off-shore, the devaluation of their mark would be likely to put them into the same (or still leave them as being ‘better’) as other marks struck outside the UK. As a result, it is likely that the UK market would still be dominated by UK Assay Office marks – either applied off-shore or on-shore.

If the value of the UK struck mark comes from a perception that this would represent a higher guarantee of the item being of the purity as marked, or lower risk of fraudulently applied marks, and this is born out in practice, then the inability to distinguish UK struck marks would reduce consumer protection. More incorrect or fake marks would appear on the UK market, and more consumers would be misled in their purchases. If, however, the perception is incorrect and/or the Assay Offices are equally successful in quality control and control of fraud as they are now, the inability to distinguish between UK struck and off-shore struck UK Assay Office marks does not, in itself, cause consumer detriment, notwithstanding the perceptions of customers.

In this variant, if one or more Assay Offices does not mark off-shore and (as assumed) this creates a very valuable distinction between that mark(s) and the others, the total volume of marking undertaken in the UK does not change significantly. (Although, clearly, *who* does the marking does change.) As a result, the impact on the low volume and bespoke market is limited as a high volume of marking still takes place in the UK, and the low volume, bespoke UK manufactured jeweller can still benefit from the economies of scale and scope enjoyed by the UK only marking Assay Offices.

If however, for whatever reason, all of the UK assay mark off-shore, then most of the high volume marking also moves off-shore. There is now no ‘marked in the UK’ mark, and it will be cheaper to get the UK mark off-shore. The impact on the jewellery that continues to be manufactured in the UK is significant. As total ‘in UK’ marking has dropped these remaining articles for marking are likely to see an increase in price and possible a reduction in the locations in the UK where Hallmarking can actually be carried out. (For more detail on this outcome, see Outcome 2 below.)

### **Conclusion: outcome 1 (UK Struck Marks are Valuable)**

Where there is a significant value placed on UK struck marks the market driven outcome should be that UK Assay Offices will *not* mark off-shore (or at least not all of them). This arises because the value of the current UK Assay Office marks is their *place* of marking, not the *institution* applying the mark. Under these circumstances the impact of allowing UK Assay Offices to apply distinguishable “off-shore” marks is minimal. There is little change from the status quo, and the status quo still has most jewellery placed on the UK market being marked in the UK.

Allowing Assay Offices to apply “domestic” marks off-shore would not alter this overall conclusion unless all the Assay Offices start to apply marks off-shore. Under these specific circumstances most high volume marking migrates off-shore. This is significantly different from the status quo, where (under these circumstances) most high volume marking remains on-shore. Given the value assigned to marking in the



UK by customers and/or retailers in this scenario, this movement of marking off-shore is unlikely to be in the customers' interests. However, this outcome can be avoided by requiring off-shore marks to be distinguishable from on-shore marks. ***It is this approach that has been unanimously agreed by the Assay Offices as the best way forward and is the policy recommended by the Hallmarking Council.***

## **Outcome 2: UK struck marks are not significantly more valuable than marks struck outside the UK (but UK Assay Office struck marks may be more valuable than marks struck by other Assay Offices )**

### **What is the problem: the general impact of the do nothing option**

The most likely outcome of these market dynamics is that over the next few years the competitive dynamics of the (high volume) retail market will result in only precious metal jewellery that is both manufactured in low cost locations, and where the hallmarking of that jewellery is adjacent to the manufacturing processes, being competitive. High volume manufacture with adjacent hallmarking within the UK, or high volume manufacture in low cost locations and hallmarking in high labour costs locations, will be unlikely to be competitive. It is estimated that the hallmarking cost represents about 0.8% of the cost of manufacture, and 0.28% of the retail price, of gold items of jewellery. In relation to the silver items of jewellery the corresponding percentages are estimated to be 1.2% and 0.5% respectively. Even where marking is not fully adjacent to the manufacturing process, the availability of marking within the low cost jurisdiction will still result in these items arriving in the UK marked with non-UK Assay Office Hallmarks. As a result most, if not all, high volume precious metal jewellery will not be marked in the UK. This outcome arises because the additional cost of marking within the UK is higher than the customers' willingness to pay for these marks (compared to non-UK marked equivalents).

In the absence of a change in UK law, a side effect of this dynamic is that the high volume jewellery on the UK market will NOT be marked with UK hallmarks, but either the marks of those existing hallmarking countries where their domestic law allows 'off-shore' marking, or CCM marks in those low cost locations as they acquire the regulatory infrastructure to create hallmarking systems.

The 'do nothing' scenario is, therefore, one in which high volume precious metal jewellery placed on the UK market will carry either marks struck by foreign Assay Offices operating in a third country (eg Dutch marks struck in China) or CCM marks struck in those low cost locations. (eg India).

The impact of this change on other parts of the jewellery manufacturing processes will be significant. Artisan jewellery and high value, high design input and low volume jewellery will continue to be produced in the UK. However, the price that will have to be paid to have this jewellery hallmarked will increase, probably significantly, as a result of the economics of operating an Assay Office and hallmarking capability.

The operation of an Assay Office and hallmarking facility exhibits strong economies of scale, both conventional scale (unit costs decline as volume increases) and the scale of batch processing (the larger the number of identical units sent for testing and marking, the lower the unit cost of assaying and applying the requisite marks). There are a number of factors behind this latter effect, including statistical sampling for assaying, and the creation of bespoke jigs for specific jewellery for applying the marks.

The loss of the high volume hallmarking market means that the sources of economies of scale will disappear. The result will be a significant reduction in the hall marking capacity required in the UK and a significant increase in unit costs and, therefore, unit prices applicable to the remaining demand for hallmarking in the UK. The on-going viability of some of the existing UK Assay Offices as standalone businesses may be called into question.

### **The general impact on the retail market**

Hallmarking is essentially a consumer protection device whereby potential customers and retailers have a method to easily and efficiently determine the fineness of the (precious) metal contained in the jewellery (or other object offered for sale). The hallmarking system also provides an efficient method for the enforcement of general requirements on retailers to provide accurate descriptions of the fineness of precious metals in objects offered for sale. Under the current market this is helped by there being a

relatively small number of marks (ie almost entirely marks of the four UK Assay Offices) on new (and recent produced) jewellery.

For the reasons set out above, under this set of assumptions in the do nothing scenario high volume jewellery on the UK will not be marked with UK hallmarks, but with marks struck in the country of manufacture. These marks will be struck either by a third country whose domestic rules allow for such off-shore marking or (when the appropriate changes have been made) by a domestic Assay Office of the country concerned (eg India, China). The overall result is likely to be that the number of different marks applied to jewellery on the UK market will increase. A side effect of this is likely to be that there is less consumer (and retailer) understanding of the marking system and enforcement of the hallmarking structure (by Trading Standards) will be made more difficult.

In addition, the current system by which the UK Assay Offices provide resources to the TSOs will come under pressure as their scope of operation will diminish. They will be not generally be in a position to provide the resources they do now as a result of their much reduced income from hallmarking

### **The general impact of a change in the law to allow UK Assay Offices to apply marks outside the UK**

Allowing UK Assay Offices to mark in low cost locations will not increase the demand for the application of marks *in* the UK. The loss of economies of scale *within* the UK will still occur. However, the outcome for the retail market in jewellery in the UK is likely to be different.

Because UK consumers and retailers are familiar with UK marks ( and in relation to this it is expected that through publicity UK consumers will quickly become familiar with UK Office marks applied offshore which are distinguishable from their onshore applied Office marks ) manufacturers in low cost locations wishing to supply the UK market are likely to prefer UK marks to other marks (eg Dutch). Indeed, a number of UK Assay Offices have already been approached by manufacturers who are keen to have UK marks applied, but who will apply other marks if UK marks are unavailable. In addition, manufacturers supplying some non-hallmarking retail markets (eg USA) are also likely to have some preference for UK marks where they still wish to have jewellery marked. It is also possible that where marking is aligned with manufacturing, and those items are to be sold across the world, manufacturers will wish to apply the same mark for all geographic markets (eg UK, USA and Italy). The CCM Marks are one way of achieving this outcome, but it is also possible that a small number of Assay Office marks become world brands in this respect.

As a result, in the scenario where UK Assay Offices can mark off-shore the most likely outcome is that the UK retail market will remain dominated by jewellery to which UK marks have been attached. This will in turn tend to reduce consumer confusion and make enforcement of the hallmarking structure by TSOs more effective and efficient.

There will also be a significant impact on the existing Assay Offices. Although the volume of marks applied in the UK will diminish by about the same extent (compared to outcome 1), at an institutional level the UK Assay Offices will still be able to mark high volume manufactured jewellery, albeit such marking will occur outside the UK.

The move of high volume marking to outside the UK has the same knock-on impact on the remaining UK produced jewellery as under this do nothing scenario, with the added advantage that at an institutional level the Assay Offices themselves are likely to have expanded into off-shore operation.

The application of either of the two variants by UK Offices - distinguishable or domestic marks - does not significantly change the outcome. By assumption in this scenario the customer or retailer is not concerned with the *place* of marking, but is concerned about understanding the marks themselves. In addition, to the extent that the existing UK Assay Offices have an existing brand reputation which makes them preferable to non-UK marks, the application of distinguishable UK marks off-shore will be preferable for consumers and/or retailers to non-UK marks applied in the same place. However, to the extent that there is some remaining additional value in mark actually applied in the UK a distinction between on-shore and off-shore marks allows Assay Offices to deliver this additional value.

### **Conclusion: outcome 2**

Under this scenario high volume marking moves off-shore irrespective of whether or not UK Assay Offices are allowed to apply UK hallmarks off-shore. The knock-on impacts into the remaining market for Hallmarks applied in the UK are, therefore, largely the same, with some relatively small potential for improvements in the supply of Hallmarks in the UK as a result of UK Assay Offices being able to be active in Hallmarking in low cost locations

At the institutional level, UK Assay Offices are more likely to survive as a result of following demand for their services outside the UK.

At the consumer level, the main change from the status quo is that although the Hallmarks are applied off-shore in both the factual and counterfactual, with the change in what UK Assay Offices can do, UK Hallmarks will be likely to continue to dominate the market for jewellery offered for sale in the UK.

## Overall conclusion

The impact of allowing UK Assay Offices to mark off-shore depends critically on the value consumers and retailers put on having marks applied in the UK. If this value is high then allowing UK Assay Offices to mark off-shore has little impact, as long as the Assay Offices recognise the value of UK marking. However, there is an outcome where the UK Assay Offices act in such a way that they collectively destroy the link between UK Assay Office marks and marks applied in the UK. Under this scenario, marking moves off-shore notwithstanding the fact that consumers/retailers would prefer marks applied in the UK. The danger of this outcome can largely be avoided by making UK Assay Office off-shore marks distinguishable from those applied in the UK.

However, if the consumers and/or retailers place little value on marks being applied in the UK, high volume marking will move off-shore irrespective of whether or not UK Assay Offices are allowed to mark off-shore. But if they are allowed to mark off-shore it is likely that the UK market would continue to be dominated by UK Assay Office marks. This holds whether or not these marks are distinguishable from marks applied in the UK.

The table below summarises the impact under these various scenarios.

Scenario	Impact	Status quo	Allow off-shore marking
Marks applied in the UK are valuable			
	High volume marking moves off-shore	NO	NO – possible exception if marks not distinguishable
	UK hallmarks remain/become world brand	NO	Possibly
	Other impacts	NO	NO
Marks applied in the UK not valuable enough to overcome cost disadvantage, but UK Assay Office marks are valuable			
	High volume marking moves off-shore	YES	YES
	UK assay marks on high volume jewellery	NO	YES
	Higher costs for marks applied in the UK	YES	YES – but slight possibility of being slightly lower

	UK hallmarks remain/become world brand	NO	YES
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As can be seen the impact on the UK jewellery market of allowing UK Assay Offices to mark off-shore depends critically on where the value of UK marks comes from. If the value of UK hallmarks derives either directly or indirectly from being struck, and seen to be being struck, in the UK there is a possible outcome that results in consumer detriment – where all UK offices mark off-shore using marks indistinguishable from those struck in the UK. However, if marks are distinguishable or if one or more Assay Office continues to mark solely in the UK, allowing UK Assay Office to mark off-shore has very little impact as there is very little demand for marks struck outside the UK.

However, if the value of UK hallmarks (or, indeed, any hallmark) arises more from *who* rather than *where* the mark is struck, not allowing UK Assay Offices to mark off-shore does have significant consequences for the UK jewellery market. In essence, under this scenario the UK market is dominated by marks that have been applied in the countries of manufacturer and which are non UK Assay Office marks. If UK Assay Offices are enabled to mark off-shore, the UK jewellery market is still dominated by marks struck outside the UK, but in this scenario those marks are (largely) struck by UK Assay Office and, therefore, the market continues to be dominated by those marks the majority of which consumers and Trading Standards are already familiar with, and the rest of which they will quickly become familiar.

There is no overall conclusive evidence as to which of these market dynamics is the most likely. Indeed, it is most likely that the basis of consumer valuation of marks varies across different consumers. Manufacturers have indicated to Assay Offices that at least some of them would integrate marking (including marking with non-UK marks) into the manufacturing process within low cost locations as soon as they were assured that it was legal to place such marked jewellery on the UK market. Others have indicated that they would do so if such practices became widespread. This only makes sense if these manufacturers believe that such marks will be acceptable to consumers.

It is theoretically possible that the value of UK struck hallmarks is such that where UK hallmarking is dealing with high volumes the cost (ie price) differential between UK struck and off-shore struck marks is smaller than value placed on UK struck hallmarks by customers, but that if the UK volumes fall the cost differential widens so as to be higher than the customers' valuation. Under these particular circumstances there are two stable market outcomes – one where most of the high volume jewellery marking is done in the UK and the other where most if not all such marking is done off-shore. Where the market ends up becomes path dependent, and in public policy terms there is a danger of tipping the market outcome into the less advantageous outcome, from which there is then no path to the better outcome.

This is a pertinent issue here as there are UK employment and other implications of the two outcomes. If the outcome where marking continues to be largely done in the UK is a stable outcome, then it would be unfortunate to arrive at the alternative stable position as a result of particular regulatory decisions on the way. However, given the current starting position in 2010 (where high volume marking is carried out in the UK) the outcome would be likely to be sent down the 'wrong' path only if there are currently significant obstacles to minimising the total costs of hallmarking undertaken in the UK, or if the differential customer valuation of where marks are struck is hidden from manufactures or from consumers themselves. The British Hallmarking Council is unaware of anything in relation to the former issue, and the differential marking of off-shore and on-shore hallmarks should enable the value of UK struck hallmarks to be made clear quickly. Thus the danger that largely off-shore marking is arrived at when on-shore marking would have a higher consumer value is minimised, although it cannot be completely eliminated.

In the absence of a known homogenous market dynamic, a risk based approach is appropriate. The potential risk arising from doing nothing is significant, but most, if not all, of the potential damage that could arise from allowing off-shore marking is ameliorated by making UK Assay Offices differentiate between marks struck on-shore and off-shore. Such marking allows UK Assay Offices to capture the demand for integrated marking and, possibly, to develop more of a world brand in the provision of Hallmarking services. It simultaneously allows for UK consumers to have access to marks indicating that the hallmarking process has taken place in the UK. In addition, it maximises the ability of customers, retailers and enforcement agencies to understand the hallmarking system.

It is for these reasons that the British Hallmarking Council is advising the Secretary of State to change UK domestic law and regulation to allow UK Assay Offices, if they wish, to apply their marks off-shore, and for these, distinguishable, marks to be recognised as authorised marks with respect to the Hallmarking Act.

## **Detailed impact on UK Assay Offices and (high volume) manufacturing in the UK**

### **Introduction**

The analysis set out above concerns the impact of allowing UK Assay Offices to mark off-shore on the market for precious metal jewellery in the UK. There will also be an impact on the Assay Offices as service providers. Set out below is the impact on Assay Offices themselves arising from the potential changes to UK law and/or regulations that would allow UK Assay Offices to mark off-shore. As with the description relating to the jewellery market, the impact on Assay Offices is determined by the market dynamics and, in particular, by whether or not consumers value hallmarks because of *where* they are applied, or *who* applies them. In addition, the major impact on the UK Assay Offices compared to what happens now (ie 2011) depends on the answer to this question and NOT on the change in the law or regulations. The additional impact of these legal *changes* is relatively minor compared to the changes that will arise if consumers (or retailers) do not place a significant value on hallmarks struck in the UK.

Given the complexity of the market dynamics a simplifying assumption has been made in this part of the analysis that if a change is made to UK law and regulations, the change is in line with BHC recommendations and marks struck by UK Assay Offices off-shore are distinguishable from UK Assay Office marks struck in the UK

### **Impact under Outcome 1: UK struck marks are valuable**

#### **Assay Offices**

In this scenario there is (very) limited demand for UK Assay Office marks struck off-shore. As a result there is very little impact on Assay Offices of *allowing* them to mark off-shore. Given the commercial nature of the Assay Offices, it is unlikely that they would apply significant resources to marking off-shore as there will be limited demand for these services. As a result, the difference between the 'do nothing' option and the option that allows UK Assay Offices to mark off-shore is very limited. As a result, no further details are provided.

#### **UK (high volume) manufacturing**

As very little marking moves off-shore, there is very little impact on the remaining high volume UK manufacturing. As a result, no further details are provided.

### **Impact under outcome 2: UK struck marks are not significantly more valuable than marks struck outside the UK (but UK Assay Office struck marks may be more valuable than marks struck by other Assay Offices)**

Under this outcome in both the do nothing and the change option most high volume marking moves off-shore. Although this change is not dependent on which option is chosen, the impact on the UK Assay Offices and the remaining high volume UK manufacturing is included in this analysis for completeness, under the do nothing option.

### **Options identification**

Three options were identified:

- Option 0: Do nothing
- Option 1: Amend the Hallmarking Act to provide a level playing field for UK Assay Offices by removing legislative restrictions so they can compete on an equal basis with the application offshore of other UK recognised EEA Assay office hallmarks – e.g. the Netherlands
- Option 2: Deregulate hallmarking

### **Option 0: Do nothing**

As indicated in the market analysis, high volume hallmarking moves off-shore, and UK Assay Offices are unable to provide this service. Although to date this outcome is limited, it is already happening with one Dutch Assay Office actively seeking out UK offshore customers and the UK Assay Offices losing business as a result. For example, London Assay Office has lost an account worth £2-3 k per year and was unable to bid for a £1 m per year deal, which went to the Dutch. Four customers of Sheffield Assay Office based in Thailand have been approached by a Dutch Assay Office and seven UK based customers of that Office have asked about the possibility of marking in overseas factories.

Because UK Assay Offices would be unable to compete with Assay Offices that operate close to the offshore manufacturer, the UK is likely to lose much of its offshore business for affixing UK national marks and any CCM marks on those items. This amounts to some 85% of current total turnover, or up to £5.6m per year. This level of reduction in turnover assumes that no more UK manufacturers decide to move their manufacturing operations offshore.

It will be apparent, and the British Hallmarking Council confirms, that loss of turnover of these levels of magnitude will have a very substantial impact on the economics of hallmarking carried out in the UK. The continued viability of the Assay Offices in the UK is such that it is likely that at least one of them and perhaps two would be forced to close as there are minimum scale efficiencies in the provision of assay and hallmarking services. Those that remained would find it very difficult to remain viable at current prices. Apart from substantially downsizing their workforce and other overheads, they would not be able to invest in new technology involved in testing and marking. Nor would they be able to resource involvement in the development or enforcement of hallmarking law or education of Trading Standards officers or the manufacturers' and retailers' trades.

At present the fixed costs of the UK Assay Offices are spread over a considerable volume of work. The low average price masks a considerable range in the actual unit costs of hallmarking, which is only partially captured in the application of minimum lot charges. The British Hallmarking Council believes that apart from cutting overheads and resources substantially, it would also be necessary for the remaining UK Assay Offices to increase their prices. London Assay Office estimates that the current average article price would increase by more than three times if they were to lose about 80% of their business and this lost business was concentrated on high volume items.

### **Detailed Impacts of Option 0: Do nothing**

#### **Assay Offices**

As indicated in the market analysis, high volume hallmarking moves off-shore, and UK Assay Offices are unable to provide this service. Although to date this outcome is limited, it is already happening with one Dutch Assay Office actively seeking out UK offshore customers and the UK Assay Offices losing business as a result. For example, London Assay Office has lost an account worth £2-3k per year and was unable to bid for a £1m per year deal, which went to the Dutch. Four customers of Sheffield Assay Office based in Thailand have been approached by a Dutch Assay Office and seven UK based customers of that Office have asked about the possibility of marking in overseas factories.

Because UK Assay Offices would be unable to compete with Assay Offices that operate close to the offshore manufacturer, the UK is likely to lose much of its offshore business for affixing UK national marks and any CCM marks on those items. This amounts to some 85% of current total turnover, or up to £5.6m per year (Source: BHC Estimates). This level of reduction in turnover assumes that no more UK manufacturers decide to move their manufacturing operations offshore, (which under these assumptions and for the reasons outlined above, may not be realistic).

There is also the loss of opportunity to gain a share of the annual turnover enjoyed by the Waarborg Office in the Far East (estimated by BHC at around £1m). Also, a share of hallmarking jewellery produced in the Far East presently unhallmarked and destined for non-UK markets, BHC estimates the value of this opportunity to be worth about £1.4m annually.

**So, we estimate that by doing nothing and maintaining the current restrictions, UK Assay Offices may potentially miss out on around £8m of turnover per annum.**

As regards the £8m turnover, this figure represents the total estimated benefit deriving from three separate elements. One is the opportunity afforded the UK Assay offices to retain their existing client base by hallmarking goods in overseas locations (at the point of manufacture). These represent clients which the Assay Offices anticipate losing should they not be allowed to hallmark overseas. The second element represents the anticipated capture of goods currently hallmarked by competitors (specifically by the Waarborg Assay Office) which would be made possible by the freedom by UK Assay Offices to hallmark offshore. The third element envisages the potential capture of business conducted in the Far East involving goods which at present do not bear hallmarks of any kind and which are destined for non-UK markets.

It will be apparent, and the British Hallmarking Council confirms, that loss of turnover of these levels of magnitude will have a very substantial impact on the economics of hallmarking carried out in the UK. The continued viability of the Assay Offices in the UK is such that it is likely that at least one of them and perhaps two would be forced to close as there are minimum scale efficiencies in the provision of assay and hallmarking services. Those that remained would find it very difficult to remain viable at current prices. Apart from substantially downsizing their workforce and other overheads, they would not be able to invest in new technology involved in testing and marking. Nor would they be able to resource involvement in the development or enforcement of hallmarking law or education of Trading Standards officers or the manufacturers' and retailers' trades. For proportionality reasons, we have not been able to monetise this impact.

At present the fixed costs of the UK Assay Offices are spread over a considerable volume of work. The low average price masks a considerable range in the actual unit costs of hallmarking, which is only partially captured in the application of minimum lot charges. The British Hallmarking Council believes that apart from cutting overheads and resources substantially, it would also be necessary for the remaining UK Assay Offices to increase their prices. London Assay Office estimates that the current average article price would increase by more than three times if they were to lose about 80% of their business and this lost business was concentrated on high volume items.

One UK Assay Offices assessment is that assuming they were to lose those customers who have been approached so far by the Dutch Assay Office (those that they know of), the consequence for them would be:-

- Turnover would fall by 36%
- The number of staff would be cut by 35%. This will result in salary costs of 63% as a percentage of sales
- Based on current prices for the remaining customers to cover basic overheads, prices would have to increase by about 27%

Further, if the manufacturers who operate in the same offshore area as those who have already been approached were to switch to a new local office, the consequence for the same Assay Office would be:-

- Turnover would fall by 60%
- Number of articles marked would be reduced by up to 75%
- The number of staff would be cut by 59%. This would leave salary costs at 69% as a percentage of sales and leaves them in a loss making position.

In order to return to break even on these lower volumes, the unit price would have to increase by about 100% on the current average unit charge.

As stated above, these figures have been provided by one of the assay offices however they have been seen by the three other offices who have confirmed that similar numbers would apply to each of them were they also to lose customers to the Dutch Office. The other Offices also confirm that most of their volume overseas customers have been approached by the Dutch Office. Accordingly the view of the BHC is that a confidence level in the region of 75% to 85% may be applied.

### **Effect on (high volume) UK manufacturers**

It follows from the above that the consequence of the loss of turnover projected would be to severely reduce the demanded capacity for hallmarking in the UK by reducing the number and size of UK-based Assay Offices. It is likely that UK-based hallmarking would still be able to compete in the luxury, high value, low volume end of the jewellery market but uncertain as to whether UK-based hallmarking would retain the capacity to provide hallmarking for high volume items at prices approaching the current prices. As a result, the unit price of hallmarking for high volume manufacturing in the UK would be likely to rise. This rise would be more likely to be concentrated where sub-office (ie integrated) marking does not take place, as where there is UK sub-office marking the individual manufacturer has already captured some (but not all) of the economies of scale. This change in the price for high volume hallmarking in the UK would, in turn, make it more difficult for the remaining high volume UK manufacturers to compete with imported items which had been hallmarked in their offshore manufacturing facilities. UK high-volume manufacturing facilities would, therefore, be likely to close in the UK and/or move offshore.

The underlying economic advantage of moving manufacturing to low cost locations is, therefore, reinforced by the impact of this move on the provision of hallmarking services in the UK.

### **Consumers**

In the event that non UK hallmarks dominate the UK market, there could be potential confusion and lower standards of enforcement and higher levels of undercarrating.

### **Option 1: Amend the Hallmarking Act to enable UK Assay Offices to operate offshore under the authority of the Hallmarking Act**

By operating offshore, the UK Assay Offices would be able to retain their offshore customers and the majority of high volume items imported into the UK would continue to be marked with UK hallmarks. They would also be more able to continue to offer competitive services in the UK for high volume items which would enable them to retain lower prices. This in turn would provide some benefit to any remaining UK-based high-volume manufacturers, and UK based low-volume, high-end, luxury producers. It would also help any manufacturer with split operations as they could obtain the *same* hallmarking services in both their place of retail market and their place of manufacturing.

The demand for overseas hallmarking facilities is already emerging. Customers of the Sheffield, London and Edinburgh Offices have already expressed an interest in establishing sub-offices in their premises or proposed premises in the Far East. If it were legally possible for the offices to meet this demand, they expect that some sub-Offices of this kind would be set up. Proximity to the manufacturing base outside the UK may allow the UK Assay Offices to increase their business by capturing other nearby manufacturers, manufacturing for other end markets.

The preferred option is Option 1: Amend the Hallmarking Act to provide a level playing field for UK Assay Offices by removing legislative restrictions so they can compete on an equal basis with the application offshore of other UK recognised EEA Assay office hallmarks.

The implementation plan is to amend the Hallmarking Act 1973 using a Legislative Reform Order. It is desirable that the Order becomes effective as soon as possible so that the four UK Assay Offices can take advantage of the deregulation at the earliest opportunity.

### **Impacts of Option 1**

Under outcome 1 where the value of UK hallmarks derives from the *location* of the marking, there is little change as a result of providing the UK Assay Offices with the ability to mark off-shore. The wider benefits that would emerge are the same as those that occur under outcome 2, where the value of the UK Assay Office hallmarks derives from who attaches the hallmark, rather than where it is attached.



This option assumes that the Hallmarking Act has been suitably amended to permit UK Assay Offices to operate offshore in a manufacturer's country including in his premises. As indicated, the loss of UK based hallmarking still occurs, and the general outcome described above in terms of UK based hallmarking occurs. The demand for UK based hallmarking thus still reduces dramatically. The details are not important at this stage but precautions would be needed to ensure the integrity of the process and the marks. Under these circumstances and given that a level playing field has been established with other foreign operators, the outlook is considerably healthier than doing nothing.

### **Effect on Assay Offices**

By operating offshore, the UK Assay Offices would be able to retain their offshore customers and the majority of high volume items imported into the UK would continue to be marked with UK hallmarks. They would also be more able to continue to offer competitive services in the UK for high volume items which would enable them to retain lower prices. This in turn would provide some benefit to any remaining UK-based high-volume manufacturers, and UK based low-volume, high-end, luxury producers. It would also help any manufacturer with split operations as they could obtain the *same* hallmarking services in both their place of retail market and their place of manufacturing.

The demand for overseas hallmarking facilities is already emerging. Customers of the Sheffield, London and Edinburgh Offices have already expressed an interest in establishing sub-offices in their premises or proposed premises in the Far East. If it were legally possible for the offices to meet this demand, they expect that some sub-Offices of this kind would be set up. Proximity to the manufacturing base outside the UK may allow the UK Assay Offices to increase their business by capturing other nearby manufacturers, manufacturing for other end markets.

At an institutional level UK Assay Offices maintain their assaying and marking capability (and, indeed, may be able to expand it). However, UK based operations will generally reduce as in the do nothing scenario. There will be some opportunity for shared overheads across UK and off-shore activity, and for those multi-national manufacturers with some base in the UK the presence of the Assay Office in more than one manufacturing location reduces the probability that all marking for such a manufacturer is taken by a non-UK Assay Office.

The overall outcome is one where UK based hallmarking is in a slightly stronger position and will have a slightly lower cost base, compared to the do nothing scenario. Effect on (high volume) UK manufacturers

Notwithstanding the fact that under this option the demand for high volume marking in the UK falls significantly, there is some reduction in the impact on prices as a result of losses of scale. To the extent that the outcomes are different for Assay Offices, and to the extent that overheads can be shared, the prices facing high volume UK manufactures will be lower than they would be under the do nothing option (although higher than they are now). As stated above, maintaining lower Assay Office charges will benefit UK-based high-volume manufacturers and UK based low-volume, high-end, luxury producers and will better able both types to continue operating in the UK.

Potential for slightly lower redundancy costs in the UK. This is because while a change to the law would lead to some redundancies there would be higher job losses were the Assay Offices not allowed to strike hallmarks offshore.

### **Consumers**

UK hallmarks dominate the UK market, which means less confusion, lower potential for lower standards of enforcement, and lower potential for undercarrating. There is also the potential gain of averting a substantial reduction in support by the Offices for the enforcement functions.

### **Monetised Benefits**

As discussed above, the opportunity to hallmark the goods presently imported at their places of manufacture, and to mark goods presently marked by by the Waarborg Office, and a share of the goods made in the Far East destined for non-UK markets presently unhallmarked, created an upside of £8m of turnover annually.

In profitability terms, the Hallmarking Council estimates 10% as a ratio to turnover for these activities; thus suggesting a beneficial figure of £800k for the identified turnover upside of £8m. The Council further notes the apparitional nature of winning all £8m of this increased turnover upside and consider that 50% of this would be readily achievable; thus £4m turnover annually **with an associated £400k profit per year.**

This is a mid-point and is based on what are viewed to be reasonable estimates provided in confidence by the assay offices. However in view of the uncertainty of the “real world” and predicting likely positive outcomes through increased sales compared with the readily quantifiable consequences of a fall in sales, the BHC attaches a slightly lower confidence level of between 70% and 80% to these figures.

These are benefits to the UK even though they would be accumulated by means of business conducted in overseas locations. The business which the Assay Offices expect to generate as a result of being able to operate offshore would be of benefit to UK plc and would reduce the number of jobs that otherwise would be lost in the longer term.

## **Costs**

Excluding the costs of actually changing the legislation, the cost impact of the changed legislation will arise mainly in relation to the one-off costs of putting the processes in place to enable the BHC to approve off-shore hallmarking should one or more of the Assay Offices choose to take up such an opportunity.

**These costs have been estimated by the BHC to be in the order of £25,000,** which represents the costs the BHC would incur in the setting up of an overseas sub-office were such an office to be set up. These would include Secretariat costs in the drafting and approval (by the BHC Technical Sub-Committee) of the procedures to be put in place for an off-shore sub office, its initial supervision, including auditing and administrative costs and the approval by the BHC of new hallmarks which would be struck on goods marked offshore so as to distinguish them from UK-struck hallmarks (this is a requirement of the LRO). This is a one off fixed cost to BHC that accrues if one or more UK Assay Offices sets up overseas (a reasonable assumption given stakeholder feedback).

Further costs that would be incurred in actually taking up an opportunity would only be incurred if an Assay Office saw this as a commercial opportunity and that Assay Office would pay for any additional costs of the BHC. As a result such expenditure would not take place unless the Assay Office predicted that the costs to itself were more than outweighed by its own internal benefits.

**Operating costs of running the overseas operation (including the annual cost of BHC monitoring) are estimated by BHC at around £2,500 p.a.** These costs are indirect; as they will only be incurred when the Assay Office has made a decision it is commercially viable to do so.

Under the existing sub Office regime operating by BHC the general costs of BHC (including setting up or changing the sub Office regime itself) are passed on to Assay Offices in accordance with their relative proportions of total annual turnover. The additional costs that may arise to BHC from this change (both one off, and ongoing) will be passed on in full to Assay Offices that choose to set up overseas. To the businesses, these costs will be absorbed into normal operating costs, and have been reflected (i.e. netted off) in the BHC estimates of profitability from these activities. Because of this, we have not included these in the cost section of the summary sheets.

The overall impact of enabling the UK Assay Offices to mark off-shore is that jewellery placed on the UK market would continue to have UK Assay Office marks. In turn this should reduce the level of confusion (for both consumers and retailers) in the market and make enforcement of the Hallmarking Act easier. A second potential impact is to cover the fixed costs of the UK Assay Offices and the operation of the hallmarking system over a larger volume of activity, albeit that a significant proportion of that activity will take place outside the UK. Given the value of goods hallmarked in 2009 in the UK (in excess of £500,000,000 at the *scrap* value of the metal hallmarked), the value of the benefits to UK customers of maintaining UK Assay Office hallmarks on the UK market has to only represent 0.01% of the value of the precious metal likely to be hallmarked outside the UK, before the benefits outweigh the costs from this source alone. A very small increase in the ability to enforce the hallmarking system on the UK market, and/or to reduce undercarrating, creates benefits significantly higher than the costs.

The potential benefits of spreading overhead costs and reducing UK related redundancy costs are additional.

## **Option 2: Deregulate hallmarking**

The British Hallmarking Council (an Executive NDPB of BIS) was reviewed as part of the Government's review of Public Bodies in 2010. A comprehensive review of the Hallmarking regime was undertaken at the same time. Ministers concluded that hallmarking legislation is still necessary and is a cost-effective and 'Hampton compliant' way of regulating. The 1973 Hallmarking Act is a simplification of complex legislation dating back to 1300. Evidence shows that hallmarking regulation stimulates economic activity, for example the recent 'prescription' of palladium metal and the introduction of commemorative marks such as the millennium mark lead to an increase in sales.

Hallmarking has other indirect benefits in so far that the trade in antiques relies to a large extent on mandatory hallmarking of precious metal items and the UK's leadership in hallmarking matters in general has commercial spin-offs for the 4 UK Assay Offices.

In 2011, Hallmarking legislation was reviewed as part of the "Red Tape Challenge" exercise. Again, Ministers decided that hallmarking should be retained and was an example of 'good regulation'.

*"We've listened to what people have said about the confusing and overlapping rules with the aim to get rid of the ones we don't need and making the ones we do simpler to understand and put into practice. At the same time though we are preserving good regulation, such as the hallmarking regime, for which there was strong support."*

This option is therefore discarded.

## **OTHER RISKS, ASSUMPTIONS, UNCERTAINTIES & UNINTENDED CONSEQUENCES**

The critical assumptions required for this analysis are set out in the analysis itself. Because the market dynamics are uncertain, however, there are a number of additional risk and uncertainties that should be noted. These are over and above the risks and uncertainties that have already been described above. In addition, only risks and uncertainties that vary between the two options are covered. In particular:

If adequate control of marks applied in low cost locations proves to be unobtainable there is risk that all UK Assay Office marks will become so tainted as to be devalued, notwithstanding that UK off-shore and on-shore marks will be distinguishable. This risk is very much higher where UK Assay Offices are allowed to mark off-shore. However, procedures are already in place for the off-shore fabrication using UK marked components which indicate that this potential risk can be adequately controlled.

In the do nothing scenario, the confusion created by the absence of UK Assay Office marks could possibly be sufficient to undermine the whole hallmarking regime.

It is possible that as a result of inadequate controls of off-shore marking off-shore applied marks are ruled as not meeting the requirements of being 'authorised marks' under the Hallmarking Act. In this case the do nothing outcome leaves hallmarking for the UK market still being carried out in the UK and therefore the volume of marking undertaken in the UK does not fall, irrespective of how customers value hallmarks (ie *where* it is struck, or *who* strikes it).

The UK Assay Offices are institutions that are not profit distributing and are an integral part of the enforcement processes of the Hallmarking Act. In the do nothing scenario where non-UK struck marks dominate, the ability of these institutions to maintain these functions may well be significantly reduced. This in itself may undermine the hallmarking system in the UK, even if perfectly acceptable off-shore struck marks are available.

This Impact Assessment assumes that the UK Assay Offices will take up the option to conduct 'offshore hallmarking' which will help the loss of business to non-UK Assay Offices. There is a risk that offshore hallmarking will result in some UK Assay Office posts being moved offshore. However we believe that this reduction in UK based jobs may be necessary to ensure the longer term viability of UK Assay Offices and ultimately to preserve jobs that may otherwise be lost.

## **IMPLEMENTATION**

NMO is responsible for implementing any amendment on offshore marking to the Hallmarking Act.

The timetable for implementation is not applicable as it depends on policy being changed. Implementation, if approved, would be through a Legislative Reform Order and would take at least one year.

Under the existing sub Office regime, BHC does not concern itself with the profitability of the sub Office and / or the commercial arrangements between the Assay Office and the customer. BHC believes that such operations are potentially profitable, however, and this is supported by the existence of eleven sub Offices operating in the UK presently.

BHC would intend to take the same approach as set out above in relation to overseas sub Offices. In other words, BHC would facilitate the creation and running of sub Offices, rather than initiating or interfering with their creation and running.

## **MONITORING**

The British Hallmarking Council collects and collates data relating to substandard goods presented to the UK Offices as well as enforcement activity which would remain unaffected if the measure is implemented. If it is not, this service is likely to disappear. The British Hallmarking Council would be principally responsible for monitoring offshore sub Offices for compliance with the Hallmarking Act and operating procedures.

## **ENFORCEMENT**

The requirements of the Hallmarking Act are primarily enforced by Trading Standards Authorities. This would be unaffected by the measure proposed. As has been previously stated, The British Hallmarking Council believes that the measure would have the effect of reducing the variety of marks present in the market which would facilitate enforcement activity.

## **BETTER REGULATION ASPECTS**

### **One In, One Out**

As an organisation NMO is within scope of OIOO because it is an Executive Agency of BIS. The Hallmarking Act is domestic legislation and it has an impact on business e.g. the jewellery sector are users of statutory hallmarks. The proposal is to remove a restriction on the ability of UK Assay Offices to hallmark outside the UK. It is deregulatory, but as the impacts on business are indirect (i.e. from improved ability to compete for work) it is out of scope of OIOO.

### **Microbusiness Exemption Rule**

The organisations affected by this proposal are manufacturers, UK Assay Offices, retailers and Trading Standards. Assay Offices tend to fall into the small businesses category, whereas manufacturers and retailers could fall into any category from sole trader to medium business.

Under the micro-business exemptions rule whereby no new regulation can apply to start-ups and organisations having fewer than 10 employees, an exemption has been sought because the proposed measure is competitively advantageous to micro-businesses (the majority of jewellers affected are micro-businesses).

Offshore marking would be voluntary so any additional costs would only be incurred by those Offices that wished to operate offshore.

Manufacturers fit into all size categories. In most cases these manufacturers of whatever size will either benefit, or it will be neutral, between the do nothing option and the option that allows UK Assay Offices to mark off-shore.

Although specific figures for the costs of setting up and running overseas operations are not available it may be assumed that the set up and running costs of specific overseas operations would be covered by the income they generate, or they would not be incurred.

### **Statutory Specific Impact Tests**

After screening the potential impact of this proposal on race, disability and gender equality, it has been decided that there will be no impact. It is not expected to have any impact on the Convention Rights of any person or class of persons, it will not affect small firms, or have an effect on rural proofing.

### **Rationale and evidence that justify the level of analysis used in the Impact Assessment (proportionality approach)**

This impact assessment has been informed by the IA put together by the British Hallmarking Council (BHC) as part of their statutory role in advising the Secretary of state on hallmarking issues. Precise financial details have been difficult to obtain because the four Assay Offices are in competition with each other for hallmarking business and there are commercial sensitivities in providing full economic data. However, the financial evidence and assumptions about the market have been agreed by the four UK Assay Offices and are provided to the BHC for this IA.

